BANK MANAGEMENT

M.Com., (Banking)

Semester – IV, Paper-IV

Lesson Writers

Dr. G. NAGA RAJU
M.Com. MBA, M.Phil., Ph.D.
Faculty
Dept. of Commerce & Business Admin.
ANU College of Arts, Commerce & Law
Acharya Nagarjuna University,
Guntur.

Dr. VISHNU VADDE
M.Com, M.Phil., Ph.D., UGC - PDF
Faculty
Dept. of Commerce & Business Admin.
ANU College of Arts, Commerce & Law
Acharya Nagarjuna University,
Guntur.

Dr. P. SRINIVASA RAO
MBA, PGDHHM, UGCNET, M.Phil. Ph.D.
Faculty
Dept. of MBA-Hospital Administration
Acharya Nagarjuna University
Guntur.

Dr. SADHIK SAYYED
MBA, M.Com., Ph.D.
Faculty
Dept. of MBA-Hospital Administration
ANU College of Arts, Commerce & Law
Acharya Nagarjuna University,
Guntur.

Lesson Writer & Editor

Dr. N.RATNA KISHOR
MBA, M.Com, MHRM, M.Phil., Ph.D.
Assistant Professor
Dept. of Commerce & Business Administration
ANU College of Arts, Commerce & Law
Acharya Nagarjuna University, Guntur.

Director

Dr. NAGARAJU BATTU
MBA., MHRM., LLM., M.Sc. (Psy).,MA (Soc)., M.Ed., M.Phil., Ph.D

CENTRE FOR DISTANCE EDUCATION
ACHARAYA NAGARJUNA UNIVERSITY
NAGARJUNANAGAR – 522510
Ph:0863-2293222,2293208,
0863-2346259(Study Material)
Website: www.anucde.info
e-mail:anucdedirector@gmail.com

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Director
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FOREWORD

Since its establishment in 1976, Acharya Nagarjuna University has been forging a head in the path of progress and dynamism, offering a variety of courses and research contributions. I am extremely happy that by gaining 'A' grade from the NAAC in the year 2016, Acharya Nagarjuna University is offering educational opportunities at the UG, PG levels apart from research degrees to students from over 443 affiliated colleges spread over the two districts of Guntur and Prakasam.

The University has also started the Centre for Distance Education in 2003-04 with the aim of taking higher education to the door step of all the sectors of the society. The centre will be a great help to those who cannot join in colleges, those who cannot afford the exorbitant fees as regular students, and even to housewives desirous of pursuing higher studies. Acharya Nagarjuna University has started offering B.A., and B.Com courses at the Degree level and M.A., M.Com., M.Sc., M.B.A., and L.L.M., courses at the PG level from the academic year 2003-2004onwards.

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

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

Prof. P. RajaSekhar
Vice-Chancellor
Acharya Nagarjuna University

M.Com (Banking)
SEMESTER-IV, Paper - IV
414CO21: BANK MANAGEMENT

1. **Nature of Banking Business**: official regulation and control overbanks in India: Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, banking companies Act, 1970.
2. **Forms of Banking**: Branch Banking, Unit Banking, Group Banking, Chain Banking, Business, Correspondent Banking. Process of Bank Management; Branch location policies and decisions, organizational Structure of Commercial Banks in India
3. **Bank Balance Sheet**: Management of Assets and Liabilities in banks – Profit, Profitability and Productivity in banks –Management of large sized branches and rural branches. Internal control and Performance budgeting system – Management Information system Income Recognition and asset classification Norms.
4. **Human Resource Development in Banks**: Manpower Planning, Recruitment, Training, Promotion, Motivation, Bank Marketing: Product Planning and Development. Computerization of Banks: Need, application, progress, problems.
5. **E-Banking** – Aspects of E-Banking – Traditional Vs. E-Banking Models – Advantages and constraints – Security Methods – Risk Management – Outsourcing E-Banking – Legal and Regulatory Compliance.

FURTHER READINGS:

1) Hawtrey, The art of Central Banking, SugustusMKelleyPublishers,1970, NewYork.
2) Narendra Kumar, Bank Nationalism of India–A Symposium, Lalvani Publishing House, 1969, Mumbai.
3) Pal Panadlkar & N.C.Mehra, Rural Banking, National Institute of Bank Management, Mumbai.
4) Vasant Desai, Indian Banking–Nature and Problems, Himalaya Publishing House, Mumbai.
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LESSON – 1

NATURE OF BANKING BUSINESS

OBJECTIVES :

After studying this unit, you should be able to:

- To understanding the Banking System in India
- To know the concept of Cash Reserve Ratio (CRR) & Statutory Liquidity Ratio (SLR)
- To acquire knowledge about significance Official Regulation and Control over Banks in India

STRUCTURE :

1.1 Introduction
1.2 Definition of Banking
1.3 Banking
1.4 Development of Banking in India (Phases)
1.5 Types of Banks in India
1.6 Types of Bank Accounts in India
1.7 The Main Features of the Indian Banking System
1.8 The Importance of Banking System in India
1.9 Official Regulation and Control over Banks in India
1.10 Cash Reserve Ratio (CRR) & Statutory Liquidity Ratio (SLR)
1.11 Conclusion
1.12 Self Assessment Questions
1.13 Further Reading

1.1 INTRODUCTION :

Banks are the important segment in Indian Financial System. An efficient banking system helps the nation's economic development. Various categories of stakeholders of the Society use the banks for their different requirements. Banks are financial intermediaries between the depositors and the borrowers. Apart from accepting deposits and lending money, banks in today's changed global business environment offer many more value added services to their clients.

1.2 DEFINITION OF BANK:

The development of banking is evolutionary in nature. A bank performs a multitude of functions and services, which cannot be crunched in to a single definition. A bank may mean different things to different people. So as per different Laws and People, some definitions of banking are as follows…

ACCORDING TO LAW:

Indian banking regulation act, 1949: Section 5 (1) (b) of the Banking Regulation Act 1949, banking is defined as "The accepting for the purpose of lending or investment, deposit of money from the public repayable on demand or otherwise and withdraw able by cheque, draft, order or otherwise."

ACCORDING TO DICTIONARY:

1. ***Oxford English dictionary*****:** "A bank is an establishment for custody of money received from or on behalf of its customers. Its essential duty is to pay their drafts on it. Its profit arises from the use of the money left unemployed by them."
2. **. *Webster's dictionary:*** "Bank is an institution which trades in money, establishment for the deposit, custody and issue of money, as also for making loans and discounts and facilitating the transmission of remittances from one place to another."

ACCORDING TO ACADEMICIANS:

1. ***Crowhther***: "Collects money from those who have it to spare or who are saving it out of their income, and lends this money out to those who require it."
2. ***Cairncroser:*** "A bank is a financial intermediary, a dealer in loans and debt."
3. ***Prof. Kinley***: "A bank is an establishment which makes to individuals such advances of money or other means of payment as may be required and safely made; and to which individuals entrust money or means of payment when not required by them for use."
4. ***Willies and Bogen***: "By banking in the most general sense is meant the business of receiving, conserving and utilizing the funds of the community or of any special section of it."

1.3 BANKING :

Banking refers to the system of financial institutions, such as banks and credit unions that provide various financial services to individuals, businesses, and governments. Banking services mainly include accepting deposits, lending money, facilitating transactions, and offering various financial products like savings accounts, loans, and credit cards. Banking plays a crucial role in the economy by facilitating the flow of money and enabling economic activities.

Genesis of Indian Banking System:

Indian Banking System for the last two centuries has seen many developments. An indigenous banking system was being carried out by the businessmen called Sharoffs, Seths, Sahukars, Mahajans, Chettis, etc. since ancient time. They performed the usual functions of lending moneys to traders and craftsmen and sometimes placed funds at the disposal of kings for financing wars. The indigenous bankers could not, however, develop to any considerable extent the system of obtaining deposits from the public, which today is an important function of a bank. Modern banking in India originated in the last decades of the 18th century. The first banks were The General Bank of India which started in 1786, and the Bank of Hindustan. Thereafter, three presidency banks namely the Bank of Bengal (this bank was originally started in the year 1806 as Bank of Calcutta and then in the year 1809 became the Bank of Bengal), the Bank of Bombay and the Bank of Madras, were set up.

For many years the Presidency banks acted as quasi-central banks. The three banks merged in 1925 to form the Imperial Bank of India. Indian merchants in Calcutta established the Union Bank in 1839, but it failed in 1848 as a consequence of the economic crisis of 1848-49. Bank of Upper India was established in 1863 but failed in 1913. The Allahabad Bank, established in 1865, is the oldest survived Joint Stock bank in India. Oudh Commercial Bank, established in 1881 in Faizabad, failed in 1958. The next was the Punjab National Bank, established in Lahore in 1895, which is now one of the largest banks in India. The

Swadeshi movement inspired local businessmen and political figures to found banks of and for the Indian community during 1906 to 1911. A number of banks established then have survived to the present such as Bank of India, Corporation Bank, Indian Bank, Bank of Baroda, Canara Bank and Central Bank of India. A major landmark in Indian banking history took place in 1934 when a decision was taken to establish 'Reserve Bank of India' which started functioning in 1935. Since then, RBI, as a central bank of the country, has been regulating banking system.

Overview of Indian Banking System :

Banks are one of the important pillars that support the edifice of economy of every country and so too in India. Banking system in its modernized form in India has evolved over the last two hundred and forty two years and it continues to do so even to the present day. India has a complex banking structure with Reserve Bank of India ('RBI') playing the pivotal role of Central bank of this country. Apart from its statutory functions (as enshrined in The RBI Act 1934) the RBI regulates Commercial banks, Cooperative banks, Payment Banks and Small Finance Banks, Regional Rural Banks, Local Area Banks, Development Banks/All-India Financial Institutions.

In view of emerging global and local regulatory compulsions such as capital adequacy and other related developments, the Government of India has effected a major consolidation of PSU Banks recently. Also to encourage and expand the reach of financial inclusion among the public at large, setting up of Small Finance Banks and Payment Banks are being actively encouraged. Apart from banks RBI is also given powers to regulate NBFCs. To have a better regulation based on activity over NBFCs, the RBI has harmonized the classification of NBFCs. Banks and banking in India has been classified into various groups. In its activities, each group has its own set of advantages and disadvantages. They have their own distinct target audience. Some work exclusively in the rural sector, while others work in both rural and urban settings. The majority of them only serve cities and major towns.

The banking industry is one of the most essential financial pillars of the financial sector, and it is critical to the economy's functioning. It is critical for a country's economic development that its trade, industrial, and farm funding needs are handled with greater commitment and responsibility. As a result, a country's progress is inextricably related to the development of banking. In today's economy, banks should be viewed as development leaders rather than money merchants. They play a crucial role in deposit mobilization and credit disbursement to many sectors of the economy.

The Reserve Bank of India (RBI), commercial banks, cooperative banks, and development banks comprise India's banking system (development finance institutions). The core of India's financial system is these institutions, which serve as a meeting point for savers and investors. Banks play a vital role in the development of poor countries by mobilizing resources and efficiently allocating them.

1.4 DEVELOPMENT OF BANKING IN INDIA (PHASES) :

Since the last three decades, Indian banking system has numerous wonderful achievements to its credit. It is not restricted for only metropolitans but it has also reached to the remote centers in India which is one of the main reasons of growth. In 1951, after independence, Indian government accepted the concept of planned economic growth for the country. Banking system in India has its unique features. Hence, it is very interesting to study the evolution of Indian banking over the last five decades. These decades has witnessed many economic developments in different ways in different period.

In the post independence period, RBI adopted some policies to strength the banking system and to reduce the bank failures. Banking industry in India has passed through different stages and developed in many respects. It has grown geographically, structurally and functionally. RBI, having extensive regulatory powers from The Banking Regulation Act, has carried out some structural reforms in the banking system. In India, commercial banks have made considerable progress on the basis of deposit mobilization and also the higher rate of growth in time deposit relative to demand deposit and rise in the number of personal accounts relative to business accounts. Earlier, banks were considered as an organization which only accepted and safeguarded deposits from the customers and out of that money; they lent these money to the people who required it. But now, this concept is no longer in existence. Now recently banking activities have been increased to a great extent. Technology has made noteworthy moves in their working style.

Since independence, banking in India has evolved through five major phases like,

1. **Foundation phase: (1949-1969)**
2. **Expansion phase: (1969-1984)**
3. **Consolidation phase: (1984-1990)**
4. **Reformatory phase: (1991 onwards)**
5. **Present phase: (beyond *2002 to up to date)***

Functions of Banks :

Banks in India offer a wide range of banking services, such as savings and checking accounts, loans (personal, business, and mortgages), credit cards, investment services, and electronic banking options like online and mobile banking.

Some of the major functions of banks are mentioned below:

- Accepting Deposits: Banks provide a safe place for individuals and businesses to deposit their money, which can be withdrawn when needed.
- Providing Loans: Banks lend money to individuals and businesses for various purposes, such as home mortgages, business expansion, or personal loans.
- Payments and Settlements: Banks enable transactions through various payment methods, like checks, debit/credit cards, and electronic transfers.
- Currency Exchange: Many banks offer foreign exchange services, allowing customers to buy, sell, or exchange foreign currencies.
- Safekeeping of Valuables: Some banks offer safe deposit boxes for customers to securely store valuable items and documents.
- Investment Services: Banks also provide investment products like mutual funds, stocks, and bonds, helping customers grow their wealth.
- Internet Banking Services: Banks offer online and mobile banking services, making it convenient for customers to access their accounts, pay bills, and transfer funds.

1.5 TYPES OF BANKS IN INDIA :

The Banking System in India is divided into several types, each serving specific functions and purposes. The table below represents the different types of banks in India and how it is further divided:

Banking Classification in India	
Types of Banks	Sub-types
Central Bank	-
Commercial Banks	a) Private Sector Banks b) Public Sector Banks c) Regional Rural Banks d) Foreign Banks
Co-operative Banks	a) State Co-operative Banks b) Urban Co-operative Banks
Payment Banks	-
Small Finance Banks	-
Scheduled Banks	-
Non-scheduled Banks	-

1) Central Bank: The Reserve Bank of India (RBI) serves as the Central Bank of India and is responsible for regulating and controlling the monetary and banking system in the country.
2) Commercial Banks These are the most common types of banks and include public sector banks, private sector banks, and foreign banks. They provide various services like savings and current accounts, loans, and investments.

These are the most common types of banks and include public sector banks, private sector banks, and foreign banks. They provide various services like savings and current accounts, loans, and investments.

- Public Sector Banks: Owned and operated by the government, examples include State Bank of India (SBI), Punjab National Bank (PNB), and Bank of Baroda (BOB).
- Private Sector Banks: These are privately owned and managed banks, such as HDFC Bank, ICICI Bank, and Axis Bank.
- Foreign Banks: These banks have branches in India and are headquartered in foreign countries. Some examples are Citibank, Standard Chartered, and HSBC.
- Regional Rural Banks (RRBs): These banks cater to rural and semi-urban areas and are owned by the government, commercial banks, and state governments.

The table below shows a few examples of Commercial Banks in India.

Commercial Banks in India		
Public Sector Banks	**Private Sector Banks**	**Foreign Banks**
Here is a list of public sector banks in India: Bank of Maharashtra Indian Bank Bank of Baroda Canara Bank State Bank of India Central Bank of India Union Bank of India	Here is the list of private sector banks in India: I.C.I.C.I. Bank R.B.L. Bank I.D.F.C. Bank South Indian Bank IDBI Bank Tamilnad Mercantile Bank YES Bank	Here is a list of foreign banks that operate in India: Australia and New Zealand Banking Group Ltd. National Australia Bank Westpac Banking Corporation

<table>
<tr>
<td>Indian Overseas Bank
UCO Bank
Punjab & Sind Bank
Bank of India
Punjab National Bank</td>
<td>Axis Bank
City Union Bank
Karnataka Bank
Dhanlaxmi Bank
Kotak Mahindra Bank
D.C.B. Bank
KarurVysya Bank
Federal Bank
Lakshmi Vilas Bank
H.D.F.C. Bank
Nainital Bank
IndusInd Bank
Bandhan Bank
Jammu and Kashmir Bank</td>
<td>Bank of Bahrain &
Kuwait BSC
AB Bank Ltd.
Credit Agricole Corporate
& Investment Bank
SocieteGenerale
Deutsche Bank
HSBC Bank
PT Bank Maybank
Indonesia TBK
Mizuho Bank Ltd.
Sumitomo Mitsui
Banking Corporation
M.U.F.G. Bank, Ltd.
CoöperatieveRabobank
U.A.
Sonali Bank Ltd.
Bank of Nova Scotia
Industrial & Commercial
Bank of China Ltd.
BNP Paribas
Doha Bank Q.P.S.C.
Qatar National Bank
(Q.P.S.C.)
JSC VTB Bank
Sberbank
United Overseas Bank
Ltd
FirstRand Bank Ltd
Shinhan Bank
Woori Bank
Barclays Bank Plc.
Standard Chartered Bank
The Royal Bank of
Scotland plc
American Express
Banking Corporation
Bank of America
Citibank
J.P. Morgan Chase Bank
N.A
Kookmin Bank
S.B.M. Bank (India)
Limited
K.E.B. Hana Bank
Industrial Bank of Korea
Bank of Ceylon
D.B.S. Bank India
Limited</td>
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		Credit Suisse A.G. C.T.B.C. Bank Co., Ltd. Krung Thai Bank Public Co. Ltd. Abu Dhabi Commercial Bank Ltd. Mashreq Bank P.S.C. First Abu Dhabi Bank P.J.S.C. Emirates Bank NBD

3) *Cooperative Banks :*

A Co-operative Bank is registered under the Co-operative Societies Act of 1912 and is run by an elected managing committee. It works on a non-profit, no-loss basis and mainly serves entrepreneurs, small businesses, self-employment, and more in urban areas.

In rural areas, it mainly functions to finance agriculture-based activities like farming, livestock, and hatcheries. There are mainly two types of Co-operative Banks:

Types of Cooperative Bank	**Description**
State Co-operative Banks	A State Co-operative Bank is a federation of the central Co-operative banks that will act as a custodian of the Co-operative banking structure in the State.
Urban Co-operative Banks	The Urban Co-operative Bank is the primary Co-operative bank located in urban and semi-urban areas. The banks essentially lent to smaller borrowers, and businesses centred on a community, locality, and more.

4) Payment Banks: The payment banks are a relatively new banking model in the country that has been conceptualized by the RBI. This bank is allowed to accept a restricted deposit. This amount is limited to Rs. 1 lakh for a customer. The bank also offers services such as ATM cards, net banking and more.

5) Small Finance Banks: These banks primarily serve the un-served and underserved sections of the population, including small businesses and low-income individuals.

This type of bank is licensed under Section 22 of the Banking Regulation Act 1949, and it is governed by the Provisions Act of 1934.

Here are a few examples of Small Finance Banks in India:

- AU Small Finance Bank Ltd.
- Utkarsh Small Finance Bank Ltd.
- Fincare Small Finance Bank Ltd.
- Ujjivan Small Finance Bank Ltd.
- Jana Small Finance Bank Ltd.

- ESAF Small Finance Bank Ltd.
- Suryoday Small Finance Bank Ltd.
- Equitas Small Finance Bank Ltd.
- Capital Small Finance Bank Ltd.
- North East Small Finance Bank Ltd.

6) Scheduled Banks: These banks are covered under the 2nd Schedule of RBI Act 1934, and they need to have a paid-up capital of Rs. 5 lahks or more.
7) Non-Scheduled Banks: The non-scheduled banks are local area banks that are not listed in the 2nd Schedule of the RBI Act 1934.

1.6 TYPES OF BANK ACCOUNTS IN INDIA :

Banks offer several types of bank accounts to cater to different financial needs. These bank accounts vary from one another based on the purpose, transaction frequency and location. Given below are the common types of bank accounts in India:

- ***Savings Account***: This is a basic account for individuals to save money. It offers interest on deposits and allows limited withdrawals.
- ***Current Account*****:** This type of account is mainly used by businesses. It has zero or very low interest rates but offers more transaction features, making it suitable for frequent transactions.
- ***Fixed Deposit Account:*** In this account, you deposit a lump sum for a fixed tenure at a higher interest rate compared to savings accounts. Funds are locked in until maturity.
- ***Recurring Deposit Account***: It is a savings plan where you deposit a fixed amount every month, and at the end of a specified period, you receive the principal and interest.
- ***NRI (Non-Resident Indian) Account****:* These are for Indians living abroad. NRE (Non-Resident External), NRO (Non-Resident Ordinary) and FCNR (Foreign Currency Non-Residential) accounts are major types of NRI accounts.
- ***Senior Citizen Savings Account***: Created for senior citizens, these accounts offer higher interest rates and additional benefits.
- ***Salary Account*****:** This account is used by an employer to credit the salary of an employee every month. It does not have any minimum balance requirement.
- ***Demat Account***: This account is created primarily for holding and trading in securities electronically, such as stocks and bonds.
- ***Joint Account*****:** It is shared by two or more individuals, often used for family or business purposes.
- ***Minor Account*****:** Opened on behalf of minors by parents or guardians. The minor gains control upon reaching a certain age.
- ***Corporate Account*****:** Used by companies and corporations for their banking needs, including payroll and transactions.

1.7 THE MAIN FEATURES OF THE INDIAN BANKING SYSTEM :

Deals with Money: A bank’s main characteristic is that it handles all financial transactions. You can put your money in a bank account, for example, to store it safely, and you will be interested in the money you save in the account.
Provides Loans: Banks gain additional money by providing loans for a variety of products. The bank earns the additional funds by lending money to the qualifying person at

predetermined rates. Banks now provide loans for a variety of purposes, including study loans, vehicle loans, housing loans, personal loans, and so on.

Withdrawal and payment facilities: Customers can use a bank's numerous payment and withdrawal services to receive their money quickly and easily. Customers can use cheques and draughts to withdraw money, as well as ATMs established by banks at various sites throughout the city.

Internet services: Modern banks now provide internet services, which is another element of a bank. The growth of the internet and its integration into the banking industry has made it even easier for customers to do numerous transactions. Through their apps, banks are providing online services. You can pay your bills, buy groceries, and shop without having cash on you.

Business: Banking's sole purpose is not to supply consumers with banking services. To make additional money, all banks are involved in subsidiary enterprises. Their only responsibility is to deliver optimum customer satisfaction and maximum interest rates in order to attract more clients to bank with them. To make a profit, money is moved from one hand to the next.

1.8 THE IMPORTANCE OF BANKING SYSTEM IN INDIA :

- Insufficient capital formation makes economic development difficult in a country. Commercial banks are encouraging individuals to save their money and mobilize it for beneficial uses at this time.
- Credit creation boosts output, boosting economic growth and, in turn, creating a large number of job prospects.
- Commercial banks promote balanced regional development in India by providing the required financial infrastructure and money to backward areas.
- By providing timely loans to agricultural farmers, commercial banks aid in the promotion of the primary sector.
- They offer advanced loans to consumers for the purchase of assets such as residences, consumer goods, and furniture, among other things, and they encourage individuals to pursue a higher level of living.
- The banking sector plays a significant part in the Indian economy, as commercial banks support the Indian government in achieving each aim of the country's planned economic development.
- For both internal and external trade, commercial banks offer the necessary financial backing and infrastructure.

1.9 OFFICIAL REGULATION AND CONTROL OVER BANKS IN INDIA :

RBI regulates banks in terms of powers it derives from The RBI Act, 1934 and The Banking Regulation Act, 1949 ('BR Act'). The RBI Act confers power to RBI in the matter of managing itself as well as discharging its supervisory duties vis-à-vis other banks as well as powers to function as Monetary Policy/Control Authority. The BR Act confers vast powers to RBI vis-à-vis banks such as issuing directions to banks in the area of Deposit Accounts, interest rates, advances, foreign exchange, CRR/SLR etc. To increase the effectiveness of regulation over NBFCs, the RBI Act has also been amended recently, to confer more powers than ever before, in tune with emerging economic/financial scenario. It also regulates credit in India as per the clauses of the BR Act. Recently RBI has also been empowered to direct banks to initiate insolvency resolution process of borrowers under Insolvency and Bankruptcy Code 2016. Apart from RBI, banks are also regulated by other regulators in a

limited way such as Securities and Exchange Board of India, Insurance Regulatory and Development Authority of India, Registrar of Companies, Central / State Registrar of Co-operatives etc. wherever applicable.

The extensive regulatory powers conferred on RBI enables it to regulate the following aspects of banking viz. advances, guarantees, rate of interest, deposit portfolio, affairs of Board of Directors/Directors/Other officials, electronic/internet banking, payment and settlement systems of banks. In order to make payment & settlement system more customer friendly, RBI has announced Harmonization of Turnaround Time (TAT) and customer compensation for failed transactions using authorized Payment Systems. RBI also issues directions in the xii interest of banking policy to banks and guidelines, on resolving stressed assets. It also maintains Depositor Education and Awareness Fund in respect of specified inoperative deposit accounts and other sundry liability items of banks provide guidance to banks on Nomination in deposit accounts, safe deposit lockers and safe custody accounts. As a part of its monetary control measures RBI controls issue of various money market instruments. It also guides and monitors the maintenance of reserve fund, Cash Reserve Ratio and Statutory Liquidity Ratios of banks.

The banking system in India is regulated by the Reserve Bank of India (RBI), through the provisions of the Banking Regulation Act, 1949. Some important aspects of the regulations that govern banking in this country, as well as RBI circulars that relate to banking in India, will be explored below.

Exposure limits :

Lending to a single borrower is limited to 15% of the bank's capital funds (tier 1 and tier 2 capital), which may be extended to 20% in the case of infrastructure projects. For group borrowers, lending is limited to 30% of the bank's capital funds, with an option to extend it to 40% for infrastructure projects. The lending limits can be extended by a further 5% with the approval of the bank's board of directors. Lending includes both fund-based and non-fund-based exposure.

1.10 CASH RESERVE RATIO (CRR) AND STATUTORY LIQUIDITY RATIO (SLR) :

Banks in India are required to keep a minimum of 4% of their net demand and time liabilities (NDTL) in the form of cash with the RBI. These currently earn no interest. The CRR needs to be maintained on a fortnightly basis, while the daily maintenance needs to be at least 95% of the required reserves. In case of default on daily maintenance, the penalty is 3% above the bank rate applied on the number of days of default multiplied by the amount by which the amount falls short of the prescribed level.

Over and above the CRR, a minimum of 22% and a maximum of 40% of NDTL, which is known as the SLR, need to be maintained in the form of gold, cash or certain approved securities. The excess SLR holdings can be used to borrow under the Marginal Standing Facility (MSF) on an overnight basis from the RBI. The interest charged under MSF is higher than the repo rate by 100 bps, and the amount that can be borrowed is limited to 2% of NDTL

Provisioning :

Non-performing assets (NPA) are classified under 3 categories: substandard, doubtful and loss. An asset becomes non-performing if there have been no interest or principal payments for more than 90 days in the case of a term loan. Substandard assets are those

assets with NPA status for less than 12 months, at the end of which they are categorized as doubtful assets. A loss asset is one for which the bank or auditor expects no repayment or recovery and is generally written off the books.

For substandard assets, it is required that a provision of 15% of the outstanding loan amount for secured loans and 25% of the outstanding loan amount for unsecured loans be made. For doubtful assets, provisioning for the secured part of the loan varies from 25% of the outstanding loan for NPAs that have been in existence for less than one year, to 40% for NPAs in existence between one and three years, to 100% for NPA's with a duration of more than three years, while for the unsecured part it is 100%. Provisioning is also required on standard assets. Provisioning for agriculture and small and medium enterprises is 0.25% and for commercial real estate it is 1% (0.75% for housing), while it is 0.4% for the remaining sectors. Provisioning for standard assets cannot be deducted from gross NPA's to arrive at net NPA's. Additional provisioning over and above the standard provisioning is required for loans given to companies that have unhinged foreign exchange exposure.

Priority sector lending :

The priority sector broadly consists of micro and small enterprises, and initiatives related to agriculture, education, housing and lending to low-earning or less privileged groups (classified as "weaker sections"). The lending target of 40% of adjusted net bank credit (ANBC) (outstanding bank credit minus certain bills and non-SLR bonds) – or the credit equivalent amount of off-balance-sheet exposure (sum of current credit exposure + potential future credit exposure that is calculated using a credit conversion factor), whichever is higher – has been set for domestic commercial banks and foreign banks with greater than 20 branches, while a target of 32% exists for foreign banks with less than 20 branches.

The amount that is disbursed as loans to the agriculture sector should either be the credit equivalent of off-balance-sheet exposure or 18% of ANBC – whichever of the two figures is higher. Of the amount that is loaned to micro-enterprises and small businesses, 40% should be advanced to those enterprises with equipment that has a maximum value of 200,000 rupees, and plant and machinery valued at a maximum of half a million rupees, while 20% of the total amount lent is to be advanced to micro-enterprises with plant and machinery ranging in value from just above 500,000 rupees to a maximum of a million rupees and equipment with a value above 200,000 rupees but not more than 250,000 rupees.

The total value of loans given to weaker sections should either be 10% of ANBC or the credit equivalent amount of off-balance sheet exposure, whichever is higher. Weaker sections include specific castes and tribes that have been assigned that categorization, including small farmers. There are no specific targets for foreign banks with less than 20 branches.

The private banks in India until now have been reluctant to directly lend to farmers and other weaker sections. One of the main reasons is the disproportionately higher amount of NPA's from priority sector loans, with some estimates indicating it to be 60% of the total NPAs. They achieve their targets by buying out loans and securitized portfolios from other non-banking finance corporations (NBFC) and investing in the Rural Infrastructure Development Fund (RIDF) to meet their quota.

New bank license norms :

The new guidelines state that the groups applying for a license should have a successful track record of at least 10 years and the bank should be operated through a non-operative financial holding company (NOFHC) wholly owned by the promoters. The

minimum paid-up voting equity capital has to be five billion rupees, with the NOFHC holding at least 40% of it and gradually bringing it down to 15% over 12 years. The shares have to be listed within three years of the start of the bank's operations.

The foreign shareholding is limited to 49% for the first five years of its operation, after which RBI approval would be needed to increase the stake to a maximum of 74%. The board of the bank should have a majority of independent directors and it would have to comply with the priority sector lending targets discussed earlier. The NOFHC and the bank are prohibited from holding any securities issued by the promoter group and the bank is prohibited from holding any financial securities held by the NOFHC. The new regulations also stipulate that 25% of the branches should be opened in previously unbanked rural areas.

Willful defaulters :

A willful default takes place when a loan isn't repaid even though resources are available, or if the money lent is used for purposes other than the designated purpose, or if a property secured for a loan is sold off without the bank's knowledge or approval. In case a company within a group defaults and the other group companies that have given guarantees fail to honor their guarantees, the entire group can be termed as a willful defaulter.

Willful defaulters (including the directors) have no access to funding, and criminal proceedings may be initiated against them. The RBI recently changed the regulations to include non-group companies under the willful defaulter tag as well if they fail to honor a guarantee given to another company outside the group.

The Bottom Line :

The way a country regulates its financial and banking sectors is in some senses a snapshot of its priorities, its goals, and the type of financial landscape and society it would like to engineer. In the case of India, the regulations passed by its reserve bank give us a glimpse into its approaches to financial governance and shows the degree to which it prioritizes stability within its banking sector, as well as economic inclusiveness.

Though the regulatory structure of India's banking system seems a bit conservative, this has to be seen in the context of the relatively under-banked nature of the country. The excessive capital requirements that have been set are required to build up trust in the banking sector while the priority lending targets are needed to provide financial inclusion to those to whom the banking sector would not generally lend given the high level of NPA's and small transaction sizes. Since the private banks, in reality, do not directly lend to the priority sectors, the public banks have been left with that burden. A case could also be made for adjusting how the priority sector is defined, in light of the high priority given to agriculture, even though its share of GDP has been going down.

1.11 CONCLUSION :

A banking system is a collection of institutions that provides us with financial services. These organizations are in charge of running a payment system, making loans, accepting deposits, and assisting with investments. The Reserve Bank of India (RBI), commercial banks, cooperative banks, and development banks comprise India's banking system (development finance institutions). The core of India's financial system is these institutions, which serve as a meeting point for savers and investors. Banks play a vital role in the development of poor countries by mobilizing resources and efficiently allocating them.

1.12 SELF ASSESSMENT QUESTIONS :

1. Explain Types of Banks in India
2. Briefly Explain Types of Bank Accounts in India
3. Explain The Importance of Banking System in India
4. Explain Official Regulation and Control over Banks in India
5. Explain Cash Reserve Ratio (CRR) & Statutory Liquidity Ratio (SLR)

1.13 SUGGESTED READINGS BOOKS

1. M.L.Tannan, revised by : Banking Law and Practice, Wadhwa& Company, Nagpur C.R. Datta& S.K. Kataria
2. A.B. Srivastavaand : Seth's Banking Law, Law Publisher's India (P) Limited K. Elumalai
3. R.K. Gupta : BANKING Law and Practice in 3 Vols. Modern Law Publications.
4. Prof. Clifford Gomez : Banking and Finance - Theory, Law and Practice, PHI Learning Private Limited
5. J.M. Holden : The Law and Practice of Banking, Universal Law Publishing

Dr. PALLEKONDA SRINIVASA RAO

LESSON - 2

BANKING REGULATION ACT, 1949

OBJECTIVES:

After studying this unit, you should be able to:

- To understanding the Banking Regulations Act
- To know the concept of Applicability of the Banking Regulations Act
- To acquire knowledge about significance of Banking Regulations Act

Banking companies are regulated in India through various laws. The principal ones among them are The Reserve Bank of India Act, 1934 and The Banking Regulations Act, 1949.

STRUCTURE:

2.1 Introduction
2.2 History of the Banking Regulations Act, 1949
2.3 Objectives of the Banking Regulations Act, 1949
2.4 Scope & Applicability of the Banking Regulations Act, 1949
2.5 Feature of the Banking Regulations Act, 1949
2.6 Important Provisions of the Banking Regulations Act, 1949
2.7 Offence and punishment under the Banking Regulations Act, 1949
2.8 Amendments to the Banking Regulations Act, 1949
2.9 The Banking Regulation (Amendment) Bill, 2020
2.10 Conclusion
2.11 Self Assessment Questions
2.12 Further Readings

2.1 INTRODUCTION:

Different types of banks, such as commercial banks, cooperative banks, rural banks, and private sector banks exist in India. The Reserve Bank of India (RBI) is the governing body for regulating and supervising the banks. Banking Regulation Act, 1949 is an Act that provides a framework for regulating the banks of India. The Act came into force on 16th March 1949. This Act gives RBI the power to control the behaviour of banks. This Act was passed as Banking Companies Act, 1949. It did not apply to Jammu and Kashmir until 1956. This Act monitors the day-to-day operations of the bank. Under this Act, the RBI can license banks, put regulation over shareholding and voting rights of shareholders, look over the appointment of the boards and management, and lay down the instructions for audits.

RBI also plays a role in mergers and liquidation. Banks in India are highly regulated and have to ensure compliance and reporting to RBI and other authorities. The principal regulations applicable to banks originate from the Banking Regulation Act and RBI Act. A detailed knowledge of these is necessary for any student of banking in India. Keeping this in mind, contents this chapter covers constitution and powers of RBI, monetary control measures adopted by banks, constitution & control of banks and other regulatory authorities of banks. These form the broad regulatory frame work of banks in India, the knowledge of which is essential for a any student on banking. The contents are of Level 1 orientation and will be useful for equipping oneself with deeper knowledge about how banks are regulated.

Meaning of Banking:

Banking means transacting business with a bank; depositing or withdrawing funds or requesting a loan etc. The development of banking is evaluation in nature. The origin of the word bank can be traced back to the German word "Banck" and Italian word "Banco" which means heap of money. Banking is an old concept in India. It was present in ancient Vedic times. There were bankers known as "Sheth", "Shah", "Shroff" or "Chettiar" who were performing the function of bank

2.2 HISTORY OF THE BANKING REGULATION ACT, 1949:

The concept of banking started in India with the establishment of the Bank of Hindustan. Before nationalisation took place in India, the banking system of India was more of a private nature. Banks were struggling to keep their branches open. Low capital and reserves and greed for obtaining high profits became a reason for the failure of the banking system. The banks were supervised under the Companies Act, 1913, but this Act was not sufficient to regulate banks. The economy was not performing well, and this started to damage the banks. Also, the concept of banks was mostly used by the upper-class people. Frauds were also one of the reasons for the decline in the usage of banks. This gave a need to regulate the banking system of India. As a result, the Banking Regulation Act was introduced in 1949. It was initially applicable to banking companies, but after the Amendment in 1965, the Act was also applicable to cooperative banks.

The Banking Regulation Act, 1949 applies to the whole of India including Jammu and Kashmir. The Act was initially brought in to force as the Banking Companies Act, 1949, and later renamed as Banking Regulations Act, 1949 w.e.f. 01.03.1966. The Banking Regulation Act does not apply to primary agricultural credit societies, non-agricultural primary credit societies and cooperative land mortgage banks as per section 3. Till 1965 the coverage of this Act was limited to Banking Companies and later in 1966 Co-operative banks was also brought under its jurisdiction. The Banking Regulation Act is applicable along other statutory laws applicable, unless specifically exempted.

Therefore provisions of Companies Act are also applicable unless there is an express special provision in the Banking Regulation Act. Broadly speaking, the Act regulates the entire activities of banking right from licensing, restrictions on share holding, directors, voting rights etc. In addition to these, by an amendment in August 2017, RBI has also been empowered to issue directions to banks to initiate insolvency resolution to recover bad loans. The Banking Regulation Act further specifies restriction on loans and advances, interest rates to be charged, maintenance of SLR reserves, Audit, inspection, submission of balance sheet and accounts. There are also provisions regarding control over managements, apart from liquidation and winding up as well as penalties. Thus, the Banking Regulation Act tries to regulate the entire gamut of banking business

2.3 OBJECTIVES OF THE BANKING REGULATION ACT, 1949:

The objectives of the Banking Regulation Act are stated below:

- The provision of the Indian Companies Act 1913 was found inadequate and unsatisfactory to regulate banking companies in India. Therefore a need was felt to have a specific legislation having comprehensive coverage on banking business in India.

- Due to inadequacy of capital many banks failed and hence prescribing a minimum capital requirement was felt necessary. The banking regulation act brought in certain minimum capital requirements for banks.
- One of the key objectives of this act was to avoid cut throat competition among banking companies. The act was regulated the opening of branches and changing location of existing branches.
- To prevent indiscriminate opening of new branches and ensure balanced development of banking companies by system of licensing.
- Assign power to RBI to appoint, reappoint and removal of chairman, director and officers of the banks. This could ensure the smooth and efficient functioning of banks in India.
- To protect the interest of depositors and public at large by incorporating certain provisions, viz. prescribing cash reserve and liquidity reserve ratios. This enable bank to meet demand depositors.
- Provider compulsory amalgamation of weaker banks with senior banks, and thereby strengthens the banking system in India.
- Introduce few provisions to restrict foreign banks in investing funds of Indian depositors outside India.
- Provide quick and easy liquidation of banks when they are unable to continue further or amalgamate with other banks.
- To meet the demand of the depositors and provide them security and guarantee.
- To provide provisions that can regulate the business of banking.
- To regulate the opening of branches and changing of locations of existing branches.
- To prescribe minimum requirements for the capital of banks.
- To balance the development of banking institutions.

This act applies to the following categories of banks

- Nationalized banks
- Non-nationalized banks
- Co-operative banks in the manner and to the extent specified in the act

Business of banking companies

A bank can effect, insure, guarantee, underwrite, or participate in the management of public or private loans, as well as the issue of stock, debentures, or shares of any company, corporate, or association, as part of its job as a state agency. It also has the ability to lend money for such uses.

- In banking regulation act 1949, section 6 it provides a list of activities which a banking company may engage in the business of banking. The Main functions are as follows.
- Acting as agents for any Government or local authority or any other person carrying the agency's business of any description but excluding of the managing agent or secretary and treasurer of a company.
- Managing the public loan and private loan and solving issues respectively.
- The insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue public or private of the State municipal or other loans or of shares, stock, debentures, stock of any company, corporation or association and the lending of money for any purpose.
- May carry on every kind of guarantee business.

- Managing, selling and realizing any property which may come into the possession of the company in satisfaction in any of its claims.
- Can acquire, hold and deal with any property or any right, title or interest in any such property which may form the security for any loan or advance which may be connected to any of that security.
- Undertaking and executing trusts.
- Undertaking the administration of estates as executor, trustee.
- Establishing and supporting of associations, institutions, funds, trusts and conveniences calculated to benefit employees or exemployees of the company.
- The acquisition, construction, maintenance and alteration of any building or works necessary for the purposes of the company.
- Selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with the property and rights of the company.
- Acquiring and undertaking the whole or part of the business of any person or a company, when such business is of a nature enumerated or described in the act.
- Doing all these things as are incidental or conducive to the advancement of the business of the company.
- Any other form of business which the Central Government fixed in the Official Gazette, and specified as a form of business in which it is lawful for a banking company to engage.

The above list of activities is exhaustive but not comprehensive. There are several kinds of services listed above both under main business as well as ancillary business; some are agency services and general utility services

Agency Services

- Carrying and transacting guarantee business on behalf of its clients, collection of bills, securities etc. purchasing and selling of shares, bonds, debenture, etc. on behalf of constituents negotiating of loans and advances, mail transfer etc. and many more agency services are grouped as follows.
- Non-fund Business o Collection of instruments and securities on behalf of customers
- Portfolio Management or Merchant Banking.
- Facility of remittance of funds
- Money Exchange business as Authorized dealer under foreign exchange business o Other agency business on behalf of Government or local body
- Factoring Services
- Special Purpose Vehicle(SPV) services for securitization of assets under securitization and reconstruction of Financial assets and Enforcement of security interest act o Collection of taxes on behalf of the people
- Collection of different dues of the people like telephone, electricity, municipal taxes.

General Utility Services

- Providing Safe-custody facility to its customers for keeping their valuables
- Providing the facility of Safe deposit vault under lease agreement to its customers for keeping their valuables
- Technology based utility services like Tele-banking, Mobile banking, online banking; DEMAT services for securities trading, ATM services, etc.

Consultancy services

- ECS services for payment of different dues of the people
- Payment of pension
- Payment of salaries of the employees

2.4 SCOPE AND APPLICABILITY OF THE BANKING REGULATION ACT, 1949:

The banking regulation 1949 act of India is mainly established to restrict trading business to eradicate non-banking sector various risks. Apart from this, the other objective or role of the banking act of 1949 is to safeguard and highly protect the depository's interest. The sections under this Act are to be interpreted along with the sections of the Companies Act, 1956, or any other laws prevalent in the banking system. This Act applies to banking companies and cooperative banks. It will not apply to a primary agricultural credit society or a cooperative land mortgage bank, or any other co-operative society, except mentioned in Part V of the Act.

2.5 FEATURES OF THE BANKING REGULATION ACT, 1949:

The Act has been divided into five parts comprising 56 sections.
The main features of the Act are mentioned below:

- Non-banking companies are forbidden to receive money deposits that are payable on demand.
- Non-banking risks are reduced by prohibiting trading by banking companies.
- Maintaining minimum capital standards.
- Regulation on the acquisition of shares of banking companies.
- Power of the Central Government to make schemes for the banks.
- Provisions regarding liquidation proceedings for banking companies.

2.6 IMPORTANT PROVISIONS OF THE BANKING REGULATION ACT, 1949:

Some important provisions of the Act are stated below:

Definitions:

The Act has defined some terms such as banking, banking company, branch office, etc. A banking company means a company that conducts banking business in India. Banking means to accept for lending or investment of deposits of money from the public which can be repaid on demand. Subsidiary banks have the same meaning as given under the State Bank of India (Subsidiary Banks) Act, 1959. A secured loan or advance means an advance or a loan secured against the security of assets.

- **Business which can be undertaken by the banking companies:** Under Section 6(1), a banking company may be involved in the business of borrowing or lending money; buying or selling bills of exchange, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures; buying or selling of foreign exchange; dealing stock, funds, shares, debentures, bonds; carrying on agency business such as clearing and forwarding of goods; conducting the business of guarantee and indemnity, etc.

- **Prohibition of trading:** Trading is prohibited under Section 8 of this Act. No banking company shall directly or indirectly deal in the buying or selling, or bartering of goods except when it is selling the goods kept in its security. The bank should also not engage in any trade or buy, sell or barter goods except for bills of exchange received due to collection or negotiation.

- **Management of bank:** The bank should not employ or be employed by the managing partner as stated under Section 10 of the Act. The bank should also not employ a person who has been adjudicated insolvent or whose remunerations depend on the profits of the company. At least 51% of the total members of the board must have professional experience in matters such as accountancy, agriculture, rural economy, banking, cooperation, economics, finance, law, small-scale industry, etc. The term of the office of the director should not be more than eight years.
- **Minimum paid-up capital and reserves:** Section 11 states that if a banking company is incorporated outside India then the total value of its paid-up capital should be more than fifteen lakhs and if it has a place of business in Calcutta or Bombay or both, then it should be more than twenty lakhs.

The banking company must deposit twenty percent of its profit for the year. If the company is incorporated in India and if it has branches in different states, then the paid-up capital is five lakhs of rupees, and if the place of business is situated in the city of Bombay or Calcutta or both, then ten lakhs of rupees must be the minimum paid-up capital. If the company has all its branches in the same state none of which is situated in the city of Bombay or Calcutta, then the paid-up capital must be one lakh rupees concerning its principal place of business, plus ten thousand rupees in respect of each of its other branches situated in the same district in which it has its principal place of business, plus twenty-five thousand rupees in respect of each branch situated elsewhere in the state otherwise than in the same district.

The subscribed capital of the company should not be less than one-half of the authorised capital, and the paid-up capital should not be less than one-half of the subscribed capital. The banking company cannot create any charge on unpaid capital. The company shall transfer every year at least twenty percent of its profits to the Reserve Fund. The banking company must inform RBI of the appropriation of the Reserve Fund within twenty-one days from the date of appropriation.

- **Limitations on nature of subsidiary companies:** A banking company should not form a subsidiary company unless the formed company is for an undertaking of a business or written permission was obtained from the Reserve Bank of India. The banking company can hold shares of an amount of more than thirty percent of the paid-up share capital of the company or its own paid-up capital.
- **Licensing of banking companies:** No banking company can carry out business in India unless it has obtained a license from the RBI. RBI can hold the inspection of books before granting the license. RBI can also cancel the license if the company stops carrying on banking business in India. Opening of new and transfer of existing branches

Every banking company must obtain the permission of RBI before opening a new branch or transferring the existing branch to a different city, town, or state. No banking company incorporated in India shall open a new branch outside India without the prior permission of RBI. However, a new branch can be opened for a temporary period not exceeding one month.

- **Accounts and balance-sheet:** The banking companies shall prepare a balance sheet and profit and loss account on the last working day.
- **Inspection:** RBI can cause the inspection of the banking company and must state its report to the company. The directors of the banking company must submit all books, accounts, or documents for inspection.

- **Power of RBI to issue directions:** RBI may frequently issue directions to the banking company if it is satisfied that the directions are in the interest of the public or to prevent the banking company from detrimentally conducting business.
- **Restriction of certain activities by the banking company:** The banking company cannot obstruct any person from entering its place of business. It cannot hold anything violent in the place of business. The banking is liable under Section 36AD for violation of the above-mentioned activities.
- **Powers and functions of RBI:** Section 36 mentions the powers of RBI. The Reserve Bank may prohibit banking companies from entering into a particular transaction and can advise the banking company. It can also assist the banking company by granting loans or advances under Section 18. It can direct the banking company to call for a meeting of its directors to discuss the matters of the company. It can also appoint officers to observe how the affairs of the banking company are conducted.
- **Suspension of business:** If the banking company for a temporary period is unable to meet its obligation, it can apply for a moratorium to the High court. The High court can grant the moratorium and stop the proceedings for a temporary period as it deems proper. The period of the moratorium shall not exceed six months. The banking company is only considered valid if it has attached the report of the RBI stating that the banking company will be able to pay its debts if the application is granted.
- **Acquisition of the undertakings of banking companies:** The undertaking of banking companies must be done by the Central Government after consulting with the Reserve Bank of India. The undertaking must be done only after the banking companies have been provided with an opportunity for showing cause for car
- **Payment of dividends:** The banking companies should only pay dividends after all the capital expenses are paid up. It shall not pay the dividends until the depreciation in the value of investments in approved securities or investments in shares, debentures, or bonds are written off.
- **Reserve fund:** Every banking company must form a reserve fund and must transfer at least twenty percent of its profit to the reserve fund. Each banking company must report to the Reserve Bank if it has appropriated any funds from the reserve fund.
- **Power of Central Government in respect of liquidation of companies:** The Central Government may order the RBI to initiate insolvency proceedings if the banking companies have committed a default under the Insolvency and Bankruptcy Code, 2016.

2.7 OFFENCES AND PUNISHMENT UNDER THE BANKING REGULATION ACT, 1949:

Various provisions are mentioned in the Act which states that a person will be liable for imprisonment and fine if he does any act which is in contravention with the Act. It is stated under Section 46 as below:

- A person will be liable for imprisonment of up to three years and a fine which may extend up to one crore rupees if he has misrepresented any facts or presented the wrong acts intentionally.
- A person will be liable to a fine of up to twenty lakh rupees and up to fifty thousand rupees in case of a continuing offence if he fails to produce the documents or books or refuses to answer the questions asked by the inspection officer.

- All the directors of the banking company will be held liable and will be imposed a fine of twice the amount of the deposits made with the banking company if the banking company has illegally received any deposit.
- The directors or the secretary will be punished if the company has caused a default or the default occurred due to the negligence of the director.

Shortcomings of the Banking Regulation Act, 1949: The Banking Regulation Act has less scope on public sector banks. The amendments in the Act are not enough to leverage the stressed assets in the financial system. There are no strict provisions for non-performing assets (NPA), and this gives a chance to the defaulters to escape from the situation. Some provisions of this act can hamper the working of the banks.

2.8 AMENDMENTS TO THE BANKING REGULATION ACT, 1949:

- **Banking Laws (Application to Co-operative Societies) Act, 1965:** Initially, the Banking Regulation Act was passed as Banking Companies Act, 1949. But with the introduction of the Banking Laws (Application to Co-operative Societies) Act, the word Companies was omitted and the word Regulation was added to the title of the Banking Regulation Act, 1949. The Act also added a new Section called Section 56 as Part V after Part IV in the Banking Regulation Act. This section will apply to co-operative societies subjected to some modifications.
- **Banking Regulation (Amendment) Act, 2020 (Act 39 of 2020):** This Act came into force on September 29, 2020. The Banking Regulation Act will not be applied to a cooperative society whose main business is providing long-term financial support for agricultural development. The amendment also mentioned that the societies should not use the words ‘bank’, ‘banker’, or ‘banking’ in their name or connection with their business. A cooperative bank may issue equity shares, preference shares, or special shares on face value or at a premium to its members or to any other person residing within its area of operation after obtaining prior approval from the Reserve Bank of India.

After the amendment, RBI may suspend the Board of Directors of a multi-cooperative bank for five years to protect the depositors. This amendment omitted some provisions like granting of unsecured loans or advances to its directors, and to private companies where the bank’s directors or chairman is an interested party, opening a new place of business, or changing the location of the cooperative bank outside of the city, town or village in which it is currently located without permission from RBI, etc.

2.9 THE BANKING REGULATION (AMENDMENT) BILL, 2020

The Banking Regulation (Amendment) Bill, 2020 was introduced in Lok Sabha by the Minister of Finance, Ms. Nirmala Sitharaman, on March 3, 2020. The Bill seeks to amend the Banking Regulation Act, 1949, with regard to cooperative banks. The Act regulates the functioning of banks and provides details on various aspects such as licensing, management, and operations of banks. The objective of the proposed amendment Bill (by amending the relevant clauses of the Banking Regulation Act, 1949 that pertain to Cooperative Banks) is to increase professionalism in cooperative banks, enable them to have better access to capital and to improve governance and oversight through the RBI for sound banking.

- **Exclusions:** The Act does not apply to certain cooperative societies. These are: (i) primary agricultural credit societies, (ii) cooperative land mortgage banks, and (iii) any other cooperative societies (except those specified in the Act). The Bill amends this provision to state that the Act will not apply to: (i) primary agricultural credit societies, and (ii) cooperative societies whose principal business is long term financing for agricultural development. Further, these societies must not: (i) use the words 'bank', 'banker' or 'banking' in their name or in connection with their business, and (ii) act as an entity that clears cheques.

- **Issuance of shares and securities by cooperative banks:** The Bill provides that a cooperative bank may issue equity shares, preference shares, or special shares on face value or at a premium to its members or to any other person residing within its area of operation. Further, it may issue unsecured debentures or bonds or similar securities with maturity of ten or more years to such persons. Such issuance will be subject to the prior approval of the Reserve Bank of India (RBI), and any other conditions as may be specified by RBI. The Bill states that no person will be entitled to demand payment towards surrender of shares issued to him by a co-operative bank. Further a co-operative bank cannot withdraw or reduce its share capital, except as specified by the RBI.
- **Supersession of Board of Directors:** The Act states that RBI may supersede the Board of Directors of a multi-state cooperative bank for up to five years under certain conditions. These conditions include cases where it is in the public interest for RBI to supersede the Board, and to protect depositors. The Bill adds that in case of a co-operative bank registered with the Registrar of Co-operative Societies of a state, the RBI will supersede the Board of Directors after consultation with the concerned state government, and within such period as specified by it.
- **Power to exempt cooperative banks:** The Bill states that RBI may exempt a cooperative bank or a class of cooperative banks from certain provisions of the Act through notification. These provisions relate to restrictions of certain types of employment, qualifications of the Board of Directors and, appointment of a chairman. The time period and conditions for the exemption will also be specified by the RBI.
- **Certain provisions omitted:** The Bill seeks to omit certain provisions from the Act. Some of these provisions are listed below:
  - The Act restricts cooperative banks from making loans or advances on the security of its own shares. Further, it prohibits the grant of unsecured loans or advances to its directors, and to private companies where the bank's directors or chairman is an interested party. The Act also specifies conditions when unsecured loans or advances may be granted and specifies the manner in which the loans may be reported to RBI. The Bill omits this provision from the Act.
  - The Act states that cooperative banks cannot open a new place of business or change the location of the bank outside of the city, town or village in which it is currently located without permission from RBI. The Bill omits this provision.
  - The Act requires a scheduled cooperative bank to maintain assets with a value not exceeding 40% of the it total demand and time liabilities, within India. The Bill omits this provision.

The recent Punjab and Maharashtra Cooperative (PMC) Bank Scam which affected lakhs of customers, has, in fact, necessitated reforms in the regulatory processes and mechanisms for Cooperative Banks in the country. Registered under the Cooperative Societies Act, 1912, Cooperative Banks, have been promoted in India to support

economically weaker sections of our society and provide them financial assistance through cooperatives. There are State levels as well as District level Cooperative Banks. Over the years, however, issues such as non-accountability, political interference, vested interest groups, internal free riders, etc. have surfaced in some cooperative banks. Such irregularities necessitated amendments in the relevant provisions of the Banking Regulation Act.

So as to protect the interests of customers and provide safety nets for the funds small depositors and ensure professionalism in the governance structure of the Cooperative Banks, the Banking Regulation (Amendment) Bill, 2020 has been introduced.

Salient Features of the Bill

- **Strengthening Cooperative Banks:** By amending necessary sections and clauses in the Banking Regulation Act, 1949, the Bill aims to provide enabling access to capital and also increase professionalism in the Cooperative Banks. These measures will certainly strengthen the cooperative banks and help them deliver the intended objective of providing support to the weaker sections in Indian society.
- **Role of the Registrar of Cooperative Societies:** The Cooperative Banks are under the dual control of the Registrars of Cooperative Societies and the RBI. The proposed provisions in the Bill while seek to enforce banking regulation of the RBI in cooperative banks, the administrative role will continue to remain with the Registrars of Cooperative Societies.
- **Consulting the Concerned State Government:** The proposed provisions also provide that before issuing order for supersession of the board of directors, the RBI shall consult the concerned State Government in the case of the Cooperative Bank is registered with the Registrar of Co-operative Societies of a State.
- **Not applicable to the Cooperative Societies for Agricultural Credit:** The proposed amendments will not be applicable to - a) Primary agricultural credit society; or b) a cooperative society whose primary objective and principal business is to provide long-term finance for agricultural development.

Summing up

As India's economic landscape is undergoing a series of reforms in different fields in the last few years starting from the introduction of GST in the field of indirect taxes, introduction of Insolvency and Bankruptcy Code in the banking sector, and many such other relevant measures, the cooperative sector which provides a finance and credit base to the economy, also necessitate reforms so as to ensure the confidence of the people who are at the bottom of the socio- 3 economic ladder of our society. Thus, the Banking Regulation (Amendment) Bill, 2020 has been introduced as an effort to address the concerns of the small depositors and make them equal partners in the growth and development of the country.

2.10 CONCLUSION:

All the banking companies will be controlled under the Banking Regulation Act, 1949. This Act provides a proper structure to the banking system in India. The Act puts restrictions on the banks to avoid fraud and protect the interests of the depositors. It also states the procedure for winding up the banking company. The Act also states the acquisition and mergers of the banking companies. Thus, this Act led to the proper growth of the banking companies which was lacking before 1949.

2.11 QUESTIONS:

1. History of the Banking Regulations Act, 1949

2. Objectives of the Banking Regulations Act, 1949
3. Scope & Applicability of the Banking Regulations Act, 1949
4. Feature of the Banking Regulations Act, 1949
5. Important Provisions of the Banking Regulations Act, 1949
6. Offence and punishment under the Banking Regulations Act, 1949
7. Amendments to the Banking Regulations Act, 1949

2.12 SUGGESTED READING BOOKS :

1. M.L.Tannan, revised by : Banking Law and Practice, Wadhwa& Company, Nagpur C.R. Datta& S.K. Kataria
2. A.B. Srivastavaand : Seth's Banking Law, Law Publisher's India (P) Limited K. Elumalai
3. R.K. Gupta : BANKING Law and Practice in 3 Vols.Modern Law Publications.
4. Prof. Clifford Gomez : Banking and Finance - Theory, Law and Practice, PHI Learning Private Limited
5. J.M. Holden : The Law and Practice of Banking, Universal Law Publishing

Dr. PALLEKONDA SRINIVASA RAO

LESSON - 3

RESERVE BANK OF INDIA 1934

OBJECTIVES :

After studying this unit, you should be able to:

- To understanding the Reserve Bank of India Act, 1934
- To know the concept of Structure and Organisation of Reserve Bank of India
- To acquire knowledge about significance of Banking Companies Act, 1970
- To understand the purpose and objectives of pivotal provisions of the Banking Companies Act, 1970

STRUCTURE :

3.1 Introduction
3.2 Reserve Bank of India Act, 1934 and Overview
3.3 Amendments to RBI Act (August 2019)
3.4 Structure and Organisation of Reserve Bank of India
3.4.1 Objectives for Setting up the RBI
3.4.2 Administrative Set-up
3.4.2.1 Central Board of Directors
3.4.2.2 Local Boards
3.4.3 Functions of RBI
3.4.4 Offices
3.4.5 Subsidiary Institutions
3.4.6 External Relations and Customer Service
3.4.6.1 Publications
3.4.6.2 Customer Service
3.4.7 Reserve Bank of India – Structure – Internal Organisation
3.5 Banking Companies Act, 1970 History
3.6 Some vital sections of the Banking Companies Act, 1970
3.7 pivotal provisions of the Banking Companies Act, 1970
3.8 conclusions

3.1 INTRODUCTION :

Banks in India are highly regulated and have to ensure compliance and reporting to RBI and other authorities. The principal regulations applicable to banks originate from the Banking Regulation Act and RBI Act. A detailed knowledge of these is necessary for any student of banking in India. Keeping this in mind, contents this chapter covers constitution and powers of RBI, monetary control measures adopted by banks, constitution & control of banks and other regulatory authorities of banks. These form the broad regulatory frame work of banks in India, the knowledge of which is essential for a any student on banking. The contents are of Level 1 orientation and will be useful for equipping oneself with deeper knowledge about how banks are regulated.

3.2 RESERVE BANK OF INDIA ACT, 1934 AN OVERVIEW :

The RBI Act was enacted with an objective of constituting Reserve Bank of India to regulate issue of bank notes, to keep reserves to ensure monetary stability, to operate currency and credit system. This Act is the basis for constitution, powers, and functions of RBI. This act does not regulate banking directly though section 18 and 42 of RBI Act are used in regulating credit. In broad sense, RBI Act deals with Incorporation, Capital, Management, Business of RBI itself, Central Banking Functions, Collection and furnishing of information, Regulating Non-Banking Institutions receiving deposits and financial institutions, Prohibition of Acceptance of deposits by unincorporated bodies, Regulation of transactions in derivatives, money market instruments, securities etc., Joint mechanism, Monetary Policy, General Provisions, Penalties along with Schedule I and II. The RBI Act was amended several times in the past to expand the powers of RBI. The last amendment to RBI Act was done in February, 2016 to provide for a Monetary Policy Committee ('MPC'), to maintain price stability under an overall objective of growth. The task of the MPC would be fixing the benchmark policy rate (repo rate) to control and contain inflation within the specified target level. The Committee-based structure is expected to bring in value addition and transparency in this area of policy decisions. MPC will hold meetings at least four times a year and publish the decisions after each such meeting

The Reserve Bank of India Act, 1934 was enacted to constitute the Reserve Bank of India with an objective to (a) regulate the issue of bank notes (b) for keeping reserves to ensure stability in the monetary system (c) to operate effectively the nation's currency and credit system The RBI Act covers: (i) the constitution (ii) powers (iii) functions of the Reserve Bank of India. The act does not directly deal with the regulation of the banking system except for few sections like Sec 42 which relates to the maintenance of CRR by banks and Sec 18 which deals with direct discount of bills of exchange and promissory notes as part of rediscounting facilities to regulate the credit to the banking system. The RBI Act deals with:

a) Incorporation, capital, management and business of the RBI
b) The functions of the RBI such as issue of bank notes, monetary control, banker to the Central and State Governments and banks, lender of last resort and other functions
c) General provisions in respect of reserve fund, credit funds, audit and accounts
d) Issuing directives and imposing penalties for violation of the provisions of the Act

3.3 AMENDMENTS TO RBI ACT (AUGUST 2019) :

While presenting the Finance Bill of in August 2019, The Finance Minister proposed the following amendments/Insertions of Sections to RBI Act 1934: **-**

45 IA-Amendments. Increasing the quantum of Net owned funds of a NBFC, 45-ID – (Insertion) Power of RBI to remove directors of an NBFC from office, 45 IE – (Insertion) Supersession of Board of directors of NBFC (other than Government Company)., 45MAA - Power to take action against auditors, '45MBA - Resolution of non-banking financial company, 45NAA – Power in respect of group companies, 58B – (Amendment) Increase in Penalties for Non-compliance and 58G – (Amendment) Increase in Penalties for Non-compliance by NBFCs. Implications of these amendments are as under:-

- RBI has been given more Powers to regulate NBFCs than before including seeking additional financial and business information including activities of group/group companies

- Empowering RBI to remove directors and Superseding board of directors of delinquent NBFCs.
- Empowering RBI for a Resolution of problematic NBFCs by way of framing of schemes of amalgamation, reconstruction or splitting in to separate companies, of NBFCs.
- Empowering RBI to force ably interfere in legitimate business of NBFCs in case of emergencies.
- Arming RBI with power of removal/ debarring of Auditors for a period of three years, at a time from auditing any RBI regulated entities.

3.4 STRUCTURE AND ORGANISATION OF RESERVE BANK OF INDIA :

The Reserve Bank of India is India's central banking institution, which controls the monetary policy of the Indian rupee. It commenced its operations on 1 April 1935 during the British Rule in accordance with the provisions of the Reserve Bank of India Act, 1934. The original share capital was divided into shares of 100 each fully paid, which were initially owned entirely by private shareholders. Following India's independence on 15 August 1947, the RBI was nationalized on 1 January 1949.

The RBI plays an important part in the Development Strategy of the Government of India. It is a member bank of the Asian Clearing Union. The general superintendence and direction of the RBI is entrusted with the 21-member Central Board of Directors: the Governor (Dr. Raghuram Rajan), 4 Deputy Governors, 2 Finance Ministry representatives, 10 government-nominated directors to represent important elements from India's economy, and 4 directors to represent local boards headquartered at Mumbai, Kolkata, Chennai and New Delhi. Each of these local boards consists of 5 members who represent regional interests, and the interests of co-operative and indigenous banks.

3.4.1 Objectives for Setting up the RBI :

As per preamble to the Reserve Bank of India Act, 1934, it is mentioned as under:

"To regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage."

The formulation, framework and institutional architecture of monetary policy in India have evolved around these objectives – maintaining price stability, ensuring adequate flow of credit to sustain the growth momentum, and securing financial stability.

The specific objectives include

- To manage the monetary and credit system of the country.
- To stabilizes internal and external value of rupee.
- For balanced and systematic development of banking in the country.
- For the development of organized money market in the country.
- For proper arrangement of agriculture finance.
- For proper arrangement of industrial finance.
- For proper management of public debts.
- To establish monetary relations with other countries of the world and international financial institutions.
- For centralization of cash reserves of commercial banks.
- To maintain balance between the demand and supply of currency.

3.4.2 Administrative Set-up :

3.4.2.1 Central Board of Directors :

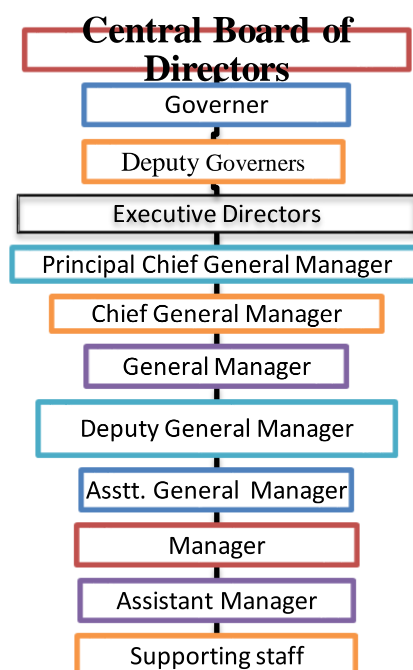
At the apex is the Central Board of Directors, which is made of official directors and Non-official directors.

- **Official Directors:** The Governor and Deputy Governor of RBI are its full time official directors. There is one Governor appointed and maximum four deputy governors. Governor and Deputy Governors are appointed by Central Government. The tenure of service is maximum of 5 years or till the age of 62 whichever is earlier.
- **Non-Official Directors:** There are 16 non-official directors in RBI. Out of them, there are 4 Non-official Directors represent the local Boards located in Delhi, Chennai, Kolkata and Mumbai representing 4 regions of India. Rest 10 Non-official directors are nominated by the Reserve Bank of India. These 10 personalities have expertise in various segments of Indian Economy. The Central Board of Directors holds minimum 6 meetings every year. Out of which, at least 1 meeting every quarter is held. Though, typically the committee of the central board meets every week (Wednesday). Assistive Boards There are two assistive bodies for Central Board of Directors viz. Board of Financial Supervision (BFS) and Board for Payment and Settlement Systems (BPSS). Both of these are chaired by RBI Governor.

3.4.2.2 Local Boards :

There are four local boards of RBI located in Chennai, Kolkata, Mumbai and New Delhi. These four local boards represent four regions of the country. Members and directors of local boards are appointed by central government for four-year terms. The local boards represent regional and economic interests and the interests of co-operative and indigenous banks. While Central Board looks after general superintendence and direction of the Bank's affairs, the function of the Local Boards is to advise the Central Board on local matters and to represent territorial and economic interests of local cooperative and indigenous banks; to perform such other functions as delegated by Central Board from time to time.

Figure: 3.4.2 Organizational Chart of Reserve Bank of India



3.4.3 Functions of RBI :

- **Issue of Bank Notes:** The Reserve Bank of India has the sole right to issue currency notes except one rupee notes which are issued by the Ministry of Finance. Currency notes issued by the Reserve Bank are declared unlimited legal tender throughout the country. This concentration of notes issue function with the Reserve Bank has a number of advantages: (i) it brings uniformity in notes issue; (ii) it makes possible effective state supervision; (iii) it is easier to control and regulate credit in accordance with the requirements in the economy; and (iv)it keeps faith of the public in the paper currency.
- **Banker to Government:** As banker to the government the Reserve Bank manages the banking needs of the government. It has to-maintain and operate the government's deposit accounts. It collects receipts of funds and makes payments on behalf of the government. It represents the Government of India as the member of the IMF and the World Bank.
- **Custodian of Cash Reserves of Commercial Banks:** The commercial banks hold deposits in the Reserve Bank and the latter has the custody of the cash reserves of the commercial banks.
- **Custodian of Country's Foreign Currency Reserves:** The Reserve Bank has the custody of the country's reserves of international currency, and this enables the Reserve Bank to deal with crisis connected with adverse balance of payments position.
- **Lender of Last Resort:** The commercial banks approach the Reserve Bank in times of emergency to tide over financial difficulties, and the Reserve bank comes to their rescue though it might charge a higher rate of interest.
- **Central Clearance and Accounts Settlement:** Since commercial banks have their surplus cash reserves deposited in the Reserve Bank, it is easier to deal with each other and settle the claim of each on the other through book keeping entries in the books of the Reserve Bank. The clearing of accounts has now become an essential function of the Reserve Bank.
- **Controller of Credit:** Since credit money forms the most important part of supply of money, and since the supply of money has important implications for economic stability, the importance of control of credit becomes obvious. Credit is controlled by the Reserve Bank in accordance with the economic priorities of the government

3.4.4 Offices :

RBI has 22 regional offices, most of them in state capitals. It has six training establishments, of which three, namely, College of Agricultural Banking, Bankers Training College and Reserve Bank of India Staff College as part of RBI. Others are autonomous institutions, such as, National Institute for Bank Management, Indira Gandhi Institute for Development Research (IGIDR), Institute for Development and Research in Banking Technology (IDRBT)

3.4.5 Subsidiary Institutions :

- **Fully owned:** National Housing Bank(NHB), National Bank for Agriculture and Rural Development(NABARD), Deposit Insurance and Credit Guarantee Corporation of India (DICGC), Bharatiya Reserve Bank Note Mudran Private Limited(BRBNMPL)
- **Majority stake:** State Bank of India
- **Minority stake:** Infrastructure Development Finance Company(IDFC), Securities Trading Corporation of India(STCI), Discount and Finance House of India(DFHI)

In keeping with its approach to avoid the potential conflict of interest created by the ownership of regulated financial institutions, the Reserve Bank divested its entire holdings in the Securities Trading Corporation of India Ltd. and the Discount and Finance House of India. Similar disinvestment is proposed for its holding in the State Bank of India, the National Housing Bank and the National Bank for Agriculture and Rural Development. In pursuance of the objective of withdrawing from development financing functions, the Reserve Bank transferred assets on account of loans and advances to Development Financial Institutions out of National Industrial Credit (Long Term Operations) Fund to the Government, replacing them with long-term Government of India securities through private placement.

3.4.6 External Relations and Customer Service :

3.4.6.1 Publications :

- **Annual:** Annual Report, Report on Trends and Progress of Banking in India, Report on Currency and Finance, Report on State Finances.
- **Quarterly:** Occasional Papers (based on research), Banking Statistics.
- **Monthly:** RBI Bulletin, Credit Information Review
- **Weekly:** Statistical Supplement
- **Press Releases:** issued every day to convey policy decisions.

3.4.6.2 Customer Service :

i. **Helpdesks:** In all departments and all offices to give general guidance to public
ii. **Regulations Review Authority:** constantly reviews rules and regulations to make them more customer-friendly

3.4.7 Reserve Bank of India - Structure - Internal Organisation :

Presently Reserve Bank of India has its internal organization structure as under. The departments function under the Central Board. The Board of Financial Supervision as the names suggests is not a department, but a separate Board, constituted as a committee of the Central Board to undertake consolidated supervision of the financial sector comprising commercial banks, financial institutions and non-banking finance companies. The BFS oversees the functioning of Department of Banking Supervision (DBS), Department of Non-Banking Supervision (DNBS) and Financial Institutions Division (FID) and gives directions on the regulatory and supervisory issues. There are total of 33 departments working on various functions of the RBI. The departments are

i. Consumer Education and Protection Department
ii. Corporate Strategy and Budget Department
iii. Department of Banking Regulation
iv. Department of Banking Supervision
v. Department of Cooperative Bank Regulation
vi. Department of Cooperative Bank Supervision
vii. Department of Corporate Services
viii. Department of Currency Management
ix. Department of Economic and Policy Research
x. Department of External Investments and Operations
xi. Department of Government and Bank Accounts
xii. Department of Information Technology
xiii. Department of Non-Banking Regulation

xiv. Department of Non-Banking Supervision
xv. Department of Payment and Settlement Systems
xvi. Department of Statistics and Information Management
xvii. Financial Inclusion and Development Department
xviii. Financial Markets Operation Department
xix. Financial Markets Regulation Department
xx. Financial Stability Unit
xxi. Foreign Exchange Department
xxii. Human Resource Management Department
xxiii. Inspection Department
xxiv. Internal Debt Management Department
xxv. International Department
xxvi. Legal Department
xxvii. Monetary Policy Department
xxviii. Premises Department
xxix. Rajbhasha Department
xxx. Risk Monitoring Department
xxxi. Secretary's Department
xxxii. Central Vigilance Cell

Some of the Important Department is discussed here

Department of Currency Management :

The Department attends to the core statutory function of note and coin issue and currency management. This involves forecasting the demand for fresh notes and coins, placing the indent with four printing presses and mints, receiving supplies against those indents and distributing them through the 18 offices (15 Issue Offices + 3 Sub-Offices) of the Bank, a wide network of currency chests, repositories and small coin depots. The Department also keeps an account of notes in circulation and also the stocks at RBI offices and (A currency chest is an extended arm of the Issue Department maintained with a commercial bank where the RBI stores fresh and re-issuable notes and allows the commercial banks to withdraw cash for its requirements and deposit its excess cash. A repository is an extension of the currency chest wherein a portion of the currency chest balance is permitted to be held at one or more other local branches of the same bank). Soiled notes are also stocked in the chests pending transportation to RBI

Urban Banks Department :

The Urban Banks Department looks after the regulation and supervision of primary co-operative banks. The banks are outside the federal rural credit structure supervised by NABARD and function primarily in the urban areas. The activities of the Department can be broadly divided into four areas, viz., regulatory, supervisory, operational and developmental. The regulation and supervision of primary co-operative banks, popularly known as "urban co-operative banks", is performed by the Urban Banks Department in co-ordination with the Registrars of Co-operative Societies of the State Governments. The Reserve Bank of India regulates the interest rates on deposits and advances only to the extent of prescribing interest rate on saving accounts and a minimum lending rate on advances. It prescribes minimum cash reserve and liquid assets to be maintained as a ratio of net demand and time liabilities, and also lays down norms for investments in other assets by primary co-operative banks.

Rural Planning and Credit Department :

Broad Work Areas

- Monitoring and facilitating flow of credit to rural, agricultural and small scale industries' sectors
- Framing policies on priority sector lending
- Making allocations for contribution to Rural Infrastructure Development Fund (RIDF) amongst scheduled commercial banks
- Implementing and monitoring Lead Bank Scheme which aims at forging a co-ordinate approach for providing bank credit to achieve overall rural development.
- Giving financial and policy support to NABARD
- Overseeing setting up of Local Area Banks : local banks which can be set up with initial capital of Rs. 5 crore for serving two or three contiguous districts
- Acting as regulators for Regional Rural Banks, State/Central Co-operative Banks and Local Area Banks.
- Monitoring implementation of Government-sponsored poverty alleviation schemes
- Implementation of Banking Ombudsman Scheme: A scheme set up by the Reserve Bank of India to give members of public an easy and inexpensive forum for redressal of their grievances against banks.

Exchange Control Department :

With the introduction of the Foreign Exchange Management Act 1999, (FEMA) with effect from June 1, 2000, the objective of the Exchange Control Department has shifted from conservation of foreign exchange to "facilitating external trade and payment and promoting the orderly development and maintenance of foreign exchange market in India". The new Act has brought about structural changes in the exchange control administration. Regulations have been framed for dealing with various types of transactions. The Department collects data relating to forex transactions from authorised dealers on a daily basis for exchange rate management and on a fortnightly basis for monthly quick estimates of balance of payments and quarterly balance of payments compilation. The Department lays down policy guidelines for risk management relating to forex transactions in banks. The Department is also entrusted with the responsibility of licensing banks/money changers to deal in foreign exchange and inspecting them. With a view of further improving facilities available to NRIs and removing irritants, the Department is also engaged, on an ongoing basis, in reviewing and simplifying the procedures and rules.

Industrial and Export Credit Department :

Historically, Industrial and Export Credit Department (IECD) laid down detailed policy prescriptions for lending operations of banks. This involved formulating inventory and receivable norms for various industries, issuance of guidelines on matters such as Maximum Permissible Bank Finance (MPBF), consortium arrangement and scrutiny of credit proposals under the Credit Authorization Scheme (CAS)/Credit Monitoring Arrangement (CMA). The stance of the Reserve Bank's policy now is to move away from micro regulation and to undertake only macro monitoring. IECD thus withdrew from prescribing detailed lending norms for banks.

It now:

- Formulates macro level policies in regard to credit to non-SSI industries, export, housing and infrastructure development, designed to speed up the credit delivery system of banks.
- Formulates policy regarding bank credit for rehabilitation of sick/weak non-SSI units.

- Authorizes food credit limits for Food Corporation of India and various State Governments and limits for procurement of oilseeds and pulses to National Agricultural Co-operative Marketing Federation of India Limited and procurement of jute to Jute Corporation of India Ltd., for drawing credit from a consortium of banks.
- Acts as a nodal department for monitoring the activities of National Housing Bank and Infrastructure Development Finance Company Ltd.
- Monitors the flow of credit to industries, housing and export sectors through a reporting system.
- Holds meetings of the Export Advisory Committee where members are banks and export promotion organizations, to deliberate on finance related and exchange control related issues affecting exporters.

Board of Financial Supervision :

Board of Financial Supervision is constituted in November 1994 as a committee of the Central Board of Directors of the Reserve Bank of India. Primary objective of BFS is to undertake consolidated supervision of the financial sector comprising commercial banks, financial institutions and non-banking finance companies.

The BFS oversees the functioning of Department of Banking Supervision (DBS), Department of Non-Banking Supervision (DNBS) and Financial Institutions Division (FID) and gives directions on the regulatory and supervisory issues.

Department of Banking Supervision :

The Department of Banking Supervision (DBS) is entrusted with the responsibility of supervising commercial banks and financial institutions in terms of the provisions of the Banking Regulation Act. It also serves as the secretariat for the BFS. Major instruments of supervision are on-site inspection and off-site monitoring and surveillance.

The Department is also currently engaged in moving towards risk-based supervision

- implementing consolidated supervision
- developing macro-prudential indicators
- introducing risk-based internal audit in banks
- developing a supervisory approach for internet banking
- better integration of off-site and on-site through data warehousing technology
- Training inspectors in modern supervision techniques.

Department of Non-Banking Supervision (DNBS) :

MISSION :

Developing NBFCs sector as an integrated and healthy part of the Financial System; and thereby

- Affording indirect protection to the interests of their depositors,
- Regulatory and Supervisory Framework and
- The RBI Act as amended in January 1997 provides for, among other things,
- Entry norms for Non-Banking Financial Companies (NBFCs) and prohibition of deposit acceptance by unincorporated bodies with some exceptions

Developmental activities :

- Co-ordination with State Governments for State Legislations to curb unauthorised and fraudulent activities in this sector.
- Publicity for depositors' education and awareness, workshops / seminars of trade and industry organizations, depositors' associations.
- Informal Advisory Group as an aid to decision making.
- Promotion of Self-Regulatory Organization (SRO) of NBFCs
- Training programmes for personnel of NBFCs, State Governments and Police Officials.

Department of Banking Operations and Development :

Developing NBFCs sector as an integrated and healthy part of the Financial System; and thereby takes up the functions of

- Affording indirect protection to the interests of their depositors
- Regulatory and Supervisory Framework
- The RBI Act as amended in January 1997 provides for, among other things,
- Entry norms for Non-Banking Financial Companies (NBFCs) and prohibition of deposit acceptance by unincorporated bodies with some exceptions

Developmental activities

- Co-ordination with State Governments for State Legislations to curb unauthorised and fraudulent activities in this sector.
- Publicity for depositors' education and awareness, workshops / seminars of trade and industry organizations, depositors' associations.
- Informal Advisory Group as an aid to decision making.
- Promotion of Self-Regulatory Organization (SRO) of NBFCs
- Training programmes for personnel of NBFCs, State Governments and Police Officials.

Department of Technology :

The Department of Information Technology (DIT) attends to:

- Computerization in RBI (Regional Offices and Central Office Departments)
- Design and development of projects for use of banks and financial institutions and
- Monitoring progress of technology in banks

Legal Department :

The main function of the department is to tender legal advice on various matters referred by the operational departments/offices/associates of the Reserve Bank. These references mainly involve interpretation of the Constitutions of India/administrative law and provisions of the Reserve Bank of India Act, Banking Regulation Act (both applicable to commercial and cooperative banks), the Foreign Exchange Management Act, Public Debt Act, Industrial Disputes Act and various other central and state statutes. The department is also required to interpret the rules and regulations governing the Reserve Bank's staff and to deal without he legal matters relating to industrial relations.

Monetary Policy Department :

The main objective of the Monetary Policy Department is formulation, monitoring and implementation of the annual monetary and credit policy. While the policy work in the

Department constantly keeps evolving in the context of developments in the economy, with a view to enhancing its functional role with focus on monetary policy and monetary management, the Department currently places greater emphasis upon market intelligence/analysis, policy evaluation and related technical studies.

The core activities of the Department include:

- Monetary projections and preparation of monetary budget
- Monitoring of movements in key monetary and banking aggregates including interest rates.
- Periodic review of monetary and credit developments
- Monitoring and review of compliance of scheduled commercial banks with CRR and SLR stipulations.
- Sanctioning and monitoring of refinance limits/utilisation in respect of scheduled commercial banks.
- Collection, compilation and analysis of data on developments in the money market.
- Collection, compilation and analysis of data on mobilisation of resources by select all-India financial institutions.
- Analysis and discussions on resource management plans of banks.
- Continuous monitoring and review of prices and credit floor in respect of sensitive commodities.

Internal Debt Management Cell :

The Reserve Bank of India manages public debt and issues new loans on behalf of the central and the state governments under the powers derived from the Reserve Bank of India Act. It also undertakes cash and liquidity management for the Government of India and state governments and administers the scheme of ways and means advances.

Internal Debt Management Cell manages internal debt. This involves auctioning the government debt from time to time, introduction of new instruments, smoothening the maturity structure of debt, placing of debt at market related rates and improving depth and liquidity of government securities by developing an active secondary market for them. To administer the monetary policy it also undertakes liquidity operations as and when required through various instruments, such as, open market operations, repos and reverses repos, etc.

Department of External Investments and Operations :

The main activities of the Department are management of exchange rate of the Indian rupee and management and investment of foreign exchange reserves of the Reserve Bank of India. This involves:

- **Exchange Rate Management:** The day-to-day movements in exchange rates are market determined. The primary objective of the Reserve Bank in regard to the management of the exchange rate continues to be the maintenance of orderly conditions in the foreign exchange market, meeting temporary supply-demand gaps which may arise due to certainties or other reasons, and curbing destabilising and self-fulfilling speculative activities. To this end, the Reserve Bank closely monitors the developments in the financial markets at home and abroad and carefully coordinates its market operations with appropriate monetary, administrative and other measures as it considers necessary from time to time.
- **Reserves Management:** The essential framework for reserves management in the Reserve Bank as regards currency, market and instruments for investment are provided in the Reserve Bank of India Act 1934. The overall stance of the Reserve

Bank of India's reserve management policy continues to be a risk averse one aiming at stable returns. The principal objectives behind the Reserve Bank's approach continue to be safety and liquidity. Within these parameters, return optimisation dictates operational strategies.

Department of Government and Bank Accounts :

The Department of Government and Bank Accounts(DGBA) is responsible for discharging certain core traditional central banking functions, viz., acting as bankers to the banks and governments and administering public debt of both, central and state governments. It is also responsible for maintenance of the Reserve Bank's internal accounts and compilation of its weekly statement of affairs and annual balance sheets. The principal deposit accounts of central and state governments are maintained at central accounts section of the Reserve Bank at Nagpur which also attends to granting of ways and means advances to central and state governments. The Department also monitors disposal of the complaints received from the members of public regarding unsatisfactory services rendered by various departments of the Reserve Bank.

Department of Economic Analysis and Policy :

The Reserve Bank of India has a rich tradition of economic research and prepares several reports and conducts research studies through its Department of Economic Analysis and Policy (DEAP):

- Studies and analyses the basic issues and problems (both domestic and international) affecting the Indian economy;
- Serves as a primary source of data and information relating to aspects of the Indian economy, such as,
- Prepares monetary and credit aggregates, balance of payments and external debt statistics, internal debt and government finance statistics, and flow-of-funds and financial saving.
- Renders advice/assistance and offer its views in the realm of economic policy formulation and in shaping monetary, banking and financial policies; and
- Prepares the Bank's economic publications.

Department of Statistical Analysis and Computer Services :

The Department of Statistics was created in 1959, out of the erstwhile Department of Research and Statistics. The Department was restructured in December 1981. It was designated as the Department of Statistical Analysis and Computer Services. The Department is headed by a Principal Adviser. The Department has its central office at Mumbai and regional offices at New Delhi, Chennai and Calcutta.

The following are the core functions of the Department:

- Collection, processing and dissemination of data on banking, corporate and external sectors.
- Planning, designing and organizing sample surveys of interest to the Reserve Bank.
- Undertaking studies in the areas of interest and relevance to the Reserve Bank.
- Generation of forecasts of important macro-economic indicators. o Providing technical support to other departments of the Reserve Bank in statistical analysis in specific areas.

- Development of methodology for the measurement and estimation of variables and improvement of the database of various sectors of the economy through participation in committees, working groups, etc.

3.5 BANKING COMPANIES ACT, 1970 HISTORY :

The Banking Companies Act, 1970, is established to regulate the various companies of India. To get an explanation about this act, you can know here.

The Banking Companies Act, 1970 is an Act which is essentially launched to give the acquisition of several banking companies. It also does the transfer of the undertakings of particular banking Companies. It is a post-independence act that has consideration to multifarious banking companies' extent, resources, scope, and association. In order additionally to manage the altitudes of the economy, to complete progressively, and conform more useful facts for the companies act. Apart from this, the requirements of the banking companies act are that it is established to promote the evolution of the economy and to encourage the people's welfare. It is also explained under the procedure of the State towards ensuring the regulations applied down in banking acts clauses (b) and (c) and Article 39 of the Indian Constitution and for consequences linked therewith or spontaneous thereto.

3.6 SOME VITAL SECTIONS OF THE BANKING COMPANIES ACT, 1970 :

If you wish to know the several sections of the banking companies act, then you will follow the below-given points.

- Section-1 of this act essentially defines the short title and commencements of the various banking companies.
- Section-2 it explains the definitions of banking companies.
- Section-3, this section of the banking companies act is defined especially for the establishment and launching of the correspondingly new businesses and banks thereof.
- Section-3A is a section that is pertinent to the trust and faith which is not existing on the register.
- Section-3B is a section that defines the register of beneficial owners of the banking companies.
- Apart from this, another section is 4, which is identified for the undertaking by the banking companies of already existing banks to vest in some interconnected new banks. It was a post-independence act.
- Section-5 is pertinent to the general impact of vesting, and another act is section-6, which is pertinent to the payment of dividends and compensations.
- Also, section 7 is pertinent to the management, administration, and head office control.
- Section 8 is interconnected with the newly established banks to be directed through the various guidelines and directions of the central government of India.
- Moreover, section 9 is also a most vital section of the Companies Act, 1970. It shows the force of the central government of India to make the various schemes.
- Thus, it is the main section of the baking companies Act of 1970. It's all the things mentioned above. You can know all the sections and their identifications from above.

3.7 PIVOTAL PROVISIONS OF THE BANKING COMPANIES ACT, 1970 :

Below are some essential and main provisions of the Banking Companies Act, 1970. If you would like to know all the provisions of the banking companies act, then know it here.

- Management and controlling the newly nationalized banks.
- Paid-up capital.
- Encouragement and launching of the newly nationalized banks into India all states.
- Transfer and acquisitions of all private banks by the banking companies act, 1970 and establishing newly nationalized banks in the position of acquisition banks.
- Another provision of the Banking Companies Act, 1970 is the removal of the bank's limited companies.
- Establishment of the business.

So, that's all the Pivotal Provisions of the Banking Companies Act, 1970.

3.8 CONCLUSION :

Thus, the following information is given above for the Banking Companies Act, 1970. This is an Act that is established to control all the companies in India. It is an act that is granted to transfer and acquire the undertaking of several banking acts of India. Apart from this, the Banking Companies (Transfer and Acquisition of Undertakings) Act was passed on the 15th day of April 1980. It is a body that controls and regulates all banking companies, which is the acquisition and transfer of undertakings. There are too many Acts, provisions, features, amendments, and other objectives of this act.

3.9 SELF SUGGESTED QUESTIONS :

1. Explain Reserve Bank of India Act, 1934
2. Explain the Amendments to RBI Act
3. Explain Structure and Organisation of Reserve Bank of India
4. Explain Banking Companies Act, 1970
5. Explain Some vital sections of the Banking Companies Act, 1970
6. Explain pivotal provisions of the Banking Companies Act, 1970

3.10 SUGGESTED READING BOOKS

1. M.L.Tannan, revised by : Banking Law and Practice, Wadhwa& Company, Nagpur C.R. Datta& S.K. Kataria
2. A.B. Srivastavaand : Seth's Banking Law, Law Publisher's India (P) Limited K. Elumalai
3. R.K. Gupta : BANKING Law and Practice in 3 Vols. Modern Law Publications.
4. Prof. Clifford Gomez : Banking and Finance - Theory, Law and Practice, PHI Learning Private Limited
5. J.M. Holden : The Law and Practice of Banking, Universal Law Publishing

Dr. PALLEKONDA SRINIVASA RAO

LESSON - 4

FORMS OF BANKING

OBJECTIVES :

The objectives of the lesson are:

- To know the Concept of Banking;
- To acquaint with different types of banks.
- To understand the branch location policies and decisions.

STRUCTURE :

4.1 Introduction
4.2 Meaning & Definitions of Banking
4.3 Branch Banking
4.3.1 Features of Brach Banking
4.3.2 Functions of Branch Banking
4.3.3 Advantages of Branch Banking
4.3.4 Disadvantages of Brach Banking
4.4 Unit Banking
4.4.1 Features of Unit Banking
4.4.2 Importance of Unit Banking
4.4.3 Unit Banking V/S Brach Banking
4.4.4 Advantages of Unit Banking
4.4.5 Disadvantages of Unit Banking
4.5 Group Banking
4.5.1 Special Considerations
4.5.2 Advantages of Group Banking
4.5.3 Disadvantages of Group Banking
4.6 Chain Banking
4.6.1 Group Banking Vs Chain Banking
4.6.2 Advantages of Chain Banking
4.6.3 Disadvantages of Chain Banking
4.7 Branch Location Policies and Decisions
4.8 Summary
4.9 Technical Terms
4.10 Self Assessment Questions
4.11 Reference Books

4.1 INTRODUCTION :

Banking in India is as old as the hills. It flourished even in ancient Vedic Times. Money was accepted on deposit and given in the form of advances. As far back as the second or third A.D., Manu, the great Hindu jurist, devoted a section of his work to deposits and advances and laid down rules relating to rates of interest to be paid or charged. During the mogul period, the indigenous bankers played a very important role in landing money and financing of foreign trade and commerce. They were also engaged in the profitable business of money-changing. Every town, big or small, had a 'sheth' also known as 'shah', 'shroff' or

'chettiar' who performed a number of banking functions. He was respected by all sections of people as on important citizens. In principal towns, besides shroffs, they were a 'nagar-sheth' or 'town banker'. These sheths are shroffs, besides doing money-lending business were instrumental in transferring funds from place to place and doing collections business mainly throughout hundis. The hundis were an accepted mode of transfer of monies for commercial transactions. Even today there is a sheth of shroff in almost every town or village.

He is operating even in the remotest corners of the country. He calls himself a banker but is essentially a money-lender. He hardly accepts deposits. Most of the money he employs in his trade is his own. The rate of interest charged by him is very high as the advances are unsecured and risky, and are repaired over a long period of time. The future of these money-lenders, however, bleak. There have been changes in the standard of public morality. Formerly, a son used to consider his decreased father's debt as a pious obligation. That is not the case now. The "money-Lender acts" passed by different states have imposed a large number of restrictions on their business. Litigation for recovery of outstanding is a protracted, expensive and uncertain process. With the growth of the banking habit, change in the public opinion and fast expansion of banking in rural and semi-urban areas. Especially after nationalization of major Indian commercial banks, the money-lenders as a class are fast losing their importance.

4.2 MEANING AND DEFINITION :

Although a number of statutes and legal decisions both in England and India have described the functions of a banker, none of them has precisely define 'banking'. An attempt has, however, been made in formulating the definition of 'banking' and 'banking company' in section 5 (1) (b & c) of the banking regulation Act, 1949, which reads as under:

5 (b) "Banking means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdraw able by cheque, draft, order or otherwise.

(c) 'Banking Company' means any company which transacts the business of banking in India."

Explanation to Section 5 (c) of the Act states, "Any company which is engaged in the manufacture of good or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking."

From the above it is clear that if any institution fulfills the following conditions, it will satisfy the definition of a banking company.

(a) Accepting of deposits from the public, repayable on demand or otherwise. The deposits may be of different types- current, fixed, savings, etc.- accept on various terms and conditions.
(b) The deposit must be withdrawn able by the cheque, draft, and order or otherwise. The opening of current accounts and operation thereon by cheques was at one time, and is even today, considered as the sine qua non of banking. Sir John Paget has said that there are four essential functions which persons calling themselves as bankers must perform. Firstly. They must tale deposit accounts; secondly, they should open current accounts; thirdly, they should issue and pay cheques, and lastly they must collect cheques crossed and uncrossed for their customers. Dr. H.L. Hart says, "A bankers is

one who, in the ordinary course of his business, honours cheques drawn upon him by persons from and for own he receives money on current accounts."

(c) Any money accepted as deposits must be for the purpose of lending or Investment. Making advances and investment of funds or equally important functions. They are the two main sources of revenue of any a bank. It is the purpose of this book to deal with advances and techniques of lending based on the experience of practical bankers. Investment in government securities, shares and debentures is a vatse subject by itself and is beyond the scope of the present treatise.

(d) The institution must be a company as defining Section 3 of Companies Act, 1956. Even a foreign company within the meaning of a Section 591 of the Companies Act, 1956, will be considered a banking company if it satisfies the conditions started in sub-paras (a), (b) and (c) above.

The State Bank of India and its subsidiaries are 'banks' under the State Bank of India Act, 1955, and the State Bank of India(subsidiary banks) Act, 1959, respectively. The twenty recently nationalized banking companies will also henceforward be known as 'banks' and not banking companies, in the context of the banking companies(Acquisition and transfer of Undertakings) Act,1970. Although they are independent institutions, they are nevertheless governed by many of the provisions of the Banking Regulation Act, 1949.

The banking system in different countries varies substantially from one another. Broadly speaking, however, there are four important types of banking system, viz., branch banking, unit banking; group banking and chain banking are given in detail below

4.3 BRANCH BANKING :

It means a system of banking in which a banking organization works at more than one place. The main place of business is called head office and the other places of business are called branches. The head office controls and co-ordinates the work at branches. The day-to-day operations are performed by the branch manager as per the policies and directions issued from time to time by the head office. Wells Fargo, Bank of America, Standard Chartered, Citibank, JPMorgan Chase, and many other banks operate through branch offices across different states. For instance, Bank of America is amongst the top largest banks in the United States.

4.3.1 Features of Branch Banking :

The characteristics or features of a branch bank are given as follows:

- ❖ **Central Office:** In branch banking system there is a central office which controls the branches.
- ❖ **Branch Office:** There may be branches in country wise or in abroad. The number of branches is depending on the ability and principles of the bank.
- ❖ **Ownership:** Generally such types of banks are owned by government or non government companies.
- ❖ **Capital:** Generally its capital is too high. Now the scheduled bank has to maintain hundred crore taka as paid up capital.
- ❖ **Legal entity:** as it is established by banking company act 1991, so it has legal entity.
- ❖ **Determining policy:** All policies are determined by the central office.
- ❖ **Direction:** Branch banks go on its activities according to the direction of central office.

- ❖ **Deposits:** its deposit amount is high because it collects deposit from various parts of the company.
- ❖ **Space of operation:** It continues its operation through the whole country.
- ❖ **Providing Loan**: As it has many branches so it can provide huge amount of loan. Observing from different aspects it can say that branch banking is wider than unit bank.

4.3.2 Functions of Branch Banking :

Let's take a look at scenario

- ❖ **Account Opening:** A bank branch consists of a staff who can guide you in choosing the account type that suits your needs. You will need to fill an account opening form with your details. For opening a current or savings account, you will usually need to deposit some money into the account.
- ❖ **Accepting Deposits:** Another important function of branches is to accept deposits from the public safeguard those deposits and provide interest on them. The different kinds of deposits are:
- ❖ **Term deposits** refer to deposits made for a fixed period. The account holder won't be allowed to withdraw his money till the date of maturity. The interest rate on a term deposit is slightly higher than the interest rate on a savings account.
- ❖ **A recurring deposit** allows us to invest a certain sum of money every month. We are free to choose the deposit's tenure and the monthly deposit amount based on our convenience. This account type is tailor-made for salaried individuals.
- ❖ **Lending:** An important branch banking job involves offering loans to customers based on their needs. It provides loans to customers up to a certain limit with some interest charged on it. The customer has to repay the loan amount along with interest in the form of monthly installments. Banks also lend money to businesses in the form of short-term loans and long-term loans.
- ❖ **Fund Transfer:** A fund transfer is the movement of funds from one person to another through the banking system. Apart from the electronic transfer of funds, you can also transfer money from one account to another by check.
- ❖ **Keeping Your Money Safe:** Safeguarding public wealth is another important function that a bank performs. Banks also provide a safe deposit locker facility. Customers can use them to store their valuables, gold, documents, and other things.
- ❖ **Demat Services:** Opening and maintaining a Demat account (**Dematerialization account**) is also a function of branches. The purpose of the account is to hold the shares and securities in an electronic format. A Demat account allows you to buy shares and keep track of your investments online.

4.3.3 Advantages of Branch Banking :

- ❖ **Better Banking Services:** Such banks, because of their large size can enjoy the economies of large scale viz., division of work and specialization. These banks can also afford to have the specialized services of bank personnel which the unit banks can hardly afford.
- ❖ **Extensive Services:** Branch banking provides extensive service to cover large area. They can open their branches throughout the country and even in foreign countries.
- ❖ **Decentralization of Risks:** In branch banking system branches are not concentrated at one place or in one industry. These are decentralized at different places and in different industries. Hence the risks are also distributed.

- **Uniform of Rates of Interest:** In branch banking, there is better control and co-ordination of the central bank. Consequently interest rates can be uniform.
- **Better Cash Management:** In branch banking there can be better cash management as cash easily be transferred from one branch to another. Therefore, there will be lesser need to keep the cash idle for meeting contingencies.
- **Easy and Economical Transfer of Funds:** Under branch banking, A bank has a widespread of branches. Therefore, it is easier and economical to transfer funds from one branch to the other.
- **Better Investment of Funds:** Such bank can afford the services of specialized and expert staff. Therefore they invest their funds in such industries where they get the highest return and appreciation without sacrificing the safety and liquidity of funds.

4.3.4 Disadvantages of Branch Banking :

Following are the disadvantages of branch banking:

- **Difficulties of Management, Supervision and Control:** Since there are hundreds of branches of a bank under this system, management, supervision and control became are inconvenient and difficult. There are possibilities of mismanagement in branches. Branch managers may misuse their position and misappropriate funds. There is great scope for fraud. Thus there are possibilities of fraud and irregularities in the financial management of the bank.
- **Lack of Initiative:** The branches of the bank under this system suffer from a complete lack of initiative on important banking problems confronting them. No branch of the bank can take decision on important problems without consulting the head office. Consequently, the branches of the bank find themselves unable to carry on banking activities in accordance with the requirements of the local situation. This makes the banking system rigid and inelastic in its functioning. This also leads to “red-tapism” which means “official delay”.
- **Monopolistic Tendencies:** Branch banking encourages monopolistic tendencies in the banking system. A few big banks dominate and control the whole banking system of the country through their branches. This can leads to the concentration of resources in the hands of a small number of men. Such a monopoly power is a source of danger to the community, whose goal is a socialistic pattern of society.
- **Regional Imbalances:** Under the branch banking system, the financial resources collected in the smaller and backward regions are transferred to the bigger industrial centres. This encourages regional imbalances in the country.
- **Continuance of Non-Profitable Branches:** Under the branch banking, the weak and unprofitable branches continue to operate under the protection cover of the stronger and profitable branches.
- **Expensiveness:** Branch banking system is much more expensive than the unit banking system. When a bank opens a number of branches at different places, then there arises the problem of co-ordination their activities with others. This necessitates the employment of expensive staff by the bank.
- **Losses by Some Branches Affect Others:** When some branches suffer losses due to certain reasons, this has its repercussions on other branches of the bank.

4.4 UNIT BANKING :

Unit banking means a system of banking under which banking services are provided by a single banking organization. Such a bank has a single office or place of work. It has its own governing body or board of directors. It functions independently and is not controlled by

any other individual, firm or body corporate. It also does not control any other bank. Such banks can become member of the clearing house and also of the Banker's Association. Unit banking system originated and grew in the U.S.A. Different unit banks in the U.S.A. are linked with each other and with other financial centres in the country through "correspondent banks." The Reserve Bank of India is a prime example of India's unit banking system. In contrast to banking services, which transfer funding to other areas, unit banking only uses its assets to improve the region in question.

4.4.1 Features of Unit Banking :

Due to its nature of operation unit bank hold some features. Those are as follows.

- **Unit office**: It has only one office i.e. it has no branches.
- **Particular area:** It deals its activities in a particular area, where it is established.
- **Ownership:** Several times the ownership of this bank is sole proprietorship. But it can also be established by partnership or Joint Stock Company.
- **Limited capital:** As the capital of the bank is provided by one or few persons, the capital is limited.
- **Small size:** Its bank of a single office and deals with small capital, so it is small in size.
- **Easy formation**: Because its size and amount of capital the bank can easily be formed.
- **Scale of operations**: Due to its small capital and size the scale of operation is small i.e. it can't provide huge loan to its clients.
- **Efficient Management**: Due to its small size of operation the management of the bank is very efficient.
- **Method of functioning**: It takes help of corresponding banking system for providing banking services throughout the country.
- **Rapid decision**: The manager can take rapid decision at the time of sanctioning loan.
- **Legal entity**: The bank has a legal entity although it's owned by a single owner. That's why people have trust on this type of bank.

4.4.2 Importance of Unit Banking :

- Unit banking is a sort of banking system used in many nations where there is just one tiny, autonomous bank serving a specific area.
- Unit banks are unaffected by fluctuations in the regional economy.
- A unit bank is more autonomous in its activities than a branch bank.
- A unit bank will spend more money when related to supervision costs.
- The sources of funding of a unit banking system are exclusive to that one unit.
- The interest rate is not set in the unit banking system because each unit bank has its own set of rules and regulations.
- In a unit banking system, the bank's profits are put to use either for internal growth or to fulfill the requirements of the neighborhood.
- A unit bank can make crucial choices on its own because it is an independent institution.

4.4.3 Unit Banking V/S Branch Banking :

Basis For Comparison	Unit Banking	Branch Banking
Meaning	Unit banking is that system of banking in which there is a single small banking company, that provides financial services to the local community	Branch banking is a banking method wherein a bank operates in more than one place to provide banking services to customers, through its branches
Local economy	Affected by the ups and downs of the local economy	It is not affected by the ups and downs of the local economy.
Independence of operations	More	Comparatively less
Supervision cost	Low	Comparatively high.
Financial Resources	Limited financial resources	Large pool of financial resources
Competition	No or little within the bank	Exist between the bank branches
Rate of Interest	Not fixed, as bank has its own policies and norms.	Fixed by the head office, and directed by the central bank.
Decision Making	Quick	Time Consuming

4.4.4 Advantages of Unit Banking :

Following are the main advantages of unit banking

- ❖ **Efficient management:** One of the most important advantages of unit banking system is that it can be managed efficiently because of its size and work. Co-ordination and control becomes effective. There is no communication gap between the persons making decisions and those executing such decisions.
- ❖ **Better Service:** Unit Banks can render efficient service to their customers. Their area of operation being limited, they can concentrate well on that limited area and provide best possible service. Moreover, they can take care of all banking requirements of a particular area.
- ❖ **Close Customer-banker Relations:** Since the area of operation is limited the customers can have direct contact. Their grievances can be redressed then and there.
- ❖ **No Evil Effects Due to Strikes or Closure:** In case there is a strike or closure of a unit, it does not have much impact on the trade and industry because of its small size. It does not affect the entire banking system.
- ❖ **No Monopolistic Practices:** Since the size of the bank and area of its operation are limited, it is difficult for the bank to adopt monopolistic practices. Moreover, there is free competition. It will not be possible for the bank to indulge in monopolistic practices.
- ❖ **No Risk of Fraud:** Due to small size of the bank, there is stricter and closer control of management. Therefore, the employees will not be able to commit fraud.
- ❖ **Closure of Inefficient Banks:** Inefficient banks will be automatically closed as they would not be able to satisfy their customers by providing efficient service.

4.4.5 Disadvantages of Unit Banking :

- **No Economies of Large Scale:** Since the size of a unit bank is small, it cannot reap the advantages of large scale viz., division of labour and specialization.
- **Lack of Uniformity in Interest Rates:** In Unit Banking system there will be large number of banks in operation. There will be lack of control and therefore their rates of interest would differ widely from place to place. Moreover, transfer of funds will be difficult and costly.
- **Lack of Control:** Since the number of unit banks is very large, their co-ordination and control would become very difficult.
- **Risk of Bank's Failure:** Unit banks are more exposed to closure risks. Bigger unit can compensate their losses at some branches against profits at the others. This is not possible in case of smaller banks. Hence, they have to face closure sooner or later.
- **Limited Resources:** Under Unit banking system the size of the bank is small. Consequently its resources are also limited. Hence, they cannot meet the requirements of large scale industries.
- **Unhealthy Competition:** A number of unit banks come into existence at an important business centre. In order to attract customers they indulge in unhealthy competition.
- **Wastage of National Resources:** Unit banks concentrate in big metropolitan cities whereas they do not have their places of work in rural areas. Consequently there is uneven and unbalanced growth of banking facilities.

4.5 GROUP BANKING :

Group banking is a system where a group of banks are brought under the control of a holding company. The holding company controls the affairs of all units in the group. But each bank in the group maintains its separate identity. The purpose of group banking is to unify the management of banks, to achieve economies of large-scale operation and to grab more power.

Under group banking system, both banking and non-banking companies may become subsidiaries of a holding company. Banks acquired by holding companies are referred to as affiliated banks (subsidiary company).

The chief advantage of this system is that each bank need not carry large cash reserve; such cash reserves are concentrated in one or few member banks of the group. In times of need the bigger banks will help the smaller banks. Secondly, economies of large-scale production can be achieved by cutting down operating cost, by purchasing supplies in bulk and improving the efficiency of management. The Big Bank may offer banking services to employees of Company A. While employees are not required to take part in the group plan, The Big Bank offers a special checking account with low or, in some cases, no fees to each and everyone who signs up into which employees can have their paycheck deposited directly. In exchange for their business, The Big Bank may also offer preferred interest rates to Company an employee with the checking account. Employees who don't have a checking account may also qualify for other, competitive rates as well. The Big Bank may also provide other promotions and special perks such as higher interest rates on savings accounts and certificates of deposit.

4.5.1 Special Considerations :

Employers benefit from offering group banking plans because many employees consider it to be an employment benefit on a par with paid time off, sick leave, health

insurance, and retirement savings plans. This means partnering with a bank to offer group banking can help businesses attract and retain high-quality talent. Group banking plans can allow employers to expand their employee benefits packages for a minimal additional cost. As companies try and become more competitive with hiring, every benefit counts-at least from a potential employee's perspective.

Members of a group banking plan do not have to be employees of the same company. In fact, members of any organization or cooperative may be able to take advantage of a group banking plan. Group banking plan members may be members of the same church, homeowner association, or other group. Even family members can sometimes be granted access.

4.5.2 Advantages of Group Banking :

The group banking system has certain advantages :

- **Pooling of Resources:** The parent company pools the resources of the group and helps the group banks to provide large loans and advances.
- **Do not need large Cash Reserves:** The banks in the group need not keep large cash reserves for they can transfer funds to each other when the need arises.
- **Increase in Efficiency:** The efficiency of the group increases when the parent company provides such specialized services as research, advice on investments, loans and legal matters to all the banks in the group.
- **Economies of Large Operations:** The group also gains from the economies of large scale banking operations when the parent company advertises, makes bulk purchases, and hires the services of experts on behalf of the banks in the group.
- **No Mergers:** As already noted above, under the group banking system the operating companies does not merge with the parent company and continue to keep their separate entities but benefit from all the advantages of a large scale organization.
- **No Unhealthy Competition:** Group banking avoids unhealthy competition among banks when they are less than one holding company.

4.5.3 Disadvantages of Group Banking :

Despite the above merits, the group banking system suffers from certain disadvantages:

- **Monopoly Banking:** The group banking system is a step towards monopoly banking which is not healthy from the economic view-point.
- **Inefficient System:** The operating banks may not follow the guidelines and policies laid down by the parent company from time to time. This may lead to inefficiency.
- **Chain Reaction:** If the business of one member declines, it may adversely affect the business of other members of the group.
- **Diversion of Funds:** If the parent company is not an operating banking company, it may divert the funds of the group in furthering its own interests. This may prove harmful for the entire operating group which may be starved of funds and ultimately bring disaster to the group.

4.6 CHAIN BANKING :

Chain banking is a form of bank governance that occurs when a small group of people control at least three independently chartered banks. In general, the controlling parties are majority shareholders or the heads of interlocking directorates. Chain banking as a practice has declined along with a surge in interstate banking.

Chain banks came into prominence after the stock market crash of 1929. They were popular because they spread risk among groups of banks, instead of concentrating it on a single entity. According to a 1931 report conducted by a Federal Reserve committee, chain banking first emerged in North Dakota, where a David H. Beecher purchased a bank in 1884 and another one in 1887.

Subsequently, this form of bank ownership became popular in the South. Starting in 1896, the Witham organization purchased a series of banks and. 30 years later; it controlled nearly 200 banks in New York, New Jersey, Georgia, and Florida.

A major reason why chain banking took root in the Northwest and Southern states is because they didn't allow branch banking. New Jersey became the first state in 1889 to establish legal precedent for the establishment of a corporation that was formed solely for the purpose of holding stocks in other companies. Banking organizations and individuals took advantage of this law to extend their ownership of other financial institutions. Chain banking became a popular method to reach out to rural communities in the Midwest during the 1970s.

4.6.1 Group Banking Vs Chain Banking :

1. The difference between Group Banking and Chain Banking is that Group Banking is a group of several that exist and function under a single holding company. In chain banking, a chain of banks lives and functions under a single person or group.
2. Group Banking refers to a system in which a group of banks functions under a single holding company; the control a company can have over 2 financial institutions. These groups of banks have to follow the rules and regulations of the company. They have to function within the barriers of the company. Chain Banking refers to a system with a chain of banks controlled by an individual or a small group of people. The individual or group of people can hold at least three chartered banks.
3. Group banking aims to cater to the diverse financial needs of a broader customer base, while chain banking focuses on expanding the network of banks to increase its geographical reach.
4. The financial institutions in Group Banking are owned by single holding company, and in Chain banking, by a single person or group of persons.
5. The institutions in group banking can be held by a company working in any sector. In contrast, in chain banking, anyone working in any sector or profession.
6. The holding company controls the administration of group banking. Although, in chain banking, the administration is governed by the owner/ owners.
7. The group banking system was popular in the USA during 1925- 1929. At the same time, the chain banking system became popular after 1929.
8. State Bank of India is an example of Group banking in India. Karur Vysya Bank and Lakshmi Vilas Bank is an example of Group banking.

4.6.2 Advantages of Chain Banking :

- **It limits risks for a community, making it possible to expand local needs for credit:** In 1921, before the creation of chain banks occurred in the United States, there were over $1 billion in losses experienced by depositors within the unit-based banking system. Many banks found themselves going out of business because the structures of that system failed. By spreading out the risks between multiple small banks instead of making every individual bank assume all risks, it became possible to offer more credit or lending products to communities where it may not have been possible to do so before.

- **This system makes it possible to access banking facilities when limited resources are present:** When there is little financial capital available in a community, then the limited resources restrict the number of banking facilities which can be supported. Some small communities, before the creation of chain banks, may not have been able to support a local bank at all. Because the nature of chain banking creates a centralized structure where common management tendencies and risk handling are present, more people can access banking facilities because more can be done with their limited resources.
- **It provides an efficient system of management for better financial control:** Chain banking is more efficient than the unit-based model because there is one core group of stakeholders who are organizing structures for multiple banks. It limits the number of executive management decisions which must be made at the local level because the stakeholders make the same decisions for multiple banks. Even when chain banking involves multiple Boards or officers who serve with one another, the similarities and cooperation involved in management create efficiencies for each banking system. This creates better financial controls for everyone involved.
- **Chain banking systems rarely take on unnecessary risks:** The system of chain banking was created to avoid risks in the first place. It is a structural response to the numerous losses that were experienced by depositors leading up to, and then during, the period of the Great Depression. Instead of taking risks with deposits in an effort to grow profits exponentially, the goal of this structure is to manage funds in a way that makes them accessible and useful to individuals without the same threats of loss. Although this process limits overall profitability, it does provide a safer place for people to keep their money until they need to have it at a later time.
- **It is an affordable system of banking:** Because there are fewer risks involved with chain banking from a consumer standpoint, it becomes affordable to use banking tools and products. Individuals have more access to credit, which allows them to start businesses, expand inventory, build new structures, or even purchase a new home. The goal of chain banking is to create as much efficiency within the system as possible, which leads to better decisions on how finances are managed at all levels within the organization.
- **Chain banking stops unhealthy competition:** Healthy competition occurs when 2+ organizations are competing for the same customers by offering innovative or differential products at a price that is similar. Unhealthy competition occurs when an organization is willing to undercut its profits to gain a bigger market share. That action creates a race to the bottom for all companies involved, as profits are slashed to maintain a market presence. By instituting a system of chain banking, the unhealthy competition that can be seen in some communities is much more difficult to implement.
- **It avoids the need for a merger:** When chain banking systems are implemented, the stakeholders do not merge their operating companies with a parent company. The banks are still operated as if they are an independent entity, even though they fall under the general control of parental stakeholders. This gives each location the advantages of having a large-scale organization, while keeping their separate entities and ability to provide localized support.
- **Individual entities benefit from purchases of scale:** Because a common set of stakeholders is involved in the chain banking process, each individual location gets to benefit from an economy of scale that they wouldn’t be able to access without a parent company or stakeholder oversight. That creates lower operational costs, which improves the bottom line of each location over time.

4.6.3 Disadvantages of Chain Banking :

- **It limits overall profitability:** Profits occur when risks are taken within the financial sector. Risks may also lead to steep losses, which chain banking cannot afford to take. For that reason, banks managed in this fashion often take a very conservative approach to investing. They create small gains for their members or customers, with only small losses the potential risk being faced. This creates an environment where the primary challenge is to have the investment gains be greater than the rate of inflation, which does not always happen.
- **There is little engagement regarding the social welfare needs of the community:** Many banks use their profits in a way that betters the welfare needs of their local communities. Because there are fewer profits available within the system of chain banking, these institutions are rarely active in social improvement activities. Their focus is to maintain the status quo, create profits where possible, and effectively manage themselves in communities where there may be limited resource availability.
- **It creates a centralized structure where one person may control the wealth:** Many chain banking systems create a centralized structure where one entity, or even one person, pulls the strings of wealth management for a series of banking locations. Even if multiple banks are managed by multiple Boards or offices, the President or central figure within the organization is often tasked with leadership decisions for it. At the local level, that means the decisions made for all banks may not be the best possible solution for a specific local bank.
- **Chain banking concentrates control of credit authorization:** The goal of chain banking is to expand opportunities for the average person to use financial tools and lending products. When banks are controlled by a common set of stakeholders, however, this structure also concentrates who is in control of credit line authorizations. That makes it easier for stakeholders to discriminate against certain groups of people if they desire to do so. Instead of being restrained by local interest controls, stakeholders are only accountable to themselves and the profitability they are able to achieve.
- **It creates a system which looks to create a monopoly:** Although the banks are technically independent within a chain banking system, they are still controlled by the same group of stakeholders. That allows the stakeholders to manage rates, products, and systems within the communities they control because they are in control of bank access. When there is no competition available within a community, then the consumers are at a disadvantage because they are forced to use the banking tools that are available to them from the one association.
- **Chain reactions create declines for everyone:** The reason why chain banking tends to be a popular structure is that when one bank creates gains, the others benefit through a chain reaction process. The gains filter down to each satellite within the established chain. The opposite is also true, however, which is why chain banking can be problematic. If one chain experiences dramatic losses, then the other chains experience that loss as well.
- **There can be rebellion within the system:** In a chain banking system, a centralized core of leadership directs operations from their parent location. These stakeholders may wish to see certain policies enacted at the local level because it improves the bottom line of the banks. If local managers disagree with these decisions, they may choose to not follow the policies or guidelines that were outlined to them. Unless the stakeholders come to the individual location, they may not realize their systems were not implemented. That process creates inefficiencies within the system which may affect other locations as well.

4.7 BRANCH LOCATION POLICIES AND DECISIONS :

Location analytics provides insights into whether a business will have the expected results in a given area. Mapping key area demographics can help pinpoint locations with a high chance of having a need for your products or services. This can be a useful tool when expanding your business.

Also, you can reduce the likelihood of failure by using location analytics to establish a market area profile. Location data insights can help you identify the best alignment between your offer and your target market's needs in each area. This analysis can give you a competitive edge and help you avoid costly mistakes. Benefits of using location intelligence for your branch location strategy Location intelligence can help you determine the best growth strategy beyond your existing market. Using location data in your market research gives you access to valuable qualitative and quantitative information. This data can provide you with a broader context about a given area.

- ❖ **Data-driven decision-making:** Location intelligence enables businesses to make informed decisions when selecting new branch locations. It uses data insights to identify areas with the highest potential for success. This leads to more strategic expansion and reduces risks associated with new branch openings.
- ❖ **Enhanced customer targeting:** Location intelligence allows businesses to tailor their offerings and marketing strategies to fulfill the needs of their target audience. To do this, businesses need to understand the demographics, preferences, and behaviors of potential customers in certain areas. This results in better customer engagement and increased sales.
- ❖ **Improved competitive advantage:** Location intelligence helps businesses analyze their competitive landscape. This helps them identify market gaps and underserved areas. Establishing a strong presence in these regions before competitors gives businesses a competitive advantage. This proactive approach can lead to a more significant market share and a more substantial brand reputation.
- ❖ **Cost optimization**: Location intelligence helps to balance real estate costs with potential foot traffic and visibility. This ensures businesses select locations that offer the best return on investment. The result is a reduction of unnecessary expenses while maximizing revenue potential.
- ❖ **Streamlined workforce management**: Location intelligence provides insights into local labor markets. Location data helps businesses understand if talent is available and suitable for their new branches. This guarantees that a skilled workforce is in place to support the growth and success of the expanded business.

These can be accomplished by analyzing data points and considering various factors:

1. Identify your target market : Use demographics, consumer preferences, purchasing behaviors, and market research to define your ideal customer. Location intelligence helps you find areas with high concentrations of potential customers, focusing your expansion efforts on the most promising regions.

2. Analyze competition : Assess the competitive landscape, identifying competitors' locations and market share. Discover unmet demands or market gaps to determine new branch opportunities in local and international markets.

3. Evaluate accessibility :

Estimate ease of access to potential branch locations, factoring in transportation infrastructure, traffic patterns, and parking availability. Easily accessible sites for customers and employees contribute to successful branches.

4. Optimize real estate costs :

Identify areas with optimal property prices, rental rates, and local regulations using location intelligence. Balancing costs with high foot traffic and visibility ensures a strong return on investment, helping you reduce costs and increase sales.

5. Assess the local workforce :

Analyze the local labor market to guarantee the availability of skilled and reliable employees. Location intelligence offers insights into education levels, skill sets, and average wages, informing your staffing decisions.

6. Monitor performance :

Maintain track new branch performance with key performance indicators (KPIs) and established benchmarks. Identify underperforming branches and factors contributing to their performance to make data-driven decisions about improvements or closures.

Integrating your marketing strategy, including social media, with location intelligence enables you to enter new markets, target small businesses, and fuel international expansion.

By harnessing location intelligence for market expansion, you can offer the right products or services, increasing your appeal to potential customers and ensuring long-term success.

4.8 SUMMARY :

Branch banking makes banking more convenient and accessible to customers. Each branch provides the same services as the main office. Although online banking is growing in popularity and is more convenient for most people, branch banking offers a human connection that can't be replicated online, as well as the ability to withdraw cash, access to financial advice, and a wider variety of products and services. Branch banking refers to the operation of storefront spinoffs that offer the same key services as the institution's flagship home office.

Location data is revolutionizing the way businesses develop their branch expansion strategies. It can help decision-makers assess market dynamics and identify the best places to set up new locations. This data helps marketing teams create better campaigns. It also enables them to provide a better in-store experience. The result is clear: An increase in customer loyalty and a boost in revenue potential.

In a unit banking, the profits earned by the bank is used either for the development of the bank or for fulfilling the needs of the local community. On the other extreme, in a branch banking system, the profits of the banks are shared between the branches and also used for increasing their presence.

Chain banking is a type of bank governance in which individuals or an entity control at least three banks that are independently chartered. This system varies from branch banking because its banks are interconnected through centralized ownership. Branch banks operate as a network of branches under a holding company. Chain banking has become much less popular with the rapid spread of interstate banking. These chain banking advantages and disadvantages show us that when resources are limited, and risks could be devastating, it is a feasible solution which brings financial tools to small communities. It may also limit the amount of profits available within the community, while focusing on the preferences of a few to manage the needs of the many. The difference between Group Banking and Chain Banking is that Group Banking is a group of several that exist and function under a single holding company. In chain banking, a chain of banks lives and functions under a single person or group.

4.9 TECHNICAL TERMS :

1. **Banking**: "Banking means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdraw able by cheque, draft, and order or otherwise.
2. **Banking Company**: 'Banking Company' means any company which transacts the business of banking in India.
3. **Branch Banking**: It means a system of banking in which a banking organization works at more than one place.
4. **Branch Location**: Branch location means an a satellite office, unit, station, facility, or space at a fixed location other than a in addition to the principal office, however designated, at which anywhere business that may be conducted at the principal office is transacted.
5. **Chain Banking**: Chain banking refers to a system with a chain of banks controlled by an individual or a small group of people.
6. **CDs**: Certificate of Deposit
7. **Group Banking**: **Group banking** is a system where a group of banks are brought under the control of a holding company.
8. **FRC**: Federal Reserve Committee
9. **HOA**: Homeowners Association,
10. **KPIs**: Key Performance Indicators
11. **Unit Banking:** Unit banking means a system of banking under which banking services are provided by a single banking organization.

4.10 SELF ASSESSMENT QUESTIONS :

1. What is branch banking? Explain about functions of branch banking.
2. What is unit banking? Discuss the advantages and disadvantages of unit banking?
3. Explain the distinction between branch banking and unit banking.
4. What you mean by group banking? State the advantages and disadvantages of group banking.
5. What is chain banking? State the advantages and disadvantages of chain banking.
6. Group banking Vs Chain banking
7. Describes the branch location policies and decisions.

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Dr. VISHNU VADDE

LESSON -5

CORRESPONDENT BANKING

OBJECTIVES :

The objectives of the lesson are:

- To understand the concept of correspondent banking;
- To know the importance and functions of correspondent banking;
- To describe the clearing and collection by correspondent banking; and
- To acquaint the initiatives and recent developments in correspondent banking.

STRUCTURE :

5.1. Introduction

5.2. Concept of Correspondent Banking

5.3. Features of Correspondent Bank

5.4. Importance of Correspondent Banking

5.5. Advantages and Disadvantages of Correspondent banking

5.6. Functions of Correspondent Banking

5.7. Correspondent Banks Vs Intermediary Banks

5.8. Correspondent Banking Bank Accounts

5.9. Clearing and Collection by Correspondent Banks

5.10. Initiates on Correspondent Banking

5.11. Recent Developments in Correspondent Banking

5.12. Summary

5.13. Technical Terms

5.14. Self Assessment Questions

5.15. Reference Books

5.1 INTRODUCTION :

Correspondent banking is an essential component of the global payment system, especially for cross border transactions. Through correspondent banking relationships, banks can access financial services in different jurisdictions and provide cross-border payment services to their customers, supporting, inter alia, international trade and financial inclusion. In addition, most payment solutions that do not involve a bank account at customer level (eg remittances) rely on correspondent banking for the actual transfer of funds. Until recently, banks have maintained a broad network of correspondent relationships, but there are growing indications that this situation might be changing. In particular, some banks providing these services are cutting back the number of relationships they maintain and are establishing few new ones. In view of the importance of correspondent banking, the keen interest of central banks in this activity and any threats to its safe and efficient functioning.

5.2 CONCEPT OF CORRESPONDENT BANKING :

Correspondent banking can be defined, in general terms as “an arrangement under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services to those respondent banks”. The ECB uses a similar basic definition in its correspondent banking survey, referring to “agreements or contractual

relationships between banks to provide payment services for each other". A more detailed definition by the Wolfs berg Group4 establishes that "Correspondent Banking is the provision of a current or other liability account, and related services, to another financial institution, including affiliates, used for the execution of third-party payments and trade finance, as well as its own cash clearing, liquidity management and short-term borrowing or investment needs in a particular currency". At the most basic level, correspondent banking requires the opening of accounts by respondent banks in the correspondent banks' books and the exchange of messages to settle transactions by crediting and debiting those accounts.

All these definitions highlight the main components of correspondent banking: a bilateral agreement between two banks by which one of them provides services to the other; the opening of accounts (by the respondent in the books of the correspondent) for the provision of services and the importance of payment services as a core function of correspondent banking. As the ECB definition highlights, these relationships are frequently reciprocal, in that each institution provides services to the other, normally in different currencies. Correspondent banking is especially important for cross-border transactions, as its importance for domestic payments within a single jurisdiction has diminished greatly due to the use of financial market infrastructures. On a cross-border level, however, correspondent banking is essential for customer payments and for the access of banks themselves to foreign financial systems for services and products that may not be available in the banks' own jurisdictions. This report analyses only cross-border correspondent banking activities6 with a focus on payment aspects.

For example-the main flows involved in correspondent banking payments and the interplay between correspondent banking services and payment systems. It shows the settlement of a payment from bank A to bank C via a correspondent bank. As banks A and C do not hold accounts with each other, they use the services of bank B as intermediary. In one case, bank B transfers the payment to C using correspondent banking only, whereas in the other, bank B uses a payment system in which both B and C participate for transferring the payment. A, B and C would normally be located in two or more different jurisdictions and there could be other banks involved on the sending and receiving sides (as intermediaries in the correspondent banking chain).

Correspondent banking may include various services, such as international funds transfers, cash management services, check clearing, loans and letters of credit or foreign exchange services. There are several ways of providing these services:

a. In traditional correspondent banking, a respondent bank enters into an agreement with the correspondent bank in order to execute payments on behalf of the respondent bank and its customers. The respondent bank's customers do not have direct access to the correspondent account, but they transact business indirectly.
b. Nested correspondent banking refers to the use of a bank's correspondent relationship by a number of respondent banks. The latter have no direct account relationship with the correspondent bank but conduct business through their relationships with the bank's direct respondent bank to execute transactions and obtain access to other financial services (eg a local bank conducts correspondent banking business indirectly via its regional savings bank)
c. Payable-through accounts, also known as "pass-through" or "pass-by" accounts, are similar to nested correspondent banking but, in this case, the respondent bank allows its customers to directly access the correspondent account to conduct business on their own behalf.

As correspondent banking services are a key element in cross-border transactions, they might be expected to grow in parallel with the expansion of international trade and cross-border financial activity.

5.3 FEATURES OF CORRESPONDENT BANKING :

The following are the important features of correspondent banking:

i. A correspondent bank act as an agent of the respondent bank.
ii. Correspondent banks offer the following services such as Treasury, clearance of cheques, drawing of demand drafts, process documentation, foreign exchange, financing, managing international investments, and more.
iii. The correspondent bank charges a specific fee for its services to the respondent bank.
iv. Services of a correspondent bank are usually needed for international financial transactions that require foreign currency exchange.

5.4 IMPORTANCE OF CORRESPONDENT BANKING :

Why is Correspondent banking needed? :

Correspondent banking is needed for several reasons:

a. **Access to foreign markets**: Through correspondent banking, banks can access services offered in other countries, facilitating cross-border transactions. This is a critical function given that most international trade transactions – regardless of the nations involved – are conducted in the United States Dollar.
b. **Payment processing**: Correspondent banking facilitates creates a more efficient international trades and investments by allowing banks to process payments and settle transactions in foreign currencies.
c. **Risk mitigation**: Foreign exchange fluctuation, compliance with local regulations, and settlement risks can all be mitigated through correspondent banking.
d. **Liquidity management**: By providing access to foreign currency funding and credit lines, correspondent banking can assist banks in managing liquidity.
e. **Supplemental services**: Correspondent banking enables smaller and regional banks – which may lack the resources or expertise in specific areas – to offer a broader range of services to their customers.

When do you need to use a Correspondent Bank?

There are many different situations in which a correspondent bank needs to be used. These situations include:

a. **International payments**: If you need to make a payment in a foreign currency, and your bank does not offer that currency or does not have a presence in the beneficiary's country, a correspondent bank will be needed to facilitate the payment.
b. **Trade finance**: If you are involved in international trade, a correspondent bank may need to provide trade finance services, such as issuing letter of credit or providing guarantees.
c. **Foreign currency transactions**: If you need to convert funds to another currency and your bank does not offer that currency, a correspondent bank may be needed to provide the foreign currency.
d. **Clearing services**: The process of settling financial transactions between two or more banks, typically involving the verification of the transaction and the transfer of funds.
e. **Access to foreign markets**: A correspondent bank may be necessary if you want to expand your business in a foreign market.

f. **Risk mitigation**: If you want to mitigate risks associated with international transactions, such as compliance with local regulations or managing settlement risks, a correspondent bank with a presence in that market may be required.

5.5 ADVANTAGES AND DISADVANTAGES OF CORRESPONDENT BANKING :

The biggest advantage that correspondent banks provide is that they empower domestic banks to access the global financial system without having to set up branches in foreign jurisdictions. Such an endeavour will no doubt be costly and fraught with regulatory risk for banks. By simply working with a correspondent bank, a domestic bank is able to offer its customers global fund transfer, check clearing, and related services, without even having a formal relationship with the bank at the other end. The correspondent bank handles everything for them. One disadvantage to customers is that transactions processed through correspondent banks tend to take time, often more so than they'd expect. A wire transfer can usually take a couple of days to be processed. It feels like an inordinate delay in a day and age where money is expected to move in mere seconds.

The added cost is another disadvantage. Since correspondent banks charge a fee for the services that they provide, customers usually have to bear these charges. This can increase transaction costs for them significantly, particularly if their bank tends to charge a premium on the fees. Nevertheless, this is all in the interest of providing safe and reliable international transactions.

5.6 FUNCTIONS OF CORRESPONDENT BANK :

As correspondent banking is based on the services that are provided by one bank to the other bank, it is largely used in international business operations. The functions covered by such arrangements, can be largely summarized as under:

Account Services :

These services require having account relationship with the foreign bank.

i. **Clearing House Functions:** The correspondent bank offers services related to handling of outward payments, receipts of Inward payments and collections, through the account maintained with it. The account is also used for reimbursement of LC claims; check collections draft/check issue on the account. The services includes include providing of statement of account at pre-defined intervals, as also advices and details of transactions, which went through the account. The services would include providing an intra-day line of credit for passing of payment instructions, in anticipation of covers to be received later in the day.

ii. **Collections:** correspondent banks provide services as agents for collection of export/import bills as well as checks, in their country. They also credit the proceeds of such collections after realization to the account maintained with them. Besides, this service may include , follow up for payments, reminders, noting and protesting of bills of exchange, as also taking steps to safe-guard the interest of client bank. The foreign bank also collects clean instruments for credit to the account of the bank.

iii. **Payments:** The correspondent bank handles and executes all payment instructions of the client bank, by debiting to the account maintained with it. The payments could be inter-bank payments, for settlement of FX details or customer payments for imports of goods and services. The payments can be for beneficiaries in the same city, country or other countries, depending upon the location of beneficiaries' correspondent bank accounts.

iv. **Overdrafts and loan facility:** The correspondent bank, by virtue of having an account of the client bank, also grants overdrafts for temporary needs, say, overnight, to fill up short-term funding gaps. It can also consider assessment of the foreign bank.
v. **Investment Services:** The correspondent bank offers services related to investment of overnight surplus balances in the account, beyond a minimum peg balances, at the domestic call rates minus a small margin. It also offers investment of funds in short-term deposits, cash management services as also in specific securities for the client bank.

Other Services :

These services would not normally require account relationship, and can be offered on standalone basis, depending upon the relationship and credit assessment by the correspondent bank.

i. Letter of Credit advising
ii. LC confirmations
iii. Bankers Acceptances
iv. Issuances of Guarantees – bid-bond, performance, etc.
v. Foreign Exchange services, including derivative products
vi. Custodial services.
vii. Trade referrals and credit reports on foreign parties.
viii. Services related to Investment of overnight surplus funds, short-term deposits, as also securities, etc.
ix. Other fund raising services, like placement of shares, bonds, ADR/GDR etc.

Bank Accounts :

We have seen in the earlier part that, correspondent banking includes one of the major functions of account relationship, even though it may not be a prerequisite. The account facilitates, handling of receipts and payments, collections and reimbursements, in the country and in the currency of the correspondent bank.

The foreign currency accounts maintained by a bank, with another bank are classified as Nostro, Vostro and Loro accounts.

a. **Nostro Account:** It means "Our Account with you". For example, SBI, Mumbai maintain an USD account with CITI Bank New York.
b. **Vostro Account:** It means "Your Account with us". Say American Express Bank, New York, maintain a Rupee Account with SBI, Mumbai.
c. **Loro Account:** It refers to accounts of other banks. For example, CITI Bank is referring to Rupee account of American Express Bank, with SBI Mumbai, or some other bank referring to the USD account of SBI, Mumbai with Citi Bank, New York.
d. **Mirror Account:** While a bank maintains Nostro account with a foreign bank,(mostly in foreign currency). It has to keep an account of the same in its books. This is more or less a reflection or a shadow of the nostro account. The entries in the mirror account are used for reconciliation of entries in the nostro account.

Electronic Modes of Transmission/Payment Gateways :

The vastness of global trade and finance, and the related payments and transfers, from one bank to another, one country to another, as also numerous interbank payments and receipts, can only be executed with the help of various payment gateways and telecommunication systems, which have proved to be foolproof over a long period of time.

1. **SWIFT:** SWIFT stands for Society for Worldwide Interbank Financial Telecommunications. This is a cooperative society owned by member banks and financial institutions, providing secured telecommunication and one point contact with 7650 member financial institutions covering over 1,25,000 users, spread over 200 countries. The system has built in security system with an automatic authentication of financial messages, through bilateral key exchange (BKE), and is available 24 hours a day and 365 in a year. The system is cost effective with cost of an average message grossly lower by almost one-fourth than the conventional telex systems.
2. **CHIPS**: CHIPS stands for Clearing House Interbank Payment System, is a major payment system in the USA, operating since 1970. It is a fully automated; computer based messaging and net settlement payment system used by major banks for settlement of a large part of US dollar payments in US. CHIPS were established by New York Clearing House, as a substitute to paper checks. Over the period, CHIPS has grown both in volumes and membership, as now over 115 members and participating banks using the system. The participating banks use the system throughout the day for sending and receiving electronic payment instructions, which at the end of the day are netted and net payment received/paid by each bank to the clearing house. The net position is then debited or credited to each bank's account with Federal Reserve. The system uses CHIP participant codes to identify the participants, and UID numbers to identify the beneficiary account. The banks maintain US dollar Nostro accounts with any of the US based banks are given a specific UID number, which facilitates Straight through Processing (STP) of most of the interbank payments and receipts, through the system. CHIPS are operative only in New York, and as such are mainly used for foreign exchange interbank settlements and Euro Dollar settlements.
3. **FEDWIRE**: This is another US payment system operated by Federal Reserve Bank, operated all over the US states, since 1918, and handles majority of domestic payments. It is an automated computer based messaging and payment system, working on gross settlement basis. All US banks maintain accounts with Federal Reserve Bank, and are allotted an "ABA Number" to identify the senders and receivers of payments. As compared to CHIPS, this is a large system, with over 9500 participants, and handles a large number of payments across USA, covering Interbank transfers out of New York, local borrowings and lending, commercial payments, as also some securities transaction related payments for domestic banks.
4. **CHAPS**: Clearing House Automated Payments System (CHAPS), is a British equivalent to CHIPS, handling receipts and payments in LONDON. This system works on the same principles as CHIPS, working on the net payment settlement system. CHAPS is used by a large number of banks in UK, with about 20 member banks and over 400 indirect members, using the system through some large bank.
5. **TARGET**: Trans-European Automated Real-Time Gross Settlement Express Transfer system is a EURO payment system comprising 15 national RTGS systems working in EUROPE. These are interconnected by common procedures and uniform platform for processing high value payments by over 30,000 participating Institutions across EUROPE. This facilitates receipts and payments of funds across the Euro Zone (all member countries).
6. **RTGS-Plus and EBA**: These are other Euro clearing systems, with RTGS plus, being a German hybrid clearing system and operating as an European oriented real time gross settlement and payment system. RTGS plus, has over 60 participants. The EBA-EURO 1, with a membership of over 70 banks, in all EU member countries, works as

a netting system with focus on cross border Euro payments. For retail payments, EBA has another system, called STEP1, with over 200 members across EU zone. STEP 2 is also in use in EU zone, which facilitates straight through processing (STP) to member banks, using industry standards.

5.7 CORRESPONDENT BANKS Vs INTERMEDIARY BANKS :

Correspondent banks and intermediary banks both serve as third-party banks and are used by beneficiary banks, or receiving banks, to execute international fund transfers and transaction settlements.

The differences between correspondent and intermediary banks aren't consistent.

Correspondent Banks	Intermediary Banks
Provide services on behalf of another bank Play role of middleman between issuing and receiving banks Can execute several transactions on behalf of domestic banks	Provide services similar to correspondent banks Act as a middleman between issuing and receiving banks, possibly in different countries Often needed for international wire transfers between two banks

5.8 CORRESPONDENT BANKING-BANK ACCOUNTS :

Correspondent banking in its true sense is the relationship between two banks which have mutual accounts with each other, or one of them having account with the other. However, in a larger sense, this means a relationship and servicing of banking needs, as agents, without having account relationship also. This was due to a large number of banks offering correspondent banking services and it was not possible to have and maintain accounts with a large number of them, but the growing needs of the international business, required help and services from a large number of banks, across the globe.

Thus, correspondent banking is a practice, where a bank is able to handle business in another city or country, through local banks there at, the local bank acting as an agent of the former, and charging fees for the services rendered. This system eliminated the need to have a global network of branches, which involved high costs and volumes to service the braches. Further it was not possible for all international banks to obtain permission for opening of branches in several countries, due to restricted foreign bank/branch licensing policies adopted by some countries. Thus the correspondent banking system allows the banks to take advantage of the business opportunities in other countries, without a branch network of its own and with minimum operational costs.

5.9 CLEARING AND COLLECTION BY CORRESPONDENT BANKS :

A correspondent bank is one that maintains reciprocal business relations with a bank in another city. Although the two banks participating in a correspondent-banking relationship may be approximately the same size, usually one bank is much larger than the other and located so as to give financial services desired by the smaller bank. This means that services given by the larger bank tend to be dominant in the mutual arrangement and that the smaller bank usually reciprocates by keeping a deposit with the larger bank. These deposits are the means for settling checks handled-a debit for payment of items collected for the smaller bank and a credit for items collected by the smaller bank for its correspondent.

The basic need of banks for out-of-town services is traced to their desire to give customers better banking services. When a business firm buys goods outside the community, its bank is called upon to settle for checks deposited in out-of-town banks. At the same time, a bank customer expects his bank to collect all checks and other items deposited that are drawn on banks located in other communities. Therefore, banks are confronted with the problem of collecting checks drawn upon banks located in distant places as well as those drawn upon local banks.

The clearing and collection of out-of-town items require sorting of items by the transit department and mailing them to correspondent banks according to previously made arrangements covering credits, minimum balances, fees, and other charges(these are similar to rules covering deposits of ordinary business firms). Obviously, it is important to checks and other items promptly to the banks on which they are drawn. Without this prompt testing of checks, there would be a deterioration of the quality of the money supply, for it would contain worthless checks and other items for weeks or months. Today, many large banks keep their transit departments functioning day and night, and in some small communities groups of banks are doing the same thing on a co-operative basis.

When a bank sends a check to a correspondent bank for collection, it usually receives immediate credit, even though the check will not be paid by the drawer's bank until later. (This similar to the immediate credit for checking purposes that most individuals are given when they deposit checks in their banks.) This practice is dangerous, but it simplifies bookkeeping and is justified for that reason. The correspondent bank may present the item to the drawer's bank indirectly through the clearinghouse if drawn on a local bank. If the drawer's bank is located in another city, however, the correspondent may deposit the check with the Federal Reserve bank for collection, mail to its correspondent in the area where the drawer's bank is located, or send it directly to the bank on which it is drawn for payment.

A bank may keep a deposit with a second bank for the same reasons that any depositor keeps an account with his bank- as a means of payment. A bank in Austin, Texas, may write checks (bank drafts) on its deposit in a New York bank in order to buy bills, notes, government bonds, and other types of assets: or the Austin bank may sell bank drafts on its account with the New York bank to customers so that they can use it as a means of payment. The buyer of the draft may not have a checking account, or his personal check may or may not be acceptable in payment of some particular obligation. The bank will charge a small fee for its draft, which will vary according to the amount of money involved.

A correspondent bank may provide its customer bank with services other than those associated with clearing and collecting checks. Among these services are giving advice on investments, loans, collection procedures, insurance protection, advertising, accounting, and auditing practices, pension and profit-sharing plans, job analysis, equipment, taxes, and other bank problems, acting as agent in making loans and investments; providing credit information on firms that borrow in the open market; providing foreign-exchange facilities, including commercial and travelers ' letters of credit and travelers' checks; sharing large loans; and providing funds "loans" in case of need.

Today New York banks are acting as correspondents for banks in hundreds of other cities, and some of the hold deposit accounts of hundreds of customer banks. Banks in other large cities are acting as correspondents for banks in smaller cities, and those in small cities are acting as correspondents for banks in towns and villages. In practice, a bank may be keeping bankers' balances, also called "interbank deposits", with several different banks at the same time. As a result, a complex voluntary working relationship among banks blankets

the country, and, since certain metropolitan banks (sometimes called "international" banks) have extended these arrangements to include banks in foreign countries, the correspondent-banking system is international in scope of operations.

5.10 INITIATIVES ON CORRESPONDENT BANKING :

Recent work and current initiatives in the field of correspondent banking by different international bodies and institutions include the following:

The Financial Stability Board (FSB) is closely cooperating with other international organizations and with national jurisdictions that are members of the FSB and its Regional Consultative Groups to assess and address the decline in correspondent banking, given the importance of correspondent banking for international payments and that, in the extreme case, the loss of access to such services can affect the functioning of local banking systems, create financial exclusion and drive some payment flows underground. At the November 2015 Antalya Summit, the G20 Leaders approved the FSB four-point action plan to assess and address the decline in correspondent banking.

Under the plan, the FSB, in partnership with other organizations, will coordinate work on the four-point action plan to: (1) further examine the dimensions and implications of the issue, including improving data collection on the scale of withdrawal, its causes and effects; (2) clarify regulatory expectations, including through guidance by the FATF; (3) expand domestic capacity-building in jurisdictions that are home to affected respondent banks; and (4) strengthen tools for customer due diligence by correspondent banks.

In March 2016, given the importance and multifaceted nature of the issue, the FSB created a Correspondent Banking Coordination Group (CBCG) to maintain impetus in delivering on the action plan and to provide efficient high-level coordination, identifying in a timely way if there are gaps or overlaps in the work. The FSB also created four work streams of technical experts to coordinate at a more detailed level on a day-to-day basis the work to take forward each of the four action points. The work streams report periodically into the CBCG and are steered by the CBCG.

The World Bank is conducting surveys to better understand the evolution and drivers of bank account closures or restrictions, in the context of correspondent banking relationships and money and value transfer services (remittances). Under the G20's Global Partnership for Financial Inclusion (GPFI), the World Bank collected information on whether and why banks are terminating or restricting business relationships with remittance service providers. With support from the FSB and CPMI, the World Bank led another survey to obtain data on whether correspondent banking relationships are being terminated or restricted, the net effect of these developments and the underlying causes. This data-gathering included non-CPMI jurisdictions. In November 2015, the World Bank published the results of the survey on correspondent banking relationships. The survey results were accompanied by the results of the GPFI-commissioned survey on remittance service providers.

The Financial Action Task Force (FATF) issued three subsequent public statements on de-risking in October 2014, in June 2015 and in October 2015 in order to clarify its approach to "de-risking", which is based on the risk-based approach as a central element of the FATF Recommendations. The risk-based approach requires financial institutions to identify, assess and understand their money laundering and terrorist financing risks, and implement AML/CFT measures that are commensurate with the risks identified. The June 2015 public

statement on "de-risking" provides additional clarification on customer due diligence for correspondent banking relationships: "When establishing correspondent banking relationships, banks are required to perform normal customer due diligence on the respondent bank. Additionally, banks are required to gather sufficient information about the respondent bank to understand the respondent bank's business, reputation and the quality of its supervision, including whether it has been subject to a money laundering or terrorist financing investigation or regulatory action, and to assess the respondent bank's AML/CFT controls. Although there will be exceptions in high risk scenarios, the FATF Recommendations do not require banks to perform, as a matter of course, normal customer due diligence on the customers of their respondent banks when establishing and maintaining correspondent banking relationships".

In October 2015, the FATF issued a public statement which confirms that de-risking will remain a priority for FATF; highlights the FATF's ongoing work to clarify regulatory expectations to ensure that AML/CFT measures are being implemented in line with its risk-based approach; and reiterates its commitment to continuing engagement with other international bodies, countries, the private sector and civil society on this important issue. The FATF is developing guidance on correspondent banking and remittances whose main objective is to clarify the applicable FATF requirements. In addition, FATF recently completed work of particular relevance to de-risking: guidance on the risk based approach for effective supervision and enforcement by AML/CFT supervisors of the financial sector and law enforcement (October 2015), guidance for risk-based approach for money or value transfer services (February 2016) and best practices on combating the abuse of non-profit organizations (June 2015).

The Basel Committee on Banking Supervision (BCBS) published in January 2014 its Sound management of risks related to money laundering and financing of terrorism, which contains an annex on correspondent banking (including money laundering/financing of terrorism risk assessments and customer due diligence requirements in correspondent banking). In February 2016, the BCBS released an expanded version of these.

5.11 RECENT DEVELOPMENTS IN CORRESPONDENT BANKING :

The following trends were identified:

Cutbacks in the number of relationships: Correspondent banking relationships are being reduced in number, especially for respondent banks that (i) do not generate sufficient volumes to recover compliance costs; (ii) are located in jurisdictions perceived to be too risky; (iii) provide payment services to customers about which the necessary information for an adequate risk assessment is not available; or (iv) offer products or services or have customers that pose a higher risk for AML/CFT and therefore are more difficult to manage. As regards (iv), comments received during the public consultation argued that some decisions by correspondent banks to withdraw services to certain respondent banks are made following specific risk assessments of an individual respondent, which may include factors in addition to jurisdiction. This may suggest that some amount of de-risking may be occurring because banks are carrying out the requirements of the AML/CFT regime and thereby mitigating their exposure to AML/CFT risks that cannot be managed effectively.

Changes in relationships: Those types of correspondent banking service that are perceived to have higher associated risks (nested correspondent banking, payable-through accounts) are being scaled back, so that traditional correspondent banking clearly predominates in the remaining relationships. These remaining relationships are often retained only to support the

cross-selling of other products to respondent banks (ie the profit is made in other business areas and correspondent services are considered as a necessary ancillary service).

Concentration of relationships: Cutbacks in the number of relationships as well as changes in their nature have resulted in a significant concentration of relationships in a relatively small number of service-providing institutions that increasingly dominate this market. In addition, a concentration of correspondent banking activities within affiliated banks was observed.

Increasing costs: The establishment and maintenance of a correspondent banking relationship are perceived to be increasingly costly both for correspondent and respondent banks.

Cutbacks to correspondent banking services in specific foreign currencies: Some correspondent banks are increasingly reluctant to provide correspondent banking services in certain foreign currencies in which the perceived risk of economic sanctions, the regulatory burden related to AML/CFT or the uncertainties related to the implementation of these requirements and the potential reputational risk in case of non-compliance seem to be higher. There are indications that correspondent banking activities in US dollars are increasingly concentrated in US banks and that non-US banks are increasingly withdrawing from providing services in this currency except for some ancillary services. Simultaneously, the very same non-US correspondent banks might still be willing to provide correspondent banking services in their domestic currency.

Geographical imbalances: Not all jurisdictions and currencies are affected equally. Respondent banks, in particular smaller banks located in jurisdictions perceived to be too risky, are especially affected by the reduction in the number of relationships.

What are the drivers that can explain these recent trends? From the demand side, at least some respondent banks are actively reducing the number of correspondent banking relationships in order to reduce their own risk management work, simplify reporting of intraday liquidity, concentrate their payment channels and cut costs. However, a significant demand for these services still seems to exist.

Most of the drivers seem to derive from the supply side (ie correspondent banks providing the service to respondent banks). One of the main drivers seems to be the growing tendency for banks to assess the profitability of their business lines, customers and even jurisdictions in a world where the cost of correspondent banking has increased and capital and liquidity are scarcer and more expensive. While the correspondent banking business seems profitable in aggregate, parts of this business are not and, as a result, correspondent banks have been dropping their less profitable customers or jurisdictions

According to anecdotal evidence, these costs have reached such a level that, for certain financial institutions, there is no business justification for continuing to engage in correspondent banking. In addition to the increased compliance costs, interviewed banks also mentioned the high degree of uncertainty as to what exactly constitutes compliance with the requirements in order to avoid penalties and related reputational damage. For example, some of the interviewed banks believe that it is necessary to "know your customers' customers (KYCC)", and there seems to be a degree of uncertainty as to when this is necessary and how detailed this knowledge should be. This uncertainty increases the difficulty of measuring the risks associated with correspondent banking and might be leading to the abandonment of some relationships. However, not all the causes seem to be directly related to increasing regulatory costs: the general trend of financial institutions to downsize and deleverage in the

wake of the financial crisis seems to be behind the decisions of some correspondent banks to eliminate or scale back this line of business, particularly if it is not considered a core activity. Also, country risk (geopolitical and financial) may have increased, so that the rising costs may be due partly to the application of existing policies to a larger number of high-risk countries, not just to higher enforcement activity and penalties.

5.12 SUMMARY :

We have seen how the areas of correspondent banking, bank accounts as well as payment gateways help the business and banking world in international trade and finance. The correspondent banking is based on the premise of relationship and goes a long way in servicing banks in other countries. In this era of electronics and telecommunications, products like SWIFT, CHIPS, TARGET, etc., play an important role in faster and secure communications and payments across the globe.

Both correspondent and intermediary banks are third-party banks, and are used by beneficiary banks to execute international fund transfers and transaction settlements. Depending on where the account holder is from, correspondent banks are either different from intermediary banks, or they may be a type of intermediary bank themselves. The number of currencies being used in a transaction is the main difference between correspondent and intermediary banks.

In summary, a correspondent bank is often required when your bank does not offer the necessary services nor has a limited presence in a foreign market. Through the process of correspondent banking, your business may be able to gain access to a range of banking services in different markets that your bank alone may not be able to provide. When expanded to the global scale, it is clear how correspondent banking is an integral part of international banking.

5.13 TECHNICAL TERMS :

1. **Nostro:** Our Account with you.
2. **Vostro:** You're Account with Us.
3. **Loro:** Their account with them (third party/bank).
4. **Non-Resident Indian**: Who is not a resident, has gone out of India with an intention of business or vocation and period of stay is indefinite.
5. **FCNR (B) Accounts:** Foreign currency accounts which can be opened by Non-resident Indians.
6. **Swift:** A communication system which provides transmission of financial messages, certifying the authenticity, across the globe between members.
7. **Target:** A payment system of European Union.
8. **AML/CFT:** Anti-Money Laundering and Countering the Financing of Terrorism.
9. **AMLEG:** BCBS AML/CFT Expert Group.
10. **BCBS:** Basel Committee on Banking Supervision
11. **BIC:** Business Identifier Code.
12. **CBCG:** FSB Correspondent Banking Coordination Group.
13. **ECB:** European Central bank.
14. **LEI:** Legal Entity Identifier.
15. **LOU:** Local Operating Unit (for the issuance and management of LEIs).

16. OFAC: Office of Foreign Assets Control.

5.14 SELF ASSESSMENT QUESTIONS :

1. What is correspondent banking? Explain briefly the services offered by correspondent banking.
2. State the importance of correspondent banking.
3. What is correspondent banking? Discuss the function of correspondent banking.
4. State the advantages and disadvantages of correspondent banking.
5. Correspondent banks Vs intermediary banks
6. Describes the recent trends in correspondent banking.
7. What are the initiations on correspondent banks? Explain.
8. Describe the clearing and collection work of a local clearinghouse of a correspondent bank.

5.15 REFERENCE BOOKS :

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Dr. VISHNU VADDE

LESSON - 6

PROCESS OF BANK MANAGEMENT

OBJECTIVES :

The objectives of the lesson are:

- To understand the concept of bank management;
- To identify the functions and functional areas of bank management; and
- To know the governing of bank management in banks.

STRUCTURE :

6.1 Introduction
6.2 Meaning and Definitions of Bank Management
6.3 Characteristics of Bank Management
6.4 Importance of Bank Management
6.5 Objectives of Bank Management
6.6 Managerial Functions of Bank Management
6.7 Functional Areas of Bank Management
6.8 Governing of Bank Management in Banks
6.8.1 Bank Management – Deposits
6.8.2 Bank Management – Advances
6.8.3 Bank Management – Liquidity
6.8.4 Bank Management – Credit
6.8.5 Bank Management – Risk Management
6.8.6 Bank Management – Asset Liability Management
6.8.7 Bank Management – Marketing
6.9 Summary
6.10 Technical Terms
6.11 Self Assessment Questions
6.12 Reference Books

6.1 INTRODUCTION :

Bank management is the process of managing a bank and all its activities. Bank management is the sector that puts all the efforts to maximize the total profit of the bank. The main target of bank management is to build an organic and optimal interaction system for total banking operations. Every successful banker has to perform managerial responsibilities along with technical banking activities. Although a bank is a financial institution like other businesses, its main objective is to maximize its wealth by earning profit. Bank business is different from other types of businesses. Other businesses can transfer/shift their goods or services from factory to office or other far places even can export to foreign countries. But banks can transfer funds or extend services only after fulfilling the demand for a loan of the area where the office or branch of that bank is situated. Efficient management can offer high-quality service, and efficient management can be ensured by efficient organization management. So, professional management is impossible without crystallizing the authority & responsibility of all the personnel employed in a bank.

A banking company, like any other company or corporate body, is an artificial person existing only in the eyes of law. It has separate legal entity with no physical existence of its own. It acts through the natural human beings that are termed as 'directors' and collectively designated as 'Board of directors'. It is the supreme authority which manages the affairs of a bank and is responsible for efficient operations and management of the bank. The board of 45 directors, by their efficient management and good organizational structure, aim at improving operating efficiency, increasing profitability, building and retaining public confidence, which will not only attract more deposits but also enhance scope for expanding banking business.

6.2 MEANING AND DEFINITION OF BANK MANAGEMENT :

One can come across many definitions of bank management. Usually, bank management means the process of governing the bank's statutory activities. Bank management can be defined by the particular object of management – financial activities connected with banking concerns. Bank management also concerns the application of management functions in the banking sector.

Bank management is characterized by the specific object of management – financial relations connected with banking activities and other relations, also connected with implementing management functions in banking. Successful optimization of the "profitability-risk" ratio in bank lending operations is largely determined using effective bank management methods. The ability to take reasonable risks is one of the elements of entrepreneurship culture in general and banking culture.

6.3 CHARACTERISTICS OF BANK MANAGEMENT :

The following characteristics determine the reliability of the bank management:

i. Management expertise in strategic analysis, planning, policy development, and management functions;
ii. Quality of planning;
iii. Risk management (credit, interest rate, and currency risks);
iv. Liquidity management;
v. Management of human resources;
vi. Creation of control systems: audit and internal audit monitoring of profitability and risks liquidity:
vii. Unified information technology system: integrated workflow accounting, current analysis and control, strategic planning.

All the above conditions show themselves during the implementation of bank management and its components.

6.4 IMPORTANCE OF BANK MANAGEMENT :

Bank's management procedure is more challenging as the regulatory system always is there to control the bank management.

1. Changing Regulation of Banks.
2. Increasing competition due to Changing Technological Development.
3. Changing International Relationship.

Changing Regulation of Banks :

At the end of the 3rd decade of the 20th century, thousands of banks worldwide failed due to the economic recession called Great Depression. Due to the bank failure, millions of

depositors suffered from a great problem, as they didn't get back their deposited money. To protect the interest of depositors, the deposit insurance scheme was made mandatory for banks. And from this time, the regulation for banks began to multiply from various angles.

Previously, receiving a registration certificate or certificate of commencement of business and submitting the financial statements were considered sufficient for the controlling agencies of banks. Some of the techniques followed by the bank regulatory authorities to control the activities of commercial banks are;

- Direction for the right price of bank services.
- Introduction of deposit insurance.
- Direction for adequate liquidity.
- Direction for capital adequacy.
- Direction for approval and non-approval of bank loan operation.
- Recruitment of directors and direction regarding recruitment and directing their duties and responsibilities.
- Loan supervision, review, and examination.
- Direction for adequacy reserve etc.
- Day by day, bank management becomes more challenging by introducing rules and regulations by bank regulatory authorities.

Increasing Competition due to Changing :

- The number of served clients and quality dimensions of services is the basis of competition. The bank, which provides better service with high quality, is capable of being successful in competition.
- Two banks jointly create new services that provide the customers with a sustainable competitive advantage.
- Why the new benefit or service that the bank offer is unique and different from that of the other organizations requires the commercial banks to participate in the multidimensional competitive environment.
- The bank, which can attract more clients, can create clients repeatedly. This technological environment absorbed more investment and new training.
- So, the bank's management creates a new strategy of banking services adjusted in the competitive banking business.

Changing International Relationship :

- In the international banking business, the bank faces an extensive amount of legislation in the event of a new problem. International relations, global or bilateral, create more competition in the banking business.
- Other factors, such as international trade and commerce, laws of fund transfer, changes in social and cultural factors, establish a new operational management system that challenges the banking business.

In this era of modern science, a solution of competitive environment and development of international relations among banks, the bank's management follows a strategy to merge banks in the international banking business.
All these factors stated make bank management more complex and challenging.

6.5 OBJECTIVES OF BANK MANAGEMENT :

The basic objective of the bank's management in the modern set up is not only to maximize profits but also to discharge social responsibilities. Social responsibilities include responsibilities towards shareholders, employees, customers, other banks, government and the weaker sections of the society. An efficient management is a prerequisite for the success of the commercial banks in achieving the following objectives

- **To improve the customer services**: one of the important objectives of bank management is to improve the customer services.
- **Maximization of Profitability**: To maximize the profits is the main objective of the bank management.
- **Introduction of New schemes**: The objective of the bank management is to innovate and introduce new schemes to expand the banking business.
- **Social Responsibility**: It is the objective of the bank management to discharge social responsibility towards the society, especially its weaker sections.
- **To Meet Challenges of Competitors**: The changing scenario arising from globalization and liberalization as well as competitors from within and outside has posed a number of challenges before the bank management , which has to be dealt with in an efficient manner.
- **Introduction of technology**: The bank management aims at computerizing and adopting new technologies to make banking services more efficient and time bound. The introduction of online banking, ATM facility, internet banking, etc. is the main examples.
- **Manpower Planning**: It is the objective of the bank management to develop its manpower by giving required training. The bank management also motivates its employees to work efficiently, productively and profitably.
- **Improvement in the system of Inspection**: The bank management tries to improve the system of inspection and social audit.
- **Improvement of Productivity**: The bank management makes serious efforts to improve the output of the bank to compete with private banks.

6.6 MANAGERIAL FUNCTIONS OF BANK MANAGEMENT :

The fundamental functions of bank management are as follows:

- **Planning:** Planning is the activity through which a bank decides its future course of action. It refers to a set of objectives or goals of a bank and determines the policies, programmes and procedures to achieve pre-decided objectives. Planning is the bridge between the present and future of a bank. It provides the bank management some goals, aims, objectives, programmes and direction towards the goals.
- **Organizing**: Organizing is the second important function of bank management. Organizing is the process of arranging and allocating the bank activities, authority and resources among the bank employees so that they can efficiently achieve the goals of the organization. Organization involves division of total bank activities into different department for efficient execution.
- **Staffing:** Staffing is the management of human resources in the organization. Staffing refers to the function of selecting, training, deciding the wages and salary and appraisal of the work of the members of the bank staff. The staffing function is concerned with the provision of right persons, in the right numbers, at the right time and in the right place in a bank. Staffing involves sufficient supply of adequately

developed and motivated people to perform their duties and tasks required to meet the banking objectives.

- **Directing:** In bank management, directing refers to instructing, guiding, counselling and supervising the bank staff. it is concerned with leading, motivating and guiding the staff of bank to perform activities in the most efficient way to achieve the desired goals.
- **Controlling:** Controlling is the measurement of the performance of the subordinates to ascertain whether or not they have met the objectives of the bank and abided by its established policies and rules. The control process involves the establishment of standards, measuring performance in accordance with these standards and correcting deviations from the established plans and programmes. Controlling also ensures efficient use of scare and valuable resources of the banks. It improves customer services, raises efficiency and control frauds and scams.
- **Communication:** it is the process of communicating the established objectives, policies and rules of operation to all who have need of them. Communication is the chain of understanding that integrates the staff members of the bank from top to bottom and bottom to top. Communication is the way of conveying the ideas, views, information and directions from one person to another. Computerization and online banking have become an important source of communication.

6.7 FUNCTIONAL AREAS OF BANK MANAGEMENT :

The functional areas of bank management refer to the important functions to be performed by the staff of the bank. It consists of the following functional areas:

i. **Deposit Mobilization**: The bank management formulates saving schemes and makes efforts for mobilization of deposits. The bank management plays an important role in inculcating banking habits.

ii. **Credit Management**: The credit management refers to appraisal, sanction, distribution, recovery and administration of the loans and other types of credit.

iii. **Liquidity Management**: Liquidity of a bank is the main determinant of bank's reputation and goodwill. It relates to Cash Reserve Ratio (CRR), statutory Liquidity Ratio (SLR), trading in bank receipts and other short term securities.

iv. **Financial Management**: The financial management includes cost control, financial planning, management accounting and other related problems.

v. **Profit evaluation**: It is an important functional area of bank management. It requires a dynamic approach. It covers cost benefit analysis, forecasting, and flow of funds and estimation of return.

vi. **Marketing Management:** The marketing management refers to marketing services, customer services and marketing research.

vii. **Investment Management**: Investment management is another important functional area of bank management. The main source of bank's profits is the investment made by the banks of their deposits. It relates to underwriting of securities and investment in equities.

viii. **Portfolio Management**: The portfolio refers to the composition of different types of income earning assets. This functional area is mainly related with asset management. The bank management has to select, make appraisal and evaluate different types of assets.

6.8 GOVERNING OF BANK MANAGEMENT IN BANKS :

A bank's efforts to maximize profits depend on a variety of concerns. You need to have all these concerns, such as asset management, liquidity management, capital management, and liability to work in conjunction to derive profits. And, Bank Management governs such concerns.

6.8.1 Bank Management – Deposits :

Commercial banks play an indispensable role in the development of the country. The main function of a commercial bank is management of its liabilities and assets. Liability management consists of the activities involved in getting funds from depositors and other creditors and determining the appropriate mix of funds for a particular bank, whereas asset management refers to allocation of the funds among investment alternatives. It is concerned with advances and loans. Deposits are the most important source of funds for commercial bank. Commercial banks almost completely rely on deposits for funds. The survival of a bank is based on the quantum of deposit held by it and the manner in which deposits are managed. Banks mobilize savings from people in urban and rural areas and make funds available for lending. Banks are always engaged in working out new plans, policies to raise more and more funds from people.

According to Oxford dictionary, "The term deposits means to lay down in particular place, store or entrust for keeping". It means money deposits in banks are known as bank deposits. Deposits are the chief source of funds of the banks. Deposit Management consists of the activities involved in obtaining funds from depositors

Type of Deposit Account :

1. **Demand Deposits**: Demand deposits or checkable deposits are also known as current accounts. These deposits can be withdrawn by the depositor or transferred to someone else at any time. Withdrawals and transfer to third parties usually are made by cheque. No interest is paid by the bank on demand deposits.
2. **Savings Deposits**: Savings account aim at the promotion of thrift. Regular saving accounts can be maintained by individuals and not profit institutions. Saving accounts do not have specified maturity dates or size limits. The accounts terminate when the holders decides. In savings accounts, deposits and withdrawals are made at anytime. Saving accounts are also known as "Pass book Accounts" because traditionally depositors receive a book known as pass book in which all the entries related to deposits and withdrawals are recorded. Interest is paid on this account.
3. **Time Deposits or Fixed Deposits**: Time deposits are those deposits that are deposited with banks for a certain period of time. Banks pay higher rate of interest on these deposits. Time deposits cannot be withdrawn by cheque but must be converted into cash or demand deposits. These deposits are specified both as to maturity and amount. Fixed deposits receipt is the most common type of time deposit. It is a receipt issued for funds deposited with the bank for a specified period of time and on which bank pays interest if left till maturity. Some of the time deposit schemes are monthly income scheme, cash certificates, annuity, retirement scheme, recurring deposits, cumulative deposits, etc,.

Deposit Mobilization Strategy :

In the face of competition as a result of liberalization of the economy, each and every bank has to formulate a suitable strategy for mobilization of deposits by keeping focus on the

segment of population from which deposits are intended to be mobilized. The formulation of deposit mobilization strategy involves a number of steps such as;

1. **Identify the Saving Potential**: The bank must identify the saving potentials of the people. For this purpose, the bank must know the strength of working people, their sources of income, their economic conditions, habit of saving, family income, preference of investment, etc. high income group will provide more money for deposits in bank than lower income group of society.
2. **Motivation for Saving**: The bank should also take into account motivation for savings to attract more deposits. As Banking Commission 1972 has said that some of motivations for saving could be:
   i. To own a house;
   ii. To provide for children education and marriage;
   iii. To provide for old age; and
   iv. To provide for medical expenditure and so on.

To make a socially gainful use of such motivations, the banks should introduce the deposit schemes which are able to exploit the motivation.

3. **Formulating Deposit Mobilization Schemes:** The bank should know the needs of people and tailor different schemes according to their needs, requirements and preferences of deposits. For example, daily wage earners and small vendors or traders prefer to spare some money daily as their savings. Neither it is convenient nor could they afford to go to bank daily to deposit small money. In such cases, the bank should introduce schemes of daily collection and depute its own employees for the collection of the money. Different banks have floated different schemes to mobilize savings from public taking into account the accessibility, convenience, feasibility and capacity of depositors.
4. **Deciding the Market Strategy:** After formulation of mobilization schemes, the banks should decide the market strategy. Different banks have different strategies due to competition among them. The marketing strategy should be formulated within the framework of corporate objectives and overall strategy of the bank. The success of marketing strategy will depend upon the involvement and effort of the staff. Therefore, all those involved in the promotion of products of the bank should understand the strategy for its proper implementation.

Fundamental Principles of Deposit Mobilization of Schemes :

To attract more deposits, the banks have to formulate new schemes of different nature and suitability to the different classes of investors in both rural and urban centres. These schemes must satisfy the following fundamental principles of

1. **Mobility:** It includes mobile bank schemes, small deposit scheme, cash collection agent scheme, etc.
2. **Flexibility:** It refers to providing morning services, evening services, Sunday and holiday services.
3. **Convenience to Customers**: It includes those facilities which make banking services convenient to customers. These include opening of branches in residential areas, shopping complexes, industrial complexes and campus of educational institutions.
4. **Automatic Facility**: It includes the use of technical devices and computerization of services.
5. **Reduction of Cash dealing**: It refers to traveler cheques and use of credit cards, etc.

6.8.2 Management Of Loans And Advances :

Lending or advancing loans is one of the two basic functions of the commercial banks. Lending is the profit or earning process of the commercial bank. Lending policy of bank is governed by monetary policy of Reserve Bank of India. The banks lend money out of deposits received from the customers. Deposits are repayable on date of maturity or on short notice or on demand by customer. Hence, the bank cannot lend money for a longer period out of deposits for short period. A commercial bank is essentially a medium or short term lender. It is clear that a commercial bank cannot lend for long period any substantial part of funds which have been borrowed for short period from depositors. On the basis of the past experiences, the bank management knows how to use their assets in the best possible manner. The principal profit making activity of commercial banks is making loans to its customer. The primary objective of loan management is to earn income by serving the credit needs of the community.

Importance of Management of Loans and Advances: One of the most important activities of commercial bank is the management of loans and advances. A commercial bank generate near about 65 to 70 percent of its income through the lending activity. The success of a bank is heavily dependent on its lending programmes. Some of the important contributions of loans and advances to economy are as follows:

1. **Agents of Indirect Production**: Bank loans are called the agent of indirect production. The producers purchase raw materials, machinery, hire labour and other means of production through these loans advance by the bank.
2. **Generates Employment**: Commercial banks have increased employment opportunities. Through their lending functions, they have contributed to mass production, mass distribution and mass consumption.
3. **Improvement in Standard of Living**: Bank loans and advances may be used to increase production and employment. This will result in higher income and improve the living standard of the people.
4. **Contribution to Economic Development**: The loans advanced by the banks promote the economic development of the country. Bank lending contributes to develop infrastructural facilities to promote production, distribution and boosts exports and imports.
5. **Raise the Level of Consumption**: Banks also increase the level of consumption through their consumer loans. Banks provide consumer loans for creating a constant demand for consumer goods like houses, furniture, appliances, fixtures etc. in addition to the financing of agricultural, commercial and industrial activities.
6. **Source of Bank's Profit**: Banking lending also plays an important role in the gross earnings and net profits of commercial banks. It is the most profitable as well as risky function performed by commercial banks. Therefore, it must be done efficiently, profitably and safely.

6.8.3 Bank Management – Liquidity :

Liquidity in banking refers to the ability of a bank to meet its financial obligations as they come due. It can come from direct cash holdings in currency or on account at the Federal Reserve or other central bank. More frequently, it comes from acquiring securities that can be sold quickly with minimal loss. This basically states highly creditworthy securities, comprising of government bills, which have short term maturities. If their maturity is short enough the bank may simply wait for them to return the principle at maturity. For short term, very safe securities favor to trade in liquid markets, stating that large volumes can be sold

without moving prices too much and with low transaction costs. Nevertheless, a bank's liquidity condition, particularly in a crisis, will be affected by much more than just this reserve of cash and highly liquid securities. The maturity of its less liquid assets will also matter. As some of them may mature before the cash crunch passes, thereby providing an additional source of funds.

Need for Liquidity :

We are concerned about bank liquidity levels as banks are important to the financial system. They are inherently sensitive if they do not have enough safety margins. We have witnessed in the past the extreme form of damage that an economy can undergo when credit dries up in a crisis. Capital is arguably the most essential safety buffer. This is because it supports the resources to reclaim from substantial losses of any nature.

The closest cause of a bank's demise is mostly a liquidity issue that makes it impossible to survive a classic "bank run" or, nowadays, a modern equivalent, like an inability to approach the debt markets for new funding. It is completely possible for the economic value of a bank's assets to be more than enough to wrap up all of its demands and yet for that bank to go bust as its assets are illiquid and its liabilities have short-term maturities. Banks have always been reclining two runs as one of their principle social intentions are to perform maturity transformation, also known as time intermediation. In simple words, they yield demand deposits and other short term funds and lend them back out at longer maturities.

Maturity conversion is useful as households and enterprises often have a strong choice for a substantial degree of liquidity, yet much of the useful activity in the economy needs confirmed funding for multiple years. Banks square this cycle by depending on the fact that households and enterprises seldom take advantage of the liquidity they have acquired. Deposits are considered sticky. Theoretically, it is possible to withdraw all demand deposits in a single day, yet their average balances show remarkable stability in normal times. Thus, banks can accommodate the funds for longer durations with a fair degree of assurance that the deposits will be readily available or that equivalent deposits can be acquired from others as per requirement, with a raise in deposit rates.

How Can a Bank Achieve Liquidity :

Large banking groups engage themselves in substantial capital markets businesses and they have considerable added complexity in their liquidity requirements. This is done to support repo businesses, derivatives transactions, prime brokerage, and other activities.

Banks can achieve liquidity in multiple ways. Each of these methods ordinarily has a cost, comprising of −

1. **Shorten asset maturities**: This can assist in two fundamental ways. The first way states that, if the maturity of some assets is shortened to an extent that they mature during the duration of a cash crunch, then there is a direct benefit. The second way states that, shorter maturity assets are basically more liquid.
2. **Improve the average liquidity of assets:** Assets that will mature over the time horizon of an actual or possible cash crunch can still be crucial providers of liquidity, if they can be sold in a timely manner without any redundant loss. Banks can raise asset liquidity in many ways. Typically, securities are more liquid than loans and other assets, even though some large loans are now framed to be comparatively easy to sell on the wholesale markets. Thus, it is an element of degree and not an absolute statement. Mostly shorter maturity assets are more liquid than longer ones. Securities

issued in large volume and by large enterprises have greater liquidity, because they do more creditworthy securities.

3. **Lengthen liability maturities**: The longer duration of a liability, the less it is expected that it will mature while a bank is still in a cash crunch.
4. **Issue more equity**: Common stocks are barely equivalent to an agreement with a perpetual maturity, with the combined benefit that no interest or similar periodic payments have to be made.
5. **Reduce contingent commitments:** Cutting back the amount of lines of credit and other contingent commitments to pay out cash in the future. It limits the potential outflow thus reconstructing the balance of sources and uses of cash.
6. **Obtain liquidity protection:** A bank can scale another bank or an insurer, or in some cases a central bank, to guarantee the connection of cash in the future, if required. For example, a bank may pay for a line of credit from another bank. In some countries, banks have assets prepositioned with their central bank that can further be passed down as collateral to hire cash in a crisis.

All the above mentioned techniques used to achieve liquidity have a net cost in normal times. Basically, financial markets have an upward sloping yield curve, stating that interest rates are higher for long-term securities than they are for short-term ones.

6.8.4 Bank Management – Credit :

Credit management is the process of monitoring and collecting payments from customers. A good credit management system minimizes the amount of capital tied up with debtors. It is very important to have good credit management for efficient cash flow. There are instances when a plan seems to be profitable when assumed theoretically but practical execution is not possible due to insufficient funds. In order to avoid such situations, the best alternative is to limit the likelihood of bad debts. This can only be achieved through good credit management practices. For running a profitable business in an enterprise the entrepreneur needs to prepare and design new policies and procedures for credit management. For example, the terms and conditions, invoicing promptly and the controlling debts.

Principles of Credit Management :

Credit management plays a vital role in the banking sector. As we all know bank is one of the major sources of lending capital. So, Banks follow the following principles for lending capital −

Liquidity: Liquidity plays a major role when a bank is into lending money. Usually, banks give money for short duration of time. This is because the money they lend is public money. This money can be withdrawn by the depositor at any point of time. A bank has its own selection criteria for choosing security. Only those securities which acquire enough liquidity are added in the bank’s investment portfolio. This is important as the bank requires funds to meet the urgent needs of its customers or depositors. The bank should be in a condition to sell some of the securities at a very short notice without creating an impact on their market rates much. There are particular securities such as the central, state and local government agreements which are easily saleable without having any impact on their market rates.

Shares and debentures of large industries are also addressed under this category. But the shares and debentures of ordinary industries are not easily marketable without having a fall in their market rates. Therefore, banks should always make investments in government securities and shares and debentures of reputed industrial houses.

Safety: The second most important function of lending is safety, safety of funds lent. Safety means that the borrower should be in a position to repay the loan and interest at regular

durations of time without any fail. The repayment of the loan relies on the nature of security and the potential of the borrower to repay the loan. Unlike all other investments, bank investments are risk-prone. The intensity of risk differs according to the type of security. Securities of the central government are safer when compared to the securities of the state governments and local bodies. Similarly, the securities of state government and local bodies are much safer when compared to the securities of industrial concerns.

Diversity: While selecting an investment portfolio, a commercial bank should abide by the principle of diversity. It should never invest its total funds in a specific type of securities; it should prefer investing in different types of securities. It should select the shares and debentures of various industries located in different parts of the country. In case of state governments and local governing bodies, same principle should be abided to. Diversification basically targets at reducing risk of the investment portfolio of a bank. The principle of diversity is applicable to the advancing of loans to different types of firms, industries, factories, businesses and markets. A bank should abide by the maxim that is “Do not keep all eggs in one basket.” It should distribute its risks by lending loans to different trades and companies in different parts of the country.

Stability: Another essential principle of a bank’s investment policy is stability. A bank should prefer investing in those stocks and securities which hold a high degree of stability in their costs. Any bank cannot incur any loss on the rate of its securities. So it should always invest funds in the shares of branded companies where the probability of decline in their rate is less. Government contracts and debentures of industries carry fixed costs of interest. Their cost varies with variation in the market rate of interest. But the bank is bound to liquidate a part of them to satisfy its needs of cash whenever stuck by a financial crisis. Else, they follow their full term of 10 years or more and variations in the market rate of interest do not disturb them. So, bank investments in debentures and contracts are more stable when compared to the shares of industries.

Profitability: This should be the chief principle of investment. A bank should only invest if it earns sufficient profits from it. Thus, it should, invest in securities that have a fair and stable return on the funds invested. The procuring capacity of securities and shares relies on the interest rate and the dividend rate and the tax benefits they hold. Broadly, it is the securities of government branches like the government at the center, state and local bodies that hugely carry the exception of their interest from taxes. A bank should prefer investing in these types of securities instead of investing in the shares of new companies which also carry tax exception. This is due to the fact that shares of new companies are not considered as safe investments. Now lending money to someone is accompanied by some risks mainly. As we know that bank lends the money of its depositors as loans. To put it simply the main job of a bank is to rent money from depositors and give money to the borrowers.

As the primary source of funds for a bank is the money deposited by its customers who are repayable as and when required by the depositors, the bank needs to be very careful while lending money to customers. Banks make money by lending money to borrowers and charging some interest rates. So, it is very essential from the bank’s part to follow the cardinal principles of lending. When these principles are abided, they assure the safety of banks’ funds and in response to that they assure its depositors and shareholders. In this whole process, banks earn good profits and grow as financial institutions. Sound lending principles by banks also help the economy of a nation to prosper and also advertise expansion of banks in rural areas.

6.8.5 Bank Management – Risk Management :

Risk refers to an undesirable or an unplanned event concerning finances that can result in loss of investment or reduced earning. It includes the possibility of losing some or the entire amount of investment. So why do banks take a risk? Well, it is because of the fundamental relationship between risk and return, there is a direct relationship between risk and return. Hence, the greater the risk, the higher the chances of profit. But it is not always the case; hence the risks that the banks take need to be managed well.

Risk Management thus refers to managing the impact of the risks by analyzing, forecasting and making predictions based on the historical trends. It also includes taking corrective measures to reduce the impact of the risks. Financial risks can be in the form of high inflation, volatility in capital markets, recession, volatility, bankruptcy, etc. The magnitude of these risks depends on the type of financial instruments in which an organization or an individual invests.

Types of Risks :

The risk may more generally be defined as the possibility of loss either in financial terms or loss of reputation. Considering the relationship between risk and return, banks are prudent enough to identify, measure and price the risk that they take and also maintain appropriate capital to take care of any unforeseen event. The different types of risk in the banking industry we have discussed all these types of risks in detail below:

- **Liquidity Risk:** This type of risk arises when an institution is unable to meet its financial commitments or is able to do so only by external borrowing. This may be due to the conversion of assets into NPAs. In the modern banking model, this is the most vulnerable risk that banks are subjected to. So, how do banks manage liquidity risk? Well, it can be efficiently managed by creating a difference in the timeframe between asset maturity and liability maturity. And then, by ensuring that those differences keep enough funds flowing in the bank to both increase assets and meet obligations when customers ask for their money.
- **Market Risk:** It will not be an understatement to say that banks operate at the whims of the market! Market risk is the risk that stems from the idea that the value of investment might decrease due to changes in factors governing a market. It is also known as a systematic risk because it is related to factors governing the market such as recession that impacts the entire market and not just one industry. Managing market risk is very crucial in times like today when the market is extremely volatile and unpredictable. The most efficient way to do manage market risk is by diversification of funds. Ensuring that the assets are held in a wide range of investment options can minimize the market risk.
- **Credit or Default Risk:** Credit or Default Risk is simply the potential of the borrower to fail to meet its obligations in accordance with the signed contract. Loans are the largest and most obvious source of credit or default risk for most banks. Amongst all, this is the most significant risk typically in the Indian banking sector where NPA size is significantly high. Although this risk can't be avoided, there are certain ways that can help in mitigating the risk. The banks manage this risk mostly by assessing the worthiness of the borrower before sanctioning the loan. A credit score is generated keeping various factors in mind, and on the basis of the score, a loan is sanctioned or suspended.
- **Operational Risk:** Operational Risk is the risk of loss that arises due to breakdown in the internal procedures, people and systems or from external events. It is important to manage operational risk for banks because banks are exposed to a higher volume of

global financial interlink ages and a high level of automation is being used in rendering banking and financial services.

6.8.6 Bank Management- Asset Liability Management :

Asset liability management is the process through which an association handles its financial risks that may come with changes in interest rate and which in turn would affect the liquidity scenario. Banks and other financial associations supply services which present them to different kinds of risks. We have three types of risks credit risk, interest risk, and liquidity risk. So, asset liability management is an approach or a step that assures banks and other financial institutions with protection that helps them manage these risks efficiently.

The model of asset liability management helps to measure, examine and monitor risks. It ensures appropriate strategies for their management. Thus, it is suitable for institutions like banks, finance companies, leasing companies, insurance companies, and other financing bodies. Asset liability management is an initial step to be taken towards the long term strategic planning. This can also be considered as an outlining function for an intermediate term. In particular, liability management also refers to the activities of purchasing money through cumulative deposits, federal funds and commercial papers so that the funds lead to profitable loan opportunities. But when there is an increase of volatility in interest rates, there is major recession damaging multiple economies. Banks begin to focus more on the management of both sides of the balance sheet that is assets as well as liabilities.

ALM Concepts :

Asset liability management (ALM) can be stated as the comprehensive and dynamic layout for measuring, examining, analyzing, monitoring and managing the financial risks linked with varying interest rates, foreign exchange rates and other elements that can have an impact on the organization’s liquidity. Asset liability management is a strategic approach of managing the balance sheet in such a way that the total earnings from interest are maximized within the overall risk-preference (present and future) of the institutions. Thus, the ALM functions include the tools adopted to mitigate liquidly risk, management of interest rate risk / market risk and trading risk management. In short, ALM is the sum of the financial risk management of any financial institution.

6.8.7 Bank Management - Marketing :

Bank marketing is known for its nature of developing a unique brand image, which is treated as the capital reputation of the financial academy. It is very important for a bank to develop good relationship with valued customers accompanied by innovative ideas which can be used as measures to meet their requirements.

Customers expect quality services and returns. There are good chances that the quality factor will be the sole determinant of successful banking corporations. Therefore, Indian banks need to acknowledge the imperative of proactive Bank Marketing and Customer Relationship Management and also take systematic steps in this direction.

Marketing Approach :

The banking industry provides different types of banking and allied services to its clients. Bank customers are mostly people and enterprises that have surplus or lack of funds and those who require various types of financial and related services. These customers are from different strata of the economy, they belong to different geographical regions, areas and are into different professions and businesses.

It is quite natural for the requirement of each individual group of customers to be unique from the requirements of other groups. Thus, it is important to acknowledge distinct

homogenous groups and even sub-groups of customers, and then with maximum precision conclude their requirements, design schemes to suit their particular requirements, and deliver them most efficiently.

Basically, banks engage in transaction of products and services through their retail outlets known as branches to different customers at the grassroots level. This is referred as the ‘top to bottom’ approach.

It should be ‘bottom to top’ approach with customers at the grassroots level as the target point to work out with different products or schemes to match the requirements of various homogenous groups of customers. Hence, bank marketing approach, is considered as a group or “collective” approach.

Bank management as a collective approach or a selective approach is a fundamental identification of the fact that banks need customer oriented approach. In simple words, bank marketing is the design structure, layout and delivery of customer-needed services worked out by checking out the corporate objectives of the bank and environmental constraints.

6.9 SUMMARY :

The basic objective of bank management in the modern set up is not only to maximize profit but also to discharge social responsibilities. Social responsibilities include responsibility towards shareholders, employees, customers, other banks, government and the weaker section of the society. The functional areas of bank management refers to the important functions to be performed by the staff of a bank like deposit mobilization, financial management, credit management, investment management, profit evaluation, etc.

Deposits are the most important source of funds for commercial bank in fact deposits are the vital source of funds. Commercial banks almost completely rely on deposits of funds. The survival of a bank is based on the quantum of deposit held by it and the manner in which deposits are managed. Banks are always engaged in working out new plans, policies to raise more and more funds from people. Lending policy of bank is governed by monetary policy of Reserve Bank of India. The banks lend money out of deposits received from the customers. Deposits are repayable on date of maturity or on short notice or on demand by customers. It is clear that a commercial bank cannot lend for long period any substantial part of funds which have been borrowed for short period. On the basis of past experiences the bank management knows how to use their assets in the best possible way. The primary objective of loan management is to earn income by serving the credit needs of the community.

Investment management is the professional asset management of various securities and other assets in order to meet the specified investment goals for the benefits of the investors. It refers to the handling of financial asset and other investments not only buying and selling them. Management includes devising a short or long term strategy for acquiring and disposing of the portfolio holding. It can also include banking, budgeting and tax services and duties as well.

6.10 TECHNICAL TERMS :

1. **AEG:** The Accounting Expert Group
2. **BCG:** The Basel Consultative Group
3. **BCBS:** The Basel Committee on Banking Supervision
4. **BSBDS**: Basic Saving bank Deposit Accounts Small scheme
5. **CGL**: Commercial General Liability Policy
6. **Charge:** Record a purchase on a credit card or withdraw funds using a debit card.

7. **Check:** Withdraw funds by writing a paper check. Choosing this type will automatically insert a number in the '#' field (the next number in sequence from the last check recorded).
8. **Credit Management**: The credit management refers to appraisal, sanction, distribution, recovery and administration of the loans and other types of credit.
9. **Deposit:** Add funds to an account by any method.
10. **Liquidity Management**: Liquidity of a bank is the main determinant of bank's reputation and goodwill. It relates to Cash Reserve Ratio (CRR), statutory Liquidity Ratio (SLR), trading in bank receipts and other short term securities.
11. **Investment:** "Investment" or "Investing", like "value" is a word of many interpretations.
12. **Profitability:** Profitability is the chief consideration of commercial banking operations. Every bank desires to maximize its profits.
13. **Safety or Solvency**: Safety implies the ability of the commercial banks to timely and promptly honours all their cash obligations towards their depositors.
14. **Stability:** Stability Commercial banks need a high degree of stability of the principal in their investment portfolio.
15. **ULIPS:** Unit-linked insurance plans

6.11 SELF ASSESSMENT QUESTIONS :

1. What do you mean by bank management? Explain the objective of bank management.
2. Explain the important functions of bank management.
3. What do you mean by deposit management? Discuss various steps in deposit management.
4. What is risk and risk management in banking sector?
5. Briefly explain the principles of credit management in banks.
6. What is liquidity? How can a bank achieve liquidity?
7. State the concept of asset liability management in banks.

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Dr. VISHNU VADDE

LESSON-7

ORGANISATION STRUCTURE OF COMMERCIAL BANKS

OBJECTIVES :

The objectives of the lesson are:

- To understand the concept of commercial banks;
- To describe the types and functions of commercial banks;
- To know the bank system and organization structure of commercial banks in India; an
- To acquaint the development of commercial banks and Indian economy.

STRUCTURE :

7.1 Introduction
7.2 Meaning & Definitions of Commercial Banks
7.3 Origin and Evolution of Commercial Banks
7.4 Type of Banks
7.5 Features of Commercial Banks
7.6 Organization Structure of Commercial Banks in India
7.7 Structure of Commercial Banking System
7.8 Commercial Banks and Economic Development
7.9 Summary
7.10 Technical Terms
7.11 Self Assessment Questions
7.12 Reference Books

7.1 INTRODUCTION :

Banking occupies one of the most important positions in the modern economic world. It is necessary for trade and industry. Hence it is one of the great agencies of commerce. Although banking in one form or another has been in existence from very early times, modern banking is of recent origin. It is one of the results of the Industrial Revolution and the child of economic necessity. Its presence is very helpful to the economic activity and industrial progress of a country.

7.2 MEANING AND DEFINITION OF A COMMERCIAL BANKS :

A commercial bank is a profit-seeking business firm, dealing in money and credit. It is a financial institution dealing in money in the sense that it accepts deposits of money from the public to keep them in its custody for safety. So also, it deals in credit, i.e., it creates credit by making advances out of the funds received as deposits to needy people. It thus, functions as a mobilize of saving in the economy. A bank is, therefore like a reservoir into which flow the savings, the idle surplus money of households and from which loans are given on interest to businessmen and others who need them for investment or productive uses.

The term 'Bank' has been defined in different ways by different economists. A few dentitions are: According to Walter Leaf "A bank is a person or corporation which holds it out to receive from the public, deposits payable on demand by cheque." Horace White has defined a bank, "as a manufacture of credit and a machine for facilitating

exchange."According to Prof. Kinley, "A bank is an establishment which makes to individuals such advances of money as may be required and safely made, and to which individuals entrust money when not required by them for use."

The Banking Companies Act of India defines Bank as "A Bank is a financial institution which accepts money from the public for the purpose of lending or investment repayable on demand or otherwise withdraw able by cheques, drafts or order or otherwise."

Thus, we can say that a bank is a financial institution which deals in debts and credits. It accepts deposits, lends money and also creates money. It bridges the gap between the savers and borrowers. Banks are not merely traders in money but also in an important sense manufacturer of money.

7.3 ORIGIN AND EVOLUTION OF COMMERCIAL BANKS :

Opinions differ so as the origin of the work "BANKING". The word "BANK" is said to be of GERMANIC Origin, cognate with the French word "BANQUE" and the Italian word "BANCA" both meaning Bench. It is surmised that the word would have drawn its meaning from the practice of the Jewish Money Changers Lombardy, a district in North Italy, who in the middle ages used to do their business setting on a Bench in the Market Place. Again the etymological origin of the word gains further relevance from the derivation of the word "BANKRUPT" from the French word "BANQUEROUTE" and the Italian word "BANCA-ROTTA" meaning broken "BENCH" due probably to the then prevalent practice of breaking the bench of the money-changer when he failed.

Banking is as old as the authentic history and Origins of Modern Commercial Banking are traceable to ancient times. The New Testament mentions about the activities of the money chargers in the temples of Jerusalem. In ancient Greece, around 2000 BC the famous temples of Ephesus, Delphi and Olympia were used as depositories for peoples surplus funds and these temples acted as the financial agents until public confidence was destroyed by the spread of disbelief in the Region. Traces of credit by compensation and by transfer orders found in Assyria, Phoenicia and Egypt before the system attained full development in Greece and Rome. In India, the ancient Hindu scriptures refer to the money lending activities in vedic period. In India during the RAMAYANA and MAHABHARATA eras, Banking had become a full-fledged business activity during the smriti period which followed the vedic period and EPIC age the business of Banking was carried on by the members of VYSYA community.

MANU, the great law gives of the time, speaks of the earning of interest as the business of VYSYAs. The banker in the smriti period performed most of those functions which banks perform in modern times, such as accepting of Deposits, granting secured and un-secured loans, acting as their customer's bailee, granting loans to kings in times of grave crisis, acting as the treasurer and Banker to the State and issuing and managing the currency of the country. Banking is different form money lending but two terms have in practice taken to convey the same meaning. Banking has two important functions to perform one of accepting deposits and other of lending money and/or investment of funds. It follows from the above that the rates of interest allowed on deposits and charged on advances must be known and reasonable. The money lender advances money out of his private own wealth, hardly accepts deposits and usually charges high rates of interest. More often, the rates of interest relate to the need of the borrower. Money lending was practiced in all countries including India, much earlier than the present type of Banking came on scene.

7.4 TYPES OF BANKS :

Broadly speaking, banks can be classified into commercial banks and central bank. Commercial banks are those which provide banking services for profit. The central bank has the function of controlling commercial banks and various other economic activities. There are many types of commercial banks such as deposit banks, industrial banks, savings banks, agricultural banks, exchange banks, and miscellaneous banks.

- **Deposit Banks:** The most important type of deposit banks is the commercial banks. They have connection with the commercial class of people. These banks accept deposits from the public and lend them to needy parties. Since their deposits are for short period only, these banks extend loans only for a short period. Ordinarily these banks lend money for a period between 3 to 6 months. They do not like to lend money for long periods or to invest their funds in any way in long term securities.
- **Industrial Banks:** Industries require huge capital for a long period to buy machinery and equipment. Industrial banks help such industrialist. They provide long term loans to industries. Besides, they buy shares and debentures of companied and enable them to have fixed capital. Sometimes, they even underwrite the debentures and shares of big industrial concerns. The important functions of industrial banks are:
  - i. They accept long term deposits.
  - ii. They meet the credit requirements of industries by extending long term loans.
  - iii. These banks advise the industrial firms regarding the sale and purchase of shares and debentures.
  - iv. The industrial banks play a vital role in accelerating industrial development. In India, after attainment of independence, several industrial banks were started with large paid up capital. They are, The Industrial Finance Corporation (I.F.C), The State Finacial Corporation's (S.F.C), Industrial Credit and Investment Corporation of India (ICICI) and Industrial Development Bank of India (IDBI) etc.
- **Savings Banks:** These banks were specially established to encourage thrift among small savers and therefore, they were willing to accept small sums as deposits. They encourage savings of the poor and middle class people. In India we do not have such special institutions, but post offices perform such functions. After nationalization most of the nationalized banks accept the saving deposits.
- **Agricultural Banks:** Agriculture has its own problems and hence there are separate banks to finance it. These banks are organized on co-operative lines and therefore do not work on the principle of maximum profit for the shareholders. These banks meet the credit requirements of the farmers through term loans, viz., short, medium and long term loans. There are two types of agricultural banks,
  - a) Agricultural Co-operative Banks, and
  - b) Land Mortgage Banks.

Co-operative Banks are mainly for short periods. For long periods there are Land Mortgage Banks. Both these types of banks are performing useful functions in India.

Exchange Banks: These banks finance mostly for the foreign trade of a country. Their main function is to discount, accept and collect foreign bills of exchange. They buy and sell foreign currency and thus help businessmen in their transactions. They also carry on the ordinary banking business.

In India, there are some commercial banks which are branches of foreign banks.

These banks facilitate for the conversion of Indian currency into foreign currency to make payments to foreign exporters. They purchase bills from exporters and sell their

proceeds to importers. They purchase and sell "forward exchange" too and thus minimize the difference in exchange rates between different periods, and also protect merchants from losses arising out of exchange fluctuations by bearing the risk. The industrial and commercial development of a country depends these days, largely upon the efficiency of these institutions.

Miscellaneous Banks: There are certain kinds of banks which have arisen in due course to meet the specialized needs of the people. In England and America, there are investment banks whose object is to control the distribution of capital into several uses. American Trade Union has got labour banks, where the saving of the laboures is pooled together. In London, there is the London Discount House whose business is "to go about the city seeking for bills to discount." There are numerous types of different banks in the world, carrying on one or the other banking business.

7.5 FUNCTIONS OF COMMERCIAL BANKS :

Commercial banks have to perform a variety of functions which are common to both developed and developing countries. These are known as 'General Banking' functions of the commercial banks. The modern banks perform a variety of functions. These can be broadly divided into two categories:

(a) Primary functions and (b) Secondary functions.

A. Primary Functions :

Primary banking functions of the commercial banks include:

1. Acceptance of deposits
2. Advancing loans
3. Creation of credit
4. Clearing of cheques
5. Financing foreign trade
6. Remittance of funds

Acceptance of Deposits: Accepting deposits is the primary functions of a commercial bank mobilize savings of the household sector. Banks generally accept three types of deposits viz.,

a) Current Deposits
b) Savings Deposits, and
c) Fixed Deposits.

a) **Current Deposits:** These deposits are also known as demand deposits. These deposits can be withdrawn at any time. Generally, no interest is allowed on current deposits, and in case, the customer is required to leave a minimum balance undrawn with the bank. Cheques are used to withdraw the amount. These deposits are kept by businessmen and industrialists who receive and make large payments through banks. The bank levies certain incidental charges on the customer for the services rendered by it.

b) Savings Deposits: This is meant mainly for professional men and middle class people to help them deposit their small savings. It can be opened without any introduction. Money can be deposited at any time but the maximum cannot go beyond a certain limit. There is a restriction on the amount that can be withdrawn at a particular time or during a week. If the customer wishes to withdraw more than the specified amount at any one time, he has to give prior notice. Interest is allowed on the credit balance of this account. The rate of interest is greater than the rate of interest on the current

deposits and less than that on fixed deposit. This system greatly encourages the habit of thrift or savings.

c) **Fixed Deposits:** These deposits are also known as time deposits. These deposits cannot be withdrawn before the expiry of the period for which they are deposited or without giving a prior notice for withdrawal. If the depositor is in need of money, he has to borrow on the security of this account and pay a slightly higher rate of interest to the bank. They are attracted by the payment of interest which is usually higher for longer period. Fixed deposits are liked by depositors both for their safety and as well as for their interest. In India, they are accepted between three months and ten years.

Advancing Loans: The second primary function of a commercial bank is to make loans and advances to all types of persons, particularly to businessmen and entrepreneurs. Loans are made against personal security, gold and silver, stocks of goods and other assets. The most common way of lending is by:

a) **Overdraft Facilities:** In this case, the depositor in a current account is allowed to draw over and above his account up to a previously agreed limit. Suppose a businessman has only Rs.30, 000/- in his current account in a bank but requires Rs.60, 000/- to meet his expenses. He may approach his bank and borrow the additional amount of Rs.30, 000/-. The bank allows the customer to overdraw his account through cheques. The bank, however; charges interest only on the amount overdrawn from the account. This type of loan is very popular with the Indian businessmen.

b) **Cash Credit:** Under this account, the bank gives loans to the borrowers against certain security. But the entire loan is not given at one particular time, instead the amount is credited into his account in the bank; but under emergency cash will be given. The borrower is required to pay interest only on the amount of credit availed to him. He will be allowed to withdraw small sums of money according to his requirements through cheques, but he cannot exceed the credit limit allowed to him. Besides, the bank can also give specified loan to a person, for a firm against some collateral security. The bank can recall such loans at its option.

c) **Discounting Bills of Exchange:** This is another type of lending which is very popular with the modern banks. The holder of a bill can get it discounted by the bank, when he is in need of money. After deducting its commission, the bank pays the present price of the bill to the holder. Such bills form good investment for a bank. They provide a very liquid asset which can be quickly turned into cash. The commercial banks can rediscount the discounted are in need of money. These bills are safe and secured bills.When the bill matures the bank can secure its payment from the party which had accepted the bill.

d) **Money at Call:** Bank also grant loans for a very short period, generally not exceeding 7 days to the borrowers, usually dealers or brokers in stock exchange markets against collateral securities like stock or equity shares, debentures, etc., offered by them. Such advances are repayable immediately at short notice hence; they are described as money at call or call money.

e) **Term Loans:** Banks give term loans to traders, industrialists and now to agriculturist also against some collateral securities. Term loans are so-called because their maturity period varies between 1 to 10 years. Term loans; as such provide intermediate or working capital funds to the borrowers. Sometimes, two or more banks may jointly provide large term loans to the borrower against a common security. Such loans or consortium finance.

f) **Consumer Credit:** Banks also grant credit to households in a limited amount to buy some durable consumer goods such as television sets, refrigerators, etc., orto meet

some personal needs like payment of hospital bills etc. Such consumer credit is made in a lump sum and is repayable in installments in a short time. Under the 20-point programme, the scope of consumer credit has been extended to cover expenses on marriage, funeral etc., as well.

g) **Miscellaneous Advances:** Among other forms of bank advances there are packing credits given to exporters for a short duration, export bills purchased/discounted, import finance-advances against import bills, finance to the self employed, credit to the public sector, credit to the cooperative sector and above all, credit to the weaker sections of the community at concessional rates.

Creation of Credit: A unique function of the bank is to create credit. Banks supply money to traders and manufacturers. They also create or manufacture money. Bank deposits are regarded as money. They are as good as cash. The reason is they can be used for the purchase of goods and services and also in payment of debts. When a bank grants a loan to its customer, it does not pay cash. It simply credits the account of the borrower. He can withdraw the amount whenever he wants by a cheque. In this case, bank has created a deposit without receiving cash. That is, banks are said to have created credit. Sayers says "banks are not merely purveyors of money, but also in an important sense, manufacturers of money."

Promote the Use of Cheques: The commercial banks render an important service by providing to their customers a cheap medium of exchange like cheques. It is found much more convenient to settle debts through cheques rather than through the use of cash. The cheque is the most developed type of credit instrument in the money market.

Financing Internal and Foreign Trade: The bank finance internal and foreign trade through discounting of exchange bills. Sometimes, the bank gives short term loans to traders on the security of commercial papers. This discounting business greatly facilitates the movement of internal and external trade.

Remittance of Funds: Commercial banks, on account of their network of branches throughout the country, also provide facilities to remit funds from one place to another for their customers by issuing bank drafts, mail transfers or telegraphic transfers on nominal commission charges. As compared to the postal money orders or other instruments, bank drafts have proved to be a much cheaper mode of transferring money and have helped the business community considerably.

B. Secondary Functions :

Secondary banking functions of the commercial banks include:

1. Agency Services
2. General Utility Services

These are discussed below.

1. **Agency Services :**

Banks also perform certain agency functions for and on behalf of their customers. The agency services are of immense value to the people at large. The various agency services rendered by banks are as follows:

(a) Collection and Payment of Credit Instruments: Banks collect and pay various credit instruments like cheques, bills of exchange, promissory notes etc., on behalf of their customers.

(b) Purchase and Sale of Securities: Banks purchase and sell various securities like shares, stocks, bonds, debentures on behalf of their customers.

(c) **Collection of Dividends on Shares:** Banks collect dividends and interest on shares and debentures of their customers and credit them to their accounts.

(d) **Acts as Correspondent**: Sometimes banks act as representative and correspondents of their customers. They get passports, traveler's tickets and even secure air and sea passages for their customers.

(e) **Income-tax Consultancy:** Banks may also employ income tax experts to prepare income tax returns for their customers and to help them to get refund of income tax.

(f) **Execution of Standing Orders:** Banks execute the standing instructions of their customers for making various periodic payments. They pay subscriptions, rents, insurance premium etc., on behalf of their customers.

(g) **Acts as Trustee and Executor**: Banks preserve the 'Wills' of their customers and execute them after their death.

2. General Utility Services :

In addition to agency services, the modern banks provide many general utility services for the community as given.

a) **Locker Facility**: Bank provides locker facility to their customers. The customers can keep their valuables, such as gold and silver ornaments, important documents; shares and debentures in these lockers for safe custody.

b) **Traveller's Cheques and Credit Cards:** Banks issue traveller's cheques to help their customers to travel without the fear of theft or loss of money. With this facility, the customers need not take the risk of carrying cash with them during their travels.

c) **Letter of Credit:** Letters of credit are issued by the banks to their customers certifying their credit worthiness. Letters of credit are very useful in foreign trade.

d) **Collection of Statistics:** Banks collect statistics giving important information relating to trade, commerce, industries, money and banking. They also publish valuable journals and bulletins containing articles on economic and financial matters.

e) **Acting Referee:** Banks may act as referees with respect to the financial standing, business reputation and respectability of customers.

f) **Underwriting Securities**: Banks underwrite the shares and debentures issued by the Government, public or private companies.

g) **Gift Cheques**: Some banks issue cheques of various denominations to be used on auspicious occasions.

h) **Accepting Bills of Exchange on Behalf of Customers:** Sometimes, banks accept bills of exchange, internal as well as foreign, on behalf of their customers. It enables customers to import goods.

i) **Merchant Banking:** Some commercial banks have opened merchant banking divisions to provide merchant banking services.

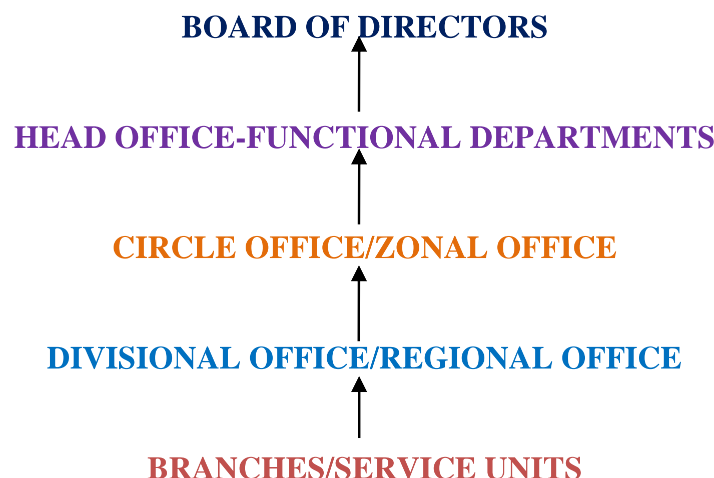
Fulfillment of Socio-Economic Objectives :

In recent years, commercial banks, particularly in developing countries, have been called upon to help achieve certain socio-economic objectives laid down by the state. For example, the nationalized banks in India have framed special innovative schemes of credit to help small agriculturists, village and cottage industries, retailers, artisans, the self employed persons through loans and advances at concessional rates of interest. Under the Differential Interest Scheme (D.I.S.) the nationalized banks in India advance loans to persons belonging to scheduled tribes, tailors, rickshaw-walas, shoe-makers at the concessional rate of 4 per cent per annum. This does not cover even the cost of the funds made available to these priority sectors. Banking is, thus, being used to subservice the national policy objectives of reducing inequalities of income and wealth, removal of poverty and elimination of unemployment in the country. It is clear from the above that banks help development of trade and industry in

the country. They encourage habits of thrift and saving. They help capital formation in the country. They lend money to traders and manufacturers. In the modern world, banks are to be considered not merely as dealers in money but also the leaders in economic development.

7.6 ORGANIZATION STRUCTURE OF COMMERCIAL BANKS IN INDIA :

In the Indian Banking scenario, we have the system of branch banking, otherwise called chain banking in operation, as against unit banking. In case of unit banking prevalent mostly in USA, the bank's operations are in general confined to a single office or in very rare cases, restricted to branches within a strictly limited area. In the case of chain banking a single bank operates in the country through a country-wide network of branches. Depending on the size of the bank, the areas in which they operate vary. This is the system being followed in UK. Banks like Midland Bank Ltd., Cloyds and Barclays have got a large network of branches. In Indian Banking scenario also this type of chain banking is in operation. Almost the major component of the banking system is by way of chain banking and the banks have a network of branches spread far wide across the country or in restricted, compact, geographic areas. Even Regional Rural Banks operate in specified regions. The structure of a commercial bank can broadly be pictured as under:



In the above structure, there is a particular department/wing at Head Office level as also at circle offices to take care of and focus on various individual facts of banking such as Credit, Deposits, Recovery, Foreign Exchange, Premises, Personnel and General Administration.

Branches have been categorized into several kinds depending upon the volume of business transacted by them as exceptionally Large Branch, Very Large Branch, medium Branch and Small Branch.

In the wake of recent changes brought through the Narasimham Committee Recommendations, restructuring has been attempted in a few banks that have abolished a few fairs in administration making the operational units report directly to Zonal office/Head Office.

Suggestions are a foot as to consolidation of and mergers of banks with a view to make the Indian banks have a size comparable to foreign banks, so that it will be easier to face the increasing global competition.

7.7 STRUCTURE OF INDIAN COMMERCIAL BANKS :

As seen elsewhere the Indian banking system is composed of different entities each with a specific role to play and specific segment to earlier to. It may not be appropriate to classify these constituents as indigenous and modern or organized and unorganized sectors. A classification based upon its role and functions will give a clearer view.

Before having a took into the structure of the commercial banking system let us quickly recount the structure of the banking system itself based upon the role and functions. The commercial banks can be broadly classified under two heads:

Scheduled Banks: Scheduled Banks refer to those banks which have been included in the Second Schedule of Reserve Bank of India Act, 1934. In India, scheduled commercial banks are of three types. These are public sector banks, private sector banks and foreign sector banks.

- **i. Public Sector Banks**: These banks are owned and controlled by the government. In other words, majority of the control is hold by the government. The main objective of these banks is to provide service to the society, not to make profits. State Bank of India, Bank of India, Punjab National Bank, Canada Bank and Corporation Bank are some examples of public sector banks. SBI and its subsidiaries and other nationalized banks are two types Public sector banks.
- **ii. Private Sector Banks:** These banks are owned and controlled by private businessmen. In other words, majority of the control is hold by the private owners. The main objective of these banks is to earn profits. ICICI Bank, HDFC Bank, and IDBI Bank are some examples of private sector banks.
- **iii. Foreign Banks:** These banks are owned and controlled by foreign promoters. When the process of economic liberalization had started in India, their number has grown rapidly. Bank of America, American Express Bank, Standard Chartered Bank are examples of foreign banks.

Non-Scheduled Banks: Non-Scheduled banks refer to those banks which are not included in the Second Schedule of Reserve Bank of India Act, 1934.

7.8 COMMERCIAL BANKS AND ECONOMIC DEVELOPMENT :

Commercial banks are considered not merely as dealers in money but also the leaders in economic development. They are not only the store houses of the country’s wealth but also the reservoirs of resources necessary for economic development. They play an important role in the economic development of a country. A well-developed banking system is essential for the economic development of a country. The “Industrial Revolution” in Europe in the19th century would not have been possible without a sound system of commercial banking. In case of developing countries like India, the commercial banks are considered to be the backbone of the economy. Commercial banks can contribute to a country’s economicdeve lopment in the following ways:

Accelerating the Rate of Capital Formation : Capital formation is the most important determinant of economic development. The basic problem of a developing economy is slow rate of capital formation. Banks promote capital formation. They encourage the habit of saving among people. They mobilize idle resources for production purposes. Economic development depends upon the diversion of economic resources from consumption to capital formation. Banks help in this direction by encouraging saving and mobilizing them for productive uses.

Provision of Finance and Credit: Commercial banks are a very important source of finance and credit for industry and trade. Credit is a pillar of development. Credit lubricates all commerce and trade. Banks become the nerve centre of all commerce and trade. Banks are instruments for developing internal as well as external trade.

Monetization of Economy: An underdeveloped economy is characterized by the existence of a large non-monetized sector. The existence of this non-monetized sector is a hindrance in the economic development of the country. The banks, by opening branches in rural and back ward areas can promote the process of monetization (conversion of debt into money) in the economy.

Innovations: Innovations are an essential prerequisite for economic development. These innovations are mostly financed by bank credit in the developed countries. But in underdeveloped countries, entrepreneurs hesitate to invest in new ventures and undertake innovations largely due to lack of funds. Facilities of bank loans enable the entrepreneurs to step up their investment on innovational activities, adopt new methods of production and increase productive capacity of the economy.

Implementation of Monetary Policy: Economic developments need an appropriate monetary policy. But a well-developed banking is a necessary pre-condition for the effective implementation of the monetary policy. Control and regulation of credit by the monetary authority is not possible without the active co-operation of the banking system in the country.

Encouragement to Right Type of Industries: Banks generally provide financial resources to the right type of industries to secure the necessary material, machines and other inputs. In this way they influence the nature and volume of industrial production.

Development of Agriculture: Underdeveloped economies are primarily agricultural economies. Majority of the population in these economies live in rural areas. Therefore, economic development in these economies requires the development of agriculture and small scale industries in rural areas. So far banks in underdeveloped countries have been paying more attention to trade and commerce and have almost neglected agriculture and industry. Banks must provide loans to agriculture for development and modernization of agriculture. In recent years, the State Bank of India and other commercial banks are granting short term, medium-term and long-term loans to agriculture and small-scale industries.

Regional Development: Banks can also play an important role in achieving balanced development in different regions of the country. They transfer surplus capital from the developed regions to the less developed regions, where it is scarce and most needed. This reallocation of funds between regions will promote economic development in underdeveloped areas of the country.

Promote Industrial Development: Industrial development needs Finance. In some countries, commercial banks encouraged industrial development by granting long-term loans also. Loan or credit is a pillar to development. In under developed countries like India, commercial banks are granting short-term and medium-term loans to industries. They are also underwriting the issue of shares and debentures by industrial concerns.

This helps industrial concerns to secure adequate capital for their establishment, expansion and modernization. Commercial banks are also helping manufacturers to secure machinery and equipment from foreign countries under installment system by guaranteeing deferred payments. Thus, banks promote or encourage industrial development.

Promote Commercial Virtues: The businessmen are more afraid of a banker than a preacher. The businessmen should have certain business qualities like industry, forethought, honesty and punctuality. These qualities are called "commercial virtues" which are essential for rapid economic progress. The banker is in a better position to promote commercial virtues. Banks are called "public conservators of commercial virtues."

Fulfilment of Socio-economic Objectives: In recent years, commercial banks, particularly in developing countries, have been called upon to help achieve certain socio-economic objectives laid down by the state. For example, nationalized bank in India have framed special innovative schemes of credit to help small agriculturists, self-employed persons and retailers through loans and advances at concessional rates of interest. Banking is thus used to achieve the national policy objectives of reducing inequalities of income and wealth, removal of poverty and elimination of unemployment in the country.

Thus, banks in a developing country have to play a dynamic role. Economic development places heavy demand on the resources and ingenuity of the banking system. It has to respond to the multifarious economic needs of a developing country. Traditional views and methods may have to be discarded. "An Institution, such as the banking system, which touches and should touch the lives of millions, has necessarily to be inspired by a larger social purpose and has to sub serve national priorities and objectives." A well-developed banking system provides a firm and durable foundation for the economic development of the country.

7.8. SUMMARY :

From the above discussion, undoubtedly, we can say that, commercial banks from the most important part of financial intermediaries. It accepts deposits from the general public and extends loans to the households, firms and the government. Banks form a significant part of the infrastructure essential for breaking vicious circle of poverty and promoting economic growth. Commercial banking in India is a unique system, the like of which exists nowhere in the world. A commercial bank is a financial institution which performs the functions of accepting deposits from the general public and giving loans for investment with the aim of earning profit. Bank credit enables entrepreneurs to innovate and invest in the large and small scale industries which accelerate the process of economic development of a country. Thus, functions of commercial banks are classified into two main categories (A) Primary functions and (B) Secondary functions.

In the above organization structure, there is a particular department/wing at Head Office level as also at circle offices to take care of and focus on various individual facts of banking such as Credit, Deposits, Recovery, Foreign Exchange, Premises, Personnel and General Administration. The commercial banks can be broadly classified under two heads of scheduled commercial bank and non-scheduled commercial. A commercial bank's main sources of funds come from the customers' deposits, the issue of certificates of deposit, and the reserves from the retained profits. But amongst all the sources of funds of commercial banks, deposits are the major source of funds. Deposits are the life and blood of commercial banks as they are the mainstay of bank funds and account for about 90 percent of bank liabilities.

7.9. TECHNICAL TERMS :

- **Commercial Bank**: A financial institution which provides the services of accepting deposits and giving loans for investment with the aim of earning profit.

- **Deposit:** A sum of money which is placed with a bank or other financial institution for some time.
- **Current Deposits:** These deposits are also known as demand deposits. These deposits can be withdrawn at any time.
- **Savings Deposits:** This is meant mainly for professional men and middle class people to help them deposit their small savings. It can be opened without any introduction.
- **Fixed Deposits:** These deposits are also known as time deposits. These deposits cannot be withdrawn before the expiry of the period for which they are deposited or without giving a prior notice for withdrawal.
- **Discounting of Bills**: Discounting of bills refers to cashing or trading a bill of exchange at less than its par value and before its maturity date.
- **Credit Creation**: It refers to a situation in which banks make more loans to consumers and businesses, with the result that the amount of money in circulation increases. This is one of the most outstanding functions of a modern bank.
- **Scheduled Bank**: A scheduled bank refers to a bank which is listed in the 2nd Schedule of the Reserve Bank of India Act, 1934 and whose minimum paid up capital is Rs. 25 lakhs.
- **Nationalized Banks** Nationalization refers to private assets being transferred to the public sector to be operated by or owned by the state. In other words, it is the process of transforming private assets into public assets by bringing them under the public ownership of a national government or state. The first nationalized bank was Imperial Bank of India and re-christened as State Bank of India (SBI) in July 1955.
- **Letter of Credit:** Letters of credit are issued by the banks to their customers certifying their credit worthiness. Letters of credit are very useful in foreign trade.
- **PSBs**: Public Sector Banks
- **RRBs**: Regional Rural Banks

7.10. SELF ASSESSMENT QUESTIONS :

1. What is a commercial bank? How far are they useful for economic development?
2. State the kinds of commercial banks.
3. What do you mean by Commercial Bank? Explain the primary and secondary functions of commercial banks.
4. State the organization structure of commercial banks in India.
5. What is a commercial bank? Explain the structure of Indian commercial banks system.
6. What is the role of commercial banks in India? Explain.

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Dr. VISHNU VADDE

LESSON – 8

MANAGEMENT OF ASSETS AND LIABILITIES IN BANKS

OBJECTIVES :

After studying this unit, you should be able to:

- To understanding the Components of Bank's Balance Sheet
- To know the concept of Asset Liability Management (ALM)
- To acquire knowledge about significance of Asset Liability Management (ALM)
- To understand the purpose and objectives of Asset Liability Management (ALM)

STRUCTURE :

8.1 Introduction

8.2 Components of Bank's Balance Sheet

8.3 Concept Asset Liability Management (ALM) In Banks

8.4 Significance of Asset Liability Management

8.5 Purpose of Asset Liability Management

8.6 Objectives of Asset Liability Management

8.7 Asset - Liability Management System in Banks – RBI Guidelines

8.7.1 ALM Information Systems

8.7.2 ALM Organization

8.7.3 ALM Process

8.8 Self Assessment Question

8.9 Suggested Readings

8.1 INTRODUCTION :

The Balance Sheet of a bank is a statement of its liabilities and assets at a particular time. The business of the banks is referred in the balance sheet. The financial position of the bank is made known through the balance sheet, it indicates whether the bank is sound and solvent or not. The balance sheet of a bank is of greater importance than that of a trading concern, because, a bank deals in others' money and as such, the entire community is interested in it.

The balance sheet lists what the banks owns (assets), what the bank owes to others (liabilities) and what the owners have invested (Capital) as of a given time. The basic balance sheet equation expresses the relationship between these accounts as:

Asset = Liabilities + Capital

8.2 COMPONENTS OF BANK'S BALANCE SHEET :

Banks in India have to prepare their profit and loss account and balance sheet in a prescribed form set out in the Schedule III of the Banking Regulation Act, 1949. The Reserve

Bank of India has given guidelines for compiling the balance sheet of banks. The specimen Balance Sheet (Form A) is shown below:

Form 'A'

Balance Sheet of ……………. Bank as on 31st March, 2023

Particulars	Schedule	Current Year (Rs.)	Previous Year (Rs.)
Capital and Liabilities:			
Capital	1	XXX	XXX
Reserves and Surplus	2	XXX	XXX
Deposits	3	XXX	XXX
Borrowings	4	XXX	XXX
Other Liabilities and Provisions	5	XXX	XXX
Total		**XXX**	**XXX**
Assets:			
Cash and Balances with RBI	6	XXX	XXX
Balances with Bank and Money at call and short notice	7	XXX	XXX
Investments	8	XXX	XXX
Advances	9	XXX	XXX
Fixed Assets	10	XXX	XXX
Other Assets	11	XXX	XXX
Total		**XXX**	**XXX**
Contingent Liabilities, Bills for collections, Acceptances/ Endorsements/ Guarantees	12	XXX	XXX
Total		**XXX**	**XXX**

Schedules

Schedule – 1: Capital

I.	For Nationalised Banks		XXX
II.	For Banks incorporated outside India		XXX
	Other Banks		XXX
III.	(Authorised/Issued/subscribed/called-up forfeited-unpaid calls)	+	XXX
Total			**XXX**

Schedule – 2: Reserves and Surplus

I.	Statutory Reserves (Op. Bal + Additions – Deductions)	XXX
II.	Capital Reserves	XXX
III.	Share Premium	XXX
IV.	Revenue and other reserves	Xxx
V.	Balance in Profit and Loss A/c	XXX
Total		**XXX**

Schedule – 3: Deposits

I.	Demand Deposits	XXX
II.	Savings Bank Deposits	XXX
III.	Term Deposits	XXX
Total		**XXX**

Schedule – 4: Borrowings

I.	Borrowings in India	
	(i) RBI	XXX
	(ii) Other Banks	XXX
II.	Borrowings outside India	XXX
Total		**XXX**

Schedule – 5: Other Liabilities and Provisions

I.	Bills Payable	XXX
II.	Inter office Adjustments	XXX
III.	Interest Accrued	XXX
Total		**XXX**

Schedule – 6: Cash and Balances with RBI

I.	Cash in Hand	XXX
II.	Balance with RBI	XXX
Total		**XXX**

Schedule – 7: Balances with Banks and Money at Call and short notice

I.	In India	XXX
II.	Outside India	XXX
Total		**XXX**

Schedule – 8: Investments

I.	**Investments in India**:	
	Government Securities	XXX
	Approved Securities	XXX
	Shares Securities	XXX
	Debentures/Bonds	XXX
II.	Outside India	XXX
Total		**XXX**

Schedule – 9: Advances

I.	Bills purchased and discounted	XXX
II.	Loan, Cash credit and ODs	XXX

III.	Term Loans	XXX
Total		**XXX**

Schedule – 10: Fixed Assets

I.	Premises (Op. Bal + Additions – Deductions)	XXX
II.	Other Fixed Assets	XXX
Total		**XXX**

Schedule – 11: Other Assets

I.	Interoffice Adjustments	XXX
II.	Interest Accrued	XXX
III	TDS/Tax paid in Advance	XXX
IV.	Stationary and Stamps	XXX
V.	NBA Acquired	XXX
Total		**XXX**

Schedule – 12: Contingent Liabilities

I.	Claims against the bank not acknowledged as debt	XXX
II.	Liability for partly paid investments	XXX
III	Liability on account of outstanding forward exchange contracts	XXX
IV.	Guarantees given on endorsement of constituents	XXX
V.	Acceptances, endorsements and other obligations	
V.	Other items for which the balance is contingently liable	XXX
Total		**XXX**

LIABILITIES SIDE :

The liabilities side had shown the sources from which a bank secures funds for its business. The various items on the liabilities side are explained below:

Capital: A bank secures capital by issue of shares to the public.

(a) **Authorised Capital**: The authorised capital is the maximum amount up to which the bank can issue shares to the public. Only a part of the authorised capital is issued in the form of shares for public subscription. The other part is kept in reserve to be issued later in times of business expansion.

(b) **Issued Capital**: The part of the authorised capital which is offered to the public for subscription is known as issued capital.

(c) **Subscribed Capital**: It is the part of issued capital which is actually scribed by the public.

(d) **Paid-up Capital**: The paid-up capital is the actual amount which is paid by the public

According to the Banking Regulation Act, the subscribed capital of a bank shall not be less than 50% of the authorised capital and the paid-up capital shall not be less than 50% of the subscribed capital.

Reserves and Surpluses: A bank generally transfers a portion of its profits to 'Reserve Fund' every year. The fund is build up to meet unforeseen and unexpected contingencies. It is a source of strength for the bank as it can withstand heavy losses. It also operates as an additional security to the customers. The amount in the Reserve Fund is invested in first class securities.

Deposits: Deposits are the largest single item on the liabilities side of the balance sheet. A bank accepts various types of deposits such as saving deposits, current deposits, fixed deposits, recurring deposits, etc. These funds are liabilities of the bank because they are to be repaid to the depositors. At the same time, these funds are assets to the bank since the bank can invest them in income yielding assets.

Borrowing from Banks: Under this head, the bank shows the loans which it has received from other banks. The bank takes loans from other banks, especially the Central Bank in terms of emergency.

Other Liabilities and provisions: These items include drafts, travellers' cheques, bankers' cheques, telegraphic transfers, mail transfers payable, interest accrued and inter-office adjustments.

ASSETS SIDE :

The nature of various items appearing on the asset side is explained below:
Cash in hand and with RBI: the first item appearing on the asset side of the balance sheet is cash in hand and cash reserve at the Central Bank. Cash is the most liquid of all assets. But it is not an earning asset. Keeping large amount of cash will affect the profitability of the bank and less cash reserve will affect liquidity. So, a bank should maintain sufficient cash to meet the demands of the depositors and invest the balance in income yielding assets. The success of the bank depends upon the proper management of cash reserves. By this experience, a banker can decide the portion of deposit to be kept in cash. This represents the 'First Line of Defence' of the bank.
Maintaining cash reserve with the Central Bank is a statutory obligation in India. Since, the minimum cash reserve to be maintained cannot be withdrawn; it is not a liquid asset.
Money at call and short notice: Balance with other banks and money at call and short notice are granted to bill brokers in Britain and to stock brokers in America. In India, such loans are given by one bank to another. These loans are repayable by the borrowers when a call is made or after a short notice. This asset has an advantage over cash reserve. It satisfies both the attributes of a sound banking asset, viz. profitability as well as liquidity.
Investment: Banks invest a part of their funds in Government bonds, shares and debentures of well established business enterprises and units of Units Trust of India. Banks prefer to invest in these securities because:

- (i) They yield a steady income;
- (ii) Repayment is assured;
- (iii) They can be sold easily without loss; and
- (iv) They can be shifted to the Central Bank or other banks.

Securities provide a convenient medium of investment during slack season when the demand for fund is at a low level.

Advances: Under this head, the bank shows the total amount of loans and advances granted to its customers. Loans and advances are the most profitable of all assets. A major part of bank's earnings are derived from this asset. Loans and advances carry a high rate of interest. So, from the point of profitability, they are good assets. But, these assets have low liquidity and no shift ability at all. This item represents the 'Fourth Line of Defence' of the bank.

Fixed Assets: Under this head, the total volumes of movable and immovable properties of the bank are included. This is often referred to as 'dead stocks'. They cannot be realised without much loss of value.
Other Assets: this item includes non-banking assets as acquired in satisfaction to claims, taxes paid in advance, interest accrued, etc.

8.3 CONCEPT OF ASSET LIABILITY MANAGEMENT (ALM) IN BANKS :

In banking institutions, asset and liability management is the practice of managing various risks that arise due to mismatches between the assets and liabilities (loans and advances) of the bank. Banks face several risks such as the risks associated with assets interest, currency exchange risks. Asset Liability management (ALM) is at tool to manage interest rate risk and liquidity risk faced by various banks, other financial services companies.

In general, ALM refers to efforts by a bank's board and senior management team to carefully balance the bank's current and long-term potential earnings with the need to maintain adequate liquidity and appropriate interest rate risk (IRR) exposures. Each bank has a distinct strategy, customer base, product selection, funding distribution, asset mix, and risk profile. These differences require that assessments of risk exposures and risk management practices be customized to each bank's specific risks and activities and not take a one-size-fits-all approach.

Mismatch of Assets and Liabilities:

Banks manage the risks of ALM mismatch by matching various assets and liabilities according to the maturity pattern or the matching the duration, by hedging and by securities. Increasing integrated risks is done on a full mark to market basis rather than the accounting basis that was at the heart of the first interest rate sensitivity gap and duration calculations.

It is an attempt to match: Assets and Liabilities In terms of: Maturities and Interest Rates Sensitivities to minimize: Interest Rate Risk and Liquidity Risk.

ALM is an integral part of the financial management process of any bank. It is concerned with strategic balance sheet management involving risks caused by changes in the interest rates, exchange rates and the liquidity position of the bank. While managing these three risks forms the crux of ALM, credit risk and contingency risk also form a part of the ALM.

ALM can be termed as a risk management technique designed to earn an adequate return while maintaining a comfortable surplus of assets beyond liabilities. It takes into consideration interest rates, earning power, and degree of willingness to take on debt and hence is also known as Surplus Management.

Definitions of ALM:

ALM is defined as, "the process of decision – making to control risks of existence, stability and growth of a system through the dynamic balances of its assets and liabilities."

It is "a risk management technique designed to earn an adequate return while maintaining a comfortable surplus of assets beyond liabilities. It takes into consideration interest rates, earning power and degree of willingness to take on debt. It is also called surplus-management".

Asset Liability Management (ALM) is the act of planning, acquiring, and directing the flow of funds through an organisation. The ultimate objective of this process is to generate adequate/stable earnings and to steadily build an organisation's equity over time, while taking reasonable and measured business risks.

Asset Liability Management (ALM) can be broadly defined as co-ordinated management of a banks' balance sheet to allow for alternative interest rate, liquidity and prepayment

summaries. It is a flexible methodology that allows the bank to test inter-relationships between a wide variety of risk factors including market risks, liquidity risks, management decisions, uncertain product cycles, etc.

8.4 SIGNIFICANCE OF ASSET LIABILITY MANAGEMENT :

A Financial institution may have enough assets to pay off its' liabilities. But if 50 per cent of the liabilities are maturing within 1 year but only 10 per cent of the assets are maturing within the same period. Though the financial institution has enough assets, it may become temporarily insolvent due to a severe liquidity crisis.

Thus, ALM is required to match the assets and liabilities and minimize liquidity as well as market risk. Asset-liability management can be performed on a per-liquidity basis by matching a specific asset to support each liability. Here for every liability, there is an equivalent tenure and amount matching asset.

Again even if the asset and liabilities maturity is matched to a large extent, the interest rates can change during the period thereby affecting the interest income from assets and interest expenses on liabilities. Depending upon the movement of interest rates the net interest margin may increase or decrease result in corresponding increase or decrease in profit during a certain period.

Asset Liability Management (ALM) views the financial institutions as a set of interrelationships that must be identified coordinated and managed as an integral system. The primary management goal is the control of interest income and expenses and the resulting net interest margins on an ongoing basis.

Some of the reasons for increasing significance of Asset Liability Management (ALM) are:

1. Volatility: Deregulation of financial system changed the dynamics of financial markets. The vagaries of such free economic environment are reflected in interest rate structures, money supply and the overall credit position of the market, the exchange rates and price levels. For a business, which involves trading in money, rate fluctuations invariably affect the market value, yields/costs of assets and liabilities, which further affect the market value of the bank and its Net Interest Income (NII).

2. Product Innovation: The second reason for growing importance of ALM is the rapid innovations taking place in the financial products of the bank. While there were some innovations that came as passing fads, others have received tremendous response. In several cases, the same product has been repeated with certain differences and offered by various banks. Whatever may be features of the products, most of them have an impact on the risk profile of the bank thereby enhancing the need for Asset Liability Management (ALM). For example, Flexi-deposit facility.

3. Regulatory Environment: At the international level, Bank for International Settlements (BIS) provides a framework for banks to tackle the market risks that may arise due to rate fluctuations and excessive credit risk. Central Bank in various countries (including Reserve Bank of India) has issued frameworks and guidelines for banks to develop Asset Liability Management (ALM).

4. Management Recognition: All the above-mentioned aspects forced bank managements to give a serious thought to effective management of assets and liabilities. The management has realized that it is just not sufficient to have a very good franchise for credit disbursement, nor is it enough to have just a very good retail deposit base. In addition to these, a bank should be in a position to relate and link the asset side with liability side.

There is increasing awareness in the top management that banking is now a different game altogether since all risks of the game have since changed.

8.5 PURPOSE OF ASSET LIABILITY MANAGEMENT :

An effective Asset Liability Management technique aims to manage the volume, mix, maturity, rate sensitivity, quality and liquidity of assets and liabilities as a whole so as to attain a predetermined acceptable risk/reward ratio. Thus, purpose of Asset Liability Management is to enhance the asset quality; quantify risks associated with the assets and liabilities and further manage them. Such a process will involve the following steps:

- Review the interest rate structure and compare the same to the interest/product pricing of both assets and liabilities.
- Examine the loan and investment portfolios in the light of the foreign exchange risk and liquidity risk that might arise.
- Examine the credit risk and contingency risk that may originate either due to rate fluctuations or otherwise and assess the quality of assets.
- Review the actual performance against the projections made and analyzes the reasons for any effect on the spreads.

Assets Liability Management techniques so designed to manage various risks primarily aim to stabilize the short-term profits, long-term earnings and long-term substance of the bank. The parameters that are selected for the purpose of stabilizing Asset Liability Management of banks are:

Net Interest Income (NII): the impact of volatility on the short-term profit is measured by Net Interest Income.
Net Interest income = Interest Income – Interest Expenses.
In order to stabilize short-term profits; banks have to minimize fluctuation in the NII.

Net Interest Margin (NIM): Net Interest Margin is defined as net interest income divided by average total assets.
Net Interest Margin (NIM) = Net Interest Income/Average Total Assets.
Net Interest Margin can be viewed as the ‘Spread’ on earning assets.
The net income of banks comes mostly from the spread maintained between total interest income and total interest expense. The higher the spread the more will be the NIM. There exists a direct correlation between risks and return. As a result, greater spreads only imply enhanced risk exposure. But since any business is conducted with the objective of making profits and achieving higher profitability is the target, it is the management of risks that holds key to success and not risk elimination.

Economic Equity Ratio: The ratio of the shareholders funds to the total assets measures the shifts in the ratio of owned funds to total funds. This fact assesses the sustenance capacity of the bank.

8.6 OBJECTIVES OF ASSET LIABILITY MANAGEMENT :

At macro-level, Asset Liability Management leads to the formulation of critical business policies, efficient allocation of capital and designing of products with appropriate pricing strategies. And at micro-level the objectives of Asset Liability Management are two folds. It aims at profitability through ***Pricing Matching*** while ensuring ***Liquidity*** by means of maturity matching.

Pricing Matching: It aims to maintain spreads by ensuring that deployment of liabilities will be at a rate higher than the costs. This exercise would indicate whether the institution is in a position to benefit from rising interest rates by having a positive gap (Assets >Liabilities) or whether it is in a position to benefit from declining interest rates by a negative gap (Liabilities>Assets).

Liquidity: It is ensured by grouping the assets/liabilities based on their maturing profiles. The gap is then assessed to identify further financing requirements. However, there are often maturity mismatches, which may to a certain extent affect the expected results.

8.7 ASSET - LIABILITY MANAGEMENT SYSTEM IN BANKS – RBI GUIDELINES

Over the last few years the Indian financial institutions have witnessed wide ranging changes at fast pace. Intense competition for business involving both the assets and liabilities, together with increasing volatility in the domestic interest rates as well as foreign exchange rates, has brought pressure on the management of banks to maintain a good balance among spreads, profitability and long-term viability. These pressures call for structured and comprehensive measures and not just ad hoc action.

The Management of banks has to base their business decisions on a dynamic and integrated risk management system and process, driven by corporate strategy. Banks are exposed to several major risks in the course of their business - credit risk, interest rate risk, foreign exchange risk, equity/commodity price risk, liquidity risk and operational risks.

This note lays down broad guidelines in respect of interest rate and liquidity risks management systems in banks which form part of the Asset-Liability Management (ALM) function. The initial focus of the ALM function would be to enforce the risk management discipline viz. managing business after assessing the risks involved. The objective of good risk management programmes should be that these programmes will evolve into a strategic tool for bank management.

The ALM process rests on three pillars:

1. ALM Information Systems
   Management Information System
   Information availability, accuracy, adequacy and expediency
2. ALM organisation
   Structure and Responsibilities
   Level of Top Management Involvement
3. ALM process
   Risk parameters
   Risk identification
   Risk measurement
   Risk management
   Risk policies and tolerance levels.

8.7.1 ALM Information Systems: Information is the key to the ALM process. Considering the large network of branches and the lack of an adequate system to collect information required for ALM which analyses information on the basis of residual maturity and behavioural pattern it will take time for banks in the present state to get the requisite information. The problem of ALM needs to be addressed by following an ABC approach i.e.

analysing the behaviour of asset and liability products in the top branches accounting for significant business and then making rational assumptions about the way in which assets and liabilities would behave in other branches. In respect of foreign exchange, investment portfolio and money market operations, in view of the centralised nature of the functions, it would be much easier to collect reliable information. The data and assumptions can then be refined over time as the bank management gain experience of conducting business within an ALM framework. The spread of computerisation will also help banks in accessing data.

8.7.2. ALM organization:

a) The Board should have overall responsibility for management of risks and should decide the risk management policy of the bank and set limits for liquidity, interest rate, foreign exchange and equity price risks.
b) The Asset-Liability Committee (ALCO) consisting of the bank's senior management including CEO should be responsible for ensuring adherence to the limits set by the Board as well as for deciding the business strategy of the bank (on the assets and liabilities sides) in line with the bank's budget and decided risk management objectives.
c) The ALM desk consisting of operating staff should be responsible for analysing, monitoring and reporting the risk profiles to the ALCO. The staff should also prepare forecasts (simulations) showing the effects of various possible changes in market conditions related to the balance sheet and recommend the action needed to adhere to bank's internal limits.

The ALCO is a decision making unit responsible for balance sheet planning from risk-return perspective including the strategic management of interest rate and liquidity risks. Each bank will have to decide on the role of its ALCO, its responsibility as also the decisions to be taken by it. The business and risk management strategy of the bank should ensure that the bank operates within the limits/parameters set by the Board. The business issues that an ALCO would consider, inter alia, will include product pricing for both deposits and advances, desired maturity profile of the incremental assets and liabilities, etc. In addition to monitoring the risk levels of the bank, the ALCO should review the results of and progress in implementation of the decisions made in the previous meetings. The ALCO would also articulate the current interest rate view of the bank and base its decisions for future business strategy on this view. In respect of the funding policy, for instance, its responsibility would be to decide on source and mix of liabilities or sale of assets. Towards this end, it will have to develop a view on future direction of interest rate movements and decide on a funding mix between fixed vs. floating rate funds, wholesale vs. retail deposits, money market vs. capital market funding, domestic vs. foreign currency funding, etc. Individual banks will have to decide the frequency for holding their ALCO meetings.

1. **Composition of ALCO:** The size (number of members) of ALCO would depend on the size of each institution; business mix and commitment of the Top Management, the CEO/CMD or ED should head the Committee. The Chiefs of Investment, Credit, Funds Management/Treasury (forex and domestic), International banking and Economic Research can be members of the Committee. In addition the Head of the Information Technology Division should also be an invitee for building up of MIS and related computerisation. Some banks may even have sub-committees.
2. **Committee of Directors:** Banks should also constitute a professional managerial and Supervisory Committee consisting of three to four directors which will oversee the implementation of the system and review its functioning periodically.

8.7. 3. ALM process:

The scope of ALM function can be described as follows:

- Liquidity Risk management
- Management of Market Risks (including Interest Rate Risk)
- Funding and Capital Planning
- Profit Planning and Growth Projection
- Trading Risk Management

The guidelines given in this note mainly address Liquidity and Interest Rate risks.

Liquidity Risk Management: Measuring and managing liquidity needs are vital activities of commercial banks. By assuring a bank's ability to meet its liabilities as they become due, liquidity management can reduce the probability of an adverse situation developing. The importance of liquidity transcends individual institutions, as liquidity shortfall in one institution can have repercussions on the entire system. Bank management should measure not only the liquidity positions of banks on an ongoing basis but also examine how liquidity requirements are likely to evolve under crisis scenarios. Experience shows that assets commonly considered as liquid like Government securities and other money market instruments could also become illiquid when the market and players are unidirectional. Therefore liquidity has to be tracked through maturity or cash flow mismatches. For measuring and managing net funding requirements, the use of a maturity ladder and calculation of cumulative surplus or deficit of funds at selected maturity dates is adopted as a standard tool.

The Maturity Profile could be used for measuring the future cash flows of banks in different time buckets. The time buckets given the Statutory Reserve cycle of 14 days may be distributed as under:

i) 1 to 14 days
ii) 15 to 28 days
iii) 29 days and up to 3 months
iv) Over 3 months and up to 6 months
v) Over 6 months and up to 12 months
vi) Over 1 year and up to 2 years
vii) Over 2 years and up to 5 years
viii) Over 5 years

Within each time bucket there could be mismatches depending on cash inflows and outflows. While the mismatches up to one year would be relevant since these provide early warning signals of impending liquidity problems, the main focus should be on the short-term mismatches viz., 1-14 days and 15-28 days. Banks, however, are expected to monitor their cumulative mismatches (running total) across all time buckets by establishing internal prudential limits with the approval of the Board/Management Committee. The mismatch during 1-14 days and 15-28 days should not in any case exceed 20% of the cash outflows in each time bucket. If a bank in view of its asset - liability profile needs higher tolerance level, it could operate with higher limit sanctioned by its Board/Management Committee giving reasons on the need for such higher limit. A copy of the note approved by Board/Management Committee may be forwarded to the Department of Banking Supervision, RBI. The discretion to allow a higher tolerance level is intended for a temporary period, till the system stabilises and the bank is able to restructure its asset-liability pattern.

The Statement of Structural Liquidity may be prepared by a placing all cash inflows and outflows in the maturity ladder according to the expected timing of cash flows. A maturing liability will be a cash outflow while a maturing asset will be a cash inflow. It would be necessary to take into account the rupee inflows and outflows on account of forex operations including the readily available forex resources (FCNR (B) funds, etc.) which can be deployed for augmenting rupee resources. While determining the likely cash inflows/outflows, banks have to make a number of assumptions according to their asset - liability profiles. For instance, Indian banks with large branch network can (on the stability of their deposit base as most deposits are renewed) afford to have larger tolerance levels in mismatches if their term deposit base is quite high. While determining the tolerance levels the banks may take into account all relevant factors based on their asset-liability base, nature of business, future strategy etc. The RBI is interested in ensuring that the tolerance levels are determined keeping all necessary factors in view and further refined with experience gained in Liquidity Management.

In order to enable the banks to monitor their short-term liquidity on a dynamic basis over a time horizon spanning from 1-90 days, banks may estimate their short-term liquidity profiles on the basis of business projections and other commitments.

Currency Risk: Floating exchange rate arrangement has brought in its wake pronounced volatility adding a new dimension to the risk profile of banks balance sheets. The increased capital flows across free economies following deregulation have contributed to increase in the volume of transactions. Large cross border flows together with the volatility has rendered the bank’s balance sheets vulnerable to exchange rate movements.

Dealing in different currencies brings opportunities as also risks. If the liabilities in one currency exceed the level of assets in the same currency, then the currency mismatch can add value or erode value depending upon the currency movements. The simplest way to avoid currency risk is to ensure that mismatches, if any, are reduced to zero or near zero. Banks undertake operations in foreign exchange like accepting deposits, making loans and advances and quoting prices for foreign exchange transactions. Irrespective of the strategies adopted, it may not be possible to eliminate currency mismatches altogether. Besides, some of the institutions may take proprietary trading positions as a conscious business strategy.

Managing Currency risk is one more dimension of Asset - Liability Management. Mismatched currency position besides exposing the balance sheet to movements in exchange rate also exposes it to country risk and settlement risk. Ever since the RBI (Exchange Control Department) introduced the concept of end of the day near square position in 1978, banks have been setting up overnight limits and selectively undertaking active day time trading. Following the introduction of "Guidelines for Internal Control over Foreign Exchange Business" in 1981, maturity mismatches (gaps) are also subject to control. Following the recommendations of Expert Group on Foreign Exchange Markets in India (Sodhani Committee) the calculation of exchange position has been redefined and banks have been given the discretion to set up overnight limits linked to maintenance of additional Tier I capital to the extent of 5 per cent of open position limit.

Presently, the banks are also free to set gap limits with RBI's approval but are required to adopt Value at Risk (VaR) approach to measure the risk associated with forward exposures. Thus the open position limits together with the gap limits form the risk management approach to forex operations. For monitoring such risks banks should follow the

instructions contained in Circular A.D (M.A. Series) No. 52 dated December 27, 1997 issued by the Exchange Control Department.

Interest Rate Risk (IRR): The phased deregulation of interest rates and the operational flexibility given to banks in pricing most of the assets and liabilities have exposed the banking system to Interest Rate Risk. Interest rate risk is the risk where changes in market interest rates might adversely affect a bank's financial condition. Changes in interest rates affect both the current earnings (earnings perspective) as also the net worth of the bank (economic value perspective). The risk from the earnings perspective can be measured as changes in the Net Interest Income (NII) or Net Interest Margin (NIM).

In the context of poor MIS, slow pace of computerization in banks and the absence of total deregulation, the traditional Gap analysis is considered as a suitable method to measure the Interest Rate Risk. It is the intention of RBI to move over to modern techniques of Interest Rate Risk measurement like Duration Gap Analysis, simulation and Value at Risk at a later date when banks acquire sufficient expertise and sophistication in MIS. The Gap or Mismatch risk can be measured by calculating Gaps over different time intervals as at a given date. Gap analysis measures mismatches between rate sensitive liabilities and rate sensitive assets (including off-balance sheet positions).

i) Over one month and up to 3 months
ii) Over 3 months and up to 6 months
iii) Over 6 months and up to 12 months
iv) Over 1 year and up to 3 years
v) Over 3 years and up to 5 years
vi) Over 5 years
vii) Non-sensitive

The Gap is the difference between Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) for each time bucket. The positive Gap indicates that it has more RSAs than RSLs whereas the negative Gap indicates that it has more RSLs. The Gap reports indicate whether the institution is in a position to benefit from rising interest rates by having a positive Gap (RSA > RSL) or whether it is in a position to benefit from declining interest rates by a negative Gap (RSL > RSA). The Gap can, therefore, be used as a measure of interest rate sensitivity.

Each bank should set prudential limits on individual Gaps with the approval of the Board/Management Committee. The prudential limits should have a bearing on the total assets, earning assets or equity. The banks may work out earnings at risk, based on their views on interest rate movements and fix a prudent level with the approval of the Board/Management Committee. RBI will also introduce capital adequacy for market risks in due course.

The classification of various components of assets and liabilities into different time buckets for preparation of Gap reports (Liquidity and Interest Rate Sensitivity) as indicated in Appendices I & II is the benchmark. Banks which are better equipped to reasonably estimate the behavioural pattern, embedded options, rolls-in and rolls-out, etc. of various components of assets and liabilities on the basis of past data/empirical studies could classify them in the appropriate time buckets, subject to approval from the ALCO/Board. A copy of the note approved by the ALCO/Board may be sent to the Department of Banking Supervision.

REGULATORY ASSESSMENT OF ASSET/LIABILITY RISK MANAGEMENT :

Regulators assess risks and risk management activities in four broad categories.

Board Oversight :

Effective oversight requires the board of directors to rely on sound ALM. Because ALM is complex, some bank directors might find overseeing interest rate and liquidity risks challenging. Senior management typically provides the board with information derived from IRR or liquidity models that contain general assumptions and produce output reports. Much of this information is driven by very detailed "behind-the-scenes" model inputs and assumptions. As a result, the directors' review is generally limited to monitoring exposures through key model output reports and measures but with little knowledge of the assumptions behind or limitations of those measures. While being able to quantify and monitor risk positions is important for sound oversight of balance-sheet exposures, effective board oversight requires more than simply evaluating model outputs; it also requires a broad perspective on all business lines and products, strategic goals, and risk management.

Board oversight should include:

- ***Understanding Risks****:* Through policies, reporting mechanisms, and discussions at board meetings, bank directors should demonstrate that they clearly understand the risks inherent in the institution's ongoing activities. Directors should also question senior management about risks and risk management costs presented by new activities and deliberate about the risk/reward trade-offs.
- ***Providing Appropriate Guidance****:* The board sets the tone and communicates the risk tolerance for the organization. Risk tolerance, including quantitative risk limits and definitions of permissible and impermissible activities, should be communicated so that the board, senior management, and other bank personnel clearly understand the bank's risk thresholds and approach to managing the effects of balance-sheet exposures on capital and earnings. This is most frequently accomplished by establishing appropriate policies and risk limits.
- ***Monitoring Exposures:*** Once the risks inherent in the institution's activities are recognized and guidance is provided to staff, directors should require that senior management report risk exposures on a timely basis. In community banks with low IRR or liquidity risks, the board should review risk reports at least quarterly. However, in community banks with high IRR or liquidity risks, the board, or a designated committee, should review risk reports more frequently. Board reports should also be meaningful to the directors in their risk oversight role. For example, many IRR models have been developed to provide detailed quantitative data. However, some of this information is more meaningful to the senior managers evaluating daily activities than to the directors overseeing

institutional risks and setting strategic direction. To be useful, board ALM reports should be timely, accurate, and appropriately detailed and should clearly note any noncompliance with bank policies. While directors should understand, at a high level, the assumptions made and any weaknesses in the models used to produce the reports, they do not need a detailed understanding of all the nuances or model mechanics. Too much or too little information, along with the wrong kind of information, can hamper the board's ability to effectively steer the institution through the sea of IRR and liquidity risks.

- ***Making Personnel Decisions and Delegating:*** Many community bank directors are specialists in fields outside of banking and likely lack a background in ALM issues and other risk areas. However, most community bank board's recruit key managers who possess the expertise necessary to effectively administer risk management activities. Bank directors also have the opportunity to allocate time and funding to train and develop individuals who need enhanced knowledge in balance-sheet risk management commensurate with the bank's risk exposure. Once key personnel are identified and developed, the board may confidently delegate daily risk oversight to these capable managers.

Senior Management Activities :

In many cases, the board delegates routine oversight of balance-sheet risks to a committee of senior managers known as the Asset and Liability Management (ALM) Committee or the Asset and Liability Committee (ALCO). A community bank's ALCO often assesses earnings, establishes loan and deposit strategies and pricing, monitors detailed IRR exposures, and evaluates liquidity risk exposures and contingency funding needs. Given the broad array of activities the ALCO conducts, representation should include senior managers from the bank's lending, investment, deposit-gathering, and accounting functions. The ALCO should make regular reports to the full board, so appropriate oversight by the board can be carried out.

Senior management activities should include:

- ***Implementing ALM Policies***:. The primary responsibility of senior management when carrying out ALM activities is to ensure that policy and risk guidance established by the board is appropriately implemented. ALM policies should provide the blueprint for ALCO and other bank personnel to follow when identifying, measuring, and controlling IRR and liquidity risks. In addition to communicating appropriate risk tolerances, policies should direct management to develop or acquire risk measurement tools that provide ongoing quantitative reporting of the relevant risk exposures.
- ***Developing Risk Monitoring and Reporting Tools:*** Many community banks use a battery of tools to oversee ALM risks depending on the complexity of their balance sheet. IRR is often monitored using vendor models to identify and measure risk exposures under various rate scenarios. Liquidity risk is typically identified, measured, and monitored through spreadsheets that compute existing balance-sheet liquidity positions, forward-looking source and use projections, and adverse scenario effects. The key consideration for any management team in determining what measurement tool to use is ensuring that the tool can quantify the institution's specific risk exposures. For example, a small bank located in a rural community with nearly 50 percent of its total assets invested in callable bonds should not be relying on a simple maturity gap, since the complexity of the balance sheet would demand a more sophisticated tool regardless of asset size. It is imperative that

management implement appropriate tools to adequately measure the risk in the balance sheet.

- ***Reporting Risk Exposures to the Board:*** Reports provided to senior management and the board should evaluate the institution's compliance with established risk limits. Regardless of asset complexity, funding characteristics, or the risk measurement mechanism used, the board relies on management's ability to properly identify the risk in the bank. For example, many community banks establish net interest income change limits for various interest rate change scenarios in their IRR management policies. In these banks, management would be expected to quantify and report to the board the level of and trend in net interest change percentages for those scenarios specified in the bank's policy. Directors should receive sufficient information to understand the bank's existing interest rate and liquidity risk profiles relative to established limits and the potential impact of strategic and tactical decisions on those exposures.
- ***Attracting and Developing Personnel:*** It is also critical that a bank's staff maintain adequate depth and expertise for carrying out risk measurement and mitigation activities. Risk oversight is dependent on having the proper personnel to understand the balance sheet's complexity and properly develop an ALM oversight program capable of ensuring that risks stay within the boundaries set by board policies. Hiring and developing appropriate staff can be particularly challenging for rapidly growing community banks or those with increasing product complexity. Typically, these banks are either acquiring other institutions or implementing new business lines. In these situations, the bank can avoid pitfalls by ensuring that the appropriate staffing infrastructure is in place to identify, measure, and report interest rate and liquidity risks from new activities prior to commencement. This requires that senior management exercise appropriate due diligence and risk analysis to determine how the new activities (for example, a new mortgage origination program) or products (for example, a new CD) could affect the bank's overall IRR profile. The results of these analyses should be presented to the board prior to implementing the new activity. This exercise, in turn, will allow senior management to propose and the board to adopt changes to policy and establish risk limits related to the new activities.

The responsibilities of the board of directors and senior management include:

Policies, Procedures, and Risk Limits :

One of the most effective tools the board and senior management can provide to their staff is a sound policy directive for the bank's various activities and risk exposures. Through sound policies, the board communicates to frontline and senior personnel its expectations with respect to risk tolerance, desirable and undesirable activities, internal control and audit, and risk measurement. Typically, directors develop ALM policies that consolidate the board's expectations for interest rate and liquidity risk exposures and oversight. When examiners evaluate ALM policies, they are looking to see that the following issues are appropriately addressed:

The policy should state the bank's objectives for ALM and provide a well-articulated strategy for managing the risks associated with balance-sheet accounts. This would typically include the board's view regarding trade-offs between earnings and interest rate and liquidity risk exposures.

- Another critical element of any ALM policy is appropriate aggregate risk limits for interest rate and liquidity risk exposures. Traditionally, community bank ALM policies would establish maturity/repricing gap risk limits to address IRR exposures and one or two liquidity ratio metrics (e.g., loans-to-deposits or noncore funding dependence ratios) for liquidity risk exposures. With the proliferation of callable bonds, mortgage-backed securities, Internet and brokered CDs, correspondent bank and Federal Home Loan Bank borrowings, and financial derivatives, many community banks have implemented more robust, forward-looking risk measurement techniques.

  While many community banks have implemented better risk measurement tools, risk limits are not always established. For example, regulatory guidance suggests that sound risk limits for IRR exposures should address the risk in relation to earnings and capital exposures – usually framed in terms of limits to net interest income, net income, and/or the economic value of equity change percentages for specific interest rate shock scenarios. Regulatory guidance has also pointed to the need for forward-looking analysis for sound liquidity risk management. Often, this takes the form of sources/uses projections. A sound policy would establish risk parameters in the form of minimum forward-looking cash flow coverage ratios. These risk limits should be clearly stated, should meaningfully address the bank's activities, and should effectively communicate the board's risk tolerance. Risk limits should also be periodically reevaluated in light of the institution's other risk exposures (e.g., credit, operational, reputational) and any new products or business activities.
- The policy should provide clear lines of authority, responsibility, and accountability regarding risk management activities. It should include addressing situations where the institution falls outside of its established risk parameters, defining who is responsible for implementing strategic and tactical activities, establishing and maintaining risk measurement systems, and identifying risks that may arise from new products or activities. In many community banks, these responsibilities fall to one or a few individuals. The board should be aware of any concentration in responsibility or authority and ensure that adequate controls are in place to mitigate any resulting risks. An effective control might include, for example, independent reviews of these activities by someone who understands the risk management activities and potential problems that could arise.
- The policy should also clearly delineate the types of activities that an institution may conduct. This might include the types of financial instruments or activities that are permissible for either the banking book or risk mitigation (that is, hedging) activities. When managing liquidity risks, the policy should indicate what types of funding are acceptable and to what degree these sources should be used. For example, some community banks have incorporated the use of Internet or brokered deposits to augment

local deposit volumes. For such institutions, the ALM policy should discuss how Internet or brokered deposits might be appropriately used and the extent to which the board considers these deposits acceptable. While non-traditional funding may change the bank's inherent liquidity risk profile, sound controls over the volume and type of inherently riskier funding sources may help to mitigate risks.

Leading ALM Risk Management Practices :

Many community banks have developed structures and policies to enable the board and senior management to effectively oversee balance-sheet risk exposures. However, examiners continue to identify opportunities to improve oversight of these risks. Occasionally, those opportunities rest with the board's knowledge of IRR and liquidity concepts. While community bank directors are not expected to be subject matter experts, board members should have a certain level of foundational understanding to effectively carry out their fiduciary responsibilities. To ensure that the board has sufficient understanding of balance-sheet risk management concepts, some banks have benefited from external resources for educating directors. Other banks have included on their board at least one outside director who possesses a sound understanding of balance-sheet management concepts.

Together, these approaches have been effective in improving boards' abilities to oversee balance-sheet risk exposures. Another leading practice is to identify risks and update policies before implementing new products or activities. In many cases, community bankers have responded to the challenge of meeting desired earnings targets by implementing new business lines or investing in new categories of assets. In some instances, while the board and senior management may have held cursory discussions regarding the characteristics of these assets or business lines, they nevertheless failed to conduct a thorough due diligence evaluation of risks, including interest rate and liquidity risks.

8.8 SELF ASSESSMENT QUESTION :

- Describe the components of bank's balance sheet?
- What are the components which appear on the assets side of bank's balance sheet?
- What are the components which appear on the liabilities side of bank's balance sheet?
- Explain the concept of Asset Liability Management (ALM).
- What is the importance of Asset Liability Management (ALM)?
- What are the factors which have made asset liability management necessary for every bank?
- Explain the benefits of Asset Liability Management (ALM).

8.9 SUGGESTED READINGS :

1. Principles & Practices of Banking, Indian Institute of Banking & Finance, Macmillan, New Delhi, 2012.
2. Ralph G. Hawtrey, the Art of Central Banking, Taylor & Francis, 2012.
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Dr. G. NAGA RAJU

LESSON – 9

MANAGEMENT INFORMATION SYSTEM (MIS) AND MANAGEMENT CONTROL SYSTEMS (MCS) IN BANKING SECTOR

OBJECTIVES :

After studying this unit, you should be able to:

- To understanding the Function of MIS in Banking Sector.
- To know the importance and need for building MIS in Banking Sector.
- To acquire knowledge about Role of MIS in Bank Industry.
- To understand the Concept and various principles of Internal Control Systems in Banking Sector.

STRUCTURE :

9.1 Introduction
9.2 Functions of MIS in Banking Sector
9.3 Structure of Management Information System in Banks
9.4 Management Information Systems in Banking Sector
9.5 Importance of Information Technology in Banking Industry
9.6 Need for building MIS
9.7 Role of MIS in Banking Industry
9.8 Impact of Information Technology on Banking Services
9.9 Other IT Applications at Banks
9.10 Internal Control Systems in Banks
9.11 Principles for the Assessment of Internal Control Systems
9.12 Summary
9.13 Key Words
9.14 Self-Assessment Questions
9.15 Suggested Readings

9.1 INTRODUCTION:

A Management Information System (MIS) in the banking sector refers to a system that collects, organizes, processes, and presents data and information to support decision-making, planning, and control within a bank or financial institution. It is a crucial tool that enables efficient management and effective utilization of resources in the banking industry. The need for an effective information system is of paramount concern to the bank now as well as in the future. Because the bank must coordinate its operations with the business universe. The most important is information about markets in which it operates current knowledge of its customers and competitors availability of capital capabilities of available personnel and knowledge concerning sources of supply. Increasing pressure on ' interest rate, rising labour costs and foreign competition signal the need for an information system that describes the bank's economic environment.

9.2 FUNCTIONS OF AN MIS IN BANKING SECTOR :

Key components and functions of an MIS in the banking sector include:

- **Data Collection and Integration**: MIS gathers data from various sources within the bank, including customer transactions, account balances, loan applications, and market data. It integrates this data into a central database for further processing.
- **Data Analysis and Reporting**: MIS analyzes the collected data to generate meaningful insights and reports. These reports can include financial statements, performance indicators, risk assessments, customer analytics, and regulatory compliance reports.
- **Decision Support**: MIS provides decision support tools and models that assist bank management in making informed decisions. This can include forecasting, scenario analysis, profitability analysis, and credit risk assessment models.
- **Operational Efficiency**: MIS streamlines internal processes by automating routine tasks, improving data accuracy, and reducing manual paperwork. It enhances operational efficiency by providing real-time information and automated workflows.
- **Regulatory Compliance**: MIS helps banks comply with regulatory requirements by monitoring and reporting on key parameters, such as capital adequacy, liquidity ratios, anti-money laundering measures, and customer due diligence.
- **Customer Relationship Management**: MIS supports customer relationship management by providing a holistic view of customer interactions, preferences, and behaviour. It helps identify cross-selling opportunities, personalize services, and improve customer satisfaction.
- **Risk Management**: MIS assists in identifying, measuring, and monitoring various risks, including credit risk, market risk, operational risk, and compliance risk. It enables proactive risk management and regulatory reporting.
- **Strategic Planning**: MIS provides data and insights for strategic planning and goal setting. It helps banks assess market trends, competitor analysis, and profitability analysis to formulate business strategies and make informed decisions.

Overall, an MIS in the banking sector plays a critical role in improving operational efficiency, risk management, customer satisfaction, and strategic decision-making. It enables banks to stay competitive, adapt to changing market dynamics, and meet regulatory requirements effectively.

9.3 STRUCTURE OF MANAGEMENT INFORMATION SYSTEM IN BANKS :

Since the output of an information system is directed towards assisting management in planning and controlling of bank activities, it is essential to distinguish the following types of information:

- Strategic
- Tactical
- Operational

Generally, lower management is concerned with operational information for decision making, while tactical information and strategic information are useful to middle and top management, respectively, for making decisions. The type of information required depends upon the internal environment of the organization and the external environment in which the organization operates. It is a general fact that internal information should be more and more summarized as the level of management for which it is prepared rises in the hierarchical structure of the organization. On the other hand, lower echelons of management, being control oriented, receive the most detailed reports. Between top and lower management is middle, management, which is planning / control oriented. All three levels of informational needs are illustrated in following Figure:

Levels of Information Needs

Overall Reports

Top Level Management

Fundamentally
Planning oriented
Comprehensive Reports

Middle Level Management

Basically planning/control oriented

Lower Level Management
(including operating personnel in new work environment)

Detailed Reports
Generally Control oriented

Information concerning the external environment of the bank should be summarized inn, exactly the opposite manner from that of the internal environment. Because the upper management levels are more planning oriented and because planning necessitates more information about the bank's external environment, this type of information should be most fully supplied to top management. It should be increasingly summarized and selective as the position of the receiver decreases in the managerial hierarchy.

Strategic Information for Top Level Management: Strategic information is used primarily by top management and its staff to cover a long time span, generally one to five years. This type of information is employed for planning purposes and for analysis of problem areas to discover the underlying reasons for specific problems or conditions. Primarily, it involves large amounts of information derived from or relating to areas of knowledge outside the bank. In many cases, strategic information finds answers to the question 'why' rather than 'what' or 'where', since it concerns itself with determining objectives, initiating priorities, developing strategies, initiating programs and establishing policies that will govern the acquisition, use and disposition of the resources needed to achieve objectives.

The purpose of generating strategic information is to assist top management in strategic decisions that are characterized by a great deal of uncertainty (since they are future oriented). These decisions establish long-range policies that affect the entire organization. The overall objectives of the organization are stated and a range of strategies are made which may entail, for example, business expansion, determination of product lines, mergers, diversification into other areas, capital expenditures. Hence, based on strategic information, appropriate strategic decisions are made to further bank objectives.

Tactical information for Middle Level Management: Tactical information that covers relatively short periods (not greater than 12 months) is used by middle management to implement and highest-level strategic plans at the functional levels. As with operations information, tactical information is used by a large number of people. Example is a functional budget report that compares actual to estimated amounts. This type of information is the resource needed by middle management for tactical decision making to allocate resources properly for the attainment of bank objectives.

Operational Information for Lower Level Management: Operational information, being at the lowest level i.e., at branch of a bank, is concerned with structured and repetitive activities that are measurable in terms of specific results. It allows line managers, such as branch manager, to measure performance against predetermined objectives, including standards and budgeted figures. Similarly, 'operational information allows lower management to comment on how operating standards aid policies can be improved to assist day-to-day operations. The

feedback of essential information from this low level keeps higher levels of management aware of unfavourable as well as favourable results.

Operational information is needed at the lowest level of decision-making that is, a process, of ensuring that specific tasks are implemented in an effective and efficient manner. This kind of decision making requires specific commands to be given for controlling specific operations. The primary management function involved is that of control with planning performed on a rather limited scale.

Classification of Information for Managerial Decision-Making: As noted in the preceding discussion, different kinds of decision making require different informational requirements. The higher level of the decision maker, the more data the individual needs, about external conditions. In a practicable situation, the lines between categories of decision making are blurred and tend to overlap. Systems analysts must, however, be aware of these types of decision making and how the information system can be designed to meet differing information requirements. The requirements for the different kinds of decision making are given in the following figure:

Characteristics of Information

Type of Information	Essential Characteristics
Strategic	1. External Information a. Competitive Actions b. Customer Actions c. Availability of Resources d. Demographic Studies e. Government Actions 2. Predictive information concerning long-term trends 3. Simulated 'what if' information of a long-term nature
Tactical	1. Descriptive-historical information 2. Current performance information 3. Short-term future information 4. Simulated 'what if' information of a short-term nature
Operational	1. Descriptive-historical information 2. Current performance information 3. Accent on Exception Reporting

9.4 MANAGEMENT INFORMATION SYSTEMS IN BANKING SECTOR

Core Banking Solutions (CBS): The banks were facing stiff competition. Markets were expanding. Costs had to be brought down. The available technology was far more advanced. It was at this juncture, the concept of core banking solution appeared on the horizon. In the increasingly competitive environment, banks took a reality check on their technology environment, to ensure that their Information Technology (IT) strategy is aligned to their business objectives. Core Banking Solution empowers banks to transform their business, leveraging agile new generation technologies. Core Banking Solution is a set or robust software components designed to meet the challenges of today's banking market. The advanced technology infrastructure supporting the core banking solution and high standard of

business functionality provides financial institutions a competitive advantage. CBS bring significant benefits to the banks as follow

- It enables the organisations, customer relationship management by providing a robust operational customer database and customer administration. A customer no longer belongs to a branch. He belongs to the bank.
- By means of simplified account administration, it provides improved customer service and cost saving. It provides support for portfolio growth with a fast track product field component.
- It could be implemented with basic modules like savings bank account, current account, fixed deposits, loans, cash credits, etc. Immediately thereafter, additional delivery channels like ATM, Internet banking, etc. could be added.
- **RTGS (Real Time Gross Settlement)**: Introduced in 2004, Real-Time Gross Settlement ('RTGS') systems are specialist high speed funds transfer systems where the transfer of money takes place from one bank to another for settlement of transactions. "Gross settlement" means the transaction is settled on one-to-one basis through RBI. "Settlement" means that once processed, payments are final and irrevocable. RTGS systems are typically used for high-value transactions that require and receive immediate money transfers. RBI works as an intermediary between banks working on specified hourly batch basis.
- **NEFT (National Electronic Fund Transfer)**: NEFT is an electronic funds transfer system maintained by the Reserve Bank of India (RBI). Started in November 2005, NEFT is a facility enabling bank customers in India to transfer funds between any two NEFT-enabled bank accounts on a one-to-one basis. It is done via electronic messages. Unlike RTGS, fund transfers through the NEFT system do not occur in real-time basis. NEFT settles fund transfers in half-hourly batches with 23 settlements.
- **Cheque Truncation**: This is the process of stopping the flow of the physical cheque issued by a drawer to the drawee branch. The physical instrument will be truncated at some point en-route to the drawee branch and an electronic image of the cheque would be sent to the drawee branch along with the relevant information like the MICR fields, date of presentation, presenting banks, etc. This would be effectively reduce the time required for payment of cheques, the associated cost of transit and delay in processing, etc., thus speeding up the process of collection or realisation of the cheques.
- **Unified Payments Interface (UPI)**: Unified Payments Interface (UPI) is an instant real-time payment system developed by National Payments Corporation of India facilitating inter-bank transactions. The interface is regulated by the Reserve Bank of India and works by instantly transferring funds between two bank accounts on a mobile platform. In this, instead of using beneficiary's IFSC code and account number, it uses the virtual ID.
- **Immediate Payment Service (IMPS):** Immediate Payment Service (IMPS) is an instant real-time inter-bank electronic funds transfer system in India. IMPS offer an inter-bank electronic fund transfer service through mobile phones. Unlike NEFT and RTGS, the service is available 24/7 throughout the year including bank holidays. It is managed by the National Payments Corporation of India (NPCI) and is built upon the existing National Financial Switch network.
- **NSS-National Settlement System**: National Settlement System is a system established by Reserve Bank of India through which the clearing houses/clearing organisations can settle the net position of the participating bank at the national level

- **SFMS-Structured Financial Messaging System**: The SFMS system provides a solution for financial message communication across the Indian Financial Network. The system enables exchange of messages in a highly secured environment.
- **ECS (Electronic clearing service)** refers to accounting of bulk payment/receipts into individual bank accounts, e.g. salary/pension/dividend payments by various organisations to their beneficiary accounts and issuance of standing instructions to the banks by its customers to pay the bills on periodic basis.

These services save lot of time and effort and make the banking operations of the retail and business customers more efficient.

Internet Banking (Online Banking): Internet banking forms part of branchless banking. It allows customers to accomplish many banking activities very conveniently sitting in the comforts of their home. It saves lot of human resources at bank branches and associative manpower costs otherwise needed at the branches. Customers can:

- View all their transaction and bank balances.
- Print statement of accounts.
- Apply for bank loans and repay loan instalments.
- Pay their bills for various services rendered by third parties.
- Pay taxes to various statutory bodies.
- Transfer funds to other accounts of the same bank.
- Send requests for cheque books.
- Import data into personal accounting software (electronic data transfer).
- Buy products and services online by availing payment gateway services.
- Get on line decision support from banks for managing personal finances.
- Avail quick and cheap cleaning services.
- Get support for account aggregation to monitor all their accounts in one place, whether they are with the bank or with other financial institutions and so on.

POS (Point of Sales) Devices – ATM/Debit Cards/ Credit Cards/ E-wallet: These services also fall under branchless banking. ATM/debit cards issued by banks offer two facilities for their customers.

They could draw cash (subject to certain limits) anytime, anywhere through ATM kiosks. The amount drawn gets immediately debited to the customer's accounts.

Some cards can also be used by the customers for making payments towards the purchase of goods and services. These cards are backed by worldwide card service providers like VISA and Mastercard, who maintain a central database of all their customers across the country/world. As the sales clerk at the retail outlets swipes the card on the electronic reader (POS device), the details related to the customer like name, account number, the bank, etc. stored in the card, electronically get transmitted to the central database.

ATM (Automated Teller Machines) Services: Automated Teller Machines have evolved as the primary delivery channel for cash withdrawals. The evolutionary trend from cash economy to cheque economy and onwards to plastic card economy is witnessed in the introduction of ATM. ATM or Automated Teller machines outwardly appears like a human weighing machine kept in Railway Platform. The ATMs released banks from the constraints of time and geographical location. They presented banks with a more economical substitute for brick and mortar branches. The revolution brought about by this technology was longer banking hours which extended beyond office hours.

These days, ATMs are securely placed inside the walls of bank's premises. The ATM measures the bank balance of a customer in rupees. ATM is a computerized telecommunications device that provides the customers of a bank with access to financial transactions in a public place without the need for a casher. Money can be deposited through ATM for credit to our account. The ATM also tells us, our bank balance, and maintains protection against wrong use of secret code number.

ATMs or 24-hour Tellers are electronic terminals that let us do banking operations almost any time. To withdraw cash, make deposits, or transfer funds between accounts. In addition cash dispensing ATMs may have many services/facilities such as:

- Account Information
- Cash Deposit
- Regular bills payment
- Purchase of Re-load Vouchers for Mobiles
- Mini/Short Statement
- Loan Account Equity, etc

However, ATMs are to be fully secured and guarded all the time against theft and misuse or fraud. ATM customers also need to be very careful and exercise enough precautions in safeguarding their accounts and PIN numbers while availing such services. It is necessary for the bank customers to get printed statement accounts every month and check all the transactions very judiciously.

Mobile Banking: Mobile banking also forms part of branchless banking. Mobile banking refers to the banking transactions that can be performed by the bank customers using their mobile phones or any other smart devices. The following services could be availed by the customers through mobile banking:

- Mini Statement of accounts
- Getting account balances
- Alerts on accounting activities
- Requesting new cheque book
- Stop payment advices
- PIN Management
- Fund Transfers
- Recharge of talk times
- Commercial POS payment
- Bills payment
- Electronic wallet
- Peer to peer payment
- Blocking of lost/stolen card
- Making micro payments, and so on.

Branchless Banking (Bank and Non-Bank based): India has vast rural population who still do not (more than 50% of its population) have access to banks/banking services. GOI has enacted various bills that will facilitate financial inclusion for such vast populace. At the same time, more than 75% of Indians have access to mobile phones, thanks to wireless communication technologies.

Branchless banking makes use of mobile phones and the services offered by mobile telecommunication companies (TELCOs). TELCOs, by virtue of their rural presence, act as

agents in offering limited banking services beyond bank branches. GOI is in the process of enabling mobile payment switches/interbank mobile payment services for this purpose.

Branchless banking primarily involves appointment of agents/business correspondents/intermediaries by the banks (e.g. TELCOs, Post Offices, Local Retailers, etc.) who will perform small value banking transactions like collections and payments on behalf of the banks at rural locations and earn some commissions for themselves.

There are three models of branchless banking:

1. **Agent-less Model:** This model covers ATMs, Internet banking, mobile phone banking and POS devices like debit/credit cards, e-wallets and so on). There are no agents/intermediaries (since all processes are carried out electronically) in the process.
2. **Bank Account Model:** Under this model, the customers perform micro level banking transactions through business correspondents/agents appointed/authorised by the banks. They could be retail shop owners. TELCOs, Post Offices, Schools, etc., who enter into some agreement with the banks in offering select services to the customers on commission basis. The customers are bank account holders. Banks are able to outreach rural population in offering financial services (financial inclusion as contemplated by GOI) using different delivery channels which are cheaper than branch bank operations.
   This makes use of the computer resources made available to the agents which are connected to the banks' computer networks. All processes are carried out by the agents through their computers.
3. **Non-bank account Model:** Under this model, customers need not be bank account holders. Agents/business correspondents perform all banking operations of the customers including account management on prescribed fees chargeable by them for each service. Banking transactions are at micro levels. Banks merely act as safe keeper or custodians of funds. This model also makes use of the computer resources made available to the agents which are connected to the banks' computer net works.

Payment Services/ECS (Electronic Clearing System): Banks allow their customers to give standing instructions to the banks to pay their bills regularly to third parties through ECS facility. This saves lot of efforts for the customer in following up and payment of bills every month. ECS has also been discussed under CBS (Core Banking Services).
Many business organisations today sell their products and services through Internet (e-commerce). Internet based consumers can make payments to the sellers through secured payment gateway services offered by the banks.

Online Trading: Many banks and non-banking financial institutions offer their customers facilities to trade on-time at various stock exchanges of India. Customers need to enter into a separate agreement with the banks for this purpose (separate account number) and buy and sell shares availing the funds they hold or availing credits offered by the banks. Banks charge certain commission on the value of the shares bought or sold (on traded values). This facility has made on-line trading an easy task for retail investors and has drawn millions of them to trading of shares/equities.

Customers can manage their shareholdings (portfolio management) of all the shares bought and their purchase prices, know current market values and so on from the computer database maintained by respective banks. These computers, in turn, process trading transactions and access required information from respective stock exchanges. The banks also enable their customers to view fluctuating share prices of all stocks being traded in real time. Trading in share markets today is hassle-free and very convenient.

Portfolio management, real time stock quotes, personalized alters/notifications on security prices and lot more facilities are also part of such services.

9.5 IMPORTANCE OF INFORMATION TECHNOLOGY IN BANKING INDUSTRY

All the new financial products that have been created in recent years contribute economic value by unbundling risks and reallocating them in a highly calibrated manner. The rising share of finance in the business output of India and other countries is a measure of the economic value added by the ability of these new instruments and techniques to enhance the process of wealth creation. The important of information technology in banking industry can be seen as follows:

- **Open New Avenues of Market Opportunities**: Technology has opened up new markets, new products, new services and efficient delivery channels for the banking industry. Online electronics banking, mobile banking and internet banking are just a few examples.
- **Provides ability to deal with the Challenges**: Information Technology has also provided banking industry with the ability to deal with the challenges the new economy poses. Information technology has been the cornerstone of recent financial sector reforms aimed at increasing the speed and reliability of financial operations and of initiatives to strengthen the banking sector.
- **Increase the volume of Financial Activities**: The information technology revolution has set the stage for unprecedented increase in financial activity across the globe. The progress of technology and the development of worldwide networks have significantly reduced the cost of global funds transfer.
- **Helps in meeting customers growing demands and expectations**: It is information technology which enables banks in meeting such high expectations of the customers who are more demanding and are also more techno-savvy compared to their counterparts of the yester years. They demand instant, anytime and anywhere banking facilities.
- **Maintenance of Accounts and Information**: Information Technology has been providing solutions to banks to take care of their accounting and back office requirements. This has, however, now given way to large scale usage in services aimed at the customer of the banks. Information Technology also facilitates the introduction of new delivery channels
- in the form of automated Teller machines, Banking, Mobile Banking and the like.
- **Increased Network**: With advancement of information technology, banks are increasingly interconnecting their computer systems not only across branches in a city but also to other geographic locations with high-speed network infrastructure, and setting up local area and wide area networks and connecting them to the Internet. As a result, information systems and networks are now exposed to a growing number.
- **Creates Time Value in Dealings**: With Information Technology, banks have become customer centric and provide services/products across a range of channels to be futuristic and have ‘time’ value in all its dealings with customers.
- **Enhanced Capabilities**: Technology in banking provides banks the following specific capabilities:

    (i) Better Customer Service
    (ii) Better Cross-Selling Ability
    (iii) Multi-channel, real-time transaction processing

9.6 NEED FOR BUILDING MIS :

The need for building MIS at banking sector has increased considerably during the last few years because of the following reasons:

- Regulatory requirements indicated by the RBI for preparation of Off-site Monitoring Surveillance (OSMOS) Reports on a regular basis in electronic format
- Regulatory requirement of filing of statutory returns such as the one under Section 42 of the Reserve Bank of India Act, 1934 for working out Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) obligations in electronic format
- Asset Liability Management (ALM) guidelines for banks being implemented by the RBI w.e.f. April 1, 1999 with the stipulation that the banks should capture 100 percent of their business through the ALM system by April1, 2000.
- •Need for timely submission of Balance Sheets and Profit & Loss Accounts.
- Focus on transaction costing and a need for relating the service charges levied on the customers to be based on cost of servicing
- Need for Inter-Branch Reconciliation of Accounts within a definite time frame
- Need to meet the stipulations made by the Central Vigilance Commission (CVC) to computerise at least 70 per cent of banking business by January 1, 2001.
- Need to undertake risk management strategies and for this purpose build up appropriate sets of data and market intelligence reports.

9.7 ROLE OF MIS IN BANKING INDUSTRY :

A bank is understood as a place where the financial services such as checking/savings and providing credit to the customers are offered. The scope of this service in today's world is expanded to a "Financial Services Super Shoppe" where the banks have become an instrument in providing financial assistance to some activities as a policy or by regulation or for meeting sociology-economic obligations. In banking also, the concept of the financial product has come in.

The customers choose a bank mainly on the following three factors:

i. The ease of doing business.
ii. The quality of personnel and service.
iii. The range of the financial services.

The factors outrank the factors such as the location, interest rates, layout, banking hours, etc. The bank has a broad range of customers like individuals, institutions, trusts, business organizations, Government, and local bodies. The banks deal with some transactions, which also vary widely regarding length and complexity. The bank customer, like any other service industry, is interested in getting final results quickly. The unique service in banking mostly means solving the customers' problems in the financial matters, and the single most widely used measure of quick service is the elapsed time of transaction execution. For example, the time is taken for crediting the amount, withdrawal of cash, the sanction of a loan or credit facility, etc. are the norms of deciding an excellent service.

The MIS in banking industry revolves around this aspect. The customer of the bank would like to know the status of the account very fast to make decisions on withdrawals or payments. He is interested in obtaining the loan assistance for his particular need with a reasonable rate of interest. Some customers would be interested in tax consulting and tax planning. Mother group of customers would be interested in investment guidance for investing in stocks and securities. To avoid the inconvenience of going to some places for

payment of small amounts, customers need service at the counter to pay electricity bills, telephone bills, taxes and duties to the local bodies and the Government. Hence, the MIS is to be designed to identify, decide and develop a service strategy for offering a distinctive service to the broad range of customers seeking a variety of service demands.

The following points should be taken care of while designing an MIS for a bank:

Customer Database :
The service expectations and perceptions revolve around the following factors:

- Customer — individuals, company, institutions, etc.
- Operator — housewife, employee, the officer of the organization. The range of service — savings, credit checking and payment, other financial services.
- Class of customers — income group, corporate bodies, etc.
- Working hours — morning, afternoon, evening, etc.
- The management of the bank should create a customer database and analyze the needs of the customers from time to time to create suitable service package.

Service to the account holders: The customers (account holders) need constant advice on the status and its operations. Most of the customers use their account for routine payments affecting the balance. Many times the account holds a large amount and it is not transacted for any purpose.

The MIS should give following reports to the management:

- The non-moving account.
- The account was having the balance of more than, say Rs.50, 000.
- The account was going down below minimum balance.
- The regular payments not made.
- The routine credits not arrived.
- The defaults on loan repayment.
- The delays on crediting cheque amounts.
- A sudden rise and fall in the account movement.
- The account holders were giving 80% business to take personal care of their service expectations and perceptions (the CRM perspective).

Based on these reports, the management of the bank should alert or warn the customer to act on his account to correct the situation. The personal and individual account holders need such a service badly as they have to manage their domestic or business activities in a tight money situation. The MIS built around such demands would help not only the bank manager but also the account holder.

Service for Business Promotions: The bank finances can be utilized in some ways to increase the banking operations by offering credit to the right kind of customers. It is, therefore, necessary to study the trend in the business industry and solicit the customers from the upcoming and growing business sector. The MIS should concentrate on data collection from various sources to analyze and conclude the future corporate strategy. Such information will help the banker to move out to talk to the customer to obtain business for the bank. Such support will also reduce the risk of the account going into the red and bad debt.

The index Monitoring System: One more feature of the MIS is to monitor the variety of indices and ratios related to banking operations, which are internal to the banking business. Some of these ratios fulfill the legal needs like the Cash Reserve Ratio (CRR)/ Statutory Liquidity Ratio (SLR); some meet the policy needs like the priority sector ratio to total advances and so on. It is necessary to build the MIS applications to support the bank manager in making decisions to keep different norms and ratios within the acceptable limits. He

should also get support through Decision Support Service to handle the problem of not meeting these legal standards.

Human Resource Upgrade: there is a lot of human aspect in the banking operations. With computerization, the service may become faster or quicker, but still, it requires a human touch and skill. It is, therefore, necessary to upgrade the expertise and knowledge of the bank employees to offer proper service to the customers. The financial world changes so fast that retaining a client base is a challenge. The financial service business is becoming competitive and offering an excellent, distinctive service is the only solution to improve the business prospects. The service has to be more aggressive for particular problem solving of the customers. The MIS should identify such needs and offer help to the management in designing training courses for the employees to improve their knowledge about banking and the financial world. In the banking industry, the traditional methods of real performance are at odds with good service. An excellent financial performance may not necessarily mean a good service quality. The customers of the bank expect the service to be delivered in a smooth, problem-free, efficient and timely manner. The managers in the bank have the service as well as the financial goals to achieve. It is, therefore, necessary to set the internal standards, accuracy, responsiveness and timeliness. The systems and the resources provided to meet these standards need monitoring, and the MIS will provide feedback on these standards so they can be regulated and controlled. For example, a multinational bank has set standards on satisfying the queries in the first phone call, cheque clearance time, waiting time, etc. It has set eighty-one separate 'Quality Indicators' for the Bank Card business and so on. The MIS measures these standards and gives feedback on achievement or non-achievement.

9.8 IMPACT OF INFORMATION TECHNOLOGY ON BANKING SERVICES :

- Results in increased efficiency (faster services) and effectiveness (lesser resources, cost reduction, etc.) of banking services.
- Greater convenience and ease of availing banking services by the customers any time/anywhere.
- Enhanced geographic reach and wider customer base.
- Increased visibility for banking products and services through websites, bank portals and internet banking.
- Complete and integrated support in all banking processes like KYC (Know Your Customer), signature verification, biometric and photo verification, online application retrieval, accepting deposits and issuance of receipts for the same, periodic interest payments, loan application processing, sanctioning and disbursements of loans, and so on.

9.9 OTHER IT APPLICATIONS AT BANKS :

Other IT applications at banks (and branches) like financial accounting systems, books of accounts, front desk transaction processing, the systems for the management of equity, Term deposits, short-term and long-term loans, assets, debtors, creditors, HR, materials/consumables inventories, fixed assets and maintenance of plant/equipment/machinery are similar to the applications. In view of distinctively different products and services offered by individual banks (to attract new customers and to excel against competition), data security requirements and distinctly different banking procedures being adopted, the banks generally develop and implement fully customized application software at their banks/branches.

9.10 INTERNAL CONTROL SYSTEMS (MCS) IN BANKS

As part of its on-going efforts to address bank supervisory issues and enhance supervision through guidance that encourages sound risk management practices, the Basle Committee on Banking Supervision is issuing this framework for the evaluation of internal control systems. A system of effective internal controls is a critical component of bank management and a foundation for the safe and sound operation of banking organisations. A system of strong internal controls can help to ensure that the goals and objectives of a banking organisation will be met, that the bank will achieve long-term profitability targets, and maintain reliable financial and managerial reporting. Such a system can also help to ensure that the bank will comply with laws and regulations as well as policies, plans, internal rules and procedures, and decrease the risk of unexpected losses or damage to the bank's reputation

9.11 PRINCIPLES FOR THE ASSESSMENT OF INTERNAL CONTROL SYSTEMS

The Basle Committee, along with banking supervisors throughout the world, has focused increasingly on the importance of sound internal controls. This heightened interest in internal controls is, in part, a result of significant losses incurred by several banking organisations. An analysis of the problems related to these losses indicates that they could probably have been avoided had the banks maintained effective internal control systems. Such systems would have prevented or enabled earlier detection of the problems that led to the losses, thereby limiting damage to the banking organisation. In developing these principles, the Committee has drawn on lessons learned from problem bank situations in individual member countries. These principles are intended to be of general application and supervisory authorities should use them in assessing their own supervisory methods and procedures for monitoring how banks structure their internal control systems.

Management oversight and the Control Culture: The board of directors should have responsibility for approving and periodically reviewing the overall business strategies and significant policies of the bank; understanding the major risks run by the bank, setting acceptable levels for these risks and ensuring that senior management takes the steps necessary to identify, measure, monitor and control these risks; approving the organisational structure; and ensuring that senior management is monitoring the effectiveness of the internal control system. The board of directors is ultimately responsible for ensuring that an adequate and effective system of internal controls is established and maintained. A strong, active board, particularly when coupled with effective upward communication channels and capable financial, legal, and internal audit functions, provides an important mechanism to ensure the correction of problems that may diminish the effectiveness of the internal control system. The board of directors should include in its activities (1) periodic discussions with management concerning the effectiveness of the internal control system, (2) a timely review of evaluations of internal controls made by management, internal auditors, and external auditors, (3) periodic efforts to ensure that management has promptly followed up on recommendations and concerns expressed by auditors and supervisory authorities on internal control Internal control systems 9 weaknesses, and (4) a periodic review of the appropriateness of the bank's strategy and risk limits.

Senior management should have responsibility for implementing strategies and policies approved by the board; developing processes that identify, measure, monitor and control risks incurred by the bank; maintaining an organisational structure that clearly assigns responsibility, authority and reporting relationships; ensuring that delegated responsibilities are effectively carried out; setting appropriate internal control policies; and monitoring the adequacy and effectiveness of the internal control system. It is important that senior

management takes steps to ensure that activities are conducted by qualified staff with the necessary experience and technical capabilities. Staff in control functions must be properly remunerated. Staff training and skills should be regularly updated. Senior management should institute compensation and promotion policies that reward appropriate behaviours and minimize incentives for staff to ignore or override internal control mechanisms.

The board of directors and senior management are responsible for promoting high ethical and integrity standards, and for establishing a culture within the organisation that emphasizes and demonstrates to all levels of personnel the importance of internal controls. All personnel at a banking organisation need to understand their role in the internal controls process and be fully engaged in the process. An essential element of an effective system of internal control is a strong control culture. It is the responsibility of the board of directors and senior management to emphasize the importance of internal control through their actions and words. This includes the ethical values that management displays in their business dealings, both inside and outside the organization. The words, attitudes and actions of the board of directors and senior management affect the integrity, ethics and other aspects of the bank's control culture.

Risk Recognition and Assessment : An effective internal control system requires that the material risks that could adversely affect the achievement of the bank's goals are being recognized and continually assessed. This assessment should cover all risks facing the bank and the consolidated banking organization (that is, credit risk, country and transfer risk, market risk, interest rate risk, liquidity risk, operational risk, legal risk and reputational risk). Internal controls may need to be revised to appropriately address any new or previously uncontrolled risks.

Banks are in the business of risk-taking. Consequently it is imperative that, as part of an internal control system, these risks are being recognized and continually assessed. From an internal control perspective, a risk assessment should identify and evaluate the internal and external factors that could adversely affect the achievement of the banking organization's performance, information and compliance objectives. This process should cover all risks faced by the bank and operate at all levels within the bank. It differs from the risk management process which typically focuses more on the review of business strategies developed to maximize the risk/reward trade-off within the different areas of the bank.

Effective risk assessment identifies and considers internal factors (such as the complexity of the organisation's structure, the nature of the bank's activities, the quality of personnel, organisational changes and employee turnover) as well as external factors (such as fluctuating economic conditions, changes in the industry and technological advances) that could adversely affect the achievement of the bank's goals.

Control Activities and Segregation of Duties : Control activities should be an integral part of the daily activities of a bank. An effective internal control system requires that an appropriate control structure is set up, with control activities defined at every business level. These should include: top level reviews; appropriate activity controls for different departments or divisions; physical controls; checking for compliance with exposure limits and follow-up on non-compliance; a system of approvals and authorisations; and, a system of verification and reconciliation.

Control activities are designed and implemented to address the risks that the bank identified through the risk assessment process described above. Control activities involve two steps: (1) the establishment of control policies and procedures; and (2) verification that the control policies and procedures are being complied with. Control activities involve all levels of personnel in the bank, including senior management as well as front line personnel. Examples of control activities include: Top level reviews, Activity controls, Physical

controls, Compliance with exposure limits, Approvals and authorisations, Verifications and reconciliations.

An effective internal control system requires that there is appropriate segregation of duties and that the personnel are not assigned conflicting responsibilities. Areas of potential conflicts of interest should be identified, minimised, and subject to careful, independent monitoring.

In reviewing major banking losses caused by poor internal controls, supervisors typically find that one of the major causes of such losses is the lack of adequate segregation of duties. Assigning conflicting duties to one individual (for example, responsibility for both the front and back offices of a trading function) gives that person access to assets of value and the ability to manipulate financial data for personal gain or to conceal losses. Consequently, certain duties within a bank should be split, to the extent possible, among various individuals in order to reduce the risk of manipulation of financial data or misappropriation of assets.

Information and Communication : An effective internal control system requires that there are adequate and comprehensive internal financial, operational and compliance data, as well as external market information about events and conditions that are relevant to decision making. Information should be reliable, timely, accessible, and provided in a consistent format.

Adequate information and effective communication are essential to the proper functioning of a system of internal control. From the bank's perspective, in order for information to be useful, it must be relevant, reliable, timely, accessible, and provided in a consistent format. Information includes internal financial, operational and compliance data, as well as external market information about events and conditions that are relevant to decision making. Internal information is part of a record-keeping process that should include established procedures for record retention

An effective internal control system requires that there are reliable information systems in place that cover all significant activities of the bank. These systems, including those that hold and use data in an electronic form, must be secure, monitored independently and supported by adequate contingency arrangements. A critical component of a bank's activities is the establishment and maintenance of management information systems that cover the full range of its activities. This information is usually provided through both electronic and non-electronic means. Banks must be particularly aware of the organisational and internal control requirements related to processing information in an electronic form and the necessity to have an adequate audit trail. Management decision-making could be adversely affected by unreliable or misleading information provided by systems that are poorly designed and controlled. Without effective communication, information is useless. Senior management of banks needs to establish effective paths of communication in order to ensure that the necessary information is reaching the appropriate people. This information relates both to the operational policies and procedures of the bank as well as information regarding the actual operational performance of the organisation.

An effective internal control system requires effective channels of communication to ensure that all staff fully understand and adhere to policies and procedures affecting their duties and responsibilities and that other relevant information is reaching the appropriate personnel.

Monitoring Activities and Correcting Deficiencies: The overall effectiveness of the bank's internal controls should be monitored on an ongoing basis. Monitoring of key risks should be part of the daily activities of the bank as well as periodic evaluations by the business lines and internal audit. Since banking is a dynamic, rapidly evolving industry, banks must

continually monitor and evaluate their internal control systems in the light of changing internal and external conditions, and must enhance these systems as necessary to maintain their effectiveness. In complex, multinational organisations, senior management must ensure that the monitoring function is properly defined and structured within the organisation.

There should be an effective and comprehensive internal audit of the internal control system carried out by operationally independent, appropriately trained and competent staff. The internal audit function, as part of the monitoring of the system of internal controls, should report directly to the board of directors or its audit committee, and to senior management. The internal audit function is an important part of the ongoing monitoring of the system of internal controls because it provides an independent assessment of the adequacy of, and compliance with, the established policies and procedures. It is critical that the internal audit function is independent from the day-to-day functioning of the bank and that it has access to all activities conducted by the banking organisation, including at its branches and subsidiaries.

Internal control deficiencies, whether identified by business line, internal audit, or other control personnel, should be reported in a timely manner to the appropriate management level and addressed promptly. Material internal control deficiencies should be reported to senior management and the board of directors. Internal control deficiencies, or ineffectively controlled risks, should be reported to the appropriate person(s) as soon as they are identified, with serious matters reported to senior management and the board of directors. Once reported, it is important that management corrects the deficiencies on a timely basis. The internal auditors should conduct follow-up reviews or other appropriate forms of monitoring, and immediately inform senior management or the board of any uncorrected deficiencies. In order to ensure that all deficiencies are addressed in a timely manner, senior management should be responsible for establishing a system to track internal control weaknesses and actions taken to rectify them

Evaluation of Internal Control Systems by Supervisory Authorities: Supervisors should require that all banks, regardless of size, have an effective system of internal controls that is consistent with the nature, complexity, and risk inherent in their on- and off-balance-sheet activities and that responds to changes in the bank’s environment and conditions. In those instances where supervisors determine that a bank's internal control system is not adequate or effective for that bank’s specific risk profile (for example, does not cover all of the principles contained in this document), they should take appropriate action.

Although the board of directors and senior management bear the ultimate responsibility for an effective system of internal controls, supervisors should assess the internal control system in place at individual banks as part of their ongoing supervisory activities. The supervisors should also determine whether individual bank management gives prompt attention to any problems that are detected through the internal control process. 46. Supervisors should require the banks they supervise to have strong control cultures and should take a risk-focused approach in their supervisory activities. This includes a review of the adequacy of internal controls. It is important that supervisors not only assess the effectiveness of the overall system of internal controls, but also evaluate the controls over high-risk areas (e.g., areas with characteristics such as unusual profitability, rapid growth, new business activity, or geographic remoteness from the head office). Certain changes in a bank’s environment should be the subject of special consideration to see whether accompanying revisions are needed in the internal control system. These changes include: (1) a changed operating environment; (2) new personnel; (3) new or revamped information systems; (4) areas/activities experiencing rapid growth; (5) new technology; (6) new lines, products, activities (particularly complex ones); (7) corporate restructurings, mergers and

acquisitions; and (8) expansion or acquisition of foreign operations (including the impact of changes in the related economic and regulatory environments).

9.12 SUMMARY :

Information Technology offers enormous potential and various opportunities to the Indian Banking sector. It provides cost-effective, rapid and systematic provision of services to the customer. The efficient use of technology has facilitated accurate and timely management of the increased transaction volumes of banks which comes with larger customer base. Indian banking industry is greatly benefiting from IT revolution all over the world. This lesson explains about the necessity of information system, management information system, role and relationship with decision support system. A system of strong internal controls can help to ensure that the goals and objectives of a banking organisation will be met, that the bank will achieve long-term profitability targets, and maintain reliable financial and managerial reporting. This lesson addresses the impact of information technology on banking services. Further, this lesson describes the essential elements of a sound internal control system and outline a number of principles for use by supervisory authorities when evaluating banks' internal control systems.

9.13 KEY WORDS

1. **Customer Relationship Management:** CRM (customer relationship management) is the combination of practices, strategies and technologies that companies use to manage and analyze customer interactions and data throughout the customer lifecycle. The goal is to improve customer service relationships and assist with customer retention and drive sales growth.
2. **Risk Management:** It is actually a combination of management of uncertainty, risk, equivocality and error. The process in which Indian banks establish a coherent framework for measuring and managing risk consistent with corporate goals and responsive to the developments in the market are called risk management.
3. **Core Banking Solutions (CBS)**: Core Banking Solution is a set or robust software components designed to meet the challenges of today's banking market. The advanced technology infrastructure supporting the core banking solution and high standard of business functionality provides financial institutions a competitive advantage.
4. **RTGS (Real Time Gross Settlement):** RTGS system is a funds transfer mechanism where transfer of money takes place from one bank to another on a 'real time' and on 'gross basis'.
5. **NEFT (National Electronic Fund Transfer):** National Electronic Funds Transfer (NEFT) is the most commonly used electronic payment method for transferring money from any bank branch to another bank in India.

9.14 SELF-ASSESSMENT QUESTIONS

1. Explain the importance of information technology in banking sector.
2. What are the functions of MIS in Banking Sector
3. Elaborate the structure of Management Information System in Banking Sector.
4. Describe the importance and need for building MIS in Banks.
5. Explain about ATM in detail.

6. Explain the Role MIS in Banking Industry.
7. What is meant by Management Control System (MCS)? Explain its principles in detail.

9.15 SUGGESTED READINGS :

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Dr. G. NAGA RAJU

LESSON – 10

PROFIT, PROFITABILITY AND PERFORMANCE BUDGETING SYSTEM IN BANKS

OBJECTIVES :

After studying this unit, you should be able to:

- To understanding the concepts of profit, profitability and sources of income of banks.
- To know the indicators of banks profitability and factors affecting the profitability of banks
- To acquire knowledge about performance budgets along with its objectives and various steps involved in preparation of performance budgets.
- To understand the significance of preparation of performance budgets in banks.

STRUCTURE :

10.1 Introduction

10.2 Sources of Income of Banks

10.2.1 Interest on Loans

10.2.2 Interest on Call Loans / Money at Short Notice

10.2.3 Interest on Investments

10.2.4 Income on Bills Purchased /Discounted

10.2.5 Income on Collection of Instruments

10.2.6 Income from Non-Fund Based Facilities like LC and BG

10.2.7 Income from Collection of Taxes on behalf of the Government

10.2.8 Income on payment of Customer's Bill

10.2.9 Locker Rent (Safe Deposit Vaults) and Safe Custody

10.2.10 Income from underwriting of Shares/D

10.2.11 Income from Foreign Exchange Dealings

10.2.12 Income from Advisory Services- Project Consultancy & Merchant Banking Operations

10.3 Banks Profitability Indicators

10.3.1 Credit Deposit Ratio: Total Advances /Total Deposits

10.3.2 Return on Assets (ROA)

10.3.3 Net Interest Margin (NIM) / Spread

10.3.4 Return on Equity (ROE)

10.3.5 Non Performing Assets

10.3.6 Provision and Contingencies

10.3.7 Operating Expenses

10.3.8 Business per Employee

10.3.9 Profit per Employee

10.4 Factors adversely affecting Bank's Profitability

10.4.1 High Cost Deposit

10.4.2 Low Yield on Advances

10.4.3 Low Net Interest Margins

10.4.4 High Establishment Costs
10.4.5 Unplanned Branch Expansion
10.4.6 Lack of Control over Other Overheads (Non-Establishment Costs)
10.4.7 Thefts /Frauds /Misappropriation of Funds by Insiders and Outsiders
10.4.8 Increase in number of Restructured Accounts
10.4.9 Unhedged Currency Exposure of Corporate Borrowers
10.4.10 Non-Performing Assets –Impact of NPAs on Profitability
10.5 Profitability Scenario of Commercial Banks in India
10.6 Bank's Performance/Challenges to Profitability
10.7 Performance Budgeting System – Introduction
10.8 Objectives of Performance Budgeting System
10.9 Components of Performance Budget
10.10 Formulation of Performance Budget
10.11 Steps in Performance Budget
10.12 Performance Budgeting System in Banks
10.13 Summary
10.14 Key Words
10.15 Self-Assessment Questions
10.16 Suggested Readings

10.1 INTRODUCTION :

Profit is the life blood of an organization. Profit is a symbol of prestige for an Institution. Profit is a sign of progress and prosperity. No Institution can remain fit without profit. If the word 'PROFIT' is broken into two parts i.e. PRO and FIT; it means and implies that always remaining in favour of fitness is the only aim of a commercial organization. Profit increases the shareholders value. Profit improves the capital adequacy. Profit adds colour to the Balance Sheet of an Organization. Profit is the present of an Organization and profit is the future of an organization. Profit creates employment opportunities in an organization. Profit builds not only an organization, but also the entire nation and nation's economy. No social banking can be undertaken by an Organization unless it is profitable. Banks accept deposits of money from the public; and profit creates trust and confidence in the public. The people always prefer to keep money in a bank which is profitable.

10.2 SOURCES OF INCOME OF BANKS :

A bank is a business organization engaged in the business of borrowing and lending money. A bank can earn income only if it borrows at a lower rate and lends at a higher rate. The difference between the two rates will represent income from core banking operations i.e. lending or investment. This profit is mainly generated out of core banking operations. In the pre-banking reforms era, a major chunk of income used to come from interest on loans and advances as well as the investments. But this scenario has undergone sea change today. Banks interest income has come under severe strain and pressure. The net interest margins (difference between interest earned on loans/advances and interest paid on deposits) have drastically gone down from the earlier 6-8% to 3-4%. Therefore, the focus has now shifted to Fee-based / Non-Interest Income. Banks are now expanding and diversifying their area of operation to earn fee based income from businesses like insurance, mutual funds, tax

collection, remittance of funds. The details of various sources of income and expenditure are given below;

10.2.1. Interest on Loans :

The main function of a commercial bank is to borrow money (accept deposits of money from the public) for the purpose of lending at a higher rate of interest. Bank grants various types of loans to different segment of industry and trade. The yields from loans constitute the major portion of the income of a bank. The banks grant loans generally for different maturities. Loans are also granted to the sectors which are accorded priority in lending by the Government of India, because they are the backbone of economy of our country. These sectors are called as Priority Sectors and carry concessional rates of interest as compared to non-priority or conventional sectors. The priority sectors as defined by Reserve Bank include inter alia the following;

a) Agriculture (Direct and Indirect)
b) Small scale industries (including setting up of industrial estates)
c) Small road and water transport operators (owning up to 10 vehicles).
d) Small business (Original cost of equipment used for business not to exceed Rs. 20 lakh)
e) Retail trade (advances to private retail traders up to Rs.10 lakh)
f) Professional and self-employed persons (borrowing limit not exceeding Rs. 10 lakh of which not more than Rs.2 lakh for working capital; in the case of qualified medical practitioners setting up practice in rural areas, the limits are Rs. 15 lakh and Rs. 3 lakh respectively and purchase of one motor vehicle within these limits can be included under priority sector)
g) State sponsored organizations for Scheduled Castes/Scheduled Tribes
h) Education (educational loans granted to individuals by banks)
i) Housing [both direct and indirect – loans up to Rs. 5 Lakh (direct loans upto Rs 10 lakh in urban/ metropolitan areas), Loans upto Rs. 1 lakh and Rs.` 2 lakh for repairing of houses in rural/ semi-urban and urban areas respectively].
j) Consumption loans (under the consumption credit scheme for weaker sections)
k) Micro-credit provided by banks either directly or through any intermediary; Loans to self help groups (SHGs) / Non Governmental Organizations (NGOs) for on lending to SHGs
l) Loans to the software industry (having credit limit not exceeding Rs.1 crore from the banking system)
m) Loans to specified industries in the food and agro-processing sector having investment in plant and machinery up to Rs.5 crore.
n) Investment by banks in venture capital (venture capital funds/ companies registered with SEBI)

Non Priority Sectors Loans

Non-priority sectors include the following categories of loans;

A. Exports –(Pre-shipment and Post-shipment Finance)
B. Real Estate Financing – Income Producing Real Estate
C. Projects Financing - Large Scale Industrial Units except infrastructure & SME's
D. Other Commercial / Conventional (Non-Priority) Loans not covered above.
E. Infrastructure Sector as defined by RBI

Note: Yield on the above category of loans is relatively higher as compared to priority sector except export finance (Pre-shipment and Post- shipment loans).

10.2.2. Interest on Call Loans / Money at Short Notice:

The banks also give call loans for shorter period's payable at a very short notice. Such loans are granted to share brokers and other banks. These assets are highly liquid because they can be called at any time. The interest on these loans is also a source of income to the bank.

10.2.3. Interest on Investments:

Banks also invest an important portion of their resources in government securities and other govt. approved securities. The interest and dividend received from time to time on these investments is a source of income for the banks. Bank also earns some income when the market prices of these securities rise.

10.2.4. Income on Bills purchased / Discounted:

Commercial banks invest a part of their funds in bills of exchange by discounting them. Banks discount both foreign and inland bills of exchange, or in other words, they purchase the bills at discount and receive the full amount at the date of maturity. For instance, if a bill of Rs.1, 000 is discounted for Rs.975, the bank earns a discount of Rs.25 because bank pays Rs.975 today, but will get Rs.1000 on the due date. Discount, as a matter of fact, is the interest on the amount paid for the remaining period of the bill. The rate of discount on bills of exchange is slightly lower than the interest rate charged on loans and advances because bills are considered to be highly liquid assets. The other way of discounting bills is to credit / pay the full amount of bill and charge commission at the prescribed rate and also interest for the period, the bank remains out of funds. Banks also discount third party cheques /drafts etc. and charges commission & interest thereon. This is a good source of income for the banks.

10.2.5. Income on Collection of Instruments:

Banks perform numerous services to their customers and charge commission, etc., for such services. Banks collect cheques, rents, dividends, etc., accept bills of exchange and issue drafts/ pay orders etc. Banks also collect pensions and salaries on behalf of their customers.

10.2.6. Income from Non-Fund Based Facilities like LC and BG:

Letter of credit and Bank Guarantee business is also very lucrative source of income for the bank. Certain developed commercial banks earn a major portion of their non-interest/ fee based income from LCs and BGs. Income under this head of these banks is second to Interest Income.

10.2.7. Income from Collection of Taxes on behalf of the Government :

For the last 10-15 years, the commercial banks are entrusted with the task of collection of taxes on behalf of the Govt. for which they get commission/fee. This also adds to the profitability of the banks.

10.2.8. Income on payment of Customer's Bills :

Banks pay insurance premiums, rents, taxes and other utility bill etc., on behalf of their customers. For all these services banks charge their commission.

10.2.9. Locker Rent (Safe Deposit Vaults) and Safe Custody :

Most of the people do not prefer to keep their valuables in their houses for fear of theft/robbery etc. In view of this the demand for lockers is increasing year after year and the income under this head is also on the increase. Besides lockers certain banks also give on hire their Safe Vaults to big corporate/Institutes which is a good source of their earning.

10.2.10. Income from underwriting of Shares/Debentures:

Recently the banks have also started underwriting the shares and debentures issued by the joint stock companies for which they receive underwriting commission.

10.2.11. Income from Foreign Exchange Dealings:

Commercial banks also deal in foreign exchange. They sell demand drafts, issue letters of credit and help remittance of funds in foreign countries. They also act as brokers in foreign exchange.

10.2.12. Income from Advisory Services- Project Consultancy & Merchant Banking Operations:

India's top three private banks ICICI Bank, HDFC Bank and Axis Bank, are leading in fee income - the income which is generated from advisory services, syndication of loans, providing letter of credit and guarantees besides sale of third-party products in absolute terms. Their income was next only to the country's top lender State Bank of India. YES Bank, which is only 6-7 years old in its banking operations earned a fee income which is much higher than what 18 state-run banks notched up after being around for decades and with a national footprint which will take the new generation private banks several years to catch up with.

10.3 BANKS PROFITABILITY INDICATORS :

Following are the indicators of profitability of commercial banks that have been applied in various studies conducted by the Experts:

10.3.1 Credit Deposit Ratio: Total Advances /Total Deposits:

This ratio is commonly used for assessing a bank's liquidity by dividing the banks total loans by its total deposits. The ratio gives the first indication of the health of a bank. A very high ratio is considered alarming because, in addition to indicating pressure on resources, it may also hint at capital adequacy issues, forcing banks to raise more capital. Moreover, the balance sheet would also be unhealthy with asset-liability mismatches. But such a situation is considered extreme as there are not many known instances of banks overstretching themselves. The high ratio of banks could have financial stability implication at the systemic level. If the ratio is too high, it means that banks might not have enough liquidity to cover any unforeseen fund requirements; if the ratio is too low, banks may not be earning as much as they could be.

Ideal CD Ratio: The regulator does not stipulate a minimum or maximum level for the ratio. But, a very low ratio indicates banks are not making full use of their resources. And if the ratio is above a certain level, it indicates a pressure on resources. The banks may have to resort to borrowings which may dent their profitability.

Current Scenario: At present, the credit-deposit ratio for the banking sector as a whole is 75 per cent. In the case of Indian banks, a credit-deposit ratio of over 70 per cent indicates pressure on resources as they have to set aside funds to maintain a cash reserve ratio of 4.5 per cent and a statutory liquidity ratio of 23 per cent. Banks can lend out of their capital, but it is not considered prudent to do so.

10.3.2. Return on Assets (ROA): In regard to banks, Return on assets is an indicator of how profitable a bank is before leverage, and is compared with other banks in the industry. Since the figure for total assets of the bank depends on the carrying value of the assets, some caution is required for bank whose carrying value may not correspond to the actual market value. Return on assets is a common figure used for comparing performance of financial institutions (such as banks), because the majority of their assets will have a carrying value that is close to their actual market value.

Return on assets is not useful for comparisons between industries because of factors of scale and peculiar capital requirements (such as reserve requirements in the insurance and banking industries).

Calculations

ROA = Bank's Net Income divided by Bank's Assets (such as loans, securities and cash)

10.3.3. Net Interest Margin (NIM) / Spread : It is a measure of the difference between the interest income generated by banks or other financial institutions and the amount of interest paid out to their lenders (for example, deposits), relative to the amount of their (interest-earning) assets. It is similar to the gross margin of non-financial companies. It is usually expressed as a percentage of what the financial institution earns on loans in a time period and other assets minus the interest paid on borrowed funds divided by the average amount of the assets on which it earned income in that time period (the average earning assets). Net interest margin is similar in concept to net interest spread, but the net interest spread is the nominal average difference between the borrowing and the lending rates, without compensating for the fact that the earning assets and the borrowed funds may be different instruments and differ in volume. The net interest margin can therefore be higher (or occasionally lower) than the net interest spread.

10.3.4. Return on Equity (ROE) : ROE measures the rate of return on the ownership interest (shareholders' equity) of the common stock owners. It measures a firm's efficiency at generating profits from every unit of shareholders' equity (also known as net assets or assets minus liabilities). ROE shows how well a company uses investment funds to generate earnings growth. ROEs between 15% and 20% are generally considered good.

ROE = Net Income divided by Capital
Net Income = Gross Income minus Bank's expenses
Capital : Equity of shareholders, Reserves and Retained Earnings

10.3.5. Non Performing Assets : Non-performing Assets has always have been a cause concern as they are a big dent on the profitability of the banks. Higher NPA's mean higher blockage of funds, higher provisioning and higher opportunity loss.

10.3.6. Provision and Contingencies:

Banks are required to make provisions for unforeseen and unexpected losses besides normal risks. Besides credit risk and market risk now operational risk is also an area where banks are required to make additional provisioning.

10.3.7. Operating Expenses:

Due to constant pressure on the spreads (NIM), the operating expenses, if high, may adversely affect the profitability of the banks. Therefore, there is a tremendous pressure on the banks to cut down their establishment costs.

10.3.8. Business per Employee:

This is calculated by dividing the total business (Deposits +Advances) by Total Number of Employees. Higher the ratio, higher would be the profit. Banks with higher ratio are

10.3.9. Profit per Employee: Net Profit/Total number of Employees

10.4 FACTORS ADVERSELY AFFECTING BANK'S PROFITABILITY :

The following are the various factors adversely affecting the profitability of Banks:

10.4.1. High Cost Deposit: Cost of deposit is the first and foremost determinant of bank's profitability. The banks are now impressing upon their branches to increase CASA (Current Account Savings Account Deposit), in order to bring down their cost of deposit. An ideal mix / composition of deposits is very essential to reduce the Net Interest Margin (NIM).

10.4.2. Low Yield on Advances: Compulsive & Mandatory lending to certain sectors is also denting the profitability of the banks. Commercial banks are being asked to do social lending to certain weaker and downtrodden sections of the society by the Government at comparatively low rates.

10.4.3 Low Net Interest Margins: Spread of almost all the commercial banks is under tremendous pressure since opening up of economy. There is almost 40-50% steep decline in the NIM since last decade. Banks are now trying to meet this gap by way of exploring areas / avenues of fee based income like mutual funds, insurance, gold etc.

10.4.4. High Establishment Costs: Besides usual increase in the establishment expenses every quarter by way of dearness allowance etc, the salaries of the bank employees is increased after every four –five years by way of wage revisions. This increase unless matched with the proportionate increase in the income may dent the profitability.

10.4.5. Unplanned Branch Expansion: Branch expansion is a very expensive proposal and involves huge expenditure at the initial stage but their recovery takes lot of time sometimes minimum two to three years. Therefore, opening of branches must correspond to the corresponding increase in income otherwise it may be a losing proposition.

10.4.6. Lack of Control over Other Overheads (Non-Establishment Costs): Besides, establishment cost (employee's overheads), other expenses like rentals, electricity, technology obsolescence, if go unchecked may severely impact the profitability. Therefore, it is imperative to have to close supervision over each and every head of expenses to keep the profits intact.

10.4.7. Thefts /Frauds /Misappropriation of Funds by Insiders and Outsiders: This is now called as operational risk by the banks. These are the areas where banks are caught unaware but the losses are sometimes unimaginable and unbearable. Therefore, an advance planning by way of adopting various internal and external checks / audits, taking adequate insurance cover against such risks and making provisions for such losses severely affect the profitability of the banks.

10.4.8. Increase in number of Restructured Accounts: Banks are facing higher provisioning on restructured advances also, with the central bank implementing the Mahapatra committee recommendation. Fresh restructured standard assets will attract provisioning requirement of 5.00 per cent, as against 2.8 per cent. The full impact of the increase in provisioning will be felt in the September quarter. Also, for the existing restructured assets portfolio, the provisioning has to be gradually raised to five per cent by March 2016.

10.4.9. Unhedged Currency Exposure of Corporate Borrowers: Unhedged foreign currency exposures can result in significant losses to companies due to exchange rate movements. These losses might reduce their capacity to service the loans taken from banks and thereby affect the health of the banking system. In several interactions with the bankers, RBI had indicated that merely 40-50 per cent of corporates' exposures are hedged. Large banks are likely to be impacted the most if the proposal is implemented. RBI has suggested

additional standard provisioning of 20 basis points to 80 basis points depending on the unhedged portion.

10.4.10 Non-Performing Assets –Impact of NPAs on Profitability: As also discussed in the earlier chapters, non-performing assets grossly dent the profitability of the banks in many ways.

- As per the Income Recognition Norms, on declaration of an account as NPA, the bank cannot treat the interest accrued thereafter as its income. Banks loose income right from the day of an account declared as NPA.
- The bank's funds that get blocked in NPAs leads to opportunity cost as the money so blocked could be invested in some other projects/ventures. As such, NPAs do not only affect current profit but also future stream of profit, which may lead to loss of some long-term beneficial opportunity.
- The blockage of funds may lead to borrowing money for shortest period of time which may further cause additional cost to the company.

The banks are required to make provisioning on these assets, which impact their profitability. The provisions are made not only against substandard /doubtful/loss assets, but also against standard assets in the following manner;

Provisions against Standard Assets:
From the year ending 31.03.2000, the banks have been making a general provision of a minimum of 0.40 percent on standard assets on global loan portfolio basis. The provisions on standard assets should not be reckoned for arriving at net NPAs. The provisions towards Standard Assets need not be netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' under 'Other Liabilities and Provisions - Others' in Schedule 5 of the balance sheet.

***Provisioning against Sub-standard Assets*:**
A general provision of 15 percent on total outstanding should be made without making any allowance for ECGC guarantee cover and securities available. However, the provisions for unsecured advances (unsecured exposures) which are identified as 'substandard' would attract additional provision of 10 per cent, i.e., a total of 25 per cent on the outstanding balance. However, in view of certain safeguards such as escrow accounts available in respect of infrastructure lending, infrastructure loan accounts which are classified as sub-standard will attract a provisioning of 20 per cent instead of the aforesaid prescription of 25 per cent. To avail of this benefit of lower provisioning, the banks should have in place an appropriate mechanism to escrow the cash flows and also have a clear and legal first claim on these cash flows. The provisioning requirement for unsecured 'doubtful' assets is 100 per cent.

***Provisions against Doubtful Assets*:**
100 percent of the extent to which the advance is not covered by the realizable value of the security to which the bank has a valid recourse and the realizable value is estimated on a realistic basis. In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 25 percent to 100 percent (25% upto One year, 40% from one year to three years and 100% above three years) of the secured portion depending upon the period for which the asset has remained doubtful.

Provisioning against Loss Assets:
Loss assets should be written off. If loss assets are permitted to remain in the books for any reason, 100 percent of the outstanding should be provided for.

I. Time and efforts of management in handling and managing NPAs would have diverted to some fruitful activities, which would have given good returns. Banks have to deploy special / skilled manpower to handle NPAs, which is additional cost to the bank.

II. NPAs adversely affect the market value of bank. The data is published in newspapers / bulletins and hits the goodwill and brand image of the bank. This may have negative impact to the people who are putting in their money in the banks.

10.5 PROFITABILY SCENARIO OF COMMERCIAL BANKS IS INDIA :

A significant improvement in the NPA portfolio has been witnessed after the introduction of reforms in this sector particularly after 2000. There has been a decline in the non-performing assets (NPAs) of Schedule Commercial Banks in 2003-04, despite adoption of 90 day delinquency norm (as against earlier norm of 180 days) from March 31, 2004. The gross NPAs of SCBs declined from 4.9 per cent of total assets in 2000-01 to 3.3 per cent in 2003-04. The corresponding decline in Net NPAs was from 2.72 per cent to 1.2 per cent. Both gross NPAs and net NPAs declined in absolute terms also. While the gross NPAs declined from Rs. 68,717 crores in 2002-03 to Rs. 64,785 crore in 2003-04, net NPAs declined from Rs. 32,632 crores to Rs. 24,396 crores in the same period.

The gross NPAs of SCBs declined by Rs.7, 309 corers during 2005-06 over and above the decline of Rs.6, 561 corers in the previous year. Increased recovery of NPAs, decline in fresh slippages and a sharp increase in gross loans and advances by SCBs led to a sharp decline in the ratio of gross NPAs to gross advances to 3.3 per cent at end-March 2006 from 5.2 per cent at end-March 2005. Likewise, net NPAs as percentage of net advances declined to 1.2 per cent from 2.0 per cent at endMarch 2005 and gross NPAs to total assets 1.83 percent at end-March 2006 from 2.52 at endMarch 2005. The setting up of the Asset Reconstruction Corporation of India (ARCIL) has provided a major boost to bank's efforts to recover their NPAs. Indian banks recovered a higher amount of NPAs during 2007-08 than that during the previous year. Though the total amount recovered and written-off at Rs.28,283 crores in 2007-08 was higher than Rs.26,243 crores in the previous year, it was lower than fresh addition of NPAs (Rs.34,420 crores) during the year.

As a result, the gross NPAs of SCBs increased by Rs.6, 136 crores in 2007-08. During the crisis year 2008-09, the gross NPA ratio remained unchanged for Indian banks. However, during 2009-10, the gross NPA ratio showed an increase to 2.39 per cent. After netting out provisions, there was a rise in the net NPA ratio of SCBs from 1.05 per cent at end-March 2009 to 1.12 per cent at end-March 2010. The growth in NPAs of Indian banks has largely followed a lagged cyclical pattern with regard to credit growth, the pro-cyclical behaviour of the banking system, wherein asset quality can get compromised during periods of high credit growth and this can result in the creation of NPAs for banks in the later years. At end- June 2010, there were 13 registered Securitization Companies / reconstruction companies in India. Of the total amount of assets securitized by these companies at end-June 2010, the largest amount was subscribed to by banks. The net NPAs to net advances ratio of each of the public sector banks as at end-March 2009 was less than 2 per cent.

10.6 BANK'S PERFORMANCE / CHALLENGES TO PROFITABILITY :

At the time of implementation of recommendations of Narisiham Committee in 1992, the balance sheets of almost all the Public Sector Banks except two-three banks were in red. Three banks, namely, UCO, United and Indian Bank were declared weak banks and were permitted to carry on only 'narrow banking (to accept deposit of money from public and

making investments in Govt. approved securities) activity. Many banks were capitalized by the Govt. as their capital and reserves were swayed away completely by the NPAs.

- The Banks have overall demonstrated a trend of continued good performance and profitability despite rising interest rates, increase in operating costs and the spill over effects of recent global financial crisis. This is reflected in higher credit growth deposit record, better return on assets, and return on equities. (ROE). The capital position improved significantly as the banks were able to mobilize substantial funds.
- The level of NPAs has been brought down by almost all the banks through certain measures like; good credit appraisal procedures, effective internal control systems as well as serious efforts to improve asset quality in their balance sheets.
- However, maintaining profitability is a challenge to commercial banks especially in a highly competitive era and opening up of banking business to NBFC and foreign banks in general. This assumes significance in a period of rising interest rates and operating costs of borrowers in general. There are lot of restrictions and preemptions on banks like maintenance of mandatory reserves like CRR and SLR. Other restrictions are lending to priority and weaker sections of the society, viz. social lending.
- Banks would make efforts to mobilize funds in order to comply with provisioning norms and capital adequacy requirements while meeting Basel III standards which will be brought in by RBI shortly. However, the Capital requirements would be large considering the varied structure of banks and financial institutions operating in the economy and their NPA levels. The capital market environment currently prevailing in the economy would pose problems for the capital mobilization by the banks.
- Finally, it is significant to note that new and private sector banks led by ICICI Bank and HDFC Bank, with their high capital adequacy ratios, enhanced proportion of common equity and better IT and other modern financial skills of the personnel, are well placed to comply with Basel III norms in general. PSU banks although dominant banks in the Indian financial system may take more time and face challenges in following the Basel III guidelines in the ensuing years.

10.7 PERFORMANCE BUDGETING SYSTEM – INTRODUCTION :

The financial system of our country during the British period was characterized by high degree of centralization, adherence to rigid financial rules and procedures, integration of accounts and audit etc. After independence, attempts have been made to make the financial administration performance-oriented, with a view to bringing about efficiency and economy in the implementation of plans, programmes and activities. Efforts were made to make the budget an efficient tool of plan implementation. The result has been the introduction of the performance budgeting system in the Government.

Performance budgeting is generally understood as a system of presentation of public expenditure terms of functions, programmes, performance units, viz. activities, projects, etc., reflecting primarily, the Governmental output and its cost. It is essentially a process which brings out the total Governmental operations through a classification by functions, programmes and activities. Through suitable narrative statements and workload data that form an integral part of the presentation, it indicates the work done, proposed to be done and the cost of carrying these out. The main thrust of performance budgeting has been on providing output-oriented budget information within a long range perspective so that resources could be allocated more efficiently and effectively. Its emphasis is on accomplishment rather than on the means of accomplishment. The purpose of Government

expenditure is more important than the object of expenditure under performance budgeting. Thus performance budgeting is a programme of action for any given year with specific indicators regarding tasks, the means of achieving them and the cost of achieving them. It tries to define the physical and financial aspects of each programme and activity and thereby establish the relationship between output and inputs. Performance budgeting has to operate within the framework of clearly defined objectives which are to be achieved through successful implementation of various programmes and activities undertaken by the concerned agency. Performance budgeting, therefore, involves the development of more refined management tools, such as work measurement, performance standards, unit costs, etc.

10.8 OBJECTIVES OF PERFORMANCE BUDGETING SYSTEM :

- i) correlate the physical and financial aspects of programmes and activities;
- ii) improve budget formulation, review and decision-making at all levels of management in the government machinery;
- iii) facilitate better appreciation and review by the legislature;
- iv) make possible more effective performance audit;
- v) measure progress towards long-term objectives as envisaged in the plan; and
- vi) bring annual budgets and developmental plans together through a common language.

10.9 COMPONENTS OF PERFORMANCE BUDGET :

The performance budgets have certain vital ingredients that need to be constantly kept in view:

- i) a programme and activity classification that represents the range of work of each organisation;
- ii) a framework of specified objectives for each programme;
- iii) a stipulation of the targets of work or achievement; and
- iv) Suitable workload factors, productivity and performance ratios that justify financial requirements of each programme.

10.10 FORMULATION OF PERFORMANCE BUDGET :

Each performance budget will in the first instance indicate the organizational structure and the broad objectives that govern the approaches and work of the administrative agency. This is followed by a Financial Requirements Table. This Table is the most important part of the performance budget and has three basic elements: - a programme and activity classification indicating the range of work of the agency in meaningful categories - object-wise classification showing the same amount distributed among the different objects of expenditure such as establishment charges; and - sources of financing indicating the budgetary and account heads under which the funds are being provided in the budget.

10.11 STEPS IN PERFORMANCE BUDGETING :

Four basic steps are involved in the introduction of performance budgeting:

- i) Establishing a meaningful classification of public expenditure in terms of functions,
- ii) The establishment, improvement and extension of activity schedules for all measurable activities of the government;

iii) The establishment of work output, employee utilisation, standard or unit costs by objective methods, i.e. bringing the system of accounting and financial management into accord with the classification; and

iv) The creation of related cost and performance recording and reporting system.

The important requirement for performance budgeting is a programme of action for any given year with specific indications regarding the tasks, the means of achieving them and the costs of achieving them. This is important even in traditional budgeting process. The distinction, however, is that under performance budgeting the organisations are compelled to think of their future activities not merely in terms of financial plans but in terms of the results, work assignment and organisational responsibilities. It is normally held that in the context of planning for economic growth, planning is a thinking process and budgeting is a doing process. Since the physical and financial aspects go together and the programme structure is expected to be the same, performance budgeting facilitates the functional integration of the thinking and doing process. The formulation of programmes for achieving the organisational goals is an important task in the budgetary process. A programme is a segment of an important function and represents a homogeneous type of work.

These programmes of work need to be developed for meeting the short-term plans, medium-term plans and long-term plans and involve formulation of schemes, laying down their targets, measuring the financial costs and benefits. The programme has to be assessed in the light of financial and economic factors i.e. ensuring adequate resources for the programme so chosen and examination of the impact of the proposed outlays on the economy as a whole through cost-benefit analysis. Complex programmes are divided into sub-programmes to facilitate execution in specific areas. Each programme or sub-programme further consists of many activities which are shown in the respective budgets. For example immunization programme is a programme under the function 'health'.

As each programme has many activities, provision for storage of vaccines could be an activity under the programme. The real commencing point in the budgetary process is allocation of resources. In the conventional system primary emphasis is laid on the previous level of allocations and spending and no emphasis is laid on its performance in terms of its objectives and the programme of action that it has set out for itself for the next year. Under performance budgeting the primary agency prepares the budget, submits its requirements as per programme classification. It indicates its past activities, their costs, and the activities to be taken up during the next year, the results expected and the pattern of assignment of responsibilities. The very basis of the performance budgeting is commitment to achievement and the awareness of accountability.

The budget so prepared is reviewed at higher level and resources are allocated keeping in view the priorities of the proposal. Sometimes due to financial constraints resources may not be available in full and a cut has to be imposed. However, this may be done in full awareness of the implications of the cut on the programme. Under performance budgeting, the programme classification and the rationale behind it indicate a group of choices with their priorities, already made. This minimizes the dis-locational effect of cuts and ensures a better identification of their impact on programme achievement.

Resource allocation is followed by budget execution. Budget execution must ensure achievement of objectives and for that the following budgetary and managerial considerations must be kept in view: i) Communication of the grants to the various subordinate agencies well in time ii) Ensuring the initiation of action for implementing the schemes provided for in the budget iii) Overseeing the regular flow of expenditures iv) Prevention of cost over-runs;

and v) Time phased plan for expenditure and work. The final stage in the performance budgeting process is appraisal and evaluation. Under the existing system evaluation of the physical achievements in certain sectors is being undertaken by the Programme Evaluation Organization. Under performance, budgeting, each programme would lend itself to an evaluation by the agency concerned, even before it is undertaken by an outside organization. The important ,aspect is that evaluation should, as far as possible, follow the completion of a programme and the administration should be enabled to formulate its future course of action in the light of results obtained.

10.12 PERFORMANCE BUDGETING SYSTEM IN BANKS :

The Banking Commission in its report in 1972 recommended various management tools including the introduction of planning and budgetary control systems in order that the banks are better able to increase their operational efficiency (4). Also in 1972, the Ministry of Finance, Banking Department of the Government of India, directed public sector banks to prepare annual business plans and take measures to introduce performance budgeting. Further, in the top management seminars sponsored by the National Institute of Bank Management in May 1972 and April 1973, it was decided to introduce performance budgeting in commercial banks. The report of the Productivity, Efficiency, and Profitability Committee on Banking (PEP committee) set up by the Reserve Bank of India in 1977 stressed the need for adopting planning and performance budgeting in banks and stated : "The performance budget helps the management to proceed along the projected goals and the performance evaluation at monthly or quarterly intervals indicates the deviations and corrective actions that should be initiated".

The performance budgeting system was initially introduced in 1972 by one of the major commercial banks in the country (State Bank of India) for accelerating the tempo of efforts to channelize credit to priority sectors. Subsequently, it was launched in other banks. Since 1974 most of the nationalized banks and some of the private sector banks have adopted this system. However, some of these banks introduced performance budgeting system in a phased manner rather than simultaneously extending its scope to all regions and all branches.

Performance budget in a bank has to be formulated after taking into account several factors:

(a) The policy framework provided by the Reserve Bank of India;
(b) business potential available in the context of the economic, political, and social environment;
(c) internal strengths and constraints in terms of the capacity of the staff and physical facilities available;
(d) past trend of business in the bank, as well as in the industry; and
(e) Anticipated changes in both environmental factors as well as policies of the Reserve Bank of India.

The overall process of performance budgeting as practised in commercial banks consists of two phases:

(a) Formulation and settlement of the budget: and
(b) Reviewing or monitoring of performance.

The settlement of budget is a vital step in the process of development of realistic and mutually acceptable budgets. It bridges the planning gap that may exist between draft branch budgets compiled by the branch manager on the basis of his judgment of the likely business potential, and aspirations of the bank as embodied in the head office policy guidelines. During the settlement meetings with the divisional manager, the branch budgets are adjusted

to the needs of the corporate plan and the available business potential. "An ideal settlement process recognizes the planning gap that usually exists between the branch manager and regional manager. It calls for a free and frank dialogue between the regional manager and the individual branch manager with a clear awareness on the part of both of the constraints under which they have to work and of the goals to be reached."

Similarly, to close the planning gap that might exist between the draft divisional and regional budgets, a settlement meeting is necessary in which the divisional and regional managers hold a face to face discussion with the chairman and managing director and the chief of functional departments at the head office.

This process of settlement of divisional budgets involves the matching of apex-level aspirations with the regional potentials, strengths, weaknesses, opportunities, and threats. Thus the budget settlement process involves the crucial matching of the macro and micro level planning expectations through an interface of the controlling authority and the executive in charge of the budget centre.

10.13 SUMMARY :

Profit is the life blood of an organization. Profit is a symbol of prestige for an Institution. Profit is a sign of progress and prosperity. No Institution can remain fit without profit. Profit increases the shareholders value. Profit improves the capital adequacy. Profit creates employment opportunities in an organization. Profit builds not only an organization, but also the entire nation and nation's economy. No social banking can be undertaken by an Organization unless it is profitable. Banks accept deposits of money from the public; and profit creates trust and confidence in the public. The people always prefer to keep money in a bank which is profitable. This lesson explains about sources of income of banks, indicators of bank's profitability, and also illustrates the factors affecting adversely the profitability of banks, banks performance/challenges to profitability. Performance budgeting is generally understood as a system of presentation of public expenditure terms of functions, programmes, performance units, viz. activities, projects, etc., reflecting primarily, the Governmental output and its cost. It is essentially a process which brings out the total Governmental operations through a classification by functions, programmes and activities. This lesson addresses the concept of performance budgeting system and its objectives, components. Further, demonstrate the formulation procedure of performance budget and various steps involved in preparation of performance budgeting and performance budgeting system in banks

10.14 KEY WORDS :

1. Bill Discounting: Bill discounting is a form of loan that is available to the beneficiary of the invoices and has to be repaid if the bank or the lender does not realize the amount of the bill when presented to the buyer at the time of maturity or at the end of the credit period.
2. Return on Assets (ROA): The term return on assets (ROA) refers to a financial ratio that indicates how profitable a company is in relation to its total assets. Corporate management, analysts, and investors can use ROA to determine how efficiently a company uses its assets to generate a profit.
3. Return on Equity (ROE):ROE measures the company's operating efficiency. It shows how the company uses its assets and financial leverage to generate revenue for the business.
4. Unhedged Currency: An unhedged investment is one that is fully exposed to the risk of currency fluctuations. The fund manager does not generally actively try to offset any dips or rises in the value of your investment caused by changes to currency values.

5. Non-Performing Assets: It is a debt instrument where the borrower has not made any previously agreed upon interest and principal repayments to the designated lender for an extended period of time. The nonperforming asset is, therefore, not yielding any income to the lender in the form of interest payments.

10.15 SELF ASSESSMENT QUESTION :

- Describe the Sources of Income of Banks?
- What are the indicators of Bank Profitability?
- Explain the factors affecting adversely the profitability of banks.
- What are the components which appear on the liabilities side of bank's balance sheet?
- Critically examine the performance budgeting system.
- What are the objectives and components of performance budgeting?
- Explain the Steps involved in preparation of performance budgets.
- Elaborate the performance budgeting system in banking sector.

10.16 SUGGESTED READINGS :

1. "Principles & Practices of Banking, Indian Institute of Banking & Finance", Macmillan, New Delhi, 2012.
2. Ralph G. Hawtrey, "The Art of Central Banking", Taylor & Francis, 2012.
3. V.S.P. Rao, "Bank Management", discovery Publishing House, New Delhi, 1999.
4. D. Muraleedharan, "Modern Banking: Theory and Practice", Prentice Hall of India Learning Pvt. Ltd., Delhi, 2014.
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Dr. G. NAGA RAJU

LESSON – 11

BANK MARKETING AND COMPUTERIZATION OF BANKS

OBJECTIVES :

After go through this lesson you are able to:

- To know the concept of Bank marketing.
- Understand the basic concepts of Convergence of networks and its related information.
- Introduction of Wireless Application Protocol (WAP), its major concepts and uses in financial sector.
- Understand Virtual Private Network (VPN), its architecture and protocols, its role in Banking and Financial sector.
- Multimedia systems and its applications in banking industry.

STRUCTURE :

11.1 Introduction
11.2 Convergence of Networks
11.3 Wireless Application Protocol (WAP)
11.4 Virtual Private Network (VPN)
11.5 Multimedia Systems
11.6 Multimedia Applications in Banking and Finance
11.7 Summery
11.8 Technical terms
11.9 Self Assessment Questions
11.10 Reference books

11.1 BANK MARKETING:

Product:

A product is a set of tangible and intangible attributes which may include, packaging, color, price, and quality, brand, and seller reputation and seller services. The first commandant in marketing is the customer and the second is the product. In narrow sense product is the product is set of basic attributes assembled in an identified form. Each product is identified by a commonly understood descriptive name, such as steel, insurance, tennis rackets etc.

There are many definitions of product by different authors

1) Product is a set of tangible and intangible attributes, which may include packaging, color, price, quality, brand and seller's services and reputations
2) Product is a service that provides the benefit of a comfortable night rest.
3) Product is a place that provides sun and sand, relaxation, romance, cross cultural Experiences and other benefits.

Explanation: We treat each brand as separate product. Any change in a feature (design, color, size, packing) however minor, creates another product. Each such change provides the

seller with inopportunity to use a new product. A product may be a good, service, place, person or idea. Customers buy products to satisfy their needs.

Classification Of Product :

Products or goods are basically of two types.

(1) Consumer goods

(2) Industrial goods

I. Consumer goods:

Consumer products are produced for personal consumption by households. There are four types of consumer goods.

i. **Convenience goods:** Goods that the consumer usually purchase frequently, immediately, and with the minimum of effort in comparison and buying for most buyers, convenience goods include many food items, inexpensive candy, drugs like aspirin and tooth paste, hardware items such as light bulbs and batteries. Convenience goods have low price are not greatly affected by fad and fashion. A manufacturer prepares these products to distribute it widely and rapidly.

ii. **Shopping goods:** A tangible product for which a consumer wants to compare quality, price and perhaps style in several stores before making a purchase is known as shopping goods. Examples of shopping are furniture, automobiles, major appliance etc. The process of searching and comparing continues as long as consumer feels satisfaction. The shopping goods can be divided into homogeneous and heterogeneous goods. The homogeneous goods are similar in quality but different in price. The heterogeneous products are different in quality and prices.

iii. **Specialty goods:** A tangible product for which a customer give preference to a strong brand and he wants to expend substantial time and effort in locating the desire brand is called a specialty good. Examples of specialty goods are men’s suits, stereo sound equipment, health foods, photograph equipment, new automobiles and certain home appliances. The specialty goods do not involve the buyer’s making comparisons, the buyer only invest time to reach the dealers carrying the wanted products.

iv. **Unsought goods:** An unsought good is a new product from which a consumer is not aware. More people are unaware of interactive movies. An electric car might be an unsought good for most people, because they are unaware of it. Bathroom tissue made strictly from cotton fiber would seem to bean unsought good. A firm faces a very difficult, perhaps impossible advertising when trying to market unsought goods. Marketers market unsought goods by placing ads on bus-stop benches or in church buildings.

II. Industrial goods/Business goods:

Industrial products are purchased to produce other products or for use in a firm’s operations. Industrial products are purchased on the basis of organization’s goals and objectives. On the basis of their uses and characteristics, industrial or business products can be classified into four categories

i. **Raw material:** Raw materials are the basic materials that actually become part of the product. They are provided form mines, forests, oceans, farms and recycled solid wastes.

ii. Fabricating Materials and parts/Capital items:-Major equipment includes large tools and machines used for production purposes. Examples are rather, cranes, Stamping machines.

iii. Accessory Equipment:-Accessory equipment does not become part of the final product but is used in production or office activities. Examples include, hand tools, type writers, fractional horse power motors etc. Accessory equipments are less expensive than capital items.

iv. Component Parts:-Component parts become a part if the physical product and either are finished items ready for assembly or are products that enter the finished product completely with no further change inform, as when small motors are put into vacuum cleaners and tires are added on automobiles. Spark plugs, tires, clocks and switches are all component parts of the automobile

New Product Development :

Here are several possible categories of new products. Each separate category may require quite a separate marketing programmed to ensure a reasonable probability of market success. Three considerable categories of new products are:

i. **Products which are really innovative:** Truly unique, e.g., a hour restores, cancer cure products for which there is a real used but for which no existing substitutes are considered satisfactory. In this case we also includes product that are quite different from existing product but satisfy the same need.

ii. **Replacement for existing products: That** is significantly different from existing goods. Annual model, change automobiles and new fashions in clothing, belong to this category.

iii. **Imitative Product:** That is new to a particular company but not new to market, with a "me-too" product. Perhaps the key criterion as to whether a given product is new is how to intend market perceives it. If a buyer perceives a product is significantly different from competitive goods in some characteristics then it is a new product.

REASONS OF FAILURE OF NEW PRODUCT

The new product fails due to certain reasons in market.

1) The idea is good, but market size is overestimated.
2) The product is not well-designed.
3) The product is incorrectly positioned in market, no advertised effectively and over- priced.
4) The product fails to gain sufficient distribution coverage or support.
5) Development costs are higher than expected.
6) Meteors fight back harder than expected.

New Product Strategy :

A new product strategy is a statement identifying the role of new product is expected to play in achieving corporate and marketing goals. New product development process

Stages :

A new product is best developed through a series of eight stages. As compared to unstructured development the formal development of new product provides benefits such as improved team work, lesser work, earlier failure detection and most important higher success rate.

1. **Idea generation:** The new product Development process with the search for ideas. New product ideas comes through interacting with various group of people , such as customer, scientists, competitors , employees and top management. Companies can also find good ideas by searching competitor's products and services. From this they can find out what the customers likes and dislike about competitors products. They can buy their competitors products, take them apart and build better ones. Many

companies also encourage employees particularly those on production line to come forth with ideas, often offering cash reward for good suggestion. New product ideas also come from inventors, university and commercial laboratories, advertising agencies. As the ideas start to flow, one wills sprat another, and within a short time hundred of new ideas may be brought to surface.

2. **Idea screening:** Idea screening is second stage in new product development once a large pool of ideas has been generated by whatever their means, their number have to be pruned to manageable level. In screening ideas the company must avoid two types of error.

   Drop error: Occurs when the company dismisses an otherwise good idea.
   Go error: Mean adoption of poor ideas

The purpose of screening is to drop poor ideas as early as possible. Many companies require their executives to write up new product on a standard form that can be received by a new product committee. The write up describes product idea, target market and competition. It makes some rough estimate of market size, product price, development cost and rate of return.

3. **Concept development and testing:** A product idea is possible product the company might offer to the market. A product concept is an elaborated version of ideas expressed in a meaningful consumer terms. Throughout the stages of idea generation and screening, the developers are only with the product idea, general concept of what product might be. Concept development involves many questions: I) who will buy the new production ii) what is the primary benefit of new product? iii) Under what circumstances, the new product may be used?

Concept testing: Concept testing involves presenting the product concept to appropriate target consumers and getting their reactions.

4. **Marketing Strategy:** Following the successful concept test, the new product manager will develop a preliminary marketing strategy plan for introducing the new product into market. The plan consists of three parts. The first part describes the target market size, structure and behavior, the planned product positioning and sales, market share, profit goals sought in the first few years. The second part outlines the planned price, distribution strategy and marketing budget for first year. The third part of marketing strategy plan describes the long run sales and profit goals and marketing strategy overtime.
5. **Business Analysis:** The next step in new product development is business analysis. The market must project costs, profit and return on investment for the new product if it were placed in market. Business analysis is not a short process; it is a detailed realistic projection of both maximum and minimum sales and their impact on economy or company. For some products such as another candy bar, marketers can use existing sales data to guide themselves. But with a product, for which sales data does not exist, only estimation can be used.
6. **Product Development:** If the result of business analysis is favorable then a prototype of the product is developed. In development stage, the idea is given in a concrete or tangible form. Up to now, the product has existed only a word description, a drawing or a prototype. This step involves a large investment. The company will determine whether the product idea can be translated into a technically and commercially feasible product.

7. **Test marketing:** After management is satisfied with functional and psychological performance, the product is ready to be dressed up with a brand name and packaging and put into a market test. Test marketing involves how large the market is and how consumers and dealers react to handling, using and repurchasing the product. The amount of test marketing is influenced by investment cost and risk on one hand anytime pressure and research cost on the other.
8. **Commercialization:** As the company goes ahead with commercialization, it will face its large gets costs to date. The company will have to contract for manufacturing facility. Another major cost is marketing

Example: To introduce a major new consumer packaged goods into the national market, the company may have to spend b/w $20 million and $80 million in advertising and promotion in the first year. In the introduction of new food products, marketing expenditures typically represents57% of sales during the first year

Today's financial business is technology driven. Technology is a source of competitive strength and is used as a competitive strategy to reach the customer at his doorstep. In the scenario, bank and finance personnel should be aware of technical opportunities in order to meet the customer expectation. The main objective of this unit is to impart the awareness about various technologies and their application in banks and financial institutions.

11.2 CONVERGENCE OF NETWORKS :

The arrival of the internet has changed the competitive climate significantly. As a result, organizations like banks and financial institutions need to address two key issues to retain and improve their competitive position: improve their customer understanding and relationship and introduce new efficiencies into the business to reduce their cost base.

"Convergence is defined as the melding of customer electronics, television, publishing, telecommunications, and computers for the purpose of facilitating new forms of information-based commerce".

There are two types of convergence multimedia convergence and cross-media convergence. Multimedia convergence is applies to the conversion of text, voice, data, image, graphics, and full-motion video into digital content. Cross-media refers to the integration of various industries entertainment, publication, and communication media-based on multimedia content.

Supporting technologies of convergence of networks: network infrastructures that were once separate and distinct voice and data, wired and wireless, premise and wide area are merging together advances in communications and networking technology are creating the bandwidth to make real convergence practical. Some of them are:

- **Optical technology:** optical networking can carry the entire per second traffic of internet on single stand of fiber. Backbone networks will handle 2000 times the amount of fiber.
- **Asynchronous Transfer Mode (ATM) Technology:** ATM is a high-speed, connection-oriented, and video telephony application. ATM was developed primarily to answer the need for variable bandwidth commonly known as bandwidth on-demand. The ATM concept aggregates a myriad of services on to a single access arrangement. Some of the applications include the following:
    a. Host-to-Host computer data links

b. Video conferencing circuits
c. LAN-to-LAN bridges or routed traffic
d. Multimedia networking services set by high speed devices

- **Digital Subscriber Line (DSL) Technology:** introduction in compression technology- most notably DSL- Digital Subscriber Line- are opening up a whole new range of options for people who need multimedia telecom delivered to remote offices.
- **Integrated Services Digital Network (ISDN) Technology:** ISDN standardizes connection interfaces, transmission protocols, and services. ISDN is ideal for intermittent access to the internet for high-volume data applications like video.
- **Wireless Application Protocol (WAP)/ General Packet Radio Services (GPRS):** the WAP is a communication architecture designed for wireless networks. WAP is a protocol and an open industry standard that tries to make internet mobile and cellular communication more useful by incorporating internet access. GPRS is a communication technology, which enables the functionality of the mobile phone by seamless and faster communication of pictures, data, and video.

Applications of Convergence: Applications of Convergence includes the following**:**

- Unified messaging that combines voice, fax and mail.
- Deliver reliable remote access for mobile employees.
- Customer focused call centers, integrated with websites and interactive TV to support electronic commerce.
- Voice over IP between branch offices to exploit lower cost voice and fax calls.
- Virtual Private Networks to link key customers and improve supply chain management.

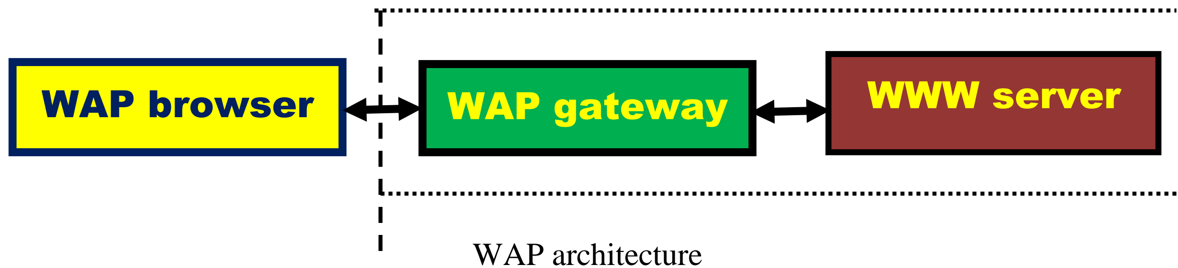
The above application ability enables organizations to create short and long term architectural and migration plans for voice, data and integrated multi-media networks, focusing on the implementation of convergence solutions to achieve strategic business value.

11.3 WIRELESS APPLICATION PROTOCOL (WAP) :

WAP bridges the gap between the mobile world and the internet as well as corporate intranets and offers the ability to deliver an unlimited range of mobile value-added services to subscribers-independent of their network, bearer, and terminal. WAP is a global standard and is not controlled by any single company. The WAP specifications define a set of protocols in application, session, transaction, security, and transport layers, which enables operators, manufacturers, and application providers to meet the challenges in advanced wireless service differentiation and fast/ flexible service creation.

"Wireless Application Protocol (WAP) is an application environment and set of communication protocols for wireless devices designed to enable manufacturer, vendor, and technology-independent access to the internet and advanced telephony services".

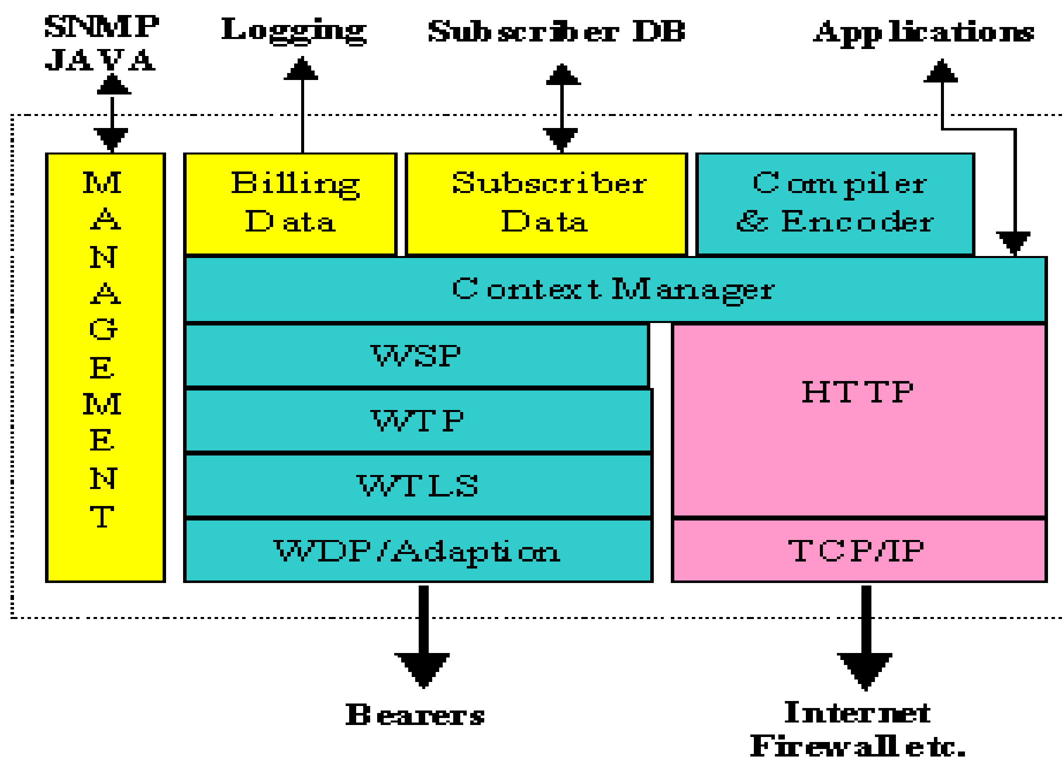
WAP Architecture: there are three participating entities: the WAP browser, the WAP gateway, the server on the internet.



WAP architecture

When the mobile device is wants to connect to the Internet, all the communication passes through the WAP gateway. This WAP gateway translates all the protocols used in WAP to the protocols used on the Internet.

WAP Gateway: this architecture contains some basic items. These are as follows.



Architecture of WAP Gateway

1. **WDP:** the WAP Datagram Protocol (WDP) is the transport layer that sends and receives messages via any available bearer network, including SMS, USSD, CSD, CDPD, IS-136 packet data, and GPRS.
2. **WTLS:** Wireless Transport Layer Security (WTLS), an optional security layer, has encryption facilities that provide the secure transport service required by many applications, such as e-commerce.

3. **WSP:** the WAP Session Protocol (WSP) layer provides a lightweight session layer to allow efficient exchange of data between applications.
4. **HTTP Interface:** the HTTP interface serves to retrieve WAP content from the internet requested by the mobile device.

Benefits of WAP:

1. **Operators:** for wireless network operators, WAP promises to decrease churn, cut costs, and increase the subscriber base both by improving existing services, such

as interfaces to voice mail and prepaid systems, and facilitating an unlimited range of new value-added services and applications, such as account management and billing enquiries.

2. **Content providers:** WAP will enable content and application developers to grasp the tag-based WML that will pave the way for services to be written and developed within an operators' network quickly and easily.
3. **End users:** end users of WAP will benefit from easy, secure access to relevant internet information and services such as unified messaging, banking, and entertainment through their mobile services.

Application of WAP in Banking/Financial Sector:

As WAP is a global and interoperable open standard, content providers have immediate access to a wealth of potential customers like banks and other financial institutions, who will seek such applications to enhance the service offerings. Banks are providing their services over mobile phones. WAP has been used by banks to promote mobile commerce (M-Commerce) in India. Some of the services offered by banks to WAP users include the following:

1. Real-time equity and Forex quotes
2. Portfolio information
3. ATM/Branch locator
4. Travel/Ticketing information

11.4 VIRTUAL PRIVATE NETWORK (VPN) :

"A Virtual Private Network (VPN) expands a private network across a public network, such as the internet. It enables users to send and receive data across shared or public networks as if their computing devices were directly connected to the private network, and thus are benefiting from the functionally, security and management policies of the private network".

A virtual private network (VPN) allows the provisioning of private network services for an organization or organizations over a public or shared infrastructure such as the Internet or service provider backbone network. The shared service provider backbone network is known as the VPN backbone and is used to transport traffic for multiple VPNs, as well as possibly non-VPN traffic. VPNs provisioned using technologies such as Frame Relay and Asynchronous Transfer Mode (ATM) virtual circuits (VC) have been available for a long time, but over the past few years IP and IP/Multiprotocol Label Switching (MPLS)-based VPNs have become more and more popular.

VPN Devices: Before describing the various VPN technologies and models, it is useful to first describe the various customer and provider network devices that are relevant to the discussion.

1. Devices in the customer network fall into one of two categories:
   - **Customer (C) devices:** C devices are simply devices such as routers and switches located within the customer network. These devices do not have direct connectivity to the service provider network. C devices are not aware of the VPN.
   - **Customer Edge (CE) devices:** CE devices, as the name suggests, are located at the edge of the customer network and connect to the provider network (via Provider Edge [PE] devices). In CE-based VPNs, CE devices are aware of the VPN. In PE-based

VPNs, CE devices are unaware of the VPN. CE devices are either categorized as Customer Edge routers (CE-r), or Customer Edge switches (CE-s).

2. In a site-to-site VPN, devices in the service provider network also fall into one of two categories:
   - **Service Provider (P) devices:** P devices are devices such as routers and switches within the provider network that do not directly connect to customer networks. P devices are unaware of customer VPNs.
   - **Service Provider Edge (PE) devices:** PE devices connect directly to customer networks via CE devices. PE devices are aware of the VPN in PE-based VPNs, but are unaware of the VPN in CE-based VPNs. There are three types of PE device: Provider Edge routers (PE-r) Provider Edge switches (PE-s) Provider Edge devices that are capable of both routing and switching (PE-rs).

VPN Technologies and Protocols: A number of technologies and protocols are used to enable site-to-site and remote access VPNs. These protocols and technologies are described in the sections that follow.

1. **Technologies and Protocols Used to Enable Site-to-Site VPNs:** In site-to-site VPNs customer user data traffic is either tunneled between CE devices or between PE devices. Site-to-Site VPNs are also occasionally referred to as LAN-to-LAN VPNs. Protocols and technologies used to enable site-to-site VPNs include IP Security (IP sec), Generic Routing Encapsulation (GRE), the Layer Two Tunneling Protocol version 3 (L2TPv3), Draft Martini pseudo wires (emulated circuits), IEEE 802.1Q tunneling (Q-in-Q), and MPLS Label Switched Paths (LSP). These protocols and technologies are described as follows:
   a. **IPSec:** IP sec consists of a suite of protocols designed to protect IP traffic between security gateways or hosts as it transits an intervening network. IPSec tunnels are often used to build a site-to-site between CE devices (CE-based VPNs).
   b. **GRE:** GRE can be used to construct tunnels and transport multiprotocol traffic between CE devices in a VPN. GRE has little or no inherent security, but GRE tunnels can be protected using IPSec.
   c. **Draft Martini (Any Transport over MPLS [ATOM]):** Draft Martini transport allows point-to-point transport of protocols such as Frame Relay, ATM, Ethernet, Ethernet VLAN (802.1Q), High-Level Data Link Control (HDLC), and PPP traffic over MPLS.
   d. **L2TPv3:** L2TPv3 allows the point-to-point transport of protocols such as Frame Relay, ATM, Ethernet, Ethernet VLAN, HDLC, and PPP traffic over an IP or other backbone.
   e. **IEEE 802.1Q tunneling (Q-in-Q):** 802.1Q tunneling allows a service provider to tunnel tagged Ethernet (802.1Q) customer traffic over a shared backbone. Customer 802.1Q traffic is tunneled over the shared provider backbone by prep ending another 802.1Q tag.
   f. **MPLS LSPs:** An LSP is a path via Label Switch Routers (LSR) in an MPLS network. Packets are switched based on labels prep ended to the packet. LSPs may be signaled using the Tag Distribution Protocol (TDP), the Label Distribution Protocol (LDP), or the Resource Reservation Protocol (RSVP).

2. **Technologies and Protocols Used to Enable Remote Access:** VPNs Protocols used to enable remote access VPNs (discussed later in this chapter) include the following:

a. **The Layer Two Forwarding (L2F) Protocol:** L2F is a Cisco proprietary protocol that is designed to allow the tunneling of PPP (or Serial Line Interface Protocol [SLIP]) frames between a NAS and a VPN gateway device located at a central site. Remote access users connect to the NAS, and the PPP frames from the remote access user are then tunneled over the intervening network to the VPN (home) gateway.
b. **The Point-to-Point Tunneling Protocol (PPTP):** PPTP is a protocol that was developed by a consortium of vendors, including Microsoft, 3Com, and Ascend Communications. Like L2F, PPTP allows the tunneling of remote access client PPP frames between a NAS and a VPN gateway/concentrator. PPTP also allows a tunnel to be set up directly from a remote access client to a VPN gateway/concentrator. PPP encapsulated packets carried over PPTP tunnels are often protected using Microsoft Point-to-Point Encryption (MPPE).
c. **The Layer 2 Tunneling Protocol versions 2 and 3 (L2TPv2/L2TPv3):** L2TP is an Internet Engineering Task Force (IETF) standard and combines the best features of L2F and PPTP. In a remote access environment, L2TP allows either tunneling of remote access client PPP frames via a NAS to a VPN gateway/concentrator or tunneling of PPP frames directly from the remote access client to the VPN gateway/ concentrator. L2TP has limited intrinsic security, and so L2TP tunnels are often protected using IPSec.
d. **IPSec:** As well as enabling site-to-site VPNs, IPSec can also be used to securely tunnel data traffic between remote access or mobile users and a VPN gateway/ concentrator.
e. **The Secure Sockets Layer (SSL):** SSL is a security protocol that was originally developed by Netscape Communications (SSL versions 1, 2, and 3), and it provides secure remote access for mobile users or home users. Functionality may be limited (when compared with L2F, PPTP, L2TPv2, or IPSec) if clientless SSL remote access VPNs are deployed.

VPN Services work in Banking :

Whenever you use the internet through an Internet Service Provider (ISP) or at another site, your computer is given an address on that provider's network. While you can reach your bank from the Internet, you will normally be denied access to services that are restricted to bank network addresses because your computer is using an address from an external network. But, if you are on the internet, you can still connect to the Bank's VPN service, in two ways. From a web browser or with a software VPN client. A VPN need not have explicit security features, such as authentication or content encryption. Virtual Private Network set up, can be used to separate traffic of different user communities over an underlying network with strong security features:

1. Seek secured private connectivity across IP networks
2. Extends geographical connectivity
3. Improves productivity
4. Improves security
5. Reduce transit time and transportation costs for remote users
6. Reduce operational costs versus traditional WAN
7. Simplify network topology
8. Provides global networking opportunities
9. Provides broadband networking compatibility
10. Provides faster ROI than traditional WAN
11. Provides telecommuter support

Such Site to site VPN allows you to have a secured connection between locations across the open internet. With the help if site to site VPN your bank can save a great deal of money, as you can use cheaper means always - on connections such as domestic broadband rather than expensive leased lines between sites. Remote Access VPN also known as Virtual Private Dialup (VPDN). It is used by banks that have staff regularly working in locations outside the office. You can connect into the office network over dial up phone/isdn lines or over broadband from anywhere. Virtual Private Network banking uses advanced encryption and tunneling to permit computers to establish secure, end-to-end, private network connections over insecure networks, such as the Internet or wireless networks. VPN services can impact your overall computing and network performance. VPNs exist to protect traffic on public data networks like the Internet. VPN Services will work with other ISP dialup services too. Try your online route for your VPN.

VPN Regarding Finance Sector :

VPN provides can impact your over all processing and community functionality. It's really a conversation network tunneled through another network, and committed for a specific network. One frequent requested is protected e-mails through people net, but a VPN do not need to have specific security functions. They overlay other networks to supply a certain operation that's meaningful to your consumer group. Digital private communities supply protected network association which can be split together with a community, like the Web. The VPN interconnection employs the World Wide Web's facilities to move protected data to and in the campus network. The differentiating features of VPNs are not security or functionality, but they overlay other networks to offer a certain efficiency that's substantial to your customer area.

Using the aid of Digital Private marketing in financial, you are able to enhance your protection, decrease total functional expenses as from the conventional WAN. Also provide prolonged physical connection, enhance efficiency, streamline system topology and supply worldwide marketing opportunities. Additionally discover broadband marketing compatibility and supply quicker ROI than conventional WAN. There are two types of Digital Private Marketing in financial:

a. INCH website to website VPN
b. INCH remote access VPN

11.5 MULTIMEDIA SYSTEMS :

The simultaneous use of data in different media forms like voice, video, text, animations, etc. is called multimedia. Digital video and audio media are the most demanding of the new media that are being added to the repertoire of computing and communications systems. These types of media are frequently referred to as Continuous Media (CM). The term multimedia computing commonly refers to the use of multimedia data types in computer applications and systems, and multimedia communications denotes communication systems which support the real-time transmission of continuous media. A dialog is called a multimedia system if it combines several communication media at the same time such as the following:

1. Speech and sound
2. Text and drawings
3. "Naturally" produced moving images (television-stills, slides)
4. "Naturally" produced moving images (video, film)
5. Synthetically produced photorealistic moving or still images
6. Real-time interactive graphics

Application of multimedia: The integration of multimedia techniques gets more and more important with the improvement of visualization software, standardized transmission protocols and a worldwide available and powerful telecommunication infrastructure. With multimedia emerging, applications in the following areas have appeared:

1. Entertainment
2. Home shopping
3. Health care
4. Education
5. Engineering
6. Finance and Banking

I. **Entertainment:** The use of interactive media for entertainment, like sophisticated games and movies, has three stages:
   - **Video-on-demand:** The amount of programming available to audience will increase in a drive to video-on-demand services. Video-on-demand is developing as an effort by the cable television industry, and broadcasters to provide greater flexibility in what programming is shown and when.
   - **Interactive television/cinema:** The use of interactive television facilities for video-on-demand will make it possible to incorporate audience participation into existing programming.
   - **Group collaboration and teaming:** Participation will move from a highly controlled audience mode to open-ended group collaboration and teaming, from many-to-one and many-to-many.

II. **Home shopping:** Now-a-days many homes have access to cable television channels and internet in which a variety of retail goods are marketed. Two possible directions that this application might that are:
   - **Interactive Television:** in the model based on the convergence of TV and the computer, greater interactivity and an increase in the number of available channels will permit home shopping to be conducted to many retailers throughout the community.
   - **Video-telephony:** in the model based on the convergence of the TV and the telephone, subscribers would dial the retailer of interest, but would connect to the live video salesperson or prerecorded showcase.

III. **Health care:** certain segments of the healthcare industry are examples of this, and several systems involving multimedia communications and computers have been tested. The use of imaging techniques such as X-rays, MRI (Magnetic Resonance Imaging), etc. is growing in healthcare. The collection, maintenance, processing, and distribution of these records can be significantly improved by using computer-based storage and high-bandwidth communications.

IV. **Education:** the ability of multimedia materials to convey by picture, sound, animation, or movie what is otherwise hard to express, to capture for reuse on any occasion remote lands, and singular events, and with the use of the computer, to provide the information in a form that can be engagingly interactive and easily recast by any aspiring communicator is the explanation for the popularity and particularly long history of multimedia technology's role in education.

V. **Engineering:** Engineering and manufacturing groups rely increasingly on CAD (Computer Aided Design) and CAM (Computer Aided Manufacture) software to design, manufacture and maintain their products. The two roles of multimedia technology in concurrent engineering are:

- Engineering and manufacturing as a visually rich domain is a natural beneficiary of multimedia information processing.
- Group communications, when conducted via the computer workstation, allow the participants to refer to and share any on-line materials that might be appropriate to the discussion.

VI. Finance and Banking: Multimedia applications in finance and banking, touch screen kiosks have entered the business. More number of banks as part of e-banking are setting up touch screen kiosks at places such as important corporate centers, retail supermarkets, airports, etc. replacing tables and text with pictures can make the information and the interaction process more direct for users.

Characteristics of Multimedia Systems: A Multimedia system has four basic characteristics

- **a.** Computer controlled
- **b.** Integrated
- **c.** Digitally
- **d.** Interactive

Desirable Features for a Multimedia System: given the above challenges the following feature a desirable for a Multimedia system.

1. Very high processing power
2. Multimedia capable file system
3. Data representations/file formats that support multimedia
4. Efficient and high I/O
5. Special operating system
6. Storage and memory
7. Network support
8. Software tools

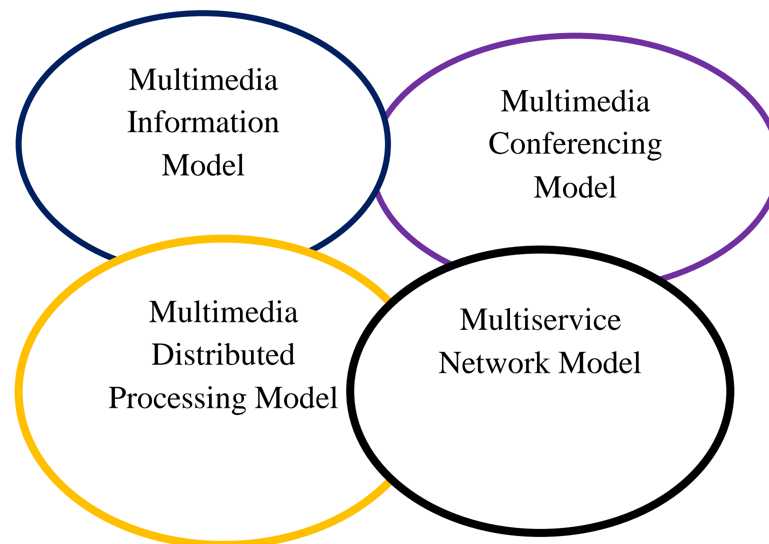
Components of Multimedia Systems: now let us consider the components (Hardware and Software) required for a multimedia system:

1. Capture devices
2. Storage devices
3. Communication networks
4. Computer systems
5. Display devices

Frame work for Multimedia Systems: The framework of Multimedia systems is an overall picture of the development of distributed multimedia systems from which system architecture can be developed. The framework highlights the dominant feature of multimedia systems; the integration of multimedia computing and communications, including traditional telecommunications and telephony functions. The four interrelated models of distributed multimedia systems are:

1. **Multimedia Distributed Processing Model:** this model includes system services, Application toolkits, and Application frameworks.
2. **Multimedia information Model:** this model includes data modeling for storage, retrieval and processing.
3. **Multiservice Network Model:** this model includes communication model with a network architecture, network protocols and interfaces.

4. **Multimedia Conferencing Model:** this model provides multiparty communication, real-time interchange of media, electronic mail, and telephony.



Multimedia conferencing: Multimedia conferencing, as a technology for supporting communications with multiple parties and media, is more than an evolution of traditional specialized teleconferencing systems. These systems are typically used by large organizations like banks and financial institutions which needed to provide frequent interaction between numbers of geographically distributed sites.

11.6 MULTIMEDIA APPLICATIONS IN BANKING AND FINANCE :

With a focus on customer service and loyalty, the banking industry is actively looking for ways to improve the value of retail banking and create more visibility of products and services. With the right digital signage strategy today's banks can promote new products and services, engage and entertain customers, and provide real-time financial information to improve in-store banking processes that bring real business results. "The digital signage network enables us to communicate better with our customers, providing them with updated information about the bank's various services and programs. The network helps us stay competitive and meet our business challenges, using advanced technologies.

1. **Value for your Customer:**

   a. Build brand value with rich in-store media experiences, personalized messaging and interactive applications.
   b. Provide helpful information and tips for financial planning, management and investment strategy.
   c. Create visibility of new products, services and incentives being offered.

2. **Improve in-store efficiency:**

   a. Assist customers with way finding throughout the bank, for all service areas.
   b. Focus more personnel resources on the customers with a centrally managed platform and medium for internal training and communication.
   c. Present retail customers with real-time information, such as stock and currency exchange data.

11.7 SUMMERY

Today's financial business is technology driven. Technology is a source of competitive strength and is used as a competitive strategy to reach the customer at his doorstep. The arrival of the internet has changed the competitive climate significantly. As a result, organizations like banks and financial institutions need to address two key issues to retain and improve their competitive position. WAP bridges the gap between the mobile world and the internet as well as corporate intranets and offers the ability to deliver an unlimited range of mobile value-added services to subscribers-independent of their network, bearer, and terminal. WAP is a global standard and is not controlled by any single company. WAP has been used by banks to promote mobile commerce (M-Commerce) in India.

A virtual private network (VPN) allows the provisioning of private network services for an organization or organizations over a public or shared infrastructure such as the Internet or service provider backbone network. The simultaneous use of data in different media forms like voice, video, text, animations, etc. is called multimedia. With a focus on customer service and loyalty, the banking industry is actively looking for ways to improve the value of retail banking and create more visibility of products and services.

11.8 TECHNICAL TERMS :

- Asynchronous Transfer Mode (ATM),
- General Packet Radio Services (GPRS),
- Gateway, HTTP,
- Virtual circuits (VC).

11.9 SELF ASSESSMENT QUESTIONS :

1. Explain the various technologies supporting convergence and applications of convergence?
2. Describe briefly on the WAP architecture and WAP applications in banking sector?
3. Write about the VPN technologies and protocols?
4. Explain applications of Multimedia systems and Multimedia characteristics?
5. Describe the Multimedia framework and Multimedia applications in banking and finance sector?

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Dr. N.RATNA KISHOR

LESSON –12

HUMAN RESOURCE DEVELOPMENTS IN BANKS

OBJECTIVES :

After studying this unit, you should be able to**:**

- To understanding the Indian Banking Sector
- To know the concept of Manpower planning
- To acquire knowledge about significance of HRD
- To understand the purpose and objectives Human Resource Planning

STRUCTURE :

12.1 General Banking Scenario
12.2 Indian Banking Sector
12.3 Human Resource Development in Banking Industry
12.4 Elements of Human Resource Management Climate
12.5 Principles of Human Resource Development
12.6 Human Resource Planning and the Strategic Business Plan
12.7 Self Assessment Questions
12.8 Suggested Reading

12.1 GENERAL BANKING SCENARIO :

In the economy of any country the growth and productivity in agriculture, small scale industry and employment largely depends on the role played by banks. In India the prosperity of millions of people took realistic picture by the banking and financial services. In the pre-banking sector, the activities relating to money were mostly in the hands of money lenders, who used to charge very high interest and abnormal terms and conditions. The emergence of organized banking and financial sector which has been regulated by the government offers different types of services for development of customers as well as socio-economic development of society. Banking industry has been the backbone of Indian economic growth. The banking sector in India prevented the country from the negative impact of world economic crisis.

In India the evolution of Modern banking can be traced in last decade of eighteenth century. The State Bank of India (SBI) has been the oldest and largest one which is in existence to date. The Scheduled and Non-Scheduled banks are the two categories of banks in Indian banking industry. The second schedule of RBI Act 1934 includes the list of scheduled banks. Nationalized banks, Regional rural banks, foreign banks and other Private sector banks constitute the nationalized banks. As regards providing banking services to the rural India several challenges still remain. Overall, the range of service providing in Indian banking sector is fairly mature.

The Industrial policy Resolution 1948 adopted by the Government of India envisaged a mixed economy. In order to play an active role in the country's economy several measures were initiated by the Government of India. As a result, two major steps took place viz., i) The establishment of RBI in 1935 and ii) enactment of the Banking Companies Regulation Act in 1949. With the merger of Bank of Bengal, Bank of Bombay and Bank of Madras, the Imperial Bank of India was formed in 1921 and after Independence became SBI in 1955. SBI has been the oldest and largest bank which still exists. The SBI was given control over eight

banks in 1960. The Government of India nationalized 14 private banks in 1969 and 6 more banks in 1980, which have been the major lenders in the sector. The only merger between nationalized banks viz the Bank of India and Punjab National Bank took place in the year 1993. The economic reforms came into being in 1990 which led to a policy of liberalization and private banks' licensing. Relaxation of Foreign Direct Investment (FDI) can be quoted as next important stage. Afterwards another major merger emerged viz, merger of State Bank of Saurashtra, State Bank of Indore, State Bank of Bikaner & Jaipur, State Bank of Mysore, State Bank of Travancore, State Bank of Patiala, SBH and BMB into SBI in 2018.

The functioning of banking sector has been dynamic at present. During 1960s banking sector was considered as an important tool in the development process of Indian economy. In 1992, a committee headed by Narasimham suggested in its report a wide-range of reforms in banking services to cope with international banking practices. The entry of private banks into the sector was mainly with amendment of Banking Companies Regulation Act in 1993.

12.2 INDIAN BANKING SECTOR :

The evolution and growth of banking sector in India has been mainly qualitative and in future it seems to grow in quantitative terms. In India the banking sector is functioning as per the provisions of Banking Companies Regulation Act, 1949. The major categories of banks comprise of Scheduled banks (Commercial banks and Co-operative banks). The commercial banks include nationalized banks, Regional rural banks and other private sector banks. All these banks put together have over 80,000 branches throughout India.

The public sector banks have been the base of the banking sector which accounts for 70 per cent of the total assets of the Indian banking industry. The public sector banks are facing a serious problem with Non-Performing Assets (NPAs), massive manpower and lack of modern technology. On the other hand, the private sector and foreign banks are making rapid progress and they are succeeding in the industry by leading in Internet banking, mobile banking, ATMs, phone banking and several other innovative products. The prominent foreign banks operating in India are, American Express Bank Ltd., ANZ Grindleys Bank, ABN-AMRO Bank, Citi Bank. Indian banking industry currently is in a transformation phase.

The public sector banks which are the main stay of Indian banking system are in the process of reducing manpower, excessive NPAs and excessive government equity. Both the public and private sector banks are consolidating themselves through mergers and acquisitions. Following the commitment of WTO agreement in respect of the service sector, foreign banks have been permitted to open up branches. The liberalized FDI rules paved the way for foreign banks taking the mergers and acquisitions route to acquire willing Indian partners. Banks are focusing on retail segment and entering into new vistas of insurance.

The key factors contributing the growth of Indian banking can be stated as under.

- High growth of Indian economy
- Rising per-capital income
- e-banking
- Financial inclusion
- Challenges of NPAs
- Managing HRD
- Changes in Global financial sector
- Technology Adoption

Banking has been backbone of Indian economy. The banking sector is playing a pivotal role in almost all sectors of Indian economy and has been continuously progressing towards quality enhancement. Because of ever-increasing quality in services the people of country have been able to fulfill their aspirations.

12.3 HRD IN BANKING INDUSTRY :

HRM in Banking Industry : The fundamental principle of HRM is to treat people as a valuable asset rather than a liability and a mere factor of production. Although Information Technology is taken to a large extent as a substitute for human resources but it should be taken only an aid to human efforts and not as a substitute. The prevailing situation of HRM in banks demands, appropriate human resource strategies, policies and practices to survive in the highly competitive banking and financial services sector. The HR strategies shall aim towards optimizing staff level and skills, building the right skills and work culture and managing individual performance to achieve the goals of the bank. In India in the post-reforms period banks implemented VRS for downsizing of employees, as a result fear of job insecurity has increased and motivation level among the employees has decreased. The early years of HRM in Indian banks an unknown area for banks. (Mankidy J., 1975). The individual bank managements, employees' unions, the Government of India, the Indian Banks Association (IBA), the Judiciary, the RBI, and NIBM have been instrumental in shaping the HRM policies and practices of the banking sector in India.

HRD issues in Banking Industry: Banking and financial services are considered as vital for economic development of the country. Banking sector is undergoing sweeping and phenomenal changes. The workforce became the key factor as banks' focus shifted from security-orientation to market-orientation. Human resource development assumes a very important role in banking industry, where the activities are all about 'relationship', provision of better services and maintaining long lasting relationship with customers. The vast potential of talented manpower in India can be utilized through high level of initiative and innovation. Indians are most successful outside the country but fail to perform in India due to the complacency, which is the biggest problem in India.

Banks have to continuously strive to give new thrust and direction to equip its employees to meet the emerging challenges through a systematic HRD strategy. In banking and financial service organizations HRD implies not only the development of skills and acquiring knowledge among the employees but also developing capabilities and attaining self-confidence and motivation. It also aims at giving more and more thrust on the human resources for better customer service. Hence, the objective of HRD in banks can be outlined as:

- Creating a climate of openness and trust
- Building a collaborative culture
- Integration of individual and organizational goals
- Promoting human competencies and capabilities
- Building a character of honesty and integrity in performance
- Training and motivating the employees
- Improving the quality of work life.

Development of HRD in Indian Banks : In the Indian banking sector sweeping changes in the environment and the increasing public scrutiny have placed a quality on the human resources. Careful management of human resources plays a vital role in tapping the potential of employees. The Reserve Bank of India's human resource management department encourages a holistic approach to the development of human resources. The major initiatives

brought up by RBI include In house training, Leadership and Executive Education Programmes. Mid-career Mandatory Training programme and incentive scheme for higher education for bridging the skill-gaps.

Recognizing the importance of training the RBI established the Bankers Training College in 1954. The Punjab National Bank started its staff training college in 1958. With the enactment of the State Bank of India Act in 1955, the staff training college was established in 1962, and in mid-sixties, several other commercial banks also set up joint staff college. The Adarkar Committee appointed by RBI emphasized the need for proper selection, induction, training, placement and career development. It also recommends that the National Institute of Bank Management (NIBM) should monitor the functioning of training programmes at banking industry level. It was during 1970s that Dr. T.V. Rao and Dr. Udai Pareek, who were pioneers in introducing integrated HRD system in Larsen & Toubro, were invited by SBI to introduce the system in their group.

In 1979, the State Bank of India (SBI) set up a formal HRD department and also focused their attention on redesigning the appraisal system. The State Bank of Patiala introduced a monthly publication “HRD Letter” to make the employees aware about the HRD philosophy. Thus, many banks realized the need for HRD and started a formal HRD department. The HRD departments established in the banks continue to perform the than existing personal policies, whereas a several new activities or functions are performed in other banks.

The key factors facilitating the growth and development of HRD programmes in Indian banking sector can be outlined as under:

Studying the history, nature, traditions and objectives of the bank, Creating conductive HRD climate in the organization, Integrating the HRD policies with the vision, mission and objectives of the bank, External consultancy to develop the HRD strategy, Introducing HRD spirit through developing individuals and solving problems, Strengthening and Re-orienting the training and developing system, Introduction of effective performance management and reward system, Human Resource capital Adequacy in banks, Infusing fresh ideas and enhance intellectual capacity to respond to the changing environment through young talented workforce, Creating an atmosphere of innovation and creativity by establishing Research & Development (R&D), Compensation and Reward Management to attract and retain talent, Sustained effort to develop the managers resources at all levels towards an effective understanding and management of industrial conflicts and union-management relations. The structure of Indian banking sector is shown in Figure

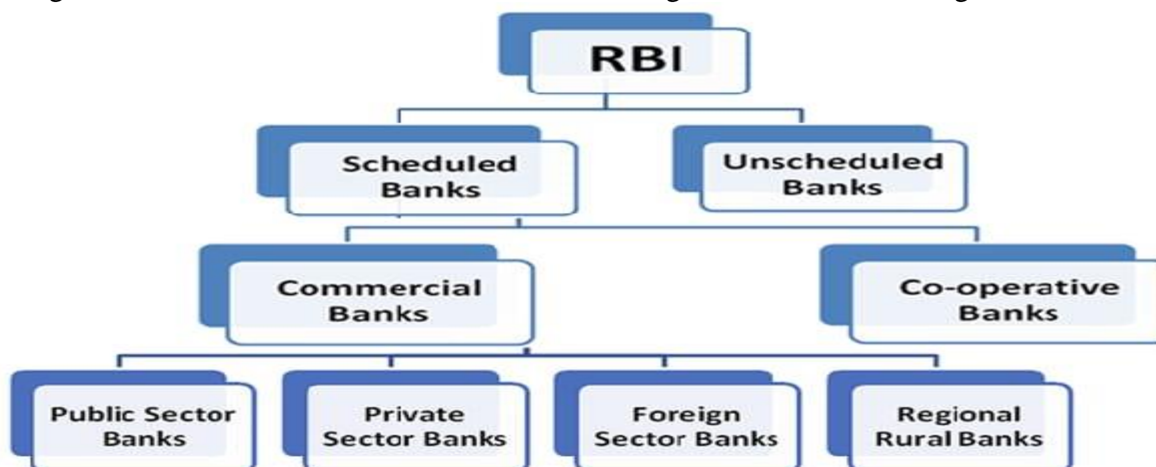


Figure: Structure of Indian Banking Sector

Public and Private Sector Banks in India

The list of public and private sector banks existing in Indian banking sector as of 2021 is presented in Table below.

Table: List of Public and Private Sector Banks in Indian Banking Sector

S.NO	Scheduled Public Sector banks (post amalgamation)
1.	Bank of Baroda
2.	Bank of India
3.	Bank of Maharashtra
4.	Canara Bank
5.	Central Bank of India
6.	Indian Bank
7.	Indian Overseas Bank
8.	Punjab and Sind Bank
9.	Punjab National Bank
10.	State Bank of India
11.	UCO Bank
12.	Union Bank of India
Scheduled Private Sector	
13.	Axis Bank Ltd.
14.	City Union Bank Ltd.
15.	DCB Bank Ltd
16.	Federal Bank Ltd.
17.	HDFC Bank Ltd.
18.	ICICI Bank Ltd.
19.	IDBI Bank Ltd.
20.	IDFC FIRST Bank Ltd
21.	IndusInd Bank Ltd
22.	Jammu and Kashmir Bank Ltd. *
23.	Karnataka Bank Ltd.
24.	Karur Vysya Bank Ltd.
25.	Kotak Mahindra Bank Ltd.
26.	RBL Bank Ltd
27.	South Indian Bank Ltd.
28.	Yes Bank Ltd.
29.	Dhanlaxmi Bank Ltd.
30.	Bandhan Bank Ltd.
31.	CSB Bank Ltd.

Source: https://www.rbi.org.in/commonman/English/Scripts/Content.aspx?id=2139

12.4 ELEMENTS OF HUMAN RESOURCE DEVELOPMENT CLIMATE :

To create a conducive climate for HRD, Top management must start subscribing some values such as treating employees as the most important resource, believing in the capabilities of employees, perceiving that development of employees is the job of every manager, encouraging risk taking and experimentation, communicating openly, creating a general climate of trust, making efforts to help employees in recognizing their strengths & weaknesses supportive personnel and HRD practices **(Rao and Abraham, 1986).** A healthy HRD climate serves in the betterment of internal environment of the organization, and in increasing employee commitment and satisfaction with the job.

The elements of HRD climate are grouped in the three Broad categories.

(1) General climate

(2) HRD culture (OCTAPACE)

(3) HRD mechanism.

General Climate: The focus is given to human resource development by top management & line managers. The following factors contribute in enhancement of human resource development climate.

- **Top Management Style and Philosophy:** Believing in individual's capabilities giving responsibilities and assigning authorities, openness and receptivity to suggestions from subordinates, participative approach are some of the dimensions that directly contribute to the creation of positive HRD climate. **(Dyer and Shafer, 1998)**
- **Personnel Policies:-**Policies with the emphasis on optimum resource allocation for welfare and development activities, policies for collaborative attitude among employees, policies that give equity and objectivity in appraisal to employees go a long way in creating positive HRD climate that is why every organization must aim at making personnel policies that shows high concern to its employees.
- **Positive Attitude towards development:-**A helpful and supportive attitude towards human resource development, organization's people and among staff plays a very essential role in generating HRD climate.
- **Commitment of Line Managers:** A supportive behaviour of line managers towards development of subordinates is a very important determiner of HRD climate. If line managers are committed and willing to spend their time for the development of super ordinate abilities, it is likely to have a positive impact.

HRD OCTAPACE Culture: The OCTAPACE item contains Openness, Confrontation, Trust, Autonomy, Proactively, Authenticity and Collaboration are valued and promoted in the organization are discussed below:

- **Openness:** is considered where people feel free in expressing their views & sharing their ideas, opinions and feelings to each other irrespective of their level of designation. This willingness of sharing and openness results in greater clarity of objectives of organization and free interaction among people. Openness also results into unbiased feed-back of performance of employees. Improved implementation of system, productive meetings and innovations are some of the indicators of openness.
- **Confrontation:** in this culture people are keen to help each other. It can also be defined as facing the problem rather than shying away from it. Everybody is ready to put their interest in the back ground for the biggest interest of organization. This involves taking up challenges. The outcome of confrontations will be improved problem solving tactics, clarity of roles, willingness to face and deal with problem and with 'difficult' employees & customers, increased team spirit, collaboration.

- **Trust:** Member of organization works in an informal environment by having full faith & trust on coach other. People respect and value each other and maintained the confidential information shared by others trust is very essential part of HRD culture and in the institution building process. Mutual trust get started building up automatically when every member of the organization becomes trustworthy and reliable and will result in to reduced stress, higher empathy, timely support effective delegation & higher productivity.
- **Authenticity:** is the value of underlying trust and speaking the truth without any fear and also keeping the promises made. The outcome of authenticity is reduced distortion in communication of organization.
- **Proactivity:** means preplanning taking preventive action, initiatives and calculating the payoffs of an alternative course before taking the action. This culture encourages the members of the organization to take steps and initiatives for new activities and processes like work process, reduction in cost, improvement in quality etc.
- **Autonomy:** In this culture members of the organization enjoy a great degree for freedom in their activities. It means respecting and encouraging members for role autonomy. Autonomy is very important in areas where individual need freedom to work in the way they want so that they can bring out their best. The outcome of autonomy can be mainly seen in knowledge industry, creating academic excellence, research and development, information technology etc.
- **Collaboration:** means working with full co-operation and giving help to, and asking for help from, others. It also means working together for solving the problems. It enhancer team spirit and results in to timely help, improved communication, team work, sharing of work experience, better resource allocation. Improved productivity, reports, involvement of staff, more meetings are few of the indicator of collaboration.
- **Experimenting:** The culture of experimentation increases the risk taking aspect of the organization. In this culture emphasis is given to develop new ideas, value creation & innovating and trying out new ways of doing things and dealing with problems of the organization.

HRD Mechanism: includes all the structure system and techniques that an organization uses to strengthen the capabilities of employees. These techniques can be used to facilitate favorable HRD climate in the organization. Some of these techniques are performance appraisal, career planning, grievance mechanism, feedback and counseling, training and development, employee welfare, quality of work life, rewards etc. **(Rao and Abraham, 1986).**

12.5 PRINCIPLES OF HUMAN RESOURCE DEVELOPMENT :

In order to make HRD more effective in an organization the following principles must be followed.

1. The human resource policy must be explicitly stated to all the employees of the organization. The policy should be communicated throughout the organization.
2. HRD system must concentrate on overall development of employees and organization as a whole and the development of the capabilities of the work force including physical, technical, psychological and moral development should be done in an organized manner.
3. The top management of the organization needs to be completely devoted towards the success of HRD of organization. Managers at all level should make conscious efforts to support subordinates and to develop their capabilities.

4. Effective HRD systems help their employees in identification of their hidden potential and make them competent enough to serve their best towards organizational success.
5. To make people more responsible and efficient certain degree of freedom should be provided to the employees so that they could take decisions and tackle the problems by themselves this is called autonomy maximization.
6. All the HRD needs of the organization should be carefully examine before making HRD plans because HRD needs differ from one organization to another. A sound plan of HRD should be followed for the proper and efficient utilization of human resource.
7. A conducive climate of HRD including all the necessary items of HRD climate, openness, autonomy, experiments, collaboration, confrontation, proaction, trust authenticity should be provided to the employees.
8. HRD professional should exchange their experiences on continuous basis for the development of professional knowledge and skills among employees.
9. Subordinates should be encouraged by their bosses or top management to contribute & participate in decision making. Atmosphere where workers are free to share their ideas is always beneficial to the organization.
10. Progress in the implementation of HRD should be regularly reviewed so that important changes and improvements should be carried out according to the need of organization on the basis of such review (**Cascio, 1998).**

12.6 HUMAN RESOURCE PLANNING AND THE STRATEGIC BUSINESS PLAN :

Today, in every organization personnel planning as an activity is necessary. It is an important part of an organization. Human Resource Planning is a vital ingredient for the success of the organization in the long run. There are certain ways that are to be followed by every organization, which ensures that it has right number and kind of people, at the right place and right time, so that organization can achieve its planned objective. The objectives of Human Resource Department are Human Resource Planning, recruitment and selection, training and development, career planning, transfer and promotion, risk management, performance appraisal and so on. Each objective needs special attention and proper planning and implementation. For every organization it is important to have a right person on a right job. Recruitment and Selection Plays a vital role in this situation. Shortage of skills and the use of new technology are putting considerable pressure on how employers go about recruiting and selecting staff. It is recommended to carry out a strategic analysis of recruitment and selection procedure.

Benefits of Human Resource Planning

Research into Human Resource Management indicates that the factors that really motivate employees are intrinsic ones which are based on meeting the personal needs of an individual. Human beings have a number of key psychological needs including:

- The need to feel that you can do something well.
- The need to be part of a group.
- The need for respect and encouragement from others.

These needs are typically met from non-financial rewards, for example, by providing opportunities:

- For promotion

- To make decisions
- To contribute to a team
- To do a variety of tasks.

Harrods recognizes these intrinsic needs and encourages job rotation, job enlargement and job enrichment to provide career development opportunities. Job rotation involves periodically changing jobs and work areas to develop new skills in different areas of the business. Cross departmental experience is viewed as important for personal development. Harrods offers a range of many different types of job opportunity including face-to-face customer operations, merchandising, recording and reporting of sales and online customer communications. Job enlargement involves encouraging and supporting staff to take on new and more challenging tasks. Job enrichment involves building existing job roles by enabling employees to engage in a wider variety of interesting tasks, for example, taking on some team leadership responsibility and removing unnecessary supervision.

Linking Recruitment and Selection with the Strategic Business Plan :

Strategic management involves employing selective and specific processes across all aspects of the business, including the recruitment and selection process, to help the business achieve optimal profit and success. For a small business, the recruitment and selection of the right employee for each position can lead to reduced costs, thus leading to an improved bottom line.

- **Identifying Needs:** Strategic management begins with identifying the needs of your organization as they relate to current and future labor demands. Accomplishing this task requires the ability to identify the various jobs and roles needed within your organization to meet current and future goals related to production and growth. Once identified, clear and concise job descriptions and duties can help ensure that recruitment remains streamlined and aimed at efficient recruitment and hiring.
- **Recruitment Activities:** Hiring managers should focus on recruiting activities aimed at attracting the right candidates for the job. Recruiting activities can include internal efforts, college hiring fairs, technical and vocational events and traditional newspaper advertisements. Based on the needs of current openings and forecasts for future needs, a hiring manager will need to direct efforts toward the best option for recruiting the right candidates. For instance, focusing on college hiring fairs and traditional newspaper advertisements is appropriate for entry-level positions with your company.
- **Selection Process:** Selecting the right candidate requires identifying the specific skills, knowledge and qualities seek and desire in an employee. This can pertain to the necessary skills and knowledge for the position itself, such as a specific degree or certification and the desired personal qualities, such as a preference to hire employees with good moral and ethical standards. Other important parts of the selection process include conducting any necessary aptitude tests and conducting a thorough background check to ensure the employee meets the basic qualifications of both the position and the company.
- **Considerations:** Strategic management also takes into account various ways to reduce costs while ensuring enough staff is in place to complete all necessary job duties and responsibilities. For instance, you can eliminate the duplication of job duties and reduce costs by consolidating job duties and restructuring your internal workforce. Other concerns include those related to replacing an aging workforce. This requires the need to plan ahead for the loss of essential employees to retirement.

12.7 STAFFING IN BANKS :

It is the function of manning the organization structure and keeping it manned. Staffing has assumed greater importance in the recent years due to advancement of technology, increase in size of business, complexity of human behavior etc. The main purpose of staffing is to put right man on right job i.e. square pegs in square holes and round pegs in round holes. According to Kootz & O'Donell, "Managerial function of staffing involves manning the organization structure through proper and effective selection, appraisal and development of personnel to fill the roles designed in the structure" Staffing involves:

- Manpower Planning (estimating man power in terms of searching, choose the person and giving the right place).
- Recruitment, selection and placement.
- Training and development.
- Remuneration.
- Performance appraisal
- Promotions and transfer

Japanese Management Culture:

The culture of Japanese management so famous in the West is generally limited to Japan's large corporations. These flagships of the Japanese economy provide their workers with excellent salaries and working conditions and secure employment. These companies and their employees are the business elite of Japan. Though not as much for the new generation still a career with such a company is the dream of many young people in Japan, but only a select few attain these jobs. Qualification for employment is limits to the few men and women who graduate from the top thirty colleges and universities in Japan. Placement and advancement of Japanese workers is heavily based on educational background.

The managerial function of staffing involves manning the organization structure through proper and effective selection, appraisal and development of the personnel to fill the roles assigned to the employers/workforce. According to Theo Haimann, "Staffing pertains to recruitment, selection, development and compensation of subordinates."

I. Nature of Staffing Function:

1. **Staffing is an important managerial function-** Staffing function is the most important managerial act along with planning, organizing, directing and controlling. The operations of these four functions depend upon the manpower which is available through staffing function.
2. **Staffing is a pervasive activity-** As staffing function is carried out by all mangers and in all types of concerns where business activities are carried out.
3. **Staffing is a continuous activity-** This is because staffing function continues throughout the life of an organization due to the transfers and promotions that take place.
4. **The basis of staffing function is efficient management of personnel-** Human resources can be efficiently managed by a system or proper procedure, that is, recruitment, selection, placement, training and development, providing remuneration, etc.
5. **Staffing helps in placing right men at the right job.** It can be done effectively through proper recruitment procedures and then finally selecting the most suitable candidate as per the job requirements.

6. **Staffing is performed by all managers** depending upon the nature of business, size of the company, qualifications and skills of managers, etc. In small companies, the top management generally performs this function. In medium and small scale enterprise, it is performed especially by the personnel department of that concern.

II. Staffing Process - Steps involved in Staffing:

1. **Manpower requirements-** The very first step in staffing is to plan the manpower inventory required by a concern in order to match them with the job requirements and demands. Therefore, it involves forecasting and determining the future manpower needs of the concern.
2. **Recruitment-** Once the requirements are notified, the concern invites and solicits applications according to the invitations made to the desirable candidates.
3. **Selection-** This is the screening step of staffing in which the solicited applications are screened out and suitable candidates are appointed as per the requirements.
4. **Orientation and Placement-** Once screening takes place, the appointed candidates are made familiar to the work units and work environment through the orientation programs and placement takes place by putting right man on the right job.
5. **Training and Development-** Training is a part of incentives given to the workers in order to develop and grow them within the concern. Training is generally given according to the nature of activities and scope of expansion in it. Along with it, the workers are developed by providing them extra benefits of in-depth knowledge of their functional areas. Development also includes giving them key and important jobsas a test or examination in order toanalyze their performances.
6. **Remuneration-** It is a kind of compensation provided monetarily to the employees for their work performances. This is given according to the nature of job-skilled or unskilled, physical or mental, etc. Remuneration forms an important monetary incentive for the employees.
7. **Performance Evaluation-** In order to keep a track or record of the behaviour, attitudes as well as opinions of the workers towards their jobs. For this regular assessment is done to evaluate and supervise different work units in a concern. It is basically concerning to know the development cycle and growth patterns of the employees in a concern.
8. **Promotion and Transfer-** Promotion is said to be a non- monetary incentive in which the worker is shifted from a higher job demanding bigger responsibilities as well as shifting the workers and transferring them to different work units and branches of the same organization.

III. Manpower Planning which is also called as Human Resource Planning consists of putting right number of people, right kind of people at the right place, right time, doing the right things for which they are suited for the achievement of goals of the organization. Human Resource Planning has got an important place in the arena of industrialization. Human Resource Planning has to be a systems approach and is carried out in a set procedure. The procedure is as follows:

1. Analyzing the current manpower inventory
2. Making future manpower forecasts
3. Developing employment programs
4. Design training programs

i. Steps in Manpower Planning :

1. **Analyzing the current manpower inventory:** Before a manager makes forecast of future manpower, the current manpower status has to be analysed. For this the following things have to be noted-
   - Type of organization
   - Number of departments
   - Number and quantity of such departments
   - Employees in these work units

   Once these factors are registered by a manager, he goes for the future forecasting
2. **Making future Manpower forecasts:** Once the factors affecting the future manpower forecasts are known, planning can be done for the future manpower requirements in several work units. The Manpower forecasting techniques commonly employed by the organizations are as follows:
   i. **Expert Forecasts:** This includes informal decisions, formal expert surveys and Delphi technique.
   ii. **Trend Analysis:** Manpower needs can be projected through extrapolation (projecting past trends), indexation (using base year as basis), and statistical analysis (central tendency measure).
   iii. **Work Load Analysis:** It is dependent upon the nature of work load in a department, in a branch or in a division.
   iv. **Work Force Analysis:** Whenever production and time period has to be analysed, due allowances have to be made for getting net manpower requirements.
   v. **Other Methods:** Several Mathematical models, with the aid of computers are used to forecast manpower needs, like budget and planning analysis, regression, new venture analysis.
3. **Developing Employment Programs:** Once the current inventory is compared with future forecasts; the employment programs can be framed and developed accordingly, which will include recruitment, selection procedures and placement plans.
4. **Design Training Programs:** These will be based upon extent of diversification, expansion plans, development programs, etc. Training programs depend upon the extent of improvement in technology and advancement to take place. It is also done to improve upon the skills, capabilities, knowledge of the workers.

ii. Importance of Manpower Planning:

1. **Key to Managerial functions-** The four managerial functions, i.e., planning, organizing, directing and controlling are based upon the manpower. Human resources help in the implementation of all these managerial activities. Therefore, staffing becomes a key to all managerial functions.
2. **Efficient Utilization-** Efficient management of personnel becomes an important function in the industrialization world of today. Setting of large scale enterprises requires management of large scale manpower. It can be effectively done through staffing function.
3. **Motivation-** Staffing function not only includes putting right men on right job, but it also comprises of motivational programs, i.e., incentive plans to be framed for further participation and employment of employees in a concern. Therefore, all types of incentive plans become an integral part of staffing function.
4. **Better human relations-** A concern can stabilize itself if human relations develop and are strong. Human relations become strong trough effective control, clear communication, effective supervision and leadership in a concern. Staffing function

also looks after training and development of the work force which leads to co-operation and better human relations.

5. **5.** Higher productivity- Productivity level increases when resources are utilized in best possible manner. Higher productivity is a result of minimum wastage of time, money, efforts and energies. This is possible through the staffing and its related activities (Performance appraisal, training and development, remuneration).

iii. Need of Manpower Planning:

Manpower Planning is a two-phased process because manpower planning not only analyses the current human resources but also makes manpower forecasts and thereby draw employment programs. Manpower Planning is advantageous to firm in following manner:

1. Shortages and surpluses can be identified so that quick action can be taken wherever required.
2. All the recruitment and selection programs are based on manpower planning.
3. It also helps to reduce the labour cost as excess staff can be identified and thereby overstaffing can be avoided.
4. It also helps to identify the available talents in a concern and accordingly training programs can be chalked out to develop those talents.
5. It helps in growth and diversification of business. Through manpower planning, human resources can be readily available and they can be utilized in best manner.
6. It helps the organization to realize the importance of manpower management which ultimately helps in the stability of a concern.

iv. Obstacles in Manpower Planning:

Following are the main obstacles that organizations face in the process of manpower planning:

1. **Under Utilization of Manpower:** The biggest obstacle in case of manpower planning is the fact that the industries in general are not making optimum use of their manpower and once manpower planning begins, it encounters heavy odds in stepping up the utilization.
2. **Degree of Absenteeism:** Absenteeism is quite high and has been increasing since last few years.
3. **Lack of Education and Skilled Labour:** The extent of illiteracy and the slow pace of development of the skilled categories account for low productivity in employees. Low productivity has implications for manpower planning.
4. **Manpower Control and Review:**
   a. Any increase in manpower is considered at the top level of management
   b. On the basis of manpower plans, personnel budgets are prepared. These act as control mechanisms to keep the manpower under certain broadly defined limits.
   c. The productivity of any organization is usually calculated using the formula:

   Productivity = Output / Input

   . But a rough index of employee productivity is calculated as follows:

   Employee Productivity = Total Production / Total no. of employees

   d. Exit Interviews, the rate of turnover and rate of absenteeism are source of vital information on the satisfaction level of manpower. For conservation of Human Resources and better utilization of men studying these conditions, manpower control would have to take into account the data to make meaningful analysis.
   e. Extent of Overtime: The amount of overtime paid may be due to real shortage of men, ineffective management or improper utilization of manpower. Manpower control would require a careful study of overtime statistics.

Few organizations do not have sufficient records and information on manpower. Several of those who have them do not have a proper retrieval system. There are complications in resolving the issues in design, definition and creation of computerized personnel information system for effective manpower planning and utilization. Even the existing technology in this respect is not optimally used. This is a strategic disadvantage.

IV. Types of Recruitment: Recruitment is of two types

1. **Internal Recruitment:** Internal Recruitment is a recruitment which takes place within the concern or organization. Internal sources of recruitment are readily available to an organization. Internal sources are primarily three Transfers, promotions and Re-employment of ex-employees. Internal recruitment may lead to increase in employee's productivity as their motivation level increases. It also saves time, money and efforts. But a drawback of internal recruitment is that it refrains the organization from new blood. Also, not all the manpower requirements can be met through internal recruitment. Hiring from outside has to be done. Internal sources are primarily three
   a. **Transfers**
   b. **Promotions (through Internal Job Postings)** and
   c. **Re-employment of ex-employees -** Re-employment of ex-employees is one of the internal sources of recruitment in which employees can be invited and appointed to fill vacancies in the concern. There are situations when ex-employees provide unsolicited applications also.
2. **External Recruitment -** External sources of recruitment have to be solicited from outside the organization. External sources are external to a concern. But it involves lot of time and money. The external sources of recruitment include - Employment at factory gate, advertisements, employment exchanges, employment agencies, educational institutes, labour contractors, recommendations etc.
   a. **Employment at Factory Level -** This a source of external recruitment in which the applications for vacancies are presented on bulletin boards outside the Factory or at the Gate. This kind of recruitment is applicable generally where factory workers are to be appointed. There are people who keep on soliciting jobs from one place to another. These applicants are called as unsolicited applicants. These types of workers apply on their own for their job. For this kind of recruitment workers have a tendency to shift from one factory to another and therefore they are called as "badli" workers.
   b. **Advertisement -** It is an external source which has got an important place in recruitment procedure. The biggest advantage of advertisement is that it covers a wide area of market and scattered applicants can get information from advertisements. Medium used is Newspapers and Television.
   c. **Employment Exchanges -** There are certain Employment exchanges which are run by government. Most of the government undertakings and concerns employ people through such exchanges. Now-a-days recruitment in government agencies has become compulsory through employment exchange.
   d. **Employment Agencies -** There are certain professional organizations which look towards recruitment and employment of people, i.e. these private agencies run by private individuals supply required manpower to needy concerns.
   e. **Educational Institutions -** There are certain professional Institutions which serve as an external source for recruiting fresh graduates from these institutes. This kind of recruitment done through such educational institutions is called as Campus Recruitment. They have special recruitment cells which help in providing jobs to fresh candidates.

f. **Recommendations -** There are certain people who have experience in a particular area. They enjoy goodwill and a stand in the company. There are certain vacancies which are filled by recommendations of such people. The biggest drawback of this source is that the company has to rely totally on such people which can later on prove to be inefficient.

g. **Labour Contractors -** These are the specialist people who supply manpower to the Factory or Manufacturing plants. Through these contractors, workers are appointed on contract basis, i.e. for a particular time period. Under conditions when these contractors leave the organization, such people who are appointed have to also leave the concern.

V. Employee Selection Process:

Employee Selection is the process of putting right men on right job. It is a procedure of matching organizational requirements with the skills and qualifications of people. Effective selection can be done only when there is effective matching. By selecting best candidate for the required job, the organization will get quality performance of employees. Moreover, organization will face less of absenteeism and employee turnover problems. By selecting right candidate for the required job, organization will also save time and money.

Proper screening of candidates takes place during selection procedure. All the potential candidates who apply for the given job are tested. But selection must be differentiated from recruitment, though these are two phases of employment process. Recruitment is considered to be a positive process as it motivates more of candidates to apply for the job. It creates a pool of applicants. It is just sourcing of data. While selection is a negative process as the inappropriate candidates are rejected here. Recruitment precedes selection in staffing process. Selection involves choosing the best candidate with best abilities, skills and knowledge for the required job.

Employee Selection Process takes place in following order-

1. **Preliminary Interviews-** It is used to eliminate those candidates who do not meet the minimum eligibility criteria laid down by the organization. The skills, academic and family background, competencies and interests of the candidate are examined during preliminary interview. Preliminary interviews are less formalized and planned than the final interviews. The candidates are given a brief up about the company and the job profile; and it is also examined how much the candidate knows about the company. Preliminary interviews are also called screening interviews.
2. **Application blanks-** The candidates who clear the preliminary interview are required to fill application blank. It contains data record of the candidates such as details about age, qualifications, reason for leaving previous job, experience, etc.
3. **Written Tests-** Various written tests conducted during selection procedure are aptitude test, intelligence test, reasoning test, personality test, etc. These tests are used to objectively assess the potential candidate. They should not be biased.
4. **Employment Interviews-** It is a one to one interaction between the interviewer and the potential candidate. It is used to find whether the candidate is best suited for the required job or not. But such interviews consume time and money both. Moreover the competencies of the candidate cannot be judged. Such interviews may be biased at times. Such interviews should be conducted properly. No distractions should be there in room. There should be an honest communication between candidate and interviewer.
5. **Medical Examination-** Medical tests are conducted to ensure physical fitness of the potential employee. It will decrease chances of employee absenteeism.

6. **Appointment Letter-** A reference check is made about the candidate selected and then finally he is appointed by giving a formal appointment letter.

Difference between Recruitment and Selection

Basis	Recruitment	Selection
Meaning	It is an activity of establishing contact between employers and applicants.	It is a process of picking up more competent and suitable employees.
Objective	It encourages large number of Candidates for a job.	It attempts at rejecting unsuitable candidates.
Process	It is a simple process.	It is a complicated process.
Hurdles	The candidates have not to cross over many hurdles.	Many hurdles have to be crossed.
Approach	It is a positive approach.	It is a negative approach.
Sequence	It precedes selection.	It follows recruitment.
Economy	It is an economical method.	It is an expensive method.
Time Consuming	Less time is required.	More time is required.

VI. Orientation and Placement:

Once the candidates are selected for the required job, they have to be fitted as per the qualifications. Placement is said to be the process of fitting the selected person at the right job or place, i.e. fitting square pegs in square holes and round pegs in round holes. Once he is fitted into the job, he is given the activities he has to perform and also told about his duties. The freshly appointed candidates are then given orientation in order to familiarize and introduce the company to him. Generally the information given during the orientation programme includes-

- Employee’s layout
- Type of organizational structure
- Departmental goals
- Organizational layout
- General rules and regulations
- Standing Orders
- Grievance system or procedure

In short, during Orientation employees are made aware about the mission and vision of the organization, the nature of operation of the organization, policies and programmes of the organization. The main aim of conducting Orientation is to build up confidence, morale

and trust of the employee in the new organization, so that he becomes a productive and an efficient employee of the organization and contributes to the organizational success. The nature of orientation program varies with the organizational size, i.e., smaller the organization the more informal is the Orientation and larger the organization more formalized is the Orientation programme. Proper Placement of employees will lower the chances of employee's absenteeism. The employees will be more satisfied and contended with their work. Training of employees takes place after orientation takes place. Training is the process of enhancing the skills, capabilities and knowledge of employees for doing a particular job. Training process moulds the thinking of employees and leads to quality performance of employees. It is continuous and never ending in nature.

VII. Importance of Training :

Training is crucial for organizational development and success. It is fruitful to both employers and employees of an organization. An employee will become more efficient and productive if he is trained well.

Training is given on four basic grounds:

1. New candidates who join an organization are given training. This training familiarizes them with the organizational mission, vision, rules and regulations and the working conditions.
2. The existing employees are trained to refresh and enhance their knowledge.
3. If any up-dation and amendments take place in technology, training is given to cope up with those changes. For instance, purchasing new equipment, changes in technique of production, computer impartment. The employees are trained about use of new equipments and work methods.
4. When promotion and career growth becomes important. Training is given so that employees are prepared to share the responsibilities of the higher level job.

a). The benefits of training can be summed up as:

1. **Improves morale of employees-** Training helps the employee to get job security and job satisfaction. The more satisfied the employee is and the greater is his morale, the more he will contribute to organizational success and the lesser will be employee absenteeism and turnover.
2. **Less supervision-** A well trained employee will be well acquainted with the job and will need less of supervision. Thus, there will be less wastage of time and efforts.
3. **Fewer accidents-** Errors are likely to occur if the employees lack knowledge and skills required for doing a particular job. The more trained an employee is, the less are the chances of committing accidents in job and the more proficient the employee becomes.
4. **Chances of promotion-** Employees acquire skills and efficiency during training. They become more eligible for promotion. They become an asset for the organization.
5. Increased productivity- Training improves efficiency and productivity of employees. Well trained employees show both quantity and quality performance. There is less wastage of time, money and resources if employees are properly trained.

b). Methods of Training: Training is generally imparted in two ways:

1. **On the job training-** On the job training methods are those which are given to the employees within the everyday working of a concern. It is a simple and cost-effective training method. The in proficient as well as semi- proficient employees can be well trained by using such training method. The employees are trained in actual working scenario. The motto of such training is "learning by doing." Instances of such on-job training methods are job-rotation, coaching, temporary promotions, etc.

2. **Off the job training-** Off the job training methods are those in which training is provided away from the actual working condition. It is generally used in case of new employees. Instances of off the job training methods are workshops, seminars, conferences, etc. Such method is costly and is effective if and only if large number of employees have to be trained within a short time period. Off the job training is also called as vestibule training, i.e., the employees are trained in a separate area(may be a hall, entrance, reception area, etc. known as a vestibule) where the actual working conditions are duplicated.

Employee Remuneration refers to the reward or compensation given to the employees for their work performances. Remuneration provides basic attraction to a employee to perform job efficiently and effectively. Remuneration leads to employee motivation. A salary constitutes an important source of income for employees and determines their standard of living. Salaries affect the employees' productivity and work performance. Thus, the amount and method of remuneration are very important for both management and employees.
There are mainly two types of Employee Remuneration:

1. **Time Rate Method**
2. **Piece Rate Method**

These methods of employee remuneration are explained below in detail:-

c). Methods of Employee Remuneration :

1. **Time Rate Method:** Under time rate system, remuneration is directly linked with the time spent or devoted by an employee on the job. The employees are paid a fixed pre-decided amount hourly, daily, weekly or monthly irrespective of their output. It is a very simple method of remuneration. It leads to minimum wastage of resources and lesser chances of accidents. Time Rate method leads to quality output and this method is very beneficial to new employees as they can learn their work without any reduction in their salaries. This method encourages employees' unity as employees of a group/cadre get equal salaries. There are some drawbacks of Time Rate Method, such as, it leads to tight supervision, indefinite employee cost, lesser efficiency of employees as there is no distinction made between efficient and inefficient employees, and lesser morale of employees.
2. **Piece Rate Method:** It is a method of compensation in which remuneration is paid on the basis of units or pieces produced by an employee. In this system emphasis is more on quantity output rather than quality output. Under this system the determination of employee cost per unit is not difficult because salaries differ with output. There is less supervision required under this method and hence the per unit cost of production is low. This system improves the morale of the employees as the salaries are directly related with their work efforts. There is greater work-efficiency in this method. There are some drawbacks of this method, such as; it is not easily computable, leads to deterioration in work quality, wastage of resources, lesser unity of employees, higher cost of production and insecurity among the employees. Piece rate system is more suitable where the nature of work is repetitive, and quantity is emphasized more than quality.

d). How to Get a Government Job in Banking

To get a job in a government bank, you have to clear the IBPS exam. SBI conducts its exam for each post of its bank. Three stages of exams are Pre, Mains, and Interview. Private Banks conduct preliminary tests and interviews. After passing all the stages of the exam, you are appointed for a job in a public sector or private bank.

VIII. Private Sector Bank Recruitment in India: Private sector banks in India like public sector banks are dedicated to serving the financial market of the country as well as playing a vital role in economic development. Private sector banks in India offer a large number of financial services to their customers that cover MSME, Agriculture and Retail Businesses, Large and Mid-Corporates, etc. Private Banks are growing at a faster rate creating job avenues for young talents. Like public sector banks in India, private sector banks also offer employment opportunities to graduates who are looking forward to making their career in the banking sector.

The private sector banks in India offer jobs for various posts. The job profiles available in the private banks include Relationship Manager, Assistant Manager, Information Technology (IT) Officer, Security Manager, Law Executive, Branch Manager Business Development Manager, etc. Private sector bank recruitment in India is done through written exams and personal interviews**.** A few private sector banks in India like Axis Bank, Yes Bank, ICICI bank select eligible candidates for the post various posts after completing Post Graduate Diploma in Banking Services offered by Manipal School of Banking and NIIT School of Banking. In this article, we have discussed about private sector bank recruitment in India. Scroll down to read more regarding the recruitment process of private sector banks in India.

IX. Private Sector Bank Recruitment Process in India :

A decade ago, private sector banks in India were limited. However, in recent time private banks have flourished immensely. Even various foreign private banks such as Citi Bank, Standard Chartered, Royal Bank of Scotland (RBS), HSBC, etc. have made their presence felt in the financial market. Domestic private banks such as Axis, ICICI, HDFC, Kotak Mahindra, Yes Bank, ING Vysya, etc. are the major players. ICICI Bank is the largest private sector bank in India and the second largest commercial bank after SBI. Private Banks in India offers various job profiles. Candidates can apply for the various posts if they have the required qualification and experience. The private bank recruitment process comprises the following two stages:

Written exam

Interview

The written exam is conducted online and comprises questions from Reasoning, Quantitative Aptitude, English, General Awareness, and Computer Aptitude**.** Candidates qualifying the written exam are called for Interview. In Interview, candidates are judged on the basis of their intelligence and personality.

12.8 SELF ASSESSMENT QUESTION :

- What are steps involved in Staffing Process?
- What are steps in Recruitment process in Banking in India?
- Define HRD? Elements of Human Resource Management Climate?
- Explain Steps in Employee Selection Process?

12.9 SUGGESTED READINGS :

1. EDWIN B. FLIPPO – Personnel Management , New York; Mc Graw Hill
2. JOHN P. CAMPBELL - Personnel Training and Development, Annual Review of Psychology
3. WILLIAM MC GHEE AND PAUL W. THAYER – Training in Business and Industry, New York; John Wiley.

Dr. N.RATNA KISHOR

LESSON – 13

TRAINING AND MOTIVATION

OBJECTIVES:

The objectives of the lesson are to:

- Explain the terms Training, development
- Importance of training and development
- Explain various Methods of training/Development
- Evaluation of Training.
- To explain the concept of motivation
- Study the various theories of motivation
- Demotivation
- How to motivate

STRUCTURE:

13.1 Introduction
13.2 Education Vs. Training Vs. Development.
13.3 Differences between Training and Development
13.4 Need and importance of Training
13.5 Objectives of Training
13.6 Training and Learning
13.7 Steps in Training Programme
13.8 Training Policy
13.9 Methods of Training
13.10 Evaluation of Training
13.11 Motivation
13.12 Determinants of motivation
13.13 How to motivate
13.14 What does demoralize.
13.15 Theories of motivation
13.16 Practical Implications
13.17 Financial Motivators
13.18 Non-financial motivators
13.19 Moral and productivity
13.20 Morle Development
13.21 Summary
13.22 Key words
13.23 Self Assessment Questions
13.24 Further Readings.

13.1 INTRODUCTION :

After selecting an employee and complete other formalities like placement and induction, the next step before the management or the organization is to train them properly, so that they can discourage their duties more effectively and efficiently. The effectiveness of an organisation largely depends upon the extent of Training and Development Opportunities

are made available to employee when helps them to realize their growth potential and also to make significant contribution towards achievement of organizational objectives at an Earliest. Training and Development tries to integrate the individual goals with organizations. In the present day job in the organizations have become complex and rapid changes are taking place in technology. In this connection the employee training is not only an activity that is desirable but also an activity that an organization must commit resources to bring out a viable and knowledgeable work force.

Training is an organized procedure for increasing the knowledge and skill of the people for a specific purpose. The trainee acquires new skill, technical knowledge, problem solving ability etc. Training is such area where employer and employee both have mutual interest. Training tries to improve the efficiency of the employee and on the other hand, training gives better employee to the enterprise.

The term training has been defined by many eminent authors as follows:

- According to Brech "Training is the organized procedure by which people learn the skills for a definite purpose".
- Eolwing B. FLIPPO defines training as "the act of increasing the knowledge and skills of an employee for a particular job".

Training involves the development of skills that are usually necessary to perform a specific job. Its purpose is to achieve a change in the behaviour of those trained and enable them to do their jobs better. Training makes newly appointed workers fully productive in the minimum of time. Training is equally necessary for the old employees, where new machines and equipment are introduced and/ or there is a change in the techniques of doing the things. In fact training is continuous process. It does not stop anywhere. The managers are continuously engaged in training their subordinates.

They should ensure that any training programme should attempt to be about positive changes in the i) knowledge (ii) skills and (iii) attitudes of the workers. From the above, it may be said that the art of acquiring knowledge and skill of doing a particular job in a particular manner is called Training. It can say that training improves changes and moulds the employees knowledge, skills, behaviour and aptitude towards the requirements of the Job and the organization.

13.2 EDUCATION vs. TRAINING vs. DEVELOPMENT :

Education, Training and Development are often used to transmit the same meaning. Before knowing those differences, let us know the meanings of these concepts. "Education is a process by means of which the knowledge learning, understanding of physical capacities or mental outlook or attitude of employees is so increased as to baring about their better judgment with their working environment."

- "Training is the process by means of which the aptitudes, skills and capabilities of individual employees to perform specific jobs are increased".
- "Development is a process by means of which an individual attains overall improvement in ability and competence and makes progress towards maturity and actualization of Personality.

From the above definitions, it can be understood that education is the process of acquiring background knowledge of a subject and it is more a person oriented than Job-oriented. Coming to the training and development, training is more jobs oriented, where as through development programmes the individual can be prepared to accept the new challenges and

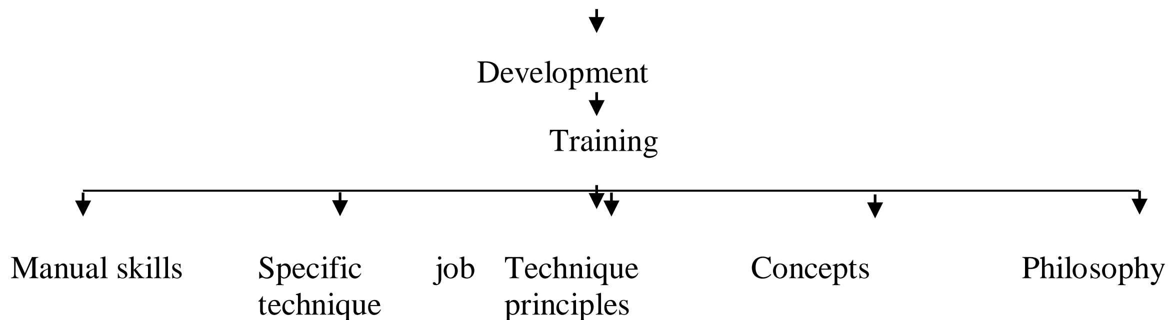
new responsibilities in future. The base for the entire process of training and development is education.

13.3 DIFFERENCES BETWEEN TRAINING AND DEVELOPMENT :

According to John P. Jkenny and others "Training an individual means helping him to learn how to carry out his present job satisfactorily. Development can be defined as preparing the individual for a future Job". In the words of Edwin B. FLIPPO " while training is the act of increasing the knowledge and skills of an employee for doing a particular Job, management development includes the process by which managers and executives acquire not only skills and competence in their present Jobs, but also capabilities for future managerial tasks of increasing difficulty and scope".

Area	**Training**	**Development**
Inputs	Technical skills & Knowledge	Behavioural aspects, Educational, Philosophical Theoretical etc.
Purposes	Job oriented	General knowledge
Period	Very short period, Terminal point is there	External, long term no any Terminal Point etc.
For whom	Non-managerial personnel	Managerial personnel.

Training Development Continuum



13.4 NEED AND IMPORTANCE OF TRAINING :

Every employee should be given training in the particular Job for which he is selected. Training is a continuous process. Whenever an employee gets promotion, transfer or job enrichment, etc., training should be imparted. Training should also be given whenever some new Technology is introduced in the organization or wherever there is some change in the existing system. Through Training only, the skills of the employee should be improved as per the requirements of the job/organization. Training necessary for the following reasons:

1. **Increased productivity:** Training improves the performance of employees. Increased skill and efficiency results in better quantity and quality of production. A trained worker will make the best use of machines and uses the material in an economical manner.
2. **High employee morale:** A trained worker derives happiness and job satisfaction from his work. The worker feels happy when has performance is up to the mark. The

employees will properly look after a worker whose performance is well. All these factors will increase employee's morals.

3. **Reduced Supervision:** When employees are properly trained, the supervision required will be less. Worker need not depend upon the supervisor for minute details and may carry on his work himself. Well trained workers will take more interest in their work and will contribute significantly in reducing managerial problems of supervision.
4. **Less wastage:** Untrained workers may waste more materials, damage machines and equipment and may cause accidents. In general accidents will occur due to the deficiency in operator and not in the machine. A trained worker will know the art of operating the machine properly, trained worker will also use the materials and other equipment in a systematic manner causing use massages.
5. **Easy adaptability:** Day to day technical advancements will require new approach to work. The methods of work are constantly undergoing a change. This requires the adoptability of workers to the changing environment. A trained worked can be more adoptable to change than an untrained worker. The trained workers will easily adapt to new situation more easily.
6. **Reduced turnover and Absenteeism**: Labour turnover and Absenteeism are mainly due to Job dissatisfaction. A trained worker will take keen interest in his job and can derive satisfaction from it. A satisfied worker may not like to leave his job and try at a new place. Training helps in reducing labour absenteeism by increasing job satisfaction among them.
7. **Employee Development:** Training helps for the development of the employees. Training first helps in identifying the talent and then develops it to the maximum. The adoptability of the worker will help him in working on new and improved jobs. If t=a worker learns first then he will be able to develop his talent and improve his performance. Training gives him an opportunity to show his work also.

Some Important Benefits of Training / Development

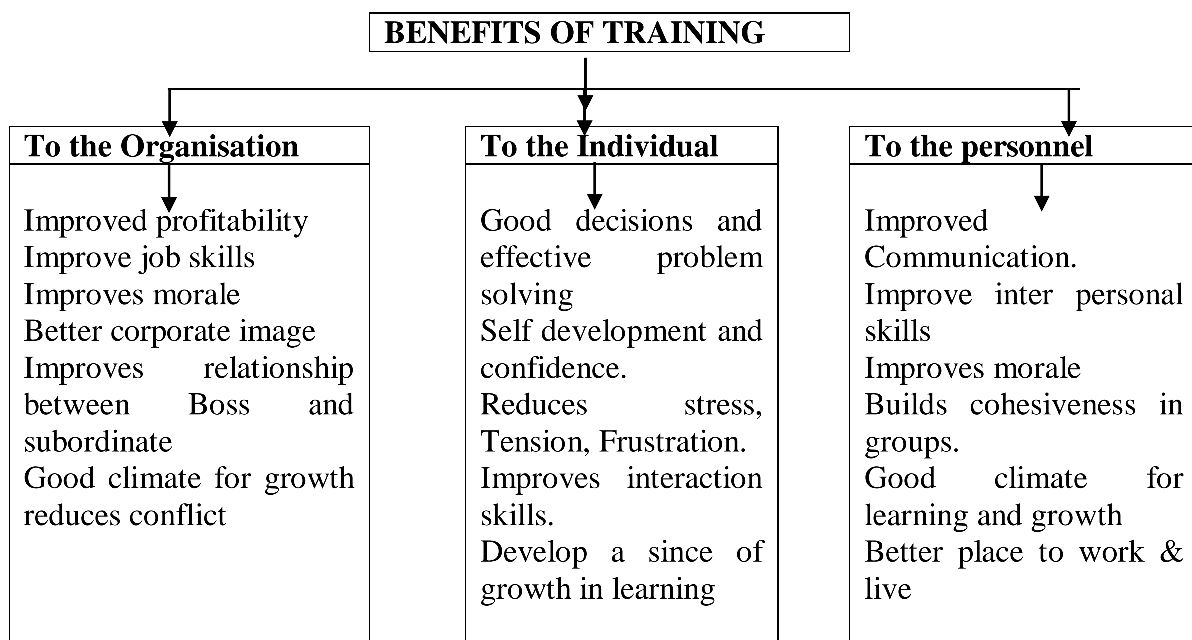
- Improved profitability.
- Improvement in knowledge and skills at all levels.
- Helps in organizational Development
- Reduction in wastages and spoilages
- Increaser the work speed.
- Reduces the burden of supervisors
- Reduces accidents and machine break downs.
- Improved quality and quantity of output.
- Personnel growth and advancement
- Improves Labour and management relations.

13.5 OBJECTIVES OF TRAINING :

The main objective of training is to improve the performance of the employees. Training should improve not only the operative and basic skills of the employees, but also their inter-personal and decision making skills. Some of the important objectives of Training one.

- To enhance the existing knowledge, skill and performance capabilities of employees.
- To keep abreast of developments in technical and management fields.

- To develop second and third line executives to strengthen the working links and levels.
- To promote individual development and create conditions for a high level of work, employment, job satisfaction, affinity with the company etc.
- To improve the quality and quantity of output, to lower the cost of waste, equipment maintenance and accidents.
- To induct new recruits into the organization.
- To mould employee attitude with the purpose of achieving a better cooperation with the company.
- To identify and develop value systems and behavioral practices and commitment to excellence in all endeavors' in the organization.
- To inculcate a sense of appreciation for other functional areas and an understanding of the linkage of their activities with other areas.



13.6 TRAINING AND LEARNING :

The concept of Learning is the base for the design and development of training and development programmes. It is chear that training and development are learning processes, through which the employee have knowledge and acquire skills. Integral part of training and development is that one has to learn the technical skills and knowledge and several desired behavioural patterns. Psychologists are of the opinion that Training / Development is almost learning and hence there are several learning principles that will accelerate the process of learning, if training/ Development Programme rest on these. According to D.S. Beach "Learning is that human process by which skills, knowledge, habits and attitudes are acquired and utilized in such a way that behaviour is modified".

Process of learning: There are four steps is learning process.

Stimulus, Response, Motivation and Reward.

1. There should be a stimulus which is clear to the learner. In work setting, unless the employee understands what the management is trying to communicate, he may not move in the proper direction.
2. Response means the act which the Learner has to perform. He should be allured and encouraged to participate.
3. There should be a motivation. Motivation involves Interest and the attitude to learn. If the individual does not want to learn, he is unlikely to learn, irrespective of his learning skills.
4. Reward or incentive refers to what satisfies a motive. For learning to be effective, the learner should be reworded. If there is no sign of such reward then they may Demotivation the employees to learn skills.

A principle of Learning includes.

1. Every human being is capable.
2. Learning is active and not passive.
3. People learn more by doing them learning alone.
4. Time must be provided to practice what has been learnt.
5. The rate of Learning decreases when complex skills are involved.
6. Learning is closely related to attention and concentration.

I. History and Evaluation of Training in Indian Banks

Institutionalized system of training in the banking industry commenced in India in 1954 with the establishment of the Banker"s Training College [BTC]. The Imperial Bank of India [State Bank of India] also set up three schools almost the same time to train probationary officers in Calcutta, Bombay and Madras. The focus of training curriculum until early 1960, however, was on hardcore principles and techniques of banking and the target group were entry-level officers and branch managers.

Nationalization of banks in 1969 ushered the concept of mass banking followed by phenomenal expansion of branches, number of employees and diversification of portfolio etc., The banking industry responded to these challenges by expanding in-house training facilities, setting up an apex level institute, National Institute of Bank Management [NIBM] to specially cater to the felt needs of the entire industry, sponsoring large number of officers to reputed management institutes and professional bodies within and outside the country. Multitude of institutions, training programs and large number of officers and staff members trained over years is a clear indication of the popularity of training and development activities in Public Sector Banks. The analyses of the available data on training in Public Sector Banks reveal that, in quantitative terms, they have a very impressive record. When the net impact of these massive effort and huge investments made has failed to make desired impact on individuals, the collective performance and overall business results is not a secret.

Absence of well-articulated and shared Human Resource Development [HRD) vision, mission and long term perspectives, glaring inadequacies in scientific analysis of training methodology, availability based sponsorship to training programs, over emphasis on concepts and theoretical aspects of banking, quality of trainers and absence of post training follow-up etc., are to a very great extent, responsible for sub-optimal results achieved by training. Observations by the Narasimham committee on banking reforms in 1998 are very apt. It urges "The management of Indian banks to review the changing training needs in individual banks keeping in mind their own business environment and to address these urgently".

Cryptic comments, on training made by the M S Verma panel on restructuring weak public sector banks [1999] though made in respect of only three Public Sector Banks echo the

state of affairs in many other banks. It says "Leadership at the middle level in three banks are seriously lacking". This is largely because of inadequacies in skill both in traditional area of bank operations as well as the new area in which most banks are now moving. In specialized areas like credit, treasury operations, foreign exchange and of course IT, the three banks are extremely deficient in skill and are almost out of the markets.

A working group on training was set up at the time of social control on banks under the chairmanship of B N Adarkar. This group studied in depth the required training in the changed context of the Indian banks. The group suggested several measures to improve knowledge, skill and attitude of bank employees through training. As a result of these efforts, the banking industry started laying increased emphasis on training and development. The Adarkar committee made valuable suggestions most of which are still valid. One of the most important suggestions pertains to the involvement of top management in training.

In this regard, the committee observed "It is sometimes considered that bank executives do not require any training, the working group considers that training is necessary at all levels and at all stages and that training programs cannot have the necessary prestige or acceptance unless the lead is given by the top management". There is yet another reason why training activity must begin at the highest level. In many operating areas of the banking industry, there are several issues and problems which need to be cleared at the highest level. Unless they are satisfactorily settled at that level, there is little likelihood of the officers getting the necessary support in developing fresh thought or new techniques in their day-to-day work in these fields. Such a block at the higher levels would inevitably defeat the purpose of training at the lower levels. Indeed, officers who undergo such training have, as a result, developed new skill and attitude inevitably feel that such training is not a waste of their time. One of the first steps taken in this regard was to provide the necessary infrastructural support to training efforts.

The National Institute of Bank Management [NIBM] was set up in 1969 as an apex training, research and consultancy organization. The basic objective of NIBM was to usher in professionalism in Indian banks and it was expected to train top and middle level bank executives as also to facilitate individual banks to develop effective training activities. NIBM, therefore, initiated a series of activities to evolve new training programs and to train the trainers from banks on different dimensions of bank management. NIBM was directed to give priority to research on different dimensions of banking and bank management. In addition to NIBM, there are also two other apex level training institutions, viz. the Bankers Training College [BTC] and the College of Agricultural Banking [CAB]. These two institutions are expected to provide functional training programs while NIBM essentially caters to the management aspects of banking. Besides these industry level institutions, there are more than three hundred individual bank level training colleges and training centres.

From mid-1969 onwards, relatively highly educated persons, most of them with postgraduate degree in Commerce, Arts and Sciences entered banks at clerical and junior officer levels, thus changing the profile of the Indian bank employees. Although they were highly qualified, to keep their skill, knowledge and attitude in line with the requirements of the industry, re-orientation efforts were necessary. However, the training systems in the banks could not catch-up with the increasing intake of manpower. This led to a major gap between the training system and the reality of banking operations. For example, it was stipulated by the Department of Banking, Government of India and Reserve Bank of India that every new employee should undergo an orientation program right at the initial stages but

the new employees got their turn for induction / orientation program only after several months of their joining date.

Although the industry had impressive number of training establishments, the training activities have not been able to effectively cater to the needs of the industry fully. A closer examination of the state of affairs regarding training in banks indicates that the real reasons for this lie elsewhere. Some of them are Lack of conviction of the concept of training Lack of top management support Improper selection of trainees Ineffective use of training methodologies and Undesirable pressure for quantity rather than quality.

A conference of training college Principals and general managers in charge of personnel management in banks held at NIBM in December 1989 identified the following constraints in making training activities effective in banks. Training does not receive due attention from the top management Identification of training needs is not done systematically No systematic effort is made to select training faculty and there is lack of opportunities for career advancement for faculty members Insistence on number of programs and number of employees to be trained to work against the quality of training and Post training placement is not done seriously by banks. Even after 40 years since the recommendations of the Adarkar committee, the top managements support to training is not very clearly visible in most banks. It is interesting to note that yet another Principal's conference held at NIBM during February 16-18, 1998 also identified most of the earlier constraints including "Lack of top management involvement, quantity based training, lack of good trainers, etc., and are still persisting".

The constraints identified by the Principal's in 1989 and 1998 are not necessarily specific to the Indian banking industry alone. Most of these deficiencies are reported as universal problems of training. To make training efforts as close as possible to reality, certain positive steps have to be initiated. This would make training a useful intervention in the banking industry. Some of the major demands being raised on the training system are categorized as Change management - the pressure on the training system to continuously upgrade and change to meet the changing environment Decision making in a fast changing environment, frequently with only incomplete / vague information available Information management i.e., to handle and analyze information is one of the challenges to be addressed Phenomenal product diversification in banking industry and the emergence of demand, call for grooming of specialists in different disciplines of banking The new attitudinal orientation needed for the workers due to the unavoidable customer orientation The need to develop a culture of team effectiveness instead of individual excellence The need to develop a system perspective than doing one's own assigned job in isolation.

Bhatawadekar M V argues that the following are the major problems faced by the bank training system in the country. Training institutions are rarely provided with adequate manpower and equipmen The training institutions do not have effective control over the numbers to be trained or the candidates to be selected A rigorous evaluation of the trainees after the completion of a program is not possible There are no means to ensure that the trained officials are posted in positions where they can use the skill they learnt during the training programs When such opportunities exist, often facilities and environment required for practicing the skills learned are not available and The output of bankers is considered non-measurable and quantitative measurement of the job performance is not undertaken.

II. Emerging Scenarios in Indian Banks

The banking system in India is currently poised with far reaching changes. The emerging business profile of banks would include non-traditional areas like merchant

banking, mutual funds, newer financial services, personal investment counseling, factoring, venture capital and possibly consultancy and research services. Besides this, to be on the top, banks will have to continuously innovate to find new areas of operations. If Indian banks will have to launch new activities, they will necessarily have to be innovative. The immediate and the possible distant changes in the environment will make Indian banking more complex as the profile of these banks will undergo major transformations.

While they continue to engage themselves in conventional banking, they will also enter areas of modern business ventures. These changes will call for new knowledge, skill and attitude and training systems will have to stand up to these challenges. No Indian bank can survive without being up to date with the latest developments. Indications to this effect are visible. If the banks go in for enhanced microelectronic assistance for its multifarious operations, it will definitely call for changes in approaches to training.

It is a fact that most significant effect of diversification and technological revolution are in the sphere of skill. With new line of business, product diversification and wide spread technology adoptions, the type of personnel required in handling jobs under most complex and competitive conditions will require skill, which are different from those required for traditional type of business. To be competitive, managers will have to match international quality and performance standards. The impacts of technology on HR in banking and insurance companies are tremendous. In a study, the group of researchers compared the old and new competencies needed to survive in the changed atmosphere. Table 10 summarizes the information.

The new competencies to operate in the ever-changing environment and the capacity to deal with non-routine work process can only effectively respond to the process of deregulation and globalization of banking. Similarly, ability to handle responsibilities and to operate in the expanding geographical and time horizons is the hallmark of emerging competencies. In addition, the changing social values with which the new generation of employees has been brought up gave them different value orientations. A study on the work goals of the bank employees clearly indicates that, besides good pay and security, ranked as number one and two respectively, other aspects like opportunity to learn, opportunity to upgrade knowledge, interesting work, match between ability and work also received fairly a high level in ranking work goals [Table 11]. 90% of the respondents in this study were below 40 years of age. This indicates that the value orientation of the bank employees is also changing.

All these changes will necessitate the training system in banks to re-orient its approaches and priorities so that training activities will become an essential part of a strategic human resource management in banks. If this linkage is not properly established, training activities will further degenerate into mere routine rituals.

The training system in the banking industry has a strong structural base and has capabilities to handle training in large numbers. The training system of the nationalized banks alone has the capacity to train about 30,000 employees at a time. The system has also developed several innovative activities in the training area such as on-location training, manager to messenger program etc., only when training becomes vibrant, the organization will be able to meet the challenges emerging from the changing environment. Specially, the role of the bank training colleges has to be substantially redefined.

The colleges have to move away from the usual „headcount‟- oriented training activities to competency building processes. This would get the training colleges to get

actively involved in the whole of training process starting from identification of training needs to evaluation of training effectiveness and its benefits to the end users - the internal and external customers. This linkage would make training interventions meaningful to bank organizations. Training is an essential ingredient to improve the quality of officers and managers. Training prepares employees at different levels to acquire new competencies in critical areas like computers, merchant banking, international banking, treasury management, asset liability management, financial services etc., and to operate effectively in ever changing environment.

Individual banks are required to undertake review of the existing training system as a whole in the context of newly emerging training needs and examine of courses, existing infrastructure, faculty development, training materials and relevancy of teaching methodologies etc., in the present scenario, banks have to develop a comprehensive training policy and demonstrate their commitment for training. Both systems for alternative methodology for classroom training and on-the-job training have to be strengthened. Time bound framework for developing a pool of competent and trained officers in the areas of credit, merchant banking, international banking, foreign exchange dealings and financial services etc., should be created.

III. Recent Development in Training Arena

Enhancing training system is very important to keep with changing pace and existing levels of activities and to keep pace with technology up gradation. The training system should be able to take care of both quantitative and qualitative aspects of training. Certain major changes required in this regard are For the purpose of de-centralizing routine skill training activities, training system has to ensure that software on different skill training is developed, sufficient facilities are provided Identify the best trainer talents in advanced area and provide them with sufficient incentives, encourage them to develop other specialists, also draw their attention to research and in-house consulting and Effective linkage between training need assessment and performance appraisal system to be established.

The Narasimham Committee on financial reforms has also enumerated a number of problems related to Human Resource Management [HRM] in banking such as over manning, lower manpower productivity, indiscipline, restrictive practices, lack of management commitment to training etc., The committee has recommended radical changes in work technology and work culture as well as adoption of forward looking personnel policies, which are seen to be objective and consistent with a satisfying work environment. Changes are happening regarding the understanding about how workplace learning happens.

A recent study shows that managers and workers most effectively learn the competencies when the training program in which they participate observe the following fundamental principles of workplace learning Link learning to what is valuable, not only for the organization but also for the individual Connect action and reflection in a continuous cycle, people learn by doing and thinking about what they have done. Address learner’s attitude, belief and behaviour, addressing only behaviour is likely to be narrow and ineffective. Provide a balance of challenge and support. Workers who make mistakes without being harmed are better able to stretch and learn create opportunities to teach as well as learn. The best learning happens when workers both discover new knowledge and share their own expertise with others and Design and cultivate learning communities, not just course materials, books and e-learning programs. These aspects deserve attention while designing the bank training system in the country.

What are the areas in which training should be provided? The soft skill training topped respondent's list of priorities. Included were the sub-group's leadership, management and supervisory skill training, with interpersonal skill, teamwork, customer service, diversity. The survey results were of no exception. In fact, soft skill training ranked second on the list, with 18.63 % learning professionals ranking the broad category as one of their main priorities for the coming year. The following types are included in the soft skill Customer service training Diversity training Interpersonal skill Leadership development Management development Teamwork

IV. Apex Bank Trainining Institutes in India

Reserve Bank of India [RBI] has six training establishments. Three of them namely, College of Agricultural Banking [CAB], Bankers Training College [BTC] and Reserve Bank of India Staff College [RBSC] are part of the Reserve Bank. Others are autonomous, such as, National Institute for Bank Management [NIBM], Indira Gandhi Institute for Development Research [IGIDR], Institute for Development and Research in Banking Technology [IDRBT]. These are not the only major bank training institutions in the country, other institutions are The North Eastern Institute of Bank Management [NIEBM], Indian Institute of Bankers [IIB] and The training institutions of SBI.

A. College of Agricultural Banking [CAB]

The College of Agricultural Banking was originally set up to impart training in agriculture and rural banking. The college has diversified into other areas such as the non-banking financial sector, human resource management and information technology. In the near future, the college proposes to consolidate those activities. Nowadays the college is extending faculty support to the workshops conducted by the reserve bank of India and off-site programs for state level financial institutions.

B. Bankers Training College [BTC]

Reserve Bank of India established Bankers Training College in 1954. It was the first conscious effort ever made by an Indian institution towards systematic training of bank personnel. The college was set-up broadly on the basis of training establishments of Bank of England and Central Banks of a few commonwealth countries. The college has been endeavoring to impart qualitative professional training for the functionaries of Indian commercial and development banks, foreign banks in India, Reserve Bank of India and certain cadres of Government of India. The College also receives participants from some of the countries in Asia and Africa. Besides, the college facilitates formulation/ implementation of banking policies by acting as a forum for interaction among the top officials of RBI and commercial banks/ financial institutions.

The training programs in BTC are constantly reviewed and updated in consultation with the user-system to make them need-based, practical and operation oriented. The programs of the college are broadly classified into: Credit delivery, forex markets, foreign exchange, international banking, financial engineering, general banking, specialized areas and specific functional groups. The BTC also holds seminars, symposia, conferences and workshops on subjects of topical importance with the objective of evolving suitable policy initiatives for meeting the challenges in the deregulated environment. Some of the programs like treasury management, asset-liability and credit management have developed into high premium programs and have been attracting overseas participants. The training methodology adopted by the college is a judicious mix of instructional and group process of learning. Several programs are enriched by using market-related stimulation games, case studies,

project assignments. BTC faculty consists of experienced officers of RBI who have diversified academic qualifications and practical experience in different departments.

C. Reserve Bank of India Staff College [RBSC]

The Reserve Bank of India Staff College caters primarily to the training and development needs of officers of the RBI. The college is expected to play a crucial role in upgrading the skill of the officers to face the challenges of new tasks and introduction of new technologies. This has assumed an added significance in the context of the large retirements under the Optional Early Retirement Scheme [OERS]. The thrust of the RBSC would continue to be on probationers and mid-level management officers.

D. National Institute for Bank Management [NIBM]

The NIBM was established in early 1969 as a part of the banking policy. It enunciated in social control to serve as an apex institute of the banking system, to initiate and co-ordinate all matters connected with training of bank personnel and relevant research and consultancy in bank management problems. Later on, with the nationalization of 14 commercial banks in 1969, the institute devoted it in ushering a new era in the development of banking and it became the „Think tank" for the banking industry and leads the industry's move towards professionalism. The NIBM has since then focused on management issues and acted as a change agent in many areas of banking. One of these was the human resource management. Personnel management was not given the required importance in banks. Formal training was almost absent. Recruitment, transfers and placements were perceived to be the management's prerogative.

The institute has broadly four functions which are Training of the higher level personnel in management and functional areas Research into problems of concern to the banking industry Consultancy to individual banks to translate policies and findings into suitable programs Education at post-graduate level to assure a steady supply of high caliber personnel to the banking industry. The institute has different roles to fulfill viz., Continuously upgrade the knowledge and skill of the top management To be the storehouse of data and information of all new and emerging issues in the banking sector To help banks to secure their financial position and make them world-class and To be a change agent by ushering in professionalism.

Conveniently divided into three areas: research, training and consultancy, the activities of the NIBM are integrated in nature. Research and consultancy complement each other and their outputs form a very important segment of the training inputs. Research activities in the NIBM have a wide range in terms of topics, scope, approach and methodology. The NIBM"s training programs are customized to the needs of the users. The institute has been bringing out a variety of publications in the form of books, journals, reports and working papers in tandem with its research and training functions.

E. Indira Gandhi Institute for Development Research [IGIDR]

The Indira Gandhi Institute of Development Research (IGIDR) is an advanced research institute established by the Reserve Bank of India for carrying out research on development issues from multi-disciplinary points of view. The aim and objective of the institute is to promote and conduct research on development (in its economic, technological, social, political and ecological aspects) from a broad inter-disciplinary perspective; to gain insights into the process of development and alternative policy options and to disseminate the knowledge so gained.

F. Institute for Development and Research in Banking Technology [IDRBT]

The IDRBT was established by the Reserve Bank of India in 1996 at Hyderabad. It is an autonomous centre for development and research in banking technology and was set up on the basis of Saraf Committee recommendations on technology related issues. The Governor of RBI is its ex-officio chairperson. The objective of the institute is to provide training, research and consultancy/advisory services in the area of information technology to banks and other financial institutions. It is actively engaged in research and development in banking technology and is working on a number of research projects in the area of electronic payment system, security standards, certification, data warehousing, multimedia products etc., it is also catering to the training needs of business executives and IT professionals in banking and financial sectors.

Its main focus is on training the trainers, executive programs and special programs for international participants, seminars and workshops on current advances in IT etc., It also collaborates with major IT companies and academic institutions to encourage active co-operation with them by facilitating research, development work on hardware / software products. The institute is also undertaking research and consultancy related assignments and projects in banking and financial sectors. The faculty of the institute comprises technical experts from both technology and banking. The interaction between these two core groups provides a good combination for meaningful research and purposeful development of products and services for the advancement of banking and technology. The institute is also publishing a newsletter on banking technology. Within a short span of time, the institute was able to draw up the technology roadmap for the Indian banking and financial sector and spearheaded technology absorption in almost every sphere of activity in banks and financial institutions.

The activities of IDRBT are backed by intensive research in the focal areas of financial network architecture, security policy, security systems, payment and settlement systems, data warehousing, multimedia, etc., specialized labs equipped with the latest technology are in place to aid the research and development teams. IDRBT is also the certifying authority for the Indian banking and financial sector under the IT Act 2000. The institute is actively involved in the development of various standards and systems for banking technology, in coordination with the Reserve Bank of India, Indian Banks Association, Ministry of Communication and Information Technology, Government of India and the various high-level committees constituted at the industry at national levels.

G. The North Eastern Institute of Bank Management [NEIBM]

This institute was established in 1983 and is sponsored by RBI, NABARD and Public Sector Banks like SBI, United Bank of India, Allahabad Bank and Central Bank of India, Indian Bank and IDBI. The institute is set up to assist the development of banking and financial institutions in the north-eastern region. It looks after the training and development activities of the banking institutions in the region. It also undertakes research studies and surveys relevant to banking and provides consultancy services.

H. Indian Institute of Bankers [IIB]

The Indian Institute of Bankers was established on 30th April 1928. It is licensed under the provisions of section 26 of the Indian Companies Act, 1913. The different classes of members are Fellow, Associate, Certified Associate [CAIIB], ordinary member and institutional member. It conducts different professional examinations for its members and encourages the study of different aspects of banking. The objectives behind the setting up of the Indian Institute of Bankers are many including To encourage the study of theory of banking and to institute a scheme of examination and to give certificates, scholarship and

prizes To promote information sharing on banking To sustain the competency developed by way of collecting and circulating statistics and other information consisting of works on banking, commerce, finance, political economy To facilitate research in banking and course innovation through award of fellowship/ scholarship To collaborate and co-ordinate with banks own training establishments to ensure healthy correlation between banking education and training To provide means of social intercourse between persons engaged in or connected with the business of banking in India. The institute has opened eight zonal offices and around 250 sub-Centers in different parts of the country to provide prompt and better services to its members.

I. The training institutions of SBI

State Bank of India, the largest Public Sector Bank in the country which has got several personnel training establishments. They include State Bank Staff College, Hyderabad, which focuses on functional training State Bank Academy, which was set up in 1982 and situated in Gurgaon which specializes in training of middle and senior management personnel State Bank Institute for Information and Communication Management, Hyderabad, started in 1987 which is catering to technology planning and execution and State Bank Institute for Rural Development, Hyderabad which was formed in 1981 with the purpose of training personnel in agriculture and allied activities. The State Bank Staff College at Hyderabad was certified by the Lloyd's Register Quality Assurance regarding the quality management system standards. The quality management system is applicable to the identification of training needs, identification of inputs, conducting training programs, evaluation of training programs, feedback processing, research and publications, selection of faculty, training of faculty and maintenance of infrastructure. Training in the State Bank is a pro-active, planned and continuous process as an integral part of organization development. It seeks to impart knowledge, improve skill and re-orient attitude for individual growth and organizational effectiveness.

13.7 STEPS IN TRAINING PROGRAMME:

A training programme should be prepared to suit the needs of the organization. A training programme has following steps.

1. Identifying Training needs.
2. Getting ready for the Job.
3. Preparation of the Trainee.
4. Explaining the Job sequence.
5. Actual try-out
6. Follow-up.

1. **Identifying the training needs:** The first step in training programme is to identify the training needs. A thorough analysis of organizational needs should be taken up. The availability of manpower resources and deficiencies in performance should be identified. Without determining proper training needs, a systematic programme for training will not be possible. Training needs can be determined in the following manner.
   i. By analysis of behaviour of employee.
   ii. Organizational weaknesses act as clues for determining training needs.
   iii. By conducting conferences
   iv. Through outside consultants.

v. Conduct of Brain storming sessions.

2. **Getting ready for the Job:** Next step is the persons to be imparted Training should be identified. Is it the new comers only on the existing persons also require training. New comers are certainly provided some kind of training. The refresher training is arranged for present employees. The supervisors and other level managers may also require training for acquainting them with latest methods of work. A training programme requires good trainers also. The trainers are the persons on whose competence training programme will depend. The various training techniques like on the job training, Lecture methods, conferences etc. should be decided. A combination of trainee, trainer and techniques will help in making training a successful one.
3. **Preparation of the trainee:** The trainee should be explained about the need for the present training and its usefulness for the work he is doing. The trainee should be encouraged to ask question about the job and the way of doing it. The trainee should be taken as close to the condition of work as possible so that he feels comfortless.
4. **Explaining the job sequence:** The trainer should explain the sequence, step by step of undertaking the job. Every step should be properly discussed with trainees. The trainer should demonstrate the method of doing the job. For this purpose the audio-visual aids may be used. The trainees may be encouraged to ask question a different step of the jobs.
5. **Actual Try-out:** Under their step the trainee is asked to do the job himself and repeat it a number of times. The trainee watches actual performance of the persons and points out mistakes. After rectifying wrong steps the trainer is asked to repeat the full sequence of doing the job. The trainees are given performance tests to judge their level of performance. They may also be given oral or written tests to ascertain their knowledge of the jobs.
6. **Follow-up:** This step is taken to test the effectiveness of the training programme. The trainee may be put on the job to see his performance. Trainee may be frequently checked to find out if he has learnt the job properly or not. A follow-up action is essential to find out-whether the trainees have improved their performance or not. The cost incurred on training and the benefits derived from it are also judged in a follow-up step.

13.8 TRAINING POLICY :

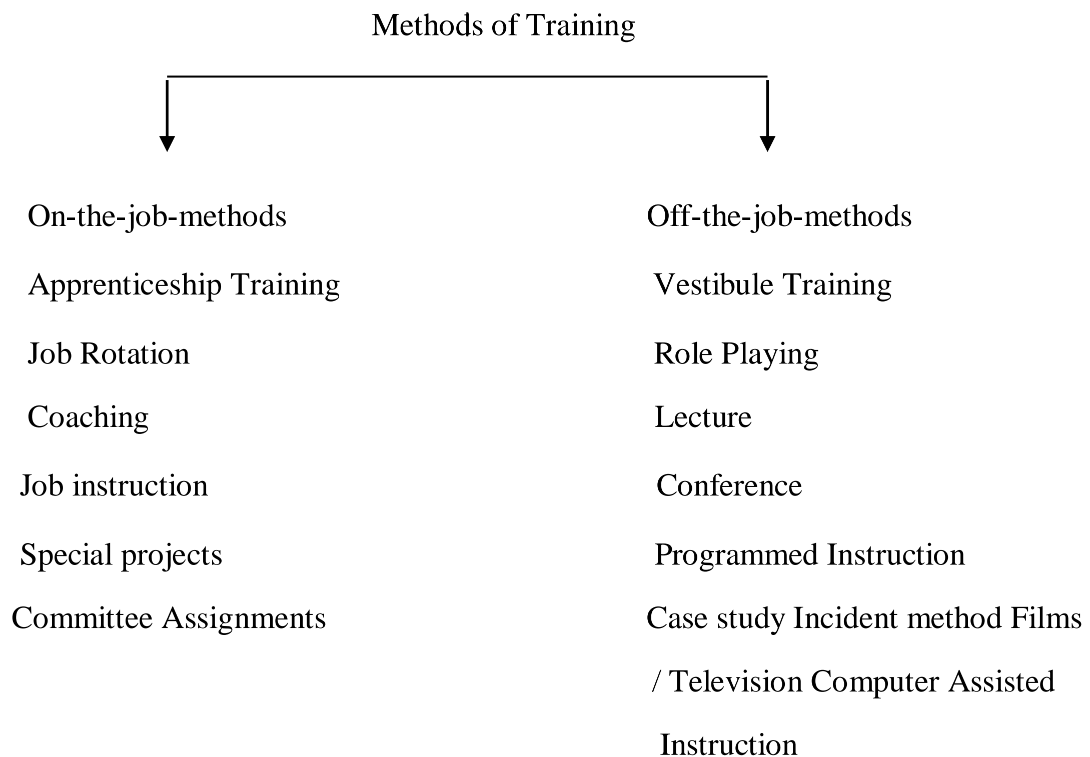
The objectives of the training programme must be clearly defined and communicated. The training policy must indicate how the training will be carried out and who will be responsible for its administration, which will bear the cost etc.

- Training policy is needed for the organization because of the following reasons.
- To indicate the employees, the intention of the top management to develop human resources in the organization.
- To identify deficit areas where training is needed in the organization.
- To provide an opportunity to the employees to develop their skills to suit the technological changes.
- A proper training mission must consider.
- Whom to train?
- What to train?
- When to train?
- How to train?

13.9 METHODS OF TRAINING:

When a person joined in a job for the first time, training may be given, which is known as Induction training. The employees on and off may be given training to enrich their knowledge and skills about the job which is known Job Training. Wherever an employee gets promotion he/she should shoulder new responsibilities. Again training is necessary at this stage and the type of training given to such employees is known as promotional training. At the time of joining in a job, employees are formally trained for those jobs. But with the passage of time, they may forget some of the methods of hand ling a particular job. So again training is given to the employees, which is known as refresher training. In addition to the above training should be given whenever.

- New Technology is introduced in the organization.
- Changes are introduced.
- Transfer of employee from one section to another section ar from one place to another place etc.



On - the Job Methods :

On-the-Job training method is the most commonly used method. Under this method, the individual is placed on a regular job and taught the skills necessary to perform the job. The trainee learns under the supervision and guidance of a qualified Instructor
On-The-Job has several advantages:

- It is relatively inexpensive
- Trainees learn while producing
- Trainees learn the skills under actual work conditions.
- There is no need to maintain any classrooms or programmed learning devices.
- Trainees learn, by actually doing the job.

- It given quick feedback about the correctness of the performance of the trainee.

On-The-Job Training may be given through different methods mentioned below.

1. Apprenticeship Training
2. Job Rotation
3. Coaching
4. Job Instruction
5. Special Projects.
6. Committee Assignments.

a) Apprenticeship Training: Apprenticeship Training is a structured process by which individuals become skilled workers through a combination of class-room instruction and on the job Training. This method helps to give the trainee sufficient knowledge and skills in those trades and crafts in which long period training is required for setting complete proficiency.

This method is oldest form of training method.

- Each apprentice is given a programme of assignments as per predetermined schedule.
- This method is mostly suitable to crafts, trades and technical areas where proficiency on a job is in proportion to length of time involved.
- Apprenticeship training period may range from 3 to 12 months.
- The apprenticeship Act 1961 requires some specified industrial units to provide training in basic skills and knowledge in some specified trades to educated unemployed to enhance the employability of these people.

Job Rotation:

- This is also come under on-the-job training.
- One special purpose may be to provide for a second line of defence.
- The job monotony (or) disgust on a job is minimized.
- People in the organization may know something about every job/trade.
- Employees are rotated from one job to another job.

b) Coaching: It is a procedure by which a superior teaches job knowledge and skills to a subordinate. The emphasis in this method is learning by doing. The coaching guides, supervises and gives the trainee necessary feedback about his performance and offers suggestions for improvement. But the limitation of this method is the trainee may not have the freedom to express his own ideas.

c) Job Instruction: Under job instruction method, the trainee explains to the trainee the way of doing the jobs, job knowledge, and skills and allows him to do the job. The trainee appraises the performance of the trainee, provides feedback information and corrects the trainee.

d) Special Projects: Under special projects method, the trainee may be asked to perform a special assignment so that he would be in a position to acquire knowledge and also to learn the work procedure. Sometimes the management may create a task force consisting of trainees representing different functions in the organization. The settings up of task force not only help to trainees in acquiring knowledge about special assignment but also to develop team spirit.

f) Committee Assignments: Under this method a group of trainees will be formed as a committee and asked to solve an organizational problem. The trainees solve the problem jointly. It develops team work among the employees.

Off-The-Job Methods:

Under this method of training, the trainee is separated from the job situation and his attention is focused upon learning the material related to his future job performance. In this method there is an opportunity for freedom of expression for the trainee. Different off-the-job Techniques one given below:

a) vestibule training

b) role playing

c) Lecture method

d) Conference method

e) Programmed instruction

f) Case study

a) **Vestibule Training:** Vestibule training is a technique in which Trainees learn on the actual equipment they will use on the job but are actually trained off the job. Actual work conditions are simulated in a class room. Material, files and equipment those are used in actual job performance are used in training. This method aims to obtain the advantage of on-the job training without actually putting the trainee on the job.

This method is used for training personnel for electrical and semi skilled jobs. The period of training may vary from a few days to few weeks.

b) **Role Playing:** Role playing teaches interpersonal skills by having two more trainees interact with in the context of a realistic situation. The situation is defined in a case format so that each trainee receives the same information. Each trainee plays a role of specific person in the situation. Role playing is a useful method in which new behaviors can be practiced by trainees. A trainer provides feedback and reinforcement. Feedback reinforcement and motivational properties of this method depend upon the trainer's skill. Few examples of role playing are: a superior discussing a grievance with an employee: an interviewer conducting an employment interview: a salesman presenting sales talk on a product. But cost of this method is moderately by high.

c) **Lecture Method:** This method is traditional and direct method of off-the-job Training. Under this method the instructor organizes the material and gives it to a group of trainees in the form of a talk. To be effective the Lecture must motivate and create interest among the trainees. The main advantage of this method is direct instruction with trainees and it can be used for a large group of Trainees. But major limitation is that it does not provide transfer of training effectively.

d) **Conference Method:** This method is directed discussion at a specific topic conducted with a relatively small group of trainees. Trainees have a large degree of verbal interaction with the discussion leader and with others. This method is useful for teaching and exploring difficult conceptual material and for changing attitudes and opinions. This method facilitates two way communications and hence feedback is provided. But the success of this method depends upon the Leadership qualities of the person who leads the group.

e) **Programmed Instruction:** Under this method, the subject matter to be learned is presented in a series of carefully planned sequential units. These units are arranged

from simple to more complex levels of instruction. The trainee goes through these units by answering the blanks. This method is expensive and time consuming.

f) **Case Study:** This is once popular method of training. This is excellent method to develop problem solving and decision making skills in managers. In this method cases, actual (or) hypothetical are given to trainee managers and asked to involve themselves deeply with those cases, incidents (or) events to identify the real problem, analyze the situation of that case/event/incident and offer the best possible solution after identifying all possible solutions. Thus, they are exposed to analytical, problem solving and decision skills. In addition they learn open mindedness, patient listening, respecting with the views of others etc. as these is very much required on the part of managerial personnel.

13.10 EVALUATION OF TRAINING PROGRAMME :

The process of training evaluation has been defined as any attempt to obtain information on the effects of training performance and to assess the value of training in the light of that information. Evaluation leads to controlling and correcting the training programme. Hamblin suggested five levels at which at which evaluation of training can take place, viz., reactions, learning, job behaviour, method of presentation, teaching methods etc.,

i. **Reactions:** Training programme is evaluated on the basis of Trainee's reactions to the usefulness of coverage of the matter, depth of the course content, method of presentation, teaching methods etc.
ii. **Learning:** Training programme is evaluated on the basis of quantity of content learned and the time in which it is learned and Lerner's ability to use or apply, the content he learned.
iii. **Job Behaviour:** training evaluation includes the manner and extent to which the trainee has applied his learning to his job.
iv. **Organization:** the evaluation measurer the use of training, learning and change in the job behaviour of the department/organization in the form of increased productivity, quality, moral, sales turnover etc.
v. **Ultimate value:** It is the measurement of the ultimate result of the contributions of training programme to the company goals like survival, growth, profitability etc. and the individual goals like development of personality and social goals like maximum social benefit.

Essentials of Successful Training programme:

In order to ensure that the training programmes are effective and the firms get good results from them, the following principles may be followed:

a) Focus should be on "real world" Problems.
b) Learners should be given opportunity to participate actively.
c) The requirements of the job for which training is intended should be taken into account.
d) The training needs should be determined properly.
e) How the trainees can apply the knowledge, skill or attitude learned through training to the job should be emphasized.
f) The trainer should listen to and respect the opinions of learners.
g) Training should be result oriented.
h) Suitable incentives should be provided to the trainees.
i) Top management should take interest in and support the training programmes.

Recent Trends in Training:

In the modern days, due to the changes in the scale of operations and also because of increasing complexity in the operations, are trying to train their employees not only on a particular job that the employee is performing but from different angles to face any challenge in future. Few areas in which the MNCS are providing training facilities to the employees are:

- Training for International Business.
- Diversity Training.
- Customer Service Training.
- Training for Team work and Empowerment
- Providing employees with Lifelong Learning etc.

In the present day employees also identify their own training needs, select appropriate training programmers organized by various organizations and undergo the training. Thus, employees are proactive than reactive to training and also learning needs, present day organizations are Learning organizations.

13.11 MOTIVATION:

Management is the process of getting things done by the others. It is the ability to put other people into motion, in the right direction, day after day. Motivation is the process of channeling a person's inner drives so that he wants to accomplish the goals of the organization. Motivation is a behavioral concept by which we try to understand why people behave as they do. Since increasing productivity is the most critical and the most baffing function of the management. Motivation is what management does to induce the subordinates to act in a desired manner. Motivation is something that induces an individual to work.

13.11.1 Mature of Motivation:

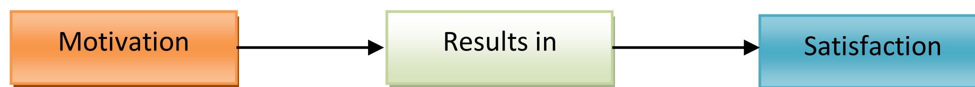
Motivation is not an easily observed phenomenon. We observe an individual's actions and then interpret his observed behaviour in terms of underlying motivation. The following points reveal that the complexities involved in understanding the motivation.

1. **Individuals differ in their motivation:** The goals to which an individual aspires are many and so are his motives. Individuals differ in then motives.
2. **Sometimes the individual himself is unaware of his motivation:** In most of the cases many cannot always verbalize his emotion to attain certain goals or even to tell what his goals are. An example can be drawn from the famous Haw throne experiments. One girl worker complained her counselor about her foreman. Later on it was found that the reason why she disliked her foreman was that, she had a step-father whom she feared and whose physical appearance was very much like her foreman, with the result that she had unconsciously transferred to her foreman the unfavorable characterizes of her step-father.
3. **Motivation change:** Motivations of each individual for time to time change, even though he many continue to behave in the same way. For example a temporary worker may produce more in the beginning to become permanent. When made permanent he may continue to produce more-this time to gain promotion and so on.
4. **Motivations are expressed differently:** The may in which the needs are eventually translated into actions also very considerably between are individual to another. One individual with strong security need may play it safe and avoid accepting responsibility for fear of falling and being fired. Another individual with same

security need may seek out responsibility for fear of being fired for low performance. The reactions of individuals to successful and unsuccessful fulfillment of their needs may also differ.

5. **Motivation is complex:** It is difficult to explain and predict the behaviour of workers. The introduction of an apparently favourable motivational device may not necessarily achieve the desired ends if it brings opposing motives into play. In a factory, when blue-green lighting was introduced to reduce eyestrain, the output of men workers increased but the women workers decreased.

6. **Motivation and satisfaction:** These two concepts are different. Motivation refers to the drive and effort to satisfy a want or goal, while satisfaction is the contentment experienced when a want is satisfied.



13.11.2 Types of Motivation :

When a manager wants to get more work from his subordinates than he will have to motivate them for improving their subordinates performance. This will either be offered incentive for more work or he may instill fear in them. The following are the types of motivation.

1. **Positive motivation:** Positive motivation is based on reward. The workers are offered incentives for achieving the desired goals. The incentives may be in the shape of many pay, promotion, recognition of work etc. The employees are offered the incentives and try to improve their efficiency. Positive motivation is achieved by the co-operation of employees and they have to feel satisfaction.
2. **Negative motivation:** Negative or fear motivation is based on force or fear. Fear causes employees to act in a certain may. In case, they do not act accordingly then they may be punished with demotions or lay-offs. The fear acts as a push mechanism. The employees will work up to a level where they want to avoid punishment. But this type of motivation causes anger and frustration. It may lead to industrial unrest.

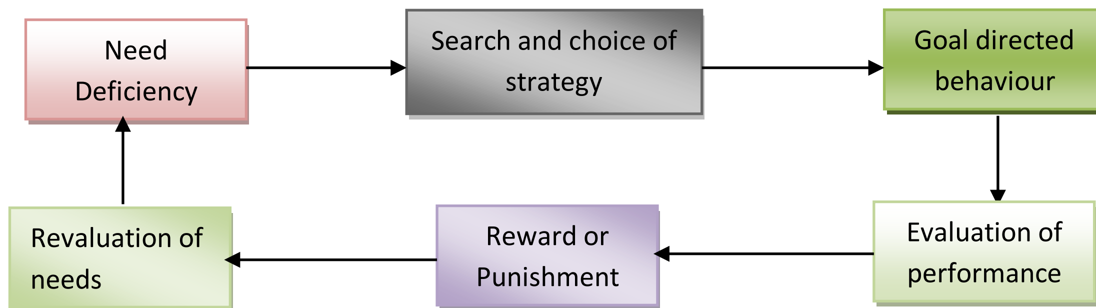
13.11.3 Importance of Management

The motivated employees become an asset to the organisation. The following is the importance of motivation.

1) **High performance:** Motivated employees put maximum efforts for achieving organizational goals. Good performance results in high productivity. When production increases, the cost of production will decrease. Motivation will act as a stimulant for improving the performance of employees.
2) **Low employee turnover and absenteeism:** When the employees are not satisfied with their jobs they will leave it whenever they get alternative offer. The dissatisfaction may also lead to absenteeism. Taking new employees into the organisation is element of cost to the organisation. When the employees are satisfied with their jobs and they well motivated by offering them financial and non-financial incentives then they will not leave the job. The rate of absenteeism will be low.
3) **Better organizational Image:** When employees are offered various monetary and non-monetary facilities to their employees have a better image among them. Motivational efforts will simplify personnel function also.

4) **Better Industrial relations:** A good motivational system will create job satisfaction among employees. The employment will offer those better service conditions and various other incentives. There will be no reason for conflict. So, motivation among employees will have to better industrial relations.
5) **Acceptability to change:** There is always a need to introduce new and better methods of work from time to time. In general employees always resist changing due to fear of an adverse effect on their employment. Motivated employees will think of positive side of new changes and will cooperate with the management.

Motivational model:



"How behaviour gets started, is energized, is sustained, is directed, is stopped and what kind of subjective reaction is present in the organism while all this is going on" (Jones, 1955).

13.12 DETERMINANTS OF MOTIVATION :

In the past, money was regarded as the only cause of human behaviour. Today in Industry there is concern with multi-motivational determinants of bahaviour. The earlier monistic approach to motivation, under which man was supported to act only to increase his monetary rewards, has now given place to a more complete pluralistic explanation which recognizes that man works to fulfill a variety of needs. It is known recognized that motivation is result of inter-play among three group factors.

a) Influences operating within the individual.
b) Influences operating within the organisation.
c) Influences operating in the external environment

a. **Influences operating within the individual:** To understand what motivates employees we must know something of their aims, needs and values. Human needs are both numerous and complex. Some of the needs had to describe and identify because people hide their real needs beneath on overlay of socially acceptable behaviour.
b. **Organization Climate:** Hawthorne experiments have shown that the climate of an organisation also plays an important role in determining the workers motivation. Some important components of organizational climate are as follows:
   i. Individual autonomy i.e., the degree of freedom from accountability to others.
   ii. Position structure i.e., the extent of direct supervision.
   iii. Reward orientation i.e., the extent of incentives provided for higher effort and motivation.
   iv. Consideration i.e., the extent of socio-emotional support provided by others.
   v. Conflict i.e., the extent of expression of differences.
   vi. Progressiveness and development i.e., the scope of growth of self, other members and organisation as a whole.

vii. Risk taking i.e., the extent of freedom experiment with new ideas.
viii. Control i.e., the degree of checks imposed on the member's behaviour.

The climate of an organisation is determined by a number of variables such as its leadership style, economic condition, structure, technology, characteristics of its people and so on.

c. **Exogenous variables:** A worker's life is not divided into two watertight compartments, one inside the factory and on the other side outside of it. The two are closely bound together so that the troubles and joys of off-the-job life cannot be put aside when reporting for work in the morning, nor can factory matters be dropped when returning home after work. Culture, customs and norms, images and attitudes conferred by society on particular jobs, professions and occupations and the workers home life all plays a strong motivational role.

13.13 HOW TO MOTIVATE:

- By recognizing the individual differences.
- By matching the jobs with the people (or) vice-versa.
- By using goals and individualizing the rewards.
- By linking rewards to performance.
- By formulating good personnel policies.
- By adopting decentralization and delegation of authority when every it is needed.
- By maximizing job satisfaction by job enrichment.
- By following systems like MBO and MBWA.
- By rewarding frankness and openness.
- By encouraging creativity of personnel.
- By creating good organizational climate and health.
- By improving employee morale etc.

13.14 WHAT DOES DEMORALIZE :

Sometimes, motivational and morale aspects in an organisation are very poor due to some practices unwarranted. Hence, it will be good if they are avoided.

- Under assignments to people capable of dealing responsibility and risk.
- Over assignments to people beyond the capacity and competence.
- Buck mastership, it is a practice where some superiors avoid doing hard work, pass on to others at the lower level and find felt with them.
- Managers must not be manipulative and cohesive in their attitudes.

13.15 THEORIES ON MOTIVATION :

1. Maslow's Need Hierarchy Theory.
2. Herzberg's two factor theory
3. Mc Gregor Theory' 'x' and theory 'y'
4. Victor Vroom's theory
5. Adam's Equity theory
6. Alderfer's ERG theory
7. Porter and Lawler Model of Motivation.

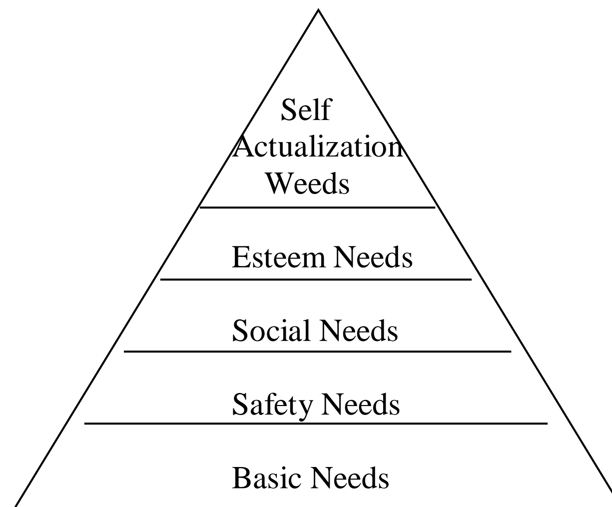
13.15.1 Maslow's Need Hierarchy Theory :

The most well known theory of motivation is Abraham Maslow's hierarchy of needs. The basic conclusion of theory is that a need that is satisfied is not any longer a need to be

satisfied further. Maslow' proposed that in every human being there exists a hierarchy of fine needs. Following are the five needs of human beings.

- Physiological or basic needs that include food, mater, clothing and shulter.
- Safety and security needs such as security to job, protection from harm.
- Social needs that include need for love, affection, friendship and belongingness.
- Esteem needs such as self-respect, status, recognition and achievement.
- Need for self-actualization, growth and fulfillment of ambition.

Maslow's Hierarchy of Needs



According to Maslow, if lower need is satisfied, the person moves up to the later to the next higher order need. It means that if basic needs are satisfied, workers can be motivated by fulfillment of next higher order needs which are safety needs. This theory implies that workers are motivated by fulfilling unsatisfied needs rather than by satisfied needs. Maslow separated basic and safety needs into social, higher other needs into status and self-actualization. While lower order needs are predominantly satisfied externally, higher order needs are satisfied internally. This theory has received wide recognition among the practicing managers because of its logical link. This does not mean that this theory is freeform criticism.

Criticism :

- Maslow's very hierarchy of needs concept, has became a big subject of ridicule.
- Several researchers couldn't find supporting evidence to the find of Maslow.
- Strength of each need varies from individual to Individual.
- Theory deals only with the content of motivation rather than the process of motivation.

13.15.2 Herzberg's two faction theory:

Herzberg and his associates developed the MOTIVATION HYGIENE THEORY, known as the two factor theory. They conducted a research study and identified two sets of factors. According to this study motivation depends upon satisfaction. The two sets of factors affect satisfaction and dissatisfaction of workers. The first set of factors he referred as

MAINTENANCE OR HYGIENE factors and the second set of factors on MOTIVATIONAL factors.

1. **Hygiene Factors:** Hygiene Factors or maintenance factors do not motivate people, they simply prevent dissatisfaction. Such factors do not produce positive results but prevent negative results. If these factors are not there it will lead to job dissatisfaction. These are not motivators as they maintain zero level of motivation, but these factors eliminate dissatisfaction. According to Herzberg the following are the maintenance factors.
    - i Company policy & Administration
    - ii Technical supervision
    - iii Inter-personal relations with supervisor
    - iv Inter-personal relations with peers
    - v Inter-personal relations with subordinates
    - vi Salary
    - vii Job security
    - viii Personal life
    - ix Working conditions
    - x Status

Hygiene factors in this theory prevent damage to efficiency but do not encourage growth.

2. **Motivational Factors:** These factors are intrinsic in nature and are related to the job. The motivational factors have a positive effect on job satisfaction and often result in an increase in the total output. Thus these factors have a positive influence on morale, satisfaction, efficiency and productivity. Hertzberg concluded that six factors motivate the employees.

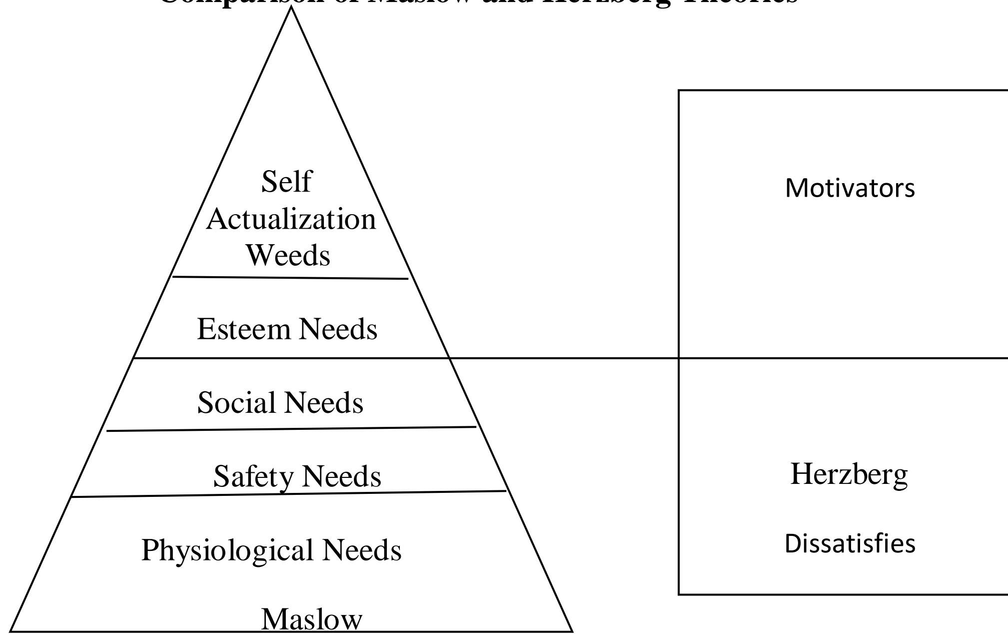
    - a. Achievement
    - b. Advancement
    - c. Possibility of growth
    - d. Recognition
    - e. Work itself
    - f. Responsibility

Any increase in these factors will improve the level of satisfaction, thus these factors can be used to motivate the employees. Herzberg concluded that today's motivational factors are tomorrow's hygiene factors. Because once a need is satisfied, it stops influencing the behaviour. Further one person's hygiene may be another person's motivator, because motivation is also influenced by the personality characteristic of individuals.

This theory is also not free from criticism.

- There is no guarantee that satisfaction leads to productivity in all cases.
- The concept of satisfaction in influenced by a good number of off the job and on the job factors.
- The impact of situational variables has been ignored in this theory.
- It is concerned with the content of motivation and not with the process of motivation.
- Too much focus on "satisfaction or dissatisfaction" etc.

Comparison of Maslow and Herzberg Theories



When Herzberg and Maslow's models are compared, it can be seen that both the theories focus their attention on the same relationship that is what motivates an individual. Maslow has given in terms of need hierarchy and Herzberg developed a two factor model. The basic needs, safety and social needs are similar to the hyginene factors of Herzberg. Maslow's esteem needs and self actualization needs are termed by Herzberg as motivators. There is a particular difference between the two models. Maslow emphasizes that any unsatisfied need will motivate individuals. In a developing economy the lower order needs may motivate the workers. But according to Herzberg there are hygiene factors.

13.15.3 Mc Gregor Theory 'x' and theory 'y':

Mc Gregor proposed two different theories namely theory 'x' and theory 'y' in 1960. These two theories explain about the human nature. While theory 'x' deals with the negative aspect of human behaviour, theory 'y' deals with positive aspect of the human behaviour. Theory 'x' involves traditional approach and is based upon the following assumptions.

Theory 'x' assumptions:

- Workers dislike work, among average persons, for work and will to avoid work if possible.
- They do not want to take-up responsibilities for themselves and seek formal direction from the boss.
- Workers place security of their job above all other factors associated with work and display little ambition.

From the above, one can easily understand that the superior should definitely be an autocratic manager to motivate the subordinates in an autocratic manner, as the mission of management is achievement of organizational goals.

The above two theories are not related with motivation. They explain about the nature of human behaviour fewer than two sets of different assumptions. However the theories help us to understand how the manager should mould his behaviour for settings done.

13.15.4 Victor Vroom's Expectancy Theory :

Victor Vroom offered an expectancy approach to the understanding of the motivation. Accordingly, motivation is a product of the anticipated worth to a person of an action and the perceived probability that a person's goals would be accomplished. Thus the Vroom's model is built around the concepts of value, expectancy and force. The concept force is basically equivalent to motivation and may be shown to the algebraic sum of the products of valences and expectations. Thus

Motivation (force) = Valence x Expectancy

According to this theory a person's desire to work at any time can be conditionally two factors.

1. Existence of one or more personal goals on the part of the employee.
2. Employees expectations in comparison with his performance for the attainment of the goals.

When a worker believes that his performance will head to the fulfillment of personal goals, he tends to become a high producing worker and vice-versa.

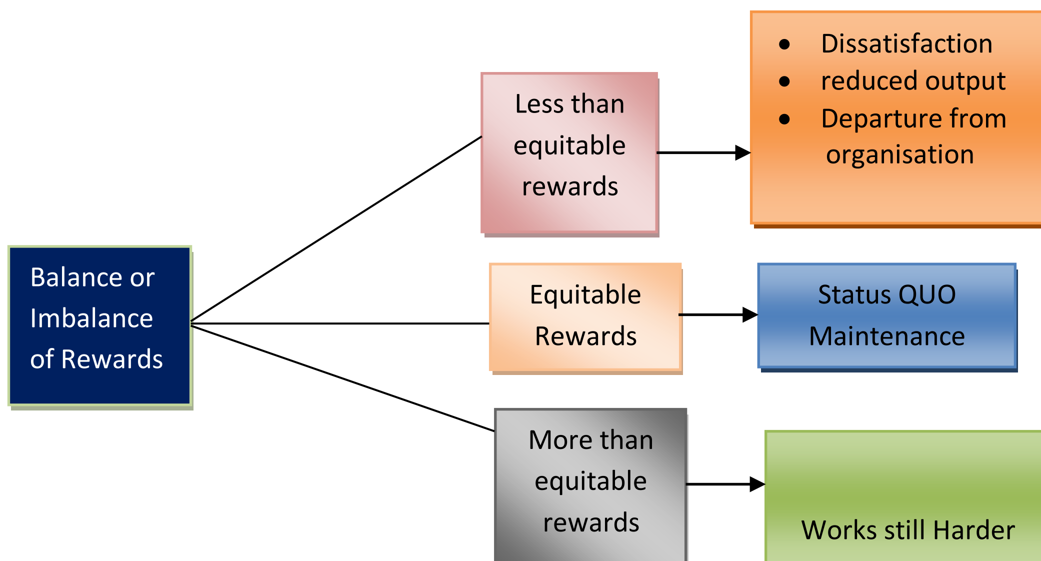
Here term valance stands for the strength of an individual's inference for an outcome and expectancy to the probability that a particular action will had to a desired outcome.,This theory establishes form important links in the process of motivation.

This theory has three important implications to managers:

1. It is necessary to provide appropriate rewards to satisfy the individual needs.
2. Managers are required to establish a close link between the efforts and performance, between performance and results and finally between rewards and personal goals.

13.15.5 Equity Theory of Motivation:

J.S. Adam equity theory is based on the simple assumption that people want to be treated fairly. Many employees are concerned not only with satisfying their own needs but also compare what others receive. The theory defines equity as the belief that we are being treated fairly in relation to others. Employee's satisfaction or dissatisfaction with comparative observation of their friends, neighbors and colleagues. The equity theory helps in understanding both causes and likely consequence of feelings of unquotable treatment among organisation members. Adams has defined two specific words viz person and other. Person is any individual for whom equity or inequity exists. Other is defined as any individual with whom a person is relevant exchange relationship or with whom a person compares himself.



Equity Theory

Comparison is a potent source of motivation. People's motivation (or) Demotivation depends upon this comparison with that of others. On comparison if people notice that there is balance, there is status-quo, if our rewards are higher, we will be motivated more and thus, we will be demotivated when our rewards are lower relatively. Thus equity or inequity in rewards motivates (or) demotivates.

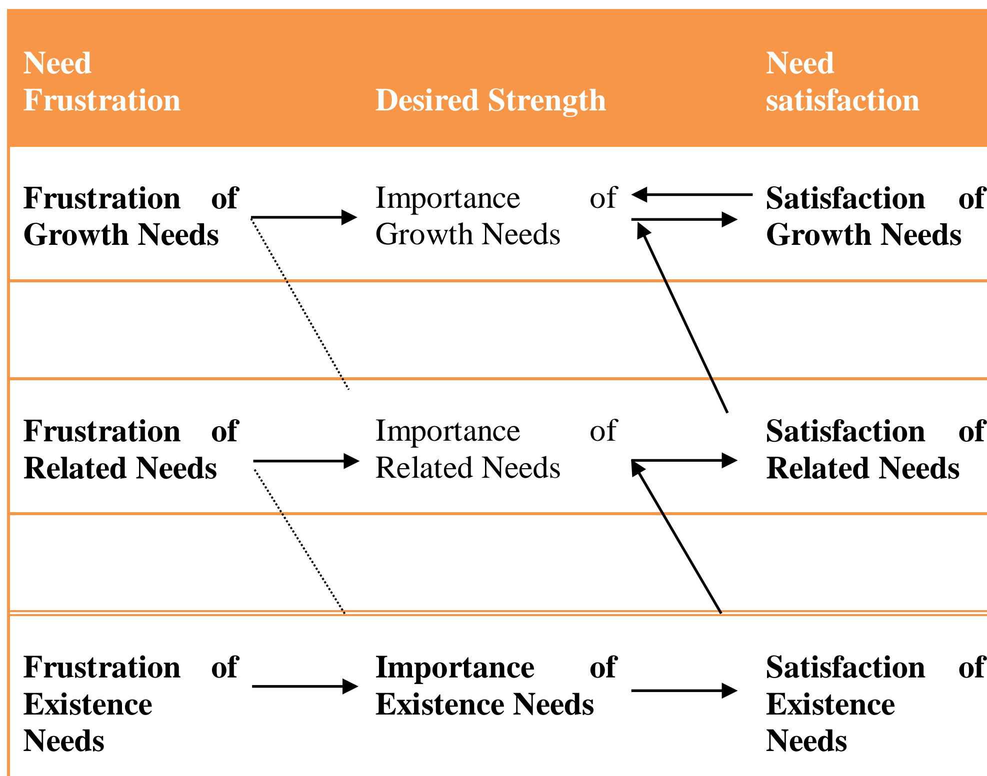
A person with a feeling of inequity can try a number of alternatives.

i Change inputs.
ii Change outcomes
iii Alter perceptions of self
iv Alter perception of others
v Change comparisons.
vi Leave situation.

The equity theory adopts a realistic approach to motivation. The managers find it very useful in managing and motivating people through equitable rewards.

13.15.6 E.R.G. Theory of Alderfer :

The E.R.G. Theory stand for existence, relatedness and growth, the three sets of needs which are the focus of this alternative theory of human needs in organizations. Existence needs are similar to the physiological and security needs of Maslow. Related needs are correspond to the Maslow's social and esteem needs. Finally an intrinsic desire for personal development, growth needs are similar to Maslow's self esteem and actualization needs. ERG Theory developed by Alderfer, argues, along with Maslow, that people do have needs that those needs are arranged in a hierarchy and that needs are important determinants of human behaviour. The ERG Theory counters by noting that when a higher level need is frustrated, the individual's desire to increase a lower-level need takes place. Thus the ERG Theory contains a frustration – regression dimension.



Satisfaction ———— Progression ⟶

Frustration — Regression ----------------

Advantages of ERG Theory

1. The ERG Theory is more consistent with our knowledge of individual difference among people. It represents a more valid version of the need hierarchy.
2. The most contemporary analysis of work done on motivation tends to support Alderfer's theory.

Disadvantages of ERG Theory:

1. This theory does not offer clear cut guidelines.
2. It too early to pass judgment on the overall validity of the theory.

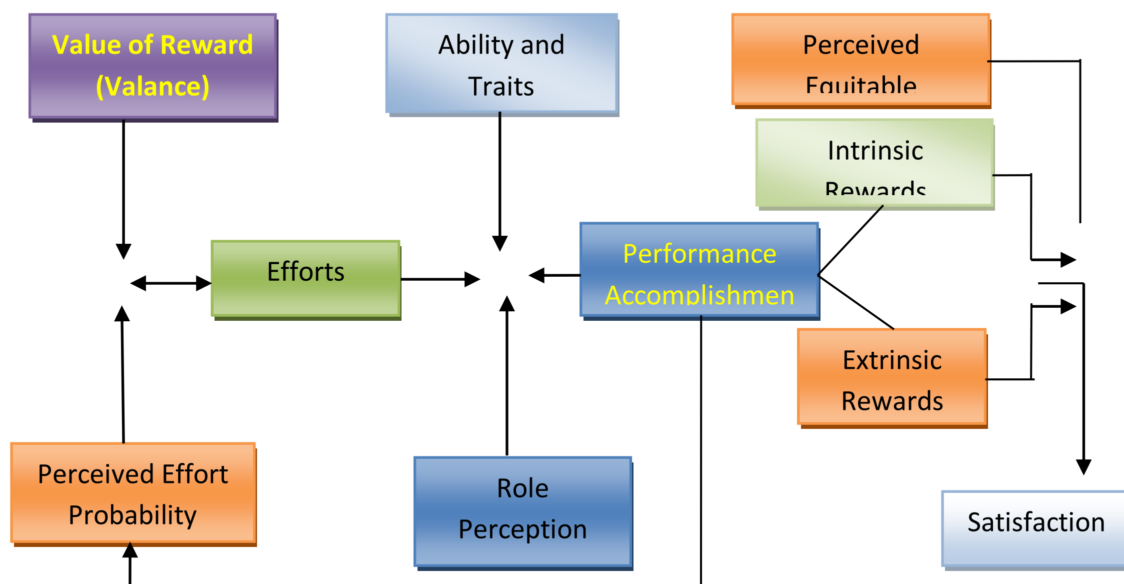
The chief point of E.R.G. Theory is that all needs can operate simultaneously.

13.15.7 Porter – Lawler Theory of Motivation:

Porter and Lawler came up with a comprehensive theory of motivation, combining the various aspects that we have so far been discussing and using two additional variability. Though built in large part on vroom's expectancy model, porter and Lawler's model is a more complete model of motivation. This model explains the relationship that exists between job attitudes and job performance. This model is based on four basic assumptions.

i It is a multi variety model. Individual's behaviors' determined by a combination of factors in the individual and in the environment.
ii Individuals are assumed to be rational human beings.
iii Individuals have different needs, desires and goals.
iv To get the desired outcome individuals decide between alternative behaviors'.

Porter and Lawler Model



The various elements of this model are.

1) Effort
2) Value Reward

3) Perceived effort reward probability
4) Performance
5) Rewards
6) Satisfaction.

Porter and Lawler model has definitely made a significant contribution to better understanding of work motivation and the relationship between performance and satisfaction. But even then it has not made much impact on the actual practice.

13.16 PRACTICAL IMPLICATIONS :

There are several practical managerial implications from these expectancy motivational theories. Managers must clearly define the casual relationship between performance and reward and discrimination by rewarding excellent performance and not rewarding poor performance. Managers must realize that different employees place different various rewards. Some are very motivated by money, whereas others really want praise and recognition and opportunity for advancement. Therefore, managers must determine the particular rewards valued by each individual by carefully observing and asking her directly what rewards she values most. Finally, managers must establish challenging, yet realistic goals with employees, consistently and clearly, communicate these goals to them and coach, develop and train them to reach the levels of performance desired by both parties recognizing that high performance produces higher level of motivation.

How to motivate Employees:

We have presented a number of theories of motivation in this chapter. If you are a manager, concerned with motivating your employees, how do you apply these theories? The following suggestions offered by experts may help you is solving the puzzle to some extent.

- **i Recognize individual difference:** Employees have different needs; they also differ in terms of attitudes, personalities and other important variables. So recognize these differences and handle the motivational issues carefully.
- **ii Matching people to jobs:** Match the abilities of the individuals to the requirements of the job, by putting right person on the right job.
- **iii Use goals:** Provide specific goals, so that the employees know what they are supposed or desired to achieve. Make people understand that they can achieve the goals in a smooth way.
- **iv Individual rewards:** To achieve and maintain motivation, use rewards selectively keeping the individual requirements in the mind. So, reward such as ray, promotion, autonomy, challenging jobs, participative management, must be used keeping the mental makeup of the employee in question.
- **v Link rewards to Performance:** Make rewards contingent on performance. Employee should be rewarded immediately after attaining the goals. Publicize the award of performance bonus, Lump sum payments for showing excellence; discussing reward structure with people openly, these will go a long way, in casing the awareness of people regarding the reward and performance linkage.
- **vi Check the system for equity:** The inputs for each job in the form of experience, abilities, effort, and special skill must be weighed carefully before arriving at the compensation package for employees. Employees must see equity between rewards obtained from the organisation and the efforts putinly them.
- **vii Importance of Money:** money is a major reason why most people work. Money is not only a means of satisfying the economic needs but also a measure of one’s power, prestige, independence, happiness and so on. Money can buy many things. It can

satisfy biological needs (food shelter, recreation etc.) as well as security, social and esteem needs.

13.17 FINANCIAL MOTIVATORS :

The commonly accepted belief is that motivation is directly or indirectly connected with money. It is true that money fulfils the higher order needs. Therefore most of the organizations use money incentive as a means of offering satisfaction among staff. Productivity linked wages, bonus, profit sharing, leave with pay, medical reimbursement, leave travel concession are included under financial motivators. Experience proved that money is most reliable motivators. Besides, money, there are some other motivators, which deal with the personal development or with the environment of the employees. Therefore goal identification and participative management also have a great role to play in motivating people.

13.18 NON-FINANCIAL MOTIVATORS :

Non-financial motivators include position, work culture and psychological mood of the employees. Some of the most commonly used non-financial motivators are:

- Praise and recognition
- Status and pride
- Job enlargement
- Job enrichment
- Job security
- Quality of work life

The services of an employee can be recognized and praised by patting on the back of the employee, recommending him for promotion or entrusting him for confidential work. Similarly, provision of costly furniture, wall-decoration, and personal assistance show the status of the employee and certainly enable the employee to feel proceed which in turn would stimulate them for better results. Enlarged jobs may be assigned to the work group so as to make the employees more responsive from planning phase to implementation stage. it makes the jobless monotonous.

Another method of motivating the people is job enrichment. Through this job is made more interesting and challenging. It provides an opportunity for psychological growth of an employee. Job security is equally important. It implies that employee will be continued with all economic and social security measures within the same plant. This kind of arrangement, no doubt encourages worker to deliver better performance. Another concept in modern organizations for motivating employees is the quality of work life. It refers to all aspects of workers life with special reference to his personal life and work environment. It includes fair compensation, good working conditions, security, growth, protection and identity.

13.19 MORALE AND PRODUCTIVITY:

Morale is an overall attitude of an individual or group towards all aspects of their work. Flippo has described morale “as a mental condition or attitude of individuals or groups which determines their willingness to co-operate. Good morale is evidenced by employee enthusiasm, voluntary confirmation with regulations and orders and a willingness to cooperate with others in accomplishment of an organisation’s objectives. Poor morale is evidence by surliness, insubordination, a feeling of discouragement and dislike of the job, company and associates”.

Halloran used the term morale in two different ways.

i) Individual Morale: Individual morale involves knowing one's own expectations and living up to them. If we recognize our needs and know how to satisfy them; our morale will be high. Hence, morale refers to the feelings of an employee towards his work; it is a matter of work satisfaction.

ii) Group Morale: Group morale reflects the general tone, or esprit-de-crops, of a group of people. Group morale emphasis social reactions and concentrates on attitudes towards group values (cohesiveness, interest, thinking, etc.). According to McFarland, morale is a concept that describes the level of favourable or unfavorable attitudes of employees collectively to all aspects of their work, the job, the company, their tasks, working condition, fellow workers, supervisors and soon.

13.19.1. Factors Affecting Morale:

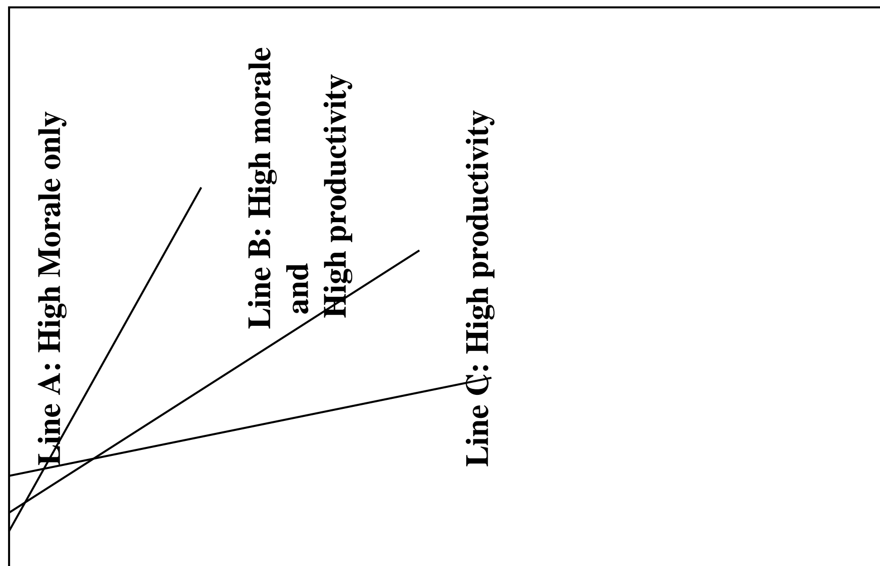
The employee morale is a very complex phenomenon and is influenced by many factors. Various authors like McFarland, Bradshaw and krugman, Roach and Apple white have given different criterion for the determination of morale.

1. **Organization:** The first factor affecting the morale of the organisation is the organization itself. The organisation influences the workers attitudes to their jobs. The public reputation of the organisation may buildup for better or worse, their attitudes towards it.
2. **The nature of work:** Dull, monotonous, repetitive work affects the employee morale adversely. On the other hand, if an employee is asked to do something interesting and challenging, his moral may be high.
3. **Level of satisfaction:** The level of satisfaction, a worker derives from his job is another determinant of morale. High job satisfaction from the job leads to high morale and low job satisfaction will adversely affect the morale.
4. **Leadership:** The actions of managers got a strong influence on the morale of the workforce. Fair treatment, equitable rewards and recognition for good work affect morale greatly, workers feel comfortable when they work under participative readership instead of Authoritarian Leadership.
5. **The level of Supervision:** The level of supervision received by an employee has got influence on the morale. If employees are given freedom to do the job, their morale will be high. Nobody likes to be supervised all the time.
6. **Co-workers:** Poor attitudes of co-workers influence others. Imagine working with a person who talks about the negative points of an organisation all day long. Such a person can make each workday an unpleasant experience to others. Good support from co-workers, positive suggestions about the work will incase the morale.
7. **Employee:** How an employee looks at him (the self concept) also influences the morale. Individuals who lack self-confidence, or who suffers poor physical or mental health frequently develop morale problems. Further, how the employees personal needs are satisfied can significantly influence their morale. Increase in salary, fringe benefits, D.A. rates, allowances may affect the employee moral positively.

13.19.2 Morale and Productivity Relationship :

Generally, it is believed that high morale will lead to high productivity. However, Pro.Keith Davis pointed out that there is not always a positive correlation between the two. There is some positive correlation between the two. There is some positive correlation

between morale and productivity but they are not absolutely related. That is an increase of five per cent in morale does not guarantee a proportional increase in productivity.



Productivity

Miller and Form have given four combinations of productivity and Morale.

i) high productivity – high morale
ii) low productivity – high morale
iii) high productivity – low morale
iv) low productivity – low morale

There is a complex relation between morale and productivity. This relationship cannot always be predicted. It may differ from organisation to organisation and from one time to another time.

13.20 MORALE DEVELOPMENT (MORALE BUILDING :

Morale building in the organisation is a continuous process and a responsibility of every manager. Some important steps are to be taken by the management for maintaining a reasonable level of morale in the organisation.

- **i) Remuneration:** The remuneration paid to the personnel must be fair and equitable. Right pay for the work done by the workers.
- **ii) Job Security:** The employee must be given job security and its continuity.
- **iii) Participation:** Employees are not tools but they are human resources. They must be allowed to participate in the decision-making process in the organisation. Employees' participation in management will increase the morale of employees.
- **iv) Job enrichment:** Enrichment is the process of making the job more responsible, challenging, and interesting. Enriched job offer employees opportunities for achievement and growth, which will lead to high morale.
- **v) Organisation structure:** Tall structure incases the gap between the manager and the employees. Communication gets distorted and control becomes difficult. In a Flat structure the employees are closer to the manager and discuss the implications of

commands on face-to-face basis. A healthy interchange of ideas will promote high morale.

vi) Grievance redressal: Many a time, grievances are the cause of low employee morale. The use of a well-established procedure helps in redressing employee grievances promptly. The cause of the employee is presented to the appropriate authority in time, putting an end to unpleasant arguments and conflicts.

vii) Two way communication: There should be proper communication between management and employees. All policies and programmes should be explained through downward communication. The feelings reactions, problems of the employees should reach the management in an upward communication. Two-way communication will help in improving morale of employees.

viii) Sound Leadership: Top management must take active interest in building the morale of the employees in the organization.

13.21 SUMMARY :

The basic purpose of training is to develop skills and efficiencies of the employees. The trained employees are assets to the organisation. Skills, attitudes and knowledge are the basic inputs of training. Every training programme should have certain objectives. The training programmers are on the job training and off-the-job training methods. The various steps in the evaluation of training and development include reaction, learning and behavioural results. To summaries, Training and development helps to understand how systematically the managerial personnel/ can be developed and make them to grow in all respects in their organization effectively and efficiently.

Motivation is the process of channeling a person's inner drives, so that he wants to accomplish the goals of the Organisation. Motivation is not an easily observed phenomenon because people differ in their motivation. Motivating employees for work is a complex and challenging assignment. A number of factors influence motivation in the Organisation. The basic process of motivation involves understanding the needs, action and satisfaction of the people at work. The various theories propose different approaches to work motivation. Understanding all these theories is important for effective management of human resource. Determinants of Motivation are the individual, Organisation climate, exogenous variables. Incentives are the inducements, which are offered to employees in order to direct their behaviour towards enterprise objectives.

13.22 KEY WORDS:

1. **Training:** It is an organized procedure by which people learn knowledge and skills for a definite purpose.
2. **Development:** it is a longtime educational process utilizing a systematic and organizational procedure by which managerial personnel get conceptual and theoretical knowledge.
3. **Education:** it is concerned with general knowledge and understanding of the employees total
4. **Sensitivity training:** A form of training based on behaviour of persons in groups and undirected group interchange, designed to make these persons more aware of their own feelings of others towards them.
5. **Under Study:** A supervisor gives training to a subordinate as his under study.
6. **Motivation:** Motivation is what managers do to induce the subordinates to act in a desired manner.

7. **Force** : It is the strength of person's motivation.
8. **Valence** : It is strength of person's references for am outcome.
9. **Expectancy:** It is the probability that a particular may had to a expected outcome.
10. **Morale** : It is the capacity of a group people to pull together persistently and consistently in pursuit of a common purpose.

13.24 SELF ASSESSMENT QUESTIONS:

1. How do you assess the training needs of your employees?
2. Explain the importance of Principals of Learning.
3. Explain various on the job training methods.
4. Describe the need for Training and Development? How do you assess the training needs?
5. Define the concept of 'Motivation'? Bring out the significance of motivation in the modern organization.
6. Explain theories of motivation.
7. Explain the Financial and non-financial incentives to motivation.
8. What is morale? How to improve it.

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Dr. N.RATNA KISHOR

LESSON - 14
E-BANKING

OBJECTIVES:

- To study on E-Banking Concept.
- To understand the importance and benefits of E-Banking
- To focus on various aspects and risks in E-Banking

STRUCTURE:

14.1 Concept of E-Banking
    14.1.1 Popular services of E-baking
    14.1.2 Other services in E- banking
14.2 Features of E-Banking
14.3 Types of E Banking
14.4 Benefits of E-Banking
    14.4.1 Benefits of e-Banking to customers
    14.4.2 Benefits of e-Banking to banks
    14.4.3 Benefits of e-Banking to Businesses
    14.4.4 Other benefits of e-banking
14.5 Aspects of E-Banking
    1.5.1 E-banking methods
    1.5.2 Elements of E-banking
14.6 Risk of E-Banking
14.7 Summary
14.8 Key words
14.9 Self-Assessment Questions
14.10 Further Readings

14.1 CONCEPT OF E-BANKING :

Banking is essentially an activity that is opted to be performed by not only individuals but also countless entities. The Banks in a country, state, or city safeguard the money from their customers and then lend it to others. This creates a balance within the economy and makes sure that one of the individuals benefits from it. E-Banking is banking with the only difference being that all the transactions take place via electronic modes. With many innovations in terms of technology, it is safe to say that this has made life pretty convenient for people. The reason is very simple straightforward. With the help of E-Banking, one can easily do several transactions at any time of the day.

Banking through Internet is called internet banking. It can also be called as electronic banking. Many banks have their own websites. They offer banking facilities such as account enquiry, request for statement and cheque books etc., on the net. The introduction of Security First Network Bank (SFNB) in 1995 in USA is the first step in the development of Internet banking. These banks also provide ATM Card, a Visa cheque and Electronic bill payment facilities. E-banking is an arrangement between a bank or a financial institution and its customers that enables encrypted transactions over the internet. Short for electronic banking,

E-banking has various types that cater to customers' different requirements, which can be resolved online.

E-banking is also helpful for non-financial transactions such as changing customers ATM PIN, getting a mini statement, updating customer’s personal details, balance inquiry or printing an account statement. Essentially, it refers to any transaction that doesn't involve any movement of funds to or from customers account. In other words, e-banking is an umbrella term for the process by which a customer may perform banking transactions electronically without visiting a branch and also includes the systems that enable customers of banks, individuals or businesses, to access accounts, transact business, or obtain information on financial products and services through a public or private network, including the Internet.

E-banking is a system that uses the internet and a telecommunication network to provide consumers with a variety of online banking services. This is a service that allows consumers to log into their bank accounts and do various financial activities over the internet. It’s sometimes referred to as online banking, virtual banking, or internet banking. E-banking is a secure, simple, and quick electronic service that allows consumers to do banking transactions from any location without having to visit a bank branch. Customers can use the e-banking service at any time, 24 hours a day, and seven days a week. Instead of exchanging numerous conventional documents such as cash, cheques, and so on, money is exchanged through the transmission of electronic signals.

There have been significant developments in the e-financial services sector in the past 30 years. According to Devlin (1995), until the early 1970s functional demarcation was predominant with many regulatory restrictions imposed. One main consequence of this was limited competition both domestically and internationally. As a result there was heavy reliance on traditional branch based delivery of financial services and little pressure for change. This changed gradually with deregulation of the industry during 1980s and 1990s, whilst during this time, the increasingly important role of information and communication. With the rapid growth of other types of electronic services since mid 1990s, banks renewed their interest in electronic modes of delivery using the Internet.

The bursting of the Internet bubble in early 2001 caused speculation that the opportunities for internet services firms had vanished. The spread of online banking has coincided with the spread of high-speed broadband connections and the increasing maturation of the internet user population.

Another factor in e-banking growth is that banks have discovered the benefits of e-banking and have become keener to offer it as an option to customers. Banks offer a wide array of services to attract and retain customers, including loans, credit and debit cards, digital financial services, and personal services.

However, a fundamental service provided by many commercial banks in today's digital age is e-banking. Known by various names such as internet banking, virtual banking, or online banking, e-banking involves the use of telecommunications and electronic networks to deliver various banking services and products. With e-banking, customers can access their accounts and perform numerous transactions using their smart phones or computers.

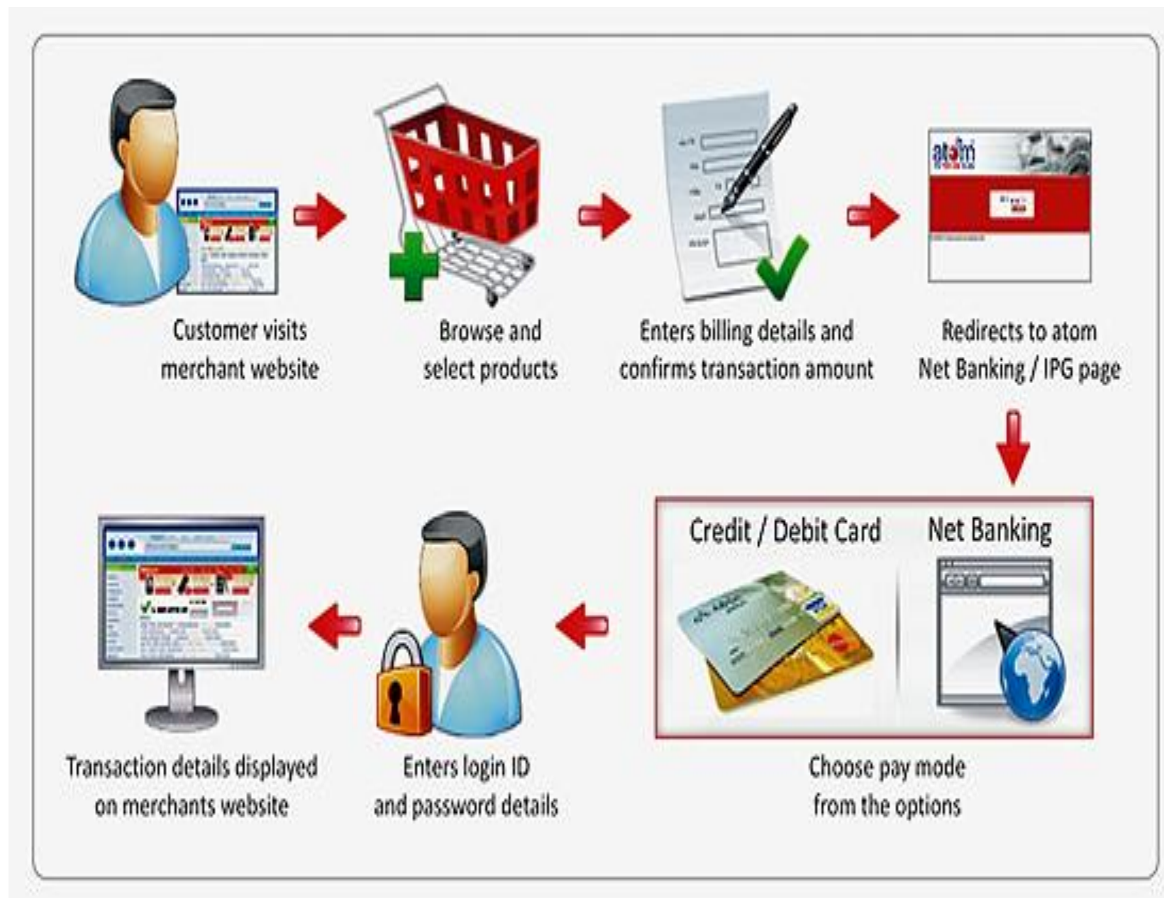


Fig: 1 E-Banking-conceptual view

Online banking (or Internet banking or E-banking) is a facility that allows customers of a financial institution to conduct financial transactions on a secured website operated by the institution. To access a financial institution's online banking facility, a customer must register with the institution for the service, and set up some password for customer verification. Online banking can be used to check balances, transfer money, shop online, pay bills etc.

E-banking is an arrangement between a bank or a financial institution and its customers that enables encrypted transactions over the internet. Short for electronic banking, E-banking has various types that cater to customers' different requirements, which can be resolved online. E-banking is defined as the automated delivery of new and traditional banking products and services directly to customers through electronic, interactive communication channels. E-banking includes the systems that enable financial institution customers, individuals or businesses, to access accounts, transact business, or obtain information on financial products and services through a public or private network, including the Internet.

Customers access e-banking services using an intelligent electronic device, such as a personal computer (PC), personal digital assistant (PDA), automated teller machine (ATM), kiosk, or Touch Tone telephone. While the risks and controls are similar for the various e-banking access channels, this booklet focuses specifically on Internet-based services due to the Internet's widely accessible public network. E-banking is also helpful for non-financial transactions such as changing ATM PIN, getting a mini statement, updating personal details, balance inquiry or printing an account statement. Essentially, it refers to any transaction that doesn't involve any movement of funds to or from account.

14.1.1 Popular services of E-baking :

In India, since 1997, when the ICICI Bank first offered internet banking services, today, most new-generation banks offer the same to their customers. In fact, all major banks provide e-banking services to their customers. The Popular services under e-banking in India are:

- **Point of Sale (POS)**: Points of sale system refers to the point, in terms of date, time and place (retail outlet) where the customer makes a payment, using a plastic card, for the purchase made or services received.

ATMs (Automated Teller Machines): An automated teller machine (ATM) is an electronic telecommunications device that enables customers of financial institutions to perform financial transactions, such as cash withdrawals, deposits, funds transfers, balance inquiries or account information inquiries, at any time and without the need for direct interaction with bank staff. Using an ATM, customers can access their bank deposit or credit accounts in order to make a variety of financial transactions, most notably cash withdrawals and balance checking, as well as transferring credit to and from mobile phones.

ATMs can also be used to withdraw cash in a foreign country. If the currency being withdrawn from the ATM is different from that in which the bank account is denominated, the money will be converted at the financial institution's exchange rate. An ATM allows customers with credit or debit cards to carry out basic banking transactions without the aid of a human bank teller. Customers can use them to withdraw cash, check their bank balance or get a printed balance statement. Some ATMs also allow customers to make cash deposits and move funds between accounts. Functions of ATMs

- Deposit of cash
- Withdrawal of cash
- Transfer of cash
- Accounts details
- Mini statement
- Regular payment of the bill
- Account balance details
- Recharge of prepaid mobile
- Change the pin code

- **Telephone Banking:** Telephone Banking is an automated service that allows customers to access customers account information and perform routine transactions from a touch-tone telephone. Phone banking is secured as well as a risk-free mode of banking. It can be used to make the utility bill payments, block the ATM card, fund transfer, open fixed deposit/recurring deposit etc. Also, account holders can use phone banking facility on any phone. Following are the services that can be availed with phone banking facility:
    - ❖ Get all the information related to the account such as account balance, or any transaction details, and even the account statement of the last six months on the mail.
    - ❖ Request for cheque book online
    - ❖ Stop payment of any cheque (Single and multiple)
    - ❖ Initiate fund transfers to self-account as well to third-party account (with some limitations)
    - ❖ Open a Fixed Deposit/Recurring Deposit
    - ❖ Check Account Balance
    - ❖ Enquire about loans
    - ❖ Generate ATM PIN
    - ❖ Access Credit Card details
    - ❖ Get the interest certificate of home loan or education loan.

  - ❖ Get the Deposit Interest Certificate
  - ❖ Know TDS deductions and other information
  - ❖ Update mobile information or mail ID

- **Electronic Clearing Cards:** Electronic Clearing System (ECS) is an electronic method of fund transfer from one bank account to another. It is generally used for bulk transfers performed by institutions for making payments like dividend, interest, salary, pension, etc. ECS can be used for both ECS credit and ECS debit. ECS Credit enables payment of amounts towards distribution of dividend, interest, salary, pension, etc., of the user institution. ECS Debit is used by an institution for raising debits to a large number of accounts (for instance, consumers of utility services, borrowers, investors in mutual funds etc.) ECS can also be used to pay bills and other charges such as payments to utility companies such as telephone, electricity, water, or for making equated monthly installments payments on loans as well as SIP investments. In this article, we look at the working process of ECS in detail. The benefits of ECS credit given to the clients are as follows:
- The end beneficiary need not make frequent visit to his bank for depositing the physical paper instruments.
- Delay in the realization of proceeds, which used to happen in the receipt of the paper instrument, is eliminated.
- The ECS user helps to save on administrative machinery for printing, dispatch and reconciliation.
- Provides the ability to make payment and ensure that the beneficiaries account gets credited on a designated date.

The benefits of ECS debit given to the clients are as follows:

- **Trouble-free:** Eliminates the need to go to the collection centres or banks and the need to stand in long queues for payment.
- **Easy to track:** Customers are not required to track down payments by last dates. The ECS users would monitor the debts. The ECS user saves on administrative machinery for collecting the cheques by monitoring their realisation and reconciliation.
- **Better cash management:** Chances of frauds due to fraudulent access to paper instruments and encashment are avoided.

The realisation of payments on a single date is enabled instead of fractured receipt of payments.

- **Smart Cards:** A **smart card** is a plastic card that contains a microprocessor and a memory chip or just a memory chip. The microprocessor card has the ability to add, delete and manipulate information on the card. A memory-chip card, such as a phone card, can only add information. Smart cards can provide personal identification, authentication, data storage, and application processing.
- **EFT (Electronic Funds Transfer) System:** An electronic funds transfer (EFT) is a transaction that takes place over a computerized network, either among accounts at the same bank or to different accounts at separate financial institutions. Electronic funds transfer (EFT) are electronic transfer of money from one bank account to another, either within a single financial institution or across multiple institutions, via computer-based systems, without the direct intervention of bank staff. Using a credit or debit card - Using this method, money is transferred electronically from customers account to the seller's account. This is one of the most widely used forms of payment.

Benefits of EFT

  - ❖ Electronic funds transfer provides an easy, cheaper and faster method of transferring money.

- ❖ It helps individuals and organizations to save on costs such as printing checks as well as the time to deliver or collect checks and deposit them in the banks for processing.
- ❖ The money moves to the recipient's account much faster since there is no manual moving of checks from one bank to the other.
- ❖ It is more efficient
- ❖ Has less administrative procedures, hence reduced labour and staff costs
- ❖ An electronic funds transfer is much safer and secure. For instance, it eliminates the need to carry huge amounts of money.

- **Mobile Banking:** Mobile banking (M-Banking) is a latest banking service that offers banking services through a mobile communication device such as Mobile Phone or Personal Digital Assistant (PDA),In Mobile banking a customer can avail services of a bank while he/she is roaming i.e not positioned at a single location. ICICI Bank was the first bank to introduce internet banking facility in the country in order to enable individuals and corporate to transact online without visiting the branch. It was also the first bank to start mobile banking in the country.

14.1.2 Other services in E- banking: Further, under Internet banking, the following services are available in India:

- ❖ **Bill payment:** Often referred by many as online banking, this has become very popular as a quick and easy way to pay monthly bills. More than two out of every three bills are now paid in an electronic form. This has recently further evolved into the ability to pay bills directly from customers mobile device or phone. Every bank has a tie-up with different utility companies, service providers, insurance companies, etc. across the country. The banks use these tie-ups to offer online payment of bills (electricity, telephone, mobile phone, etc.). Further, the customer can create a standing instruction to pay recurring bills automatically every month.
- ❖ **Funds transfer**: A customer can transfer funds from his account to another with the same bank or even a different bank, anywhere in India. He needs to log in to his account, specify the payee's name, account number, his bank, and branch along with the transfer amount. The transfer is affected within a day or so.
  - **RTGS:** Real Time Gross Settlement is a fund transfer method through which money is sent in real time basis without any delays. This electronic fund transfer system allows the money sent by the remitter to immediately reach the payee/beneficiary as and when the money transfer transaction is initiated. Here, Gross Settlement refers to the processing of transactions on an individual basis and not in a batch wise system.

    Money can be sent using RTGS through net banking. To initiate such a transaction, it is important to collect some details from the payee such as account number, bank name, IFSC code, and account holder name. Another interesting feature about this wire transfer method is that transactions can be scheduled in advance. The RTGS payment system is maintained by the Reserve Bank of India (RBI) and hence is a safe and reliable method of sending and receiving money at any given point of time in the country. In fact, RTGS is one among the fastest ways to send money to anyone. It is much faster than the NEFT method of payment.
  - **NEFT:** National Electronic Funds Transfer (NEFT) is a mode of online funds transfer that is introduced by the Reserve Bank of India (RBI). It quickly transfers money between banks throughout India. A bank branch must be NEFT-enabled for a customer to be able to transfer the funds to another party. For a flawless transfer of funds on the Internet, NEFT helps customers to transfer any amount of

money quickly. NEFT is flexible payment options which are very economical. To utilise this facility, customers don't have to pay a huge sum of money to bank. The processing charges are economical, and customers can transfer any amount of money without any difficulty. NEFT, an integral aspect of Internet banking, is a highly dependable method of making payments and receiving funds online. In India, most of the banks are regulated under the norms set by RBI and, hence, the Internet banking facility too is quite safe. Unlike the regular banking methods of fund transfer, NEFT transfer is really quick, and customers can enjoy rapid settlement of accounts, thereby improving the overall functionality of customers business.

- **SWIFT:** Society for Worldwide Inter-bank Financial Telecommunications is a society that provides a network that enables financial institutions worldwide to send and receive information about financial transaction in a secure, standardized and reliable environment. The SWIFT messaging system uses standard SWIFT codes. It was established in 1973 in response to a growing need for an Internationally sound communications network that would facilitate business transactions across borders effectively, quickly and securely

❖ **Investing:** Through electronic banking, a customer can open a fixed deposit with the bank online through funds transfer. Further, if a customer has a demat account and a linked bank account and trading account, he can buy or sell shares online too. Additionally, some banks allow customers to purchase and redeem mutual fund units from their online platforms as well.

❖ **Shopping:** With an e-banking service, a customer can purchase goods or services online and also pay for them using his account. Shopping at his fingertips. E-commerce is an ongoing business technique which is very much in trend nowadays. And easy to access wherever customers are situated. With the functions of e-Commerce, customers can sell or buy product and services over the internet. Advantages of e-shopping

- Sell Globally/Large Market
- 24/7 Services
- Low-Cost Budget
- Customer Insights And Analytics
- Showcase Bestseller
- Increased Sales with Instant Response
- Remarketing Technique

❖ SMS Banking: SMS banking uses short text messages sent through the client's mobile phone. SMS text messages can be used for both passive and active operations similarly as with classic telephone banking. A client can automatically receive information about his account balance: an SMS is sent to the client immediately after a certain operation is performed, or on request: a client sends the bank a correctly formatted message which processes it and answers the client's request by SMS.

❖ Mail Banking: Mail banking is another electronic banking service that makes it possible to communicate with the bank by electronic mail or e-mail. The most frequently used service is sending account statements at agreed periodicity to the client's mailbox. E-mail is not used for more complex operations.

14.2 FEATURES OF E-BANKING :

The customer using this facility can conduct transactional and non-transactional tasks including:

❖ The customer can view account statements.

- It is 24 x 7 services.
- The customer can check the history of the transactions for a given period by the concerned bank.
- Bank, statements, various types of forms, applications can be downloaded.
- The customer can transfer funds, pay any kind of bill, recharge mobiles, DTH connections, etc.
- The customer can buy and sell on e-commerce platforms.
- The customer can invest and conduct trade.
- The customer can book, transport, travel packages, and medical packages.
- Banking that is guided through a secure and convenient platform
- The platform should be password protected
- Customers should find it easy to use both financial and non-financial banking products and services
- The digital banking account should be easily accessible
- The platform should enable easeful management of tracking with the latest updated balance, last transaction, and account statements
- Digital banking features for online fund transfer should support NEFT, RTGS, and IMPS without interruption.
- It should have the option of quick automated bill processing
- Track investments and credits
- Cancel automatic payments

14.3 TYPES OF E-BANKING :

Banks offer various types of services through electronic banking platforms. These are of three types:

- ***First level:*** This is the basic level of service that banks offer through their websites. Through this service, the bank offers information about its products and services to customers. Further, some banks may receive and reply to queries through e-mail too.
- ***Second level:*** In this level, banks allow their customers to submit instructions or applications for different services check their account balance, etc. However, banks do not permit their customers to do any fund-based transactions on their accounts.
- ***Third level:*** In the third level, banks allow their customers to operate their accounts for funds transfer, bill payments, and purchase and redeem securities, etc.

14.4 BENEFITS OF E-BANKING :

Understanding e-banking is important for several stakeholders, not least of which is management of banking related organizations, since it helps them to derive benefits from it. The Internet as a channel for services delivery is fundamentally different from other channels such as branch networks, telephone banking or Automated Teller Machines (ATMs). Therefore, it brings up unique types of challenges and requires innovative solutions. Many banks and other organizations have already implemented or are planning to implement e-banking because of the numerous potential benefits associated with it. We will look at the importance of electronic banking for banks, individual customers, and businesses separately. E-banking is beneficial for both customers and banks. The benefits of e-banking are as follows:

14.4.1 Benefits of e-Banking to customers

- E-banking covers digital payments, which have transparency.

- It usually supports 24×7 access to banking services. So customers can avail services as per their time.
- It is a very convenient and easy to use service for customers as they do not have to visit the bank branches every time.
- It provides the best features, such as notification services which inform customers of anything and everything happening with their banking services.
- Financial discipline is inculcated as each and every transaction is recorded.
- Lower cost per transaction – since the customer does not have to visit the branch for every transaction, it saves him both time and money.
- No geographical barriers – In traditional banking systems, geographical distances could hamper certain banking transactions. However, with e-banking, geographical barriers are reduced.

14.4.2 Benefits of e-Banking to banks :

- It reduces banks' transaction costs. Operation cost per unit service decreases.
- It is completely electronically managed, which reduces the chance of mistakes in the transaction.
- Banks can easily attract customers for various offers via phone calls, emails and apps, as the customer doesn't have to visit the branches anymore for any product specific information.
- Banks have to hire less people and also it will reduce the branch size and area, which helps in overall revenue growth.
- It provides a competitive advantage to the banks.
- With the help of e-banking, banks have a wider coverage area as banks are now not limited to the number of branches.
- Loads of branches are reduced as a centralized database is present.
- Lesser transaction costs – electronic transactions are the cheapest modes of transaction
- A reduced margin for human error – since the information is relayed electronically, there is no room for human error
- Lesser paperwork – digital records reduce paperwork and make the process easier to handle. Also, it is environment-friendly.
- Reduced fixed costs – A lesser need for branches which translates into a lower fixed cost.
- More loyal customers – since e-banking services are customer-friendly, banks experience higher loyalty from its customers.

14.4.3 Benefits of e-Banking to Businesses

- **Account reviews:** Business owners and designated staff members can access the accounts quickly using an online banking interface. This allows them to review the account activity and also ensure the smooth functioning of the account.
- **Better productivity:** Electronic banking improves productivity. It allows the automation of regular monthly payments and a host of other features to enhance the productivity of the business.
- **Lower costs:** Usually, costs in banking relationships are based on the resources utilized. If a certain business requires more assistance with wire transfers, deposits, etc., then the bank charges it higher fees. With online banking, these expenses are minimized.
- **Lesser errors:** Electronic banking helps reduce errors in regular banking transactions. Bad handwriting, mistaken information, etc. can cause errors which

can prove costly. Also, easy review of the account activity enhances the accuracy of financial transactions.

- **Reduced fraud:** Electronic banking provides a digital footprint for all employees who have the right to modify banking activities. Therefore, the business has better visibility into its transactions making it difficult for any fraudsters to play mischief.

14.4.4 Other benefits of e-banking :

- **Very convenient: -** Online banking is a totally easy thing to do. In the comfort of customers home or offices.
- **No time constraint: -** Online banking is also stress free because it never closes unlike the traditional banking that has cut-off time.
- **Easy way of payment: -** Bill payments can also be handled properly and smartly. Instead of waiting for certain due dates, customers can easily pay all customers transactions using customers computer and in coordination with bank.
- **Smart:** Online banking is also ubiquitous or simply put smart. This enables to do troubleshooting regarding any problem that may arise from business.

Although we have lot of benefits of E-banking services, there are certain disadvantages too, like understanding the usage of e-banking might be difficult for a beginner at the first go. Though there are some sites which offer a demo on how to use internet banking, but all does not offer this facility. So, a person who is new to internet baking might face some difficulty. Bank customer cannot have access to internet banking if he doesn’t have an internet connection. Security of transactions is a big issue. Customer account information might get hacked by unauthorized people over the internet. Password security is a must. After getting, Customer net banking password, do change it and memorize it otherwise. Customer account may be misused by someone who gets to know, Customer password inadvertently. Customer cannot use internet banking, in case; the bank’s server is down. Another issue is that sometimes it becomes difficult to note weather. Customer transaction was successful or not. E-banking causes internet fraud or trickery.

14.5 ASPECTS OF E-BANKING :

Each account holder needs to enroll for an online banking administration at his/her bank where they have an account so as to gain admittance. Most banks give a net-banking sign-in unit or kit as and when customers apply for an account in a particular bank.

14.5.1 E-banking methods: To begin using net banking for customers day-to-day transactions, follow these methods -

- Download the application form from Customers bank's true website, finish filling up the form and then take up a print of the same. Customers can even visit the bank branch straightforwardly and finish up the application form for net banking.
- Present the application form at the bank.
- After the bank does a thorough verification, Customers will get a special User ID and secret phrase utilizing which Customers can sign into internet banking.

14.5.2 Elements of E-banking: Here are the absolute best elements of internet banking that an individual must know:

- Gives admittance to financial as well as non-financial banking services.
- E-banking allows them to check their bank balance at any time of the day when the client requires it.
- Make payments to different accounts as and when required with ease and speed.
- Keep in mind the contracts, credits, and savings account that is connected to the bank account.

- Free from any fraud that the banking system can hold.
- Safeguarded with secret ID and secret pass code.
- Clients can apply for the issuance of a cheque book online.
- Purchase general insurance.
- Set up or drop programmed recurring payments and standing requests.
- Keep in check the investments connected to the bank account the customer holds.

14.6 RISKS OF E-BANKING :

Electronic banking offers a lot of benefits to individual customers, businesses, and banks. However, one should not ignore the risks associated with virtual banking either.

1. **Operational Risk:** Operation risk or transactional risk is the most common type of risk of e-banking. Apart from technological errors, human factors like negligence (customers or employees), employee frauds, hackers, etc. are a potential source of operational risk of e-banking. It includes: Incorrect transaction processing, compromises in the integrity of data, data privacy, and confidentiality, unauthorized access to the bank's systems and Non-enforceability of contracts, etc.
2. **Security Risk:** When we talk about banking transactions, security of the transaction is of paramount importance. All customers want their transactions to be confidential. However, since all information is online, there is always a chance that someone might retrieve the information and misuse it. The security risk of e-banking also arises from hacking threats and unauthorized access to the bank's systems.
3. **Reputational Risk:** For any business, its reputation is of critical importance. When it comes to electronic banking, if a bank fails to perform critical functions or not work according to the expectations of its customers, then it faces a risk of loss of reputation. This eventually leads to a loss of funding or customers. Some reasons for this risk are a system or product not functioning as expected, significant deficiencies in the system, security breaches (external or internal), misinforming customers about the processes and policies of using e-banking, certain communication issues that hinder the customer from accessing his account, etc.
4. **Legal Risk:** Whenever there is a violation of laws, regulations, or prescribed practices, or when the legal rights and obligations of any of the parties to a transaction are not established, then there is a legal risk involved. E-Banking is relatively new to the industry and there is a lot of uncertainty and ambiguity about certain laws and rules. This increases the legal risk.
5. **Money Laundering Risk:** All transactions through the e-banking channel are done remotely. Therefore, it is difficult for banks to use traditional methods to detect and prevent criminal activities. While there is certain money laundering rules in place, for electronic payments, their feasibility is questionable. Therefore, banks carry the risk of money laundering.
6. **Strategic Risk:** This risk is associated with issues pertaining to, the development of a business plan, having sufficient resources available to support the business plan, in the case of outsourced activities, the credibility of the vendor, for employees, any change in the work environment and level of technology used in comparison with the available technology, etc.
7. **Other Risks:** The other risks of e-banking are the same as those of traditional banking like credit risk, liquidity risk, interest rate risk, market risk, etc. However, in e-banking, these risks are magnified due to the use of electronic channels and the absence of geographical boundaries. All the risks mentioned above can arise due to

some flaws in design, insufficient technology, negligent employees, and unauthorized system access (intentional or not). Therefore, it is important that banks adopt the right technology and systems and have proper access control for a secure transacting environment.

The Reserve Bank of India (RBI) has a working group which examines various issues of e-banking and suggests different ways to solve them. Some of these recommendations are:

- ❖ Keeping security concerns in mind, all banks in India must follow a standard. Also, the Indian Banks Association should design this standard.
- ❖ All banks must adopt adequate security measures to maintain the secrecy and confidentiality of data. Further, they must use logical access control to implement it.
- ❖ In order to mitigate the money laundering risk, banks must develop an anti-money laundering (ALM) technology for reporting and querying.
- ❖ Banks must have an internal grievance redressal system to adopt a fraud-free culture of banking.
- ❖ All banks must have an explicit security plan along with documentation. Further, banks must strictly ensure physical access control.
- ❖ Banks must adopt an extensive e-banking network so that the rural and remote areas of the country can also benefit.

14.7 SUMMARY :

In this lesson briefly given the concept related to the E-banking. E-banking is an arrangement between a bank or a financial institution and its customers that enables encrypted transactions over the internet. Short for electronic banking, E-banking has various types that cater to customers' different requirements, which can be resolved online. In other words, e-banking is an umbrella term for the process by which a customer may perform banking transactions electronically without visiting a branch and also includes the systems that enable customers of banks, individuals or businesses, to access accounts, transact business, or obtain information on financial products and services through a public or private network, including the Internet. Online banking (or Internet banking or E-banking) is a facility that allows customers of a financial institution to conduct financial transactions on a secured website operated by the institution.

E-banking involves the use of telecommunications and electronic networks to deliver various banking services and products. With e-banking, customers can access their accounts and perform numerous transactions using their smart phones or computers. The customer using this facility can conduct transactional and non-transactional tasks including view account statements, in 24 x 7 services. The customer can check the history of the transactions for a given period by the concerned bank. Customers can download various types of forms, applications and customer can transfer funds, pay any kind of bill, recharge mobiles, DTH connections, etc.

And the lesson also highlighted the various types of E-banking services to the customers. E- Banking is very much helpful to the customers and it had adequate benefits to the banks and others to. Finally, the lesson concludes to incorporate E-Banking aspects, various methods, elements and risk of e-banking with recommendations from RBI

14.8 KEY WORDS :

- ❖ **E-Banking:** It is banking with the only difference being that all the transactions take place via electronic modes. Banking through Internet is called internet banking. It can also be called as electronic banking. Many banks have their own websites. E-Banking is a secure, simple, and quick electronic service that allows consumers to

do banking transactions from any location without having to visit a bank branch. Customers can use the e-banking service at any time, 24 hours a day, and seven days a week. Instead of exchanging numerous conventional documents such as cash, cheques, and so on, money is exchanged through the transmission of electronic signals.

- ❖ **Need for E-banking:** E-Banking is also helpful for non-financial transactions such as changing ATM PIN, getting a mini statement, updating personal details, balance inquiry or printing an account statement. Essentially, it refers to any transaction that doesn't involve any movement of funds to or from account. To access a financial institution's E-Banking facility, a customer must register with the institution for the service, and set up some password for customer verification. Online banking can be used to check balances, transfer money, shop online, pay bills etc.
- ❖ **ATMs (Automated Teller Machines):** An automated teller machine (ATM) is an electronic telecommunications device that enables customers of financial institutions to perform financial transactions, such as cash withdrawals, deposits, funds transfers, balance inquiries or account information inquiries, at any time and without the need for direct interaction with bank staff. Using an ATM, customers can access their bank deposit or credit accounts in order to make a variety of financial transactions, most notably cash withdrawals and balance checking, as well as transferring credit to and from mobile phones.
- ❖ **Electronic Clearing Cards:** Electronic Clearing System (ECS) is an electronic method of fund transfer from one bank account to another. It is generally used for bulk transfers performed by institutions for making payments like dividend, interest, salary, pension, etc. ECS can be used for both ECS credit and ECS debit. ECS Credit enables payment of amounts towards distribution of dividend, interest, salary, pension, etc., of the user institution.
- ❖ **EFT (Electronic Funds Transfer) System:** An electronic funds transfer (EFT) is a transaction that takes place over a computerized network, either among accounts at the same bank or to different accounts at separate financial institutions. Electronic funds transfer (EFT) are electronic transfer of money from one bank account to another, either within a single financial institution or across multiple institutions, via computer-based systems, without the direct intervention of bank staff.
- ❖ **RTGS:** Real Time Gross Settlement is a fund transfer method through which money is sent in real time basis without any delays. This electronic fund transfer system allows the money sent by the remitter to immediately reach the payee/beneficiary as and when the money transfer transaction is initiated.
- ❖ **SWIFT:** Society for Worldwide Inter-bank Financial Telecommunications is a society that provides a network that enables financial institutions worldwide to send and receive information about financial transaction in a secure, standardized and reliable environment.
- ❖ **Mail Banking:** Mail banking is another electronic banking service that makes it possible to communicate with the bank by electronic mail or e-mail.
- ❖ **Easy way of payment:** A Bill payment is **one of the benefits of e-banking.** Bill payments can also be handled properly and smartly. Instead of waiting for certain due dates, customers can easily pay all customers transactions using customers computer and in coordination with bank.
- ❖ **Operational Risk:** Operation risk or transactional risk is the most common type of risk of e-banking. Apart from technological errors, human factors like negligence (customers or employees), employee frauds, hackers, etc. are a potential source of operational risk of e-banking.

- **Legal Risk:** Whenever there is a violation of laws, regulations, or prescribed practices, or when the legal rights and obligations of any of the parties to a transaction are not established, then there is a legal risk involved. E-Banking is relatively new to the industry and there is a lot of uncertainty and ambiguity about certain laws and rules.

14.9 SELF-ASSESSMENT QUESTIONS :

1. What is E-Banking? Explain the concept of E-Banking.
2. Define E-Banking? What are the popular services of E-Banking?
3. Explain the various types of E-Banking.
4. Discuss the benefits of E-Banking?
5. What are the E-Banking methods and explain the elements involved in E-Banking?
6. Define risk of E-Banking? What are the recommendations given by RBI?

14.10 FURTHER READINGS :

- Bank Management, by Timothy W. Koch (Author), S. Macdonald (Author) South-Western; 7th edition (1 August 2009)
- Bank Management, by Timothy W. Koch (Author), S. Macdonald (Author) South-Western; 8th edition (11 September 2014)
- Risk Management in Banks, by Dr Mustari Hanmanth N (Author), Dr Waghamare Shivaji (Author), Lulu.com (9 March 2014)
- Bank Financial Management by IIBF (Author) Macmillan; First Edition (2 April 2023)
- Bank Management and Financial Services, by Peter Rose (Author), Sylvia Hudgins (Author) McGraw Hill Education; 8th edition (1 July 2017)
- Bank Financial Management by IIBF (Author) Macmillan Education India (1 January 2018)

Dr. SADHIK SAYYED

LESSON - 15

TRADITIONAL Vs E-BANKING MODELS

OBJECTIVES:

- To understand the traditional models
- To describe the various E-Banking Models
- To study on security methods in E-Banking

STRUCTURE:

15.1 Traditional banking models
15.2 Traditional Vs E-Banking Models
15.3 Advantages and constrains of E-Banking Models
15.4 Security methods
  15.4.1 Security Threats
  15.4.2 E- Banking Security Tips
  15.4.3 User's Security Obligations
15.5 Types of security methods in E-Banking
15.6 Security Measures
  15.6.1 Specific Security Measures
  15.6.2 Other Security Measures
  15.6.3 Banks measures on security
15.7 Summary
15.8 Key words
15.9 Self-Assessment Questions
15.10 Further Readings

15.1 TRADITIONAL BANKING MODELS :

Traditional banking traces back to the earliest forms of banking. Banks in this model have a physical presence, domestic banking license, own-branded ATMs, a headquarters, face-to-face customer service, dedicated account managers. Many customers loyal to traditional banks find it difficult to trust digital models, because the physical presence of a bank building communicates security and safety for their money. The following are some of features of traditional banking models

- **Time:** In the traditional banking system, customers visited the bank only during banking hours (mostly from 10am to 4 pm) but in the modern banking system, one avails the services anytime, round the clock.
- **Paper work:** Earlier everything was paper based and hand written, for instance, the passbook was updated manually by the cashier or the clerk.
- **No training:** The bankers didn't get any training as such, they were expected to learn on the job and mistakes had repercussions as well.
- **Old banking system**: In the tradition banking system, all transactions and records were dependent on the memory of those manning the bank counters. And records on name, family members, and bank account etc of their customers just by merely looking at them.
- **Preparation of Manual:** In the traditional banking system, the ledger entry was manual. On an everyday basis, bankers were not allowed to leave the bank unless

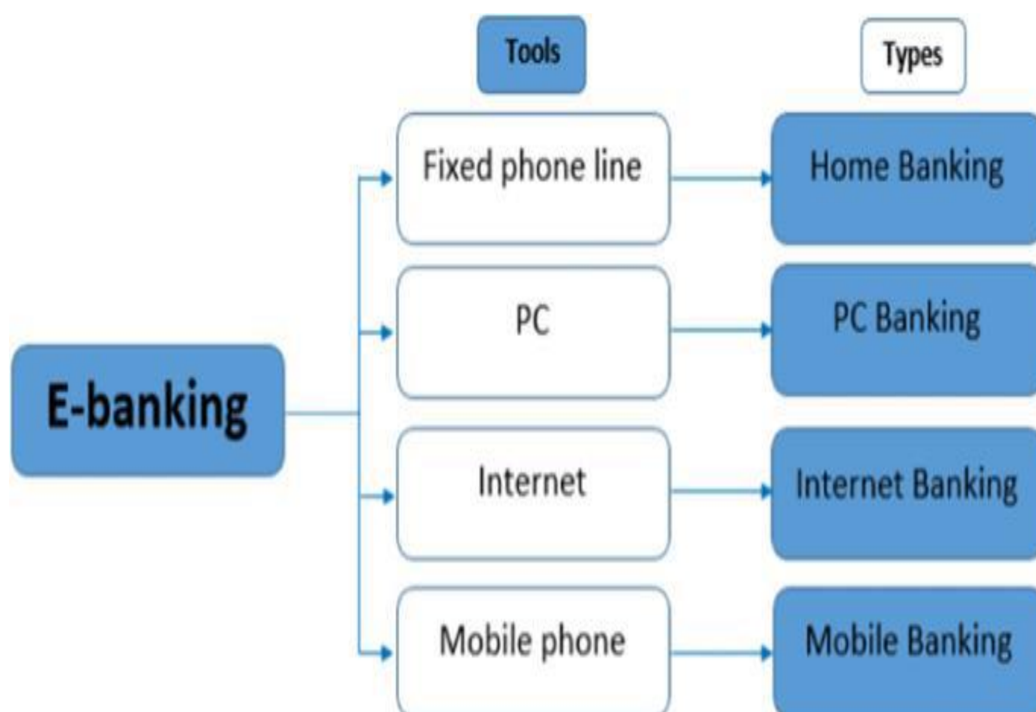
and until all the transactions were recorded in the ledger irrespective of their number.

- **Limited use of technology:** In the traditional banking system, the use of technology began very late and its use was limited.
- **Huge cost:** In the traditional banking system, the banks incur a lot of fixed and operating costs whereas, in the modern banking system, these costs are eliminated.

15.2 TRADITIONAL Vs E-BANKING MODELS :

The traditional banking model can also be referred to as "brick and mortar." This model has been in effect since the inception of banking and is based on the presumption that customers want (or need) to stop by their local branch to perform all of their banking needs in person. This approach to banking was of course necessary before much our lives moved into the digital space. The benefits of Local branches offer walk-in, face-to-face customer service, greater number of banking products so that customers can keep all banking and personal finance needs with a single provider and more options for cash deposits. And the drawbacks of traditional banking model are often have higher monthly fees, usually have lower interest rates on savings accounts, less established mobile banking and website-based options that increase time and reduce functionality for most every-day banking needs, often smaller network of ATMs, and fewer options in under-banked geographic areas.

E- Banking models offers a lot of benefits when compared to a traditional bank. Often referred to as digital banking, online banking allows people to do many everyday banking tasks through a website or mobile app. As we talked about, most banks these days will have an online service, but online-only banks are different. Without any branches for their customer to visit, E- Banking models only banks need to offer a greater array of features through their digital interfaces.



Online only banks typically have larger ATM networks. The pros of online banking are higher interest rates on savings accounts, typically better checking account and cards

reward programs, fee free! Many don't charge any fees at all, better accessibility for everyone, typically better digital-by-design customer service, typically better access to ATMs an greater access.

A majority of people of old age, especially senior citizens, still believe in the traditional banking system and opt not to take ATM cards and internet banking facilities. The youth and the millennial are very comfortable with using online banking services via mobile app. Despite the threat of getting hacked by hackers or online fraud, they hardly prefer to go to the bank's branch to avail any services unless necessary. Banks' apps (mobile banking) and digital banking have made banking very easy and time saving. Perks like free foreign tour, furniture, newspaper, internet and mobile allowance etc. are given to bank employees of top public sector banks like SBI, Bank of Baroda etc These days, people, as customers, have become more aware of their rights and RBI's guidelines and they don't refrain from arguing with bank employees for something right. On the contrary, this was hardly seen in the old days. Unlike public sector banks, private banks treat their customers very well and their customer support and problem resolution process is very fast.

Traditional Models Vs E-Banking Models

Traditional Models	E-Banking Models
Physical branches	Available 24/7 and conveniently be accessed from anywhere
Higher interest rates, monthly service fees, account fees	Financial transactions can be processed quick and efficiently
Traditional Practice provides limited coverage.	E-Banking Practices involve global coverage while sitting at home/office.
Traditional Practices involves process which requires more time.	E-Banking same lot of line as there is no need to stand in long queues.
Traditional banking practices do not provide a complete check on banking transactions.	With the system of reconciliation of inter-branch transactions, frauds and errors could be reduced.
Bank executives have to perform a lot of paperwork which increases both time and cost.	Cost and time could be reduced or everything is to be through some interval and no need for huge paperwork.
In the case of traditional business, a person has to carry cash at each point of time.	E-banking provides banking without carrying cash as plastic money (ATMs, Credit cards are available)

Both online banking and traditional banking services have strengths and weaknesses. Online banking is available 24/7 for customers to conveniently and efficiently manage their finances from anywhere with an internet connection. Transactions are processed quickly and customers can check balances, transfer money and pay bills electronically. Traditional banks, on the other hand, can meet more complex banking needs through face-to-face interactions with bank representatives. They also have physical branches where can get services like lockers. However, the traditional bank may not have the same high level of security measures as online banks and customers' personal and financial information may be at risk if proper precautions are not taken. Traditional banks may also offer additional services such as investment advice, retirement planning, and small business loans.

15.3 ADVANTAGES AND CONSTRAINS OF E-BANKING MODELS :

15.3.1 Advantages of e-banking models

- Elimination of paper documents and manual processing of financial transactions
- Transfer of funds at the moment of payment (online), which drastically increases the speed of financial transactions
- Operating costs are kept to minimum
- Increase market share by introducing new business models
- The creation of innovative image of the banking system that provides its clients with the latest technological solutions
- The interactive features of communication over the Internet
- Funds transfer between own accounts.
- Third party transfers to accounts maintained at any branch of bank
- Inter Bank Transfers to accounts with other Banks
- Credit PPF accounts across branches
- Request for Issue of Demand Draft
- Request for opening of new accounts
- Request for closure of Loan Accounts
- Request for Issue of Cheque Book
- Earn reward points for transactions through Internet Banking
- Utility bill payments
- Online Ticket Booking for travel by Road, Rail and Air
- insurance payments
- Online Application for IPO
- Fee Payment to select educational institutions

15.3.2 Constrains of E-Banking Models

- Internet Requirement. Access to Internet banking services can be hindered in the absence of a stable internet connection.
- Safety situations around ATMs.
- Abuse of bank cards by fraudsters at ATMs.
- Danger of giving card number when buying online.
- Internet Fraud.
- Disruptions in Technology-related Services
- Difficulties for Beginners
- Deposit Restrictions
- Remembering Multiple Passwords – Cons of e-banking

15.4 SECURITY METHODS :

Security in the banking sector can be defined as a financial instrument or asset that can be easily traded in the open market. Many banks have integrated fingerprint authentication into their mobile banking apps. Other forms of biometric security measures include facial and voice recognition. These verification methods are easy to use and hard for criminals to replicate. Physical and digital security are paramount to ensuring that banks and other financial institutions are able to keep the money they are trusted with and the individuals who regularly are present in the institution safe.

A security policy must be able to prevent sensitive information from being modified or retrieved by unauthorized users, but easy enough to administer. As banking becomes increasingly digitization, so too do people’s rightful concerns about internet banking security. Banks operate complex, high-level security protocols to ensure the integrity of their systems

and assure their customers that their accounts and money are protected. This includes, for example, protecting data and communications with encryption, and using multifactor authentication, security alerts, and automatic logouts as standard features to ensure online bank security. Directory Server Enterprise Edition provides the following security methods:

1. **Authentication:** Provides a means for one party to verify another's identity. For example, a client gives a password to Directory Server during an LDAP bind operation. As part of the authentication process, password policies define the criteria that a password must satisfy to be considered valid, for example, age, length, and syntax. Account inactivation disables a user account, group of accounts, or an entire domain so that all authentication attempts are automatically rejected.
2. **Encryption:** Protects the privacy of information. When data is encrypted, the data is scrambled in a way that only the recipient can decode. The Secure Sockets Layer (SSL) maintains data integrity by encrypting information in transit. If encryption and message digests are applied to the information being sent, the recipient can determine that the information was not tampered with during transit. Attribute encryption maintains data integrity by encrypting stored information.
3. **Access control:** Tailors the access rights that are granted to different directory users, and provides a means of specifying required credentials or bind attributes.
4. **Auditing:** Enables to determine if the security of directory has been compromised. For example, can audit the log files maintained by customer directory.

These security tools can be used in combination in security design. And can also use other features of the directory, such as replication and data distribution, to support security design.

15.4.1 Security Threats :

A comprehensive security program should be designed to identify, assess, and manage risks, and should be regularly reviewed and updated to ensure that it continues to provide effective protection against potential threats. When combined, administrative, technical, and physical controls provide a layered approach to security that is essential to protect business assets from potential threats. In an e-Banking environment, security threats largely fall into the following categories:

- **Login Detail Disclosure:** The most commonly used by the criminals through whom they acquire login details like number, PIN which is enough to access anyone's account and steal money.
- **Computer Spy Viruses:** These are computer programs which are circulated through email or other means. Once a customer opens a malicious email a program is automatically installed in his/her computer. These programs collect login id or other financial information which is used to conduct a range of criminal activities such as credit card cloning or unauthorized funds transfer.
- **Dummy Sites:** Sometimes dummy website which looks very similar to a bank's website is created by criminals and when customers enter login details it will be recorded and use for criminal activities.
- **Loss of Personal Relationship:** There is a lack of face-to-face contact in e- banking, which leads to lack of trust in the system of working and the products of e-banking. To compensate, e-banks must deliver high value products and to cut operational costs to remain competitive, which in turn may further erode the avenues for building personal relationships with customers.
- **Organizational Structures and Resistance:** E-Banking requires many structural changes in the organization and managerial changes. This may lead to morale

problems as changes are not usually welcomed in any organizations. The project having change management process has less success rates.

- **Trust Issues:** Another major hurdle in the growth of E-banking is the lack of trust by the customers. They hesitate to share their personal information due to security reasons. The lack of trust among the customers is also legitimate since, in some cases even bank people will also not help them when there is any misappropriation. As such e-banking services are less used by the people.
- **Change Management Issues:** Adaptation to e-banking requires major changes in the organizational structure. The reasons being technical drawbacks, high start-up cost and strategically issues.
- **Ethical Issues:** In this context the main issues may include security/privacy of information about individuals, accuracy of information, ownership of information and intellectual property, accessibility of information held and what uses of this information are ethically acceptable. These relate to: freedom of choice; transparency; facilitating fraud (ethical/illegal activities of others).

15.4.2 E- Banking Security Tips :

- Change Password at regular intervals
- Help banks in preventing frauds (phishing) by reporting such incidents to bank mail id.
- Access bank portal
- Do not click on any shortcuts/links
- Avoid accessing account from public places like cyber cafes
- Use virtual keyboard to enter user ID and Password
- Avoid entering sensitive info in pop-ups
- Track all transactions and usage history regularly
- Use latest and genuine software on own system with secure settings

15.4.3 User's security Obligations :

- The Username and the Password given by the Bank must be replaced by Username and Password of the user at the time of FIRST log-in. This is Mandatory.
- The registered user is free to choose a User Name and Password of his choice as per the guidelines on the site. However, he/she is advised to avoid choosing a password that is generic in nature, guessable/inferable from the personal data such as name, date of birth, address, telephone number, driving license/car number etc.
- The user is welcome to access bank web portal from anywhere anytime. However, as a matter of precaution and safety, he should avoid using PCs with public access.
- There is no way to retrieve the Password from the system. In case the user forgets his/her Password, he/she will have to use the Trouble Logging In option in the site or approach the branch for getting a new password.
- The user must keep the user name and Password strictly confidential and known only to himself/herself. It is a good practice to commit the password to memory rather than write it down somewhere. Bank will not be responsible for any loss sustained by the user due to breach of this condition.
- The Bank presupposes that log-in using valid user name and Password is a valid session initiated by none other than the user to whom they said username and the Password belongs.
- All transactions executed through a valid session as defined above will be construed to have been emanated from the registered user and will be legally

binding on him/her. The user is cautioned against leaving the computer unattended during a valid session.

- Should the user notice that any information relating to his/her account(s) is incorrect or discrepant the same should be immediately brought to the notice of the Branch (es) by e-mail or with letters?
- The user will not attempt or permit others to attempt accessing bank portal through any unlawful means.

15.5 TYPES OF SECURITY METHODS IN E-BANKING :

I.Login Security:

- ❖ Use unique and complex passwords.
- ❖ Remember to change passwords frequently.
- ❖ Never disclose, store or write down user ID, passwords or PIN. Remember, Bank never asks for user ID/passwords/Card No/PIN/Passwords/CVV.
- ❖ Disable ‘Auto Save’ or ‘Remember’ function in personal device to avoid storing of user ID and passwords.

II. Internet Security:

- ❖ Always look for “https” in the address bar of our banking site.
- ❖ Do not perform online banking transactions at public places using public / open Wi-Fi networks.
- ❖ Always logout and close the browser when customer is done with his work.

III.UPI Security:

- ❖ Keep mobile PIN and UPI PIN different and random.
- ❖ Do not respond to any unknown UPI requests.
- ❖ Report suspicious requests.
- ❖ Always remember that a PIN is needed only for transferring amounts, not for receiving.
- ❖ Instantly disable UPI service on customer account if any transaction has happened without doing it.

IV.Debit/Credit Card Security:

- ❖ Beware of surroundings while performing ATM transactions through ATM machines or POS devices. Cover the keypad while entering the PIN.
- ❖ Always verify the authenticity of e-commerce websites before performing the transactions.
- ❖ Manage debit card transactions through online Banking. Set a limit for card transactions at e-commerce platforms, POS and ATM both for domestic and international transactions.

V.Mobile Banking Security:

- ❖ Strong passwords/ Biometric permission should be enabled on phone, tablets.
- ❖ Do not share mobile PIN with anyone, Use biometric authentication wherever feasible.
- ❖ Do not download any unknown app suggested by strangers.
- ❖ Applications should be downloaded only through official stores.
- ❖ Regularly monitor the permissions of critical apps installed in mobile and keep a track of unnecessary and unused apps.
- ❖ Avoid connecting phones to public wireless networks.

VI. Social Media Security:

- ❖ Confirm the identity of the person is interacting with.
- ❖ Do not share personal/financial information on any social media platform.
- ❖ Do not discuss confidential information in public places.

15.6 SECURITY MEASURES :

The banks should also consider, and if deemed appropriate, implement the following control and security measures to minimize exposure to man-in-the middle attacks:

15.6.1 Specific Security measures :

i. OTPs for adding new payees: Each new payee should be authorized by the customer based on an OTP from a second channel which also shows payee details or the customer’s handwritten signature from a manual procedure which is verified by the bank.

ii. Individual OTPs for value transactions (payments and fund transfers): Each value transaction or an approved list of value transactions above a certain monetary threshold determined by the customer should require a new OTP.

iii. OTP time window: Challenge-based and time-based OTPs provide strong security because their period of validity is controlled entirely by the bank and does not depend on user behavior. It is recommended that banks should not allow the OTP time window to exceed 100 seconds on either side of the server time since the smaller the time window, the lower the risk of OTP misuse.

iv. Payment and fund transfer security: Digital signatures and Key-based Message Authentication Codes (KMAC) for payment or fund transfer transactions could be considered for detection of unauthorized modification or injection of transaction data in a middleman attack. For this security solution to work effectively, a customer using a hardware token would need to be able to distinguish the process of generating a one-time password from the process of digitally signing a transaction. What he signs digitally must also be meaningful to him, which means the token should at least explicitly show the payee account number and the payment amount from which a hash value may be derived for the purpose of creating a digital signature. Different crypto keys should be used for generating OTPs and for signing transactions.

v. SSL server certificate warning: Internet banking customers should be made aware of and shown how to react to SSL or EV-SSL certificate warning.

15.6.2 Other Security Measures :

- In internet banking scenario, there is very little scope for banks to act on stop-payment instructions from the customers. Hence, banks should clearly notify to the customers the timeframe and the circumstances in which any stop-payment instructions could be accepted.
- The Consumer Protection Act, 1986 defines the rights of consumers in India and is applicable to banking services as well. The rights and liabilities of customers availing of internet banking services need to be clearly explained to customers opting for internet banking. Considering the banking practice and rights enjoyed by customers in traditional banking, the banks' liability to the customers on account of unauthorized transfer through hacking, denial of service on account of technological failure, etc. needs to be assessed and banks providing internet banking should insure themselves against such risks.
- Hyperlinks from banks' websites often raise the issue of reputational risk. Such links should not mislead the customers into believing that banks sponsor any particular product or any business unrelated to banking. Hyperlinks from banks' websites should be confined to only those portals with which they have a payment arrangement. Hyperlinks to banks' websites from other portals are normally meant for passing on information relating to purchases made by banks' customers in the portal.

- Banks must follow recommended security precautions while dealing with requests received from other websites relating to customers' purchases.
- Second channel notification / confirmation: The bank should notify the customer, through a second channel, of all payment or fund transfer transactions above a specified value determined by the customer.
- Banks should put in place risk-based transaction monitoring and surveillance process. Study of customer transaction behavior pattern and stopping irregular transaction or obtaining prior confirmation from customers for outlier transactions may be incorporated in the software.

15.6.3 Banks measures on security :

Banks take all necessary measures to keep customer information protected.

- **Secure Platform:** Strong authentication & authorization controls are implemented for all our digital banking applications for secure access. The bank follows the 'security by design' approach to provide secure access and protected platform to perform financial transactions.
- **Session Layer Security:** Secure channel of communication is implemented on all our banking services to prevent unauthorized interception of activity on our digital platform. Nearly 256 bit encryption is implemented on all traffic to secure the transactions performed over internet. Customer's login session is logged out after some idle time to protect against misuse.
- **Login Security:** Captcha is implemented to prevent from **Brute Force Attacks/Botnet attacks.** One Time Password (OTP) is sent to customer Registered Mobile Number (RMN) as a 2nd Factor of Authentication (2FA) for login to Internet Banking (INB) application. Virtual Keyboard is provided for logging to customer net banking in order to prevent from key logger attacks.
- **Profile Security:** Access to privileged pages for carrying out privileged activities such as Adding Beneficiary, changing user profile etc. is controlled through a Profile Password. Alerts are sent every time to access customer profile section.
- **Transfer Security:** All NEFT/ RTGS transactions other than quick transfer are performed only after addition of beneficiary and within the transaction limit defined by customer. Transfer to a newly added beneficiary can be performed after a cooling period of up to 4 hours.
- **Notification:** OTP is sent to RMN as a 2FA for transactions carried out through Internet Banking site. Text messages over Short Message Service (SMS) are sent for transactions carried out in the account through e-banking. All activities happening in customer account are promptly notified to customer through SMS or Email alerts.
- **Mobile Security:** SIM binding and device binding has been enabled on mobile apps. Anti-tampering is implemented to prevent un-authorized changes to mobile apps.
- **End To End Security:** End to End encryption is implemented to keep customer data confidential and invisible to everyone within the Bank as well. Customer credentials are hashed and protected with industry standard encryption to maintain secrecy.
- **Transaction Monitoring:** Robust solutions, systems, and processes are deployed to monitor the safety of customer accounts. Bank security team is deployed 24/7 to monitor, analyze and detect any abnormal activity, indicating a potential breach, security incident or malicious attempts to the system.
- **Customer Care:** 24*7 customer services are provided to customers to raise any issues and get quick redressal.

15.7 SUMMARY :

Today, modern banking has tendency of dynamic evolution, adapting its business to valuable changes occurring in the global marketplace and a new philosophy of banking business that is oriented towards end users. New banking business philosophy with new business strategies, new organizational design, and new business models based on Internet technologies, distribution systems, mobile computing and business intelligence can provide the survival, growth, and development to each of the banking system.

The dynamic development of information and telecommunications technology moves time and geographical boundaries and significantly improves and facilitates the implementation of financial or banking transactions worldwide. Electronic banking is a form of banking business and provides banking services to individuals and corporate entities, which are offered and performed with the use of computer networks and telecommunications media. Electronic banking is an attempt to merge a number of different technologies (electronic cash, ATM, POS, credit cards, home banking, online banking, Internet banking, mobile banking, etc.), each of them evolved in a different direction and in a different way, with the aim of providing various banking products and services to end-users.

Many traditional banks have the best advantage over online banks which is in-person customer service as the majority of people prefer to have their banking issues solved in person In online banks, customer service is often provided by email, chatbots, or phone help, and may have limited customer service hours. E-banking provides enormous benefits to consumers in terms of ease and cost of transactions, either through Internet, telephone or other electronic delivery. Electronic finance (E-finance) has become one of the most essential technological changes in the financial industry.

Security in the banking sector can be defined as a financial instrument or asset that can be easily traded in the open market. Many banks have integrated fingerprint authentication into their mobile banking apps. When combined, administrative, technical, and physical controls provide a layered approach to security that is essential to protect business assets from potential threats. And the lesson also highlighted the security tips to customers like, cross check and validate the beneficiary account details by calling a known contact number / authorised person in the beneficiary / exporter / sellers office. Always check the email ID of the beneficiary, enhanced due diligence should be undertaken where remittance requests or revised instructions received from overseas customer to pay to third country or third parties.

Changes or variance identified in the beneficiary name/account number/bank or country with previous payment instructions should be cross checked with beneficiary / seller / exporter over a phone call, share documents/instructions in encrypted formats only and change password at regular intervals. Finally, the lesson concludes user's Security Obligations, various types of security methods and security Measures in E-Banking.

15.8 KEY WORDS :

- **Understanding of Traditional banking:** Traditional banking traces back to the earliest forms of banking. Banks in this model have a physical presence, domestic banking license, own-branded ATMs, a headquarters, face-to-face customer service, dedicated account managers.
- **Traditional banking model:** The traditional banking model can also be referred to as "brick and mortar." This model has been in effect since the inception of banking and is based on the presumption that customers want (or need) to stop by their local branch to perform all of their banking needs in person.
- **E- Banking models:** It offers a lot of benefits when compared to a traditional bank. Often referred to as digital banking, online banking allows people to do many

everyday banking tasks through a website or mobile app. As we talked about, most banks these days will have an online service, but online-only banks are different.

- **Traditional banking Vs E-Banking banking:** Both traditional banking and online banking services have strengths and weaknesses. Online banking is available 24/7 for customers to conveniently and efficiently manage their finances from anywhere with an internet connection. Transactions are processed quickly and customers can check balances, transfer money and pay bills electronically. Traditional banks, on the other hand, can meet more complex banking needs through face-to-face interactions with bank representatives. They also have physical branches where customer can get services like lockers.
- **Computer Spy Viruses:** These are computer programs which are circulated through email or other means. Once a customer opens a malicious email a program is automatically installed in his/her computer. These programs collect login id or other financial information which is used to conduct a range of criminal activities such as credit card cloning or unauthorized funds transfer.
- **Mandatory User's security Obligations:** The Username and the Password given by the Bank must be replaced by Username and Password of the user at the time of first log-in.
- **Mobile Banking Security:** Strong passwords/ Biometric permission should be enabled on phone, tablets. Do not share mobile PIN with anyone, use biometric authentication wherever feasible. Do not download any unknown app suggested by strangers. Applications should be downloaded only through official stores. Regularly monitor the permissions of critical apps installed in mobile and keep a track of unnecessary and unused apps.
- **Customer Care:** 24*7 customer services are provided to customers to raise any issues and get quick redressal.

15.9 SELF-ASSESSMENT QUESTIONS :

1.Define Traditional banking models? Give its features.
2.Differentiate between tradition banking models with E-Banking models?
3.Write about advantages and constrains of E-Banking Models?
4.What is security in E-Banking? What are the security threats in E-Banking?
5.Discuss various E-Banking security tips and E-Banking user security obligations?
6.What are E-Banking Security methods? Explain different types of security methods in E-Banking?
7.Explain Security Measures in E-Banking?

15.10 FURTHER READINGS :

1. Banking Laws, by R.N. Chaudhary (Author) Central Law Publications; Fifth edition (31 December 2021)
2. Commercial Banking: The Management of Risk by Benton E Gup (Author), James W. Kolari (Author), Wiley India Pvt Ltd; 3rd edition (12 December 2006)
3. Law Of E-Banking(Law Of Internet Or Online Banking) by S.R Myneni (Author) New Era Law Publication, Faridabad (1 January 2022)
4. Indian Banking System by Dr. V. C. Sinha (Author, Preface), SBPD Publishing House (1 January 2020)
5. Banking Principles and Operations by M.N.Gopinath (Author), Snow White (1 January 2017)

Dr. SADHIK SAYYED

LESSON-16

RISK MANAGEMENT AND OUTSOURCING E-BANKING

OBJECTIVES:

- To know the Risk Management Concept.
- To describe the various types of Risk Management
- To study on outsourcing E-Banking

STRUCTURE:

16.1 Concept of Risk Management
16.2 Risk Management important-features
  16.2.1 Risk Management process
  16.2.2 Risk Management under BASEL Norms
16.3 Types of Risk Management
16.4 Outsourcing E-Banking
  16.4.1 Reasons for choosing to outsource
  16.4.2 Importance of outsourcing
  16.4.3 Stages of outsourcing process
  16.4.4 Benefits of outsourcing
  16.4.5 Types of outsourcing
16.5 Problems of outsourcing
16.6 Golden rules to avoid problems of outsourcing
16.7 Summary
16.8 Key words
16.9 Self-Assessment Questions
16.10 Further Readings

16.1 CONCEPT OF RISK MANAGEMENT :

Accurate, complete and timely data is a foundation for effective risk management. However, data alone does not guarantee that the board and senior management will receive appropriate information to make effective decisions about risk. To manage risk effectively, the right information needs to be presented to the right people at the right time. Risk reports based on risk data should be accurate, clear and complete. They should contain the correct content and be presented to the appropriate decision-makers in a time that allows for an appropriate response.

To effectively achieve their objectives, risk reports should comply with the following principles.

- ❖ **Accuracy:** Risk management reports should accurately and precisely convey aggregated risk data and reflect risk in an exact manner. Reports should be reconciled and validated.
- ❖ **Comprehensiveness:** Risk management reports should cover all material risk areas within the organization. The depth and scope of these reports should be consistent with the size and complexity of the bank’s operations and risk profile, as well as the requirements of the recipients.

- **Clarity and usefulness:** Risk management reports should communicate information in a clear and concise manner. Reports should be easy to understand yet comprehensive enough to facilitate informed decision-making. Reports should include meaningful information tailored to the needs of the recipients.
- **Frequency:** The board and senior management (or other recipients as appropriate) should set the frequency of risk management report production and distribution. Frequency requirements should reflect the needs of the recipients, the nature of the risk reported, and the speed, at which the risk can change, as well as the importance of reports in contributing to sound risk management and effective and efficient decision-making across the bank. The frequency of reports should be increased during times of stress/crisis.
- **Distribution:** Risk management reports should be distributed to the relevant parties while ensuring that confidentiality is maintained.

16.2 RISK MANAGEMENT – IMPORTANT FEATURES :

- Risk management policies should be approved by the board. It should cover all the required guidelines and directives of the regulators and applicable legal frame work
- There should be a good support from the Information Technology wing for creating an integrated system whereby an effective and efficient MIS would be an integral part of the risk management
- There should be clear demarcation of functions and authority levels to ensure better internal control systems (ex: front office, mid office and back office of an integrated treasury)
- An effective communication system coupled with the training programs
- One of the risk mitigation measures is to setup appropriate limits for various aspects like counter party limit, country limit, currency limit, over night and intraday limits, stop loss limit, individual and group exposure limits etc.
- Inbuilt checking and balancing systems, such as input and output controls, access control to the computer systems, and sensitive areas of the banks
- Apart from review by the ALCO members, a periodical review and evaluation system should be in place

16.2.1 RISK Management process:

Risk Management is a methodology that helps managers makes best use of their available resources. The process consists of important steps like:

- ***Identification of risks:*** Identify the types of risks are associated with the banking business and operations. Define the types of risk, with special reference to the goals and objectives of the organization. Based on the past experience and future forecasts, risks can be identified and classified in to different levels like High, Medium and Low levels
- ***Analyzing the risks:*** Risks arise out of many factors like, PESTEL factors, Micro and Macroeconomic policies, ineffective internal control systems, speculation etc., Risks can be identified by means of using various analysis like financial, technical, trend and sensitivity analysis based on probability, trend , etc.,
- ***Evaluating the risks:*** The risk may be evaluated by following the Regulators guidelines and directives and also based on past experiences as well. At the time of evaluation, proper weight ages needs to be assigned for different types of risks as per banks' risk management policies, such as, risk category, cost associated in managing such risks and also the impact of such risks.
- ***Monitor and review:*** Monitoring and review process is an important segment in risk management. An effective monitoring system would assist bank management to identify

or forecast risks to enable it to strengthen risk management with more controls to manage the risks which might arise from their business models and their exposure to various markets, across borders. In identifying, prioritizing and treating risks, organizations make assumptions and decisions based on situations that are subject to change, (e.g., the business environment, trading patterns or government policies).

- ***Mitigation of risks:*** One of the main objectives of the Risk Management is to ensure that risks are either avoided or minimized. While it is agreed that not all risks.

16.2.2 Risk Management under BASEL Norms :

- BASEL I

The Basel Committee on Banking Supervision (BCBS) is a committee which was set up by the Central Bank Governors of a group of ten countries, to address international issues relating to the banking supervision. The Basel Committee on Banking Supervision in 1988 came out with a Capital Accord for banks, covering the areas of risks in respect of banks' assets and liabilities in the balance sheet and off balance sheet exposures. Under the Basel I Accord, only the credit risk factor was considered and the minimum requirement of capital funds was fixed at 8 per cent of the total risk weighted assets. In India, banks are required to maintain a minimum of 9 percent (Capital to Risk Weighted Asset Ratio – CRAR) on an ongoing basis.

- BASEL II

The Second Accord brought in significant changes in risk management in banks. The Basel II accord introduced a new approach based on the three pillars:

Pillar I: Minimum Capital Requirements: The minimum capital requirement should be calculated based on three risks viz.,
(a) Credit Risk – (i) Standardized Approach (ii) Internal Ratings Based Approach
(b) Operational Risk and
(c) Market Risk

Pillar II: Supervisory Review Process

This pillar addresses the issues like the key aspects of supervisory review, risk management guidance and transparency and accountability. It also covers the treatment of interest rate risk in the banking book, credit risk (stress testing, credit concentration risk etc) operational risk, enhanced cross border risks. The committee had identified four key principles of supervisory review:

- Banks should have in place a process for assessing their overall capital adequacy in respect of their risk profile vs. maintenance of capital level
- Supervisors should play a key role in reviewing and evaluating banks' internal capital adequacy assessments and strategies. Supervisors should also be satisfied with the banks' abilities in managing the capital adequacy ratios and comply with the regulators' guidelines. If not satisfied with the performance of banks in their compliance requirements, the supervisors should take appropriate
- Supervisors should ensure that banks maintain and operate above the minimum regulatory capital ratios
- Supervisors should intervene at an early stage, to prevent capital level from falling below the minimum levels required and take quick remedial measures

Pillar III – Market Discipline :

As part of an effective risk management, banks are expected to disclose important information. Such market discipline can contribute to a safe and sound banking environment. These disclosures would assist various stakeholders to review and understand the status of the

banks' operations and strategies in a competitive business environment. These disclosures would assist the investors to make their investment decisions

❖ **BASEL III**

As per Basel Committee on Banking Supervision (BCBS), Basel III reforms have been introduced to improve the banking sector's ability to absorb shocks arising from financial and economic stress, thus reducing the risk spillover from the financial sector to the real economy.

Basel III norms address the following:

- At micro level, through prudential regulation to strengthen the individual banking institution's ability to handle crisis in the period of stress
- At macro level, through prudential regulation to address system wide risks across banking sector as well as the pro-cyclical amplification of these risks over a period of time
- Raising the quality and level of capital to ensure that the banks are better equipped to absorb losses on both, a going concern basis and a gone concern basis
- Increase the level of risk coverage of the capital framework by introducing leverage ratio to serve as a backdrop to the risk-based capital
- Raise the standards for supervisory review (Pillar 2) and public disclosures(Pillar
- The capital buffers- capital conservation buffer and the countercyclical buffer- are expected to protect the banking sector from the periods of excess credit growth.

16.3 TYPES OF RISK MANAGEMENT :

Credit Risk Management: Credit risk arises when one of the counter parties fails to fulfil the obligation to settle the payment or repay the borrowed amount. It is also called as default risk and/or settlement risk. The identification of credit risk is to close monitoring of operations in operating loan account like working capital finance, cash credit and overdraft accounts would assist the bank to identify the risk based on the signals and warnings from the manner in which the account is being operated.

Also non submission of stock statements, wrong information provided in stock statements, regular inspections of stocks, and review of market reports are essential tools to identify the credit risk. Credit Risk can be mitigated if the banks follow certain norms like, Adherence to KYC and Credit Appraisal

BASEL-II provides two options for measurement of capital charge for credit risk

- ❖ ***Standardized Approach (SA):*** Under the SA, the banks use a risk-weighting schedule for measuring the credit risk of its assets and off-balance sheet positions. A risk weight of 100% indicates that an exposure is included in calculation of assets for full value, by assigning risk weights based on the rating assigned by the external credit rating agencies.
- ❖ ***Internal Rating Based Approach (IRB):*** The IRB approach, on the other hand, allows banks to use their own internal ratings of counterparties and exposures, which permit a finer differentiation of risk for various exposures and hence delivers capital requirements that are better aligned to the degree of risks.

Liquidity Risk: As explained earlier, one of the important risks faced by banks is the liquidity risk. The banks' treasury handles the liquidity management through money market and forex market operations; hence a careful strategy needs to be in place for market related activities.

Review of asset and liability mismatch is one of the eye openers. There should be close control on the utilization of short term funds for long term assets and vice versa, that would lead to maturity mismatches. An effective credit monitoring and operations of the

banks can reduce the impact of the liquidity risk. A good internal control review and online monitoring system, identification of weakness in the systems and procedure etc, would also assist the bank to manage the inflow and outflow of funds effectively. Internal limits for cash management including foreign funds and an effective reconciliation of nostro accounts are some of the measures to reduce the impact of the liquidity risk.

The role of the treasury in managing the liquidity position is very important. The treasury should closely watch the market movements and accordingly handle the situations. To effectively monitor the risk, banks should set up limits for currency, country and adhere to investment exposure norms as well. A close watch on the macro level factors at different markets and ensuring necessary control measures of revising exposure limits and other aspects would also assist to manage the liquidity risk. Review and understanding the various features of the monetary policy and quarterly review by the Central Bank (Reserve Bank of India) and appropriately adjust the strategies would assist the banks in effectively managing the liquidity position.

Market Risk: In a sense, the market risk arises on account of the external factors, i.e., market forces of demand and supply factors. Market risk arises from the adverse movements in market price. Market risk can also be defined as the risk of losses on account of on-balance sheet and off-balance sheet positions due to the movements in market prices. The market risk can be broadly recognized as:

- **Interest Rate Risk:** One of the important factors that affect the bottom line of any bank is the volatile movement of. Interest rate. . The interest rates of deposits/loans are basically determined by the market forces (i.e., demand and supply for/ of funds). These are influenced by various factors like, Government Policies, Speculation, Inflow and outflow of funds, present and future commitments and other factors such as opportunities to invest in other markets etc.
- **Foreign Exchange Rate Risk:** The price movement in terms of foreign exchange transactions (deals) is called the exchange rate risk. The exchange rate movement is mainly felt in case of the floating exchange rate system (price/exchange rate is decided by the demand and supply factors). As the markets are wide spread and the exchange rate movement is so quick and moves either way (up and down), it is difficult to assess the market movements when it is very volatile. The volatility in the exchange rates movement are due to various factors such as the Government and Regulators' policies, speculation, forecasting, markets operating in different time zones almost on 24 x7 basis etc.

IV Operational Risk: In banks, the risks which arise out of the failure in internal systems and procedures, internal control system and/or human and system errors, and other internal/ external factors like non compliance of regulatory and legal frame work, frauds, misappropriation etc., one or more of the above mentioned risks are collectively called as the "Operational Risk".

- ***Information Technology Risk:*** Banks in India are well supported by the Information Technology to carry out their banking business and operations. This has increased the banks' operational risk. The risks associated with IT are Error Risk, Fraud Risk, Interruption Risk etc., In case of weak IT controls and non adherence to the laid down policies and procedures, the computerize systems could be exposed to unauthorized access. Pre acceptance tests if not properly carried out can lead to issues which can be termed as operational risk on account of IT. If the computerized control (both around the computer system and through the computer system) is not properly ensured, it can lead to a situation of fraudulent activities. Failure on the part of the management to ensure regular testing of disaster management control, in case of emergency, might

increase the risks. Hence importance should be given and care should also be exercised by having a proper operational risk management with special reference to the Information Technology.

- **Legal Risk:** With the changing economic scenario, banks are not only exposed to risks associated with the domestic markets, but also to international markets as well. More and more banking activities across borders, banks have to comply with more than one regulatory authority and also a number of legal frame work of international importance. The cross border or country specific legal requirements needs to be properly interpreted and understood and applied in the case of international trade and finance. The money laundering has become an important international issue; banks have to be careful in its operations. Banks should appoint international legal firms to handle their legal compliance to avoid legal risks.

16.4 OUTSOURCING E-BANKING :

The bank should embrace and accept outsourcing banking-related services as a strategic extension to their business for managing the core processes. They should choose high-end, organized service partners over low-cost ones, which is a great suggestion. It will undoubtedly help banks gain a long-term competitive edge. The most noticeable thing about the banking industry is its typical procedural way of working. It can be a significant bottleneck to developing the necessary changes, especially when adopting new technologies or services. Therefore, outsourcing provides an opportunity to outsource to access the skills and expertise needed for technological advancement.

Outsourcing banking-related services can bring more sustainability, agility, and value addition to banks. For example, banks can outsource processes such as customer service, data entry operations, and entire business functions such as risk management and IT support. It will help them manage these core functions more effectively and efficiently with better control over cost and timelines without compromising on quality.

'Outsourcing' is defined as the NBFC’s use of a third party (either an affiliated entity within a corporate group or an entity that is external to the corporate group) to perform activities on a continuing basis that would normally be undertaken by the NBFC itself, now or in the future. Outsourcing is a cost-effective option when business needs to scale up market share, staffing, and production rapidly. There are many advantages of outsourcing, and, if done correctly, it will help maximize the performance of staff by making them more efficient and allowing them to focus on their core responsibilities.

16.4.1 Reasons for Choosing to Outsource :

Outsourcing is a concept people get fired up about. Some people love it; others hate it. It seems as though nothing divides a room full of business professionals faster than the idea of sending some services out of house.

Outsourcing is the practice of using outside firms to handle work normally performed within accompanies and is a familiar concept to many entrepreneurs. Small companies routinely outsource their payroll processing, accounting, distribution, and many other important functions often because they have no other choice. Many large companies turn to outsourcing to cut their costs. In response, entire industries have evolved to serve companies’ outsourcing needs. But not many businesses thoroughly understand the benefits of outsourcing. The reason so many businesses are choosing to outsource:

- **Lower Operating Costs:** Operating costs are especially low when just pay for the services need. Unlike with an employee, there’s no need to pay neither for a set number of hours (even when there’s no work to do) nor for things like benefits or equipment.

- **Reduce the Pressure on Team:** By lowering the demands on team, free up time to focus on core business activities. As a result, it has complete tasks faster.
- **Save on Office Space:** Through outsourcing, may be able to rent a smaller office or may never even need to rent an office at all. It's often possible for and employees to work remotely if have outsourcing.
- **Receive Skills Lack in House:** By outsourcing, it can gain expertise and skills that none of employees possess. There's no need to spend time trying to learn new skills in house.
- **Access Talent from Anywhere in the World:** It was not restricted to professionals in local area with outsourcing can even contract the best in the industry (provided can afford them, of course). Alternatively, it can find talent in a country where living costs are lower and workers charge less.
- **Customer Can Decide to Work with Someone Else at Any Time:** Turnover is simple if decided rather work with a different professional or firm. When start working with a provider, can often choose from various types of outsourcing contracts, including project-based and fixed-term contracts that last only a short amount of time. This means it can just decide not to renew the contract once it's over and quickly find someone else to take over.
- **Access to Technology:** Receive tools and software need without paying for subscriptions. The professionals outsource will also know how to use the tech without any training. Plus, if they ever do need training, can expect the provider to take care of it.

16.4.2 Importance of Outsourcing :

The inability to engage in face-to-face discussions, brainstorm, or explore nuances of obstacles could cripple a project's flow. Distance, too, can increase the likelihood of outages disabling the communication infrastructure between the vendor and the outsourcing firm. Depending on where the outsourced work is performed, there can be critical cultural or language-related differences between the outsourcing company and the vendor. Such differences can have important customer implications. For example, if customer call centers are outsourced, the manner in which an agent answers, interprets, and reacts to customer telephone calls (especially complaints) may be affected by local culture and language.

- **Cost effective:** Cost-cutting may not be the only reason to outsource, but it's certainly a major factor. Many businesses embrace outsourcing as a way to realize cost savings or better cost control over the outsourced function. Outsourcing converts fixed costs into variable costs, releases capital for investment elsewhere in business, and allows avoiding large expenditures in the early stages of business. The most important benefit is that outsourcing of work allows one to get the work done at a very low cost and in a much more efficient way. There is a vast difference in the wage patterns of the western developed countries and the developing companies. The kind of work which is done in the west for a very high price can be obtained at a much cheaper rate in the developing countries and the difference varies to up to 60%. Offshore outsourcing allows the organization to obtain high quality services at a low operational cost.
- **Increased efficiency:** Companies that do everything themselves have much higher research, development, sales & marketing, and distribution expenses, all of which must be passed on to customers. Outsourcing the business functions and working with an outside provider's cost structure and economy of scale can give firm an important competitive advantage.

- **Focus:** Every business has limited resources, and every manager has limited time and attention. Outsourcing can free the entrepreneur from tedious and time-consuming tasks, such as payroll, so that he or she can concentrate on the marketing and sales activities that are most essential to the firm's long-term growth and prosperity. Outsourcing can help business to shift its focus from peripheral activities towards work that serves the customer, and it can help managers set their priorities more clearly.
- **Growth:** While growth is usually a good thing, a business can experience growing pains. A good outsourcing firm has the resources to start a project right away. Handling the same project in-house might involve taking weeks or months to hire the right people, train them, and provide the support they need. And if a project requires major capital investments (such as building a series of distribution centers), the start-up process can be even more difficult. Teaming up with a third-party provider is the best thing can do.
- **Reduced risks:** Every business and business investment carries a certain amount of risk. Markets, competition, financial conditions, government regulations and technologies all change very quickly. Outsourcing the business functions to the right providers, assume and manage this risk for and they generally are much better at deciding how to avoid risk in their areas of expertise.
- **Access to technology:** Some experts tout outsourcing of computer programming and other information technology functions as a way to gain access to new technology and outside expertise. Infrastructure cost is another major concern when it comes to in-house services. Companies that outsource HR might choose to do so because implementing a new payroll system is expensive. A firm that sends customer service out of house might be looking at the total cost of implementing the technology needed to run the most up-to-date contact center and provide customers with the best service possible. The third-party provider has already invested in the technology needed to deliver the services seek and reps are already trained to use it.
- **Loss of Control:** Managers often complain about loss of control over their own process technologies and quality standards when specific processes or services are outsourced. The consequences can be severe. When tasks previously performed by company personnel are given to outsiders, over whom the firm has little or no control, quality may suffer, production schedules may be disrupted, or contractual disagreements may develop. If outsourcing contracts inappropriately or incorrectly detail work specifications, outsourcers may be tempted to behave opportunistically for example, by using subcontractors or by charging unforeseen or unwarranted price increases to exploit the company's dependency. Control issues can also be exacerbated by geographic distance, particularly when the vendor is offshore. Monitoring performance and productivity can be challenging, and coordination and communication maybe difficult with offshore vendors.
- **Loss of Innovation:** Companies pursuing innovation strategies recognize the need to recruit and hire highly qualified individuals, provide them with a long-term focus and minimal control, and appraise their performance for positive long-run impact. When certain support services such as IT, software development, or materials management are outsourced, innovation may be impaired. Moreover, when external providers are hired for the purposes of cutting costs, gaining labor pool flexibility, or adjusting to market fluctuations, long-standing cooperative work patterns are interrupted, which may adversely affect the company's corporate culture.
- **Loss of Organizational Trust:** For many firms, a significant no quantifiable risk occurs because outsourcing, especially of services, can be perceived as a breach in the

employer-employee relationship. Employees may wonder which group or what function will be the next to be outsourced. Workers displaced into an outsourced organization often feel conflicted as to who their "real" boss is: the new external service contractor or the client company by which they were previously employed?

- **Higher-Than-Expected Transaction Costs:** Some outsourcing costs and benefits are easily identified and quantified because they are captured by the accounting system. Other costs and benefits are decision-relevant but not part of the accounting system. Such factors cannot be ignored simply because they are difficult to obtain or because they require the use of estimates. One of the most important and least understood considerations in the make-or-buy decision is the cost of outsourcing risk.

16.4.3 Stages of Outsourcing Process :

Since outsourcing is work done for a company by people other than the company's fulltime employees, every outsourcing program, regardless of the organization's size, will move through these seven stages of outsourcing process:

We'll now take a quick look at what each of these stages entails.

- **Stage One-Assessing Business Needs and Deciding Sourcing Strategy:** This is the most crucial stage in the process largely because an inaccurate assessment of the business' core needs will lead to inaccurate solutions. To accurately diagnose the organization's needs, leaders must take a holistic view of the organization and of outsourcing's potential role in it. Failing to do this can have unforeseen consequences down the line, with the worst possible scenario being choosing the wrong partner or contractual structure to implement the needed change.

After accurate diagnosis, management must take the time to strategize on how it intends to meet the need in a cost efficient and highly effective manner. The decision will fall into either of two categories: to in-source or outsource it. If after careful consideration, the decision is to outsource the solution, the next step is to conduct a benefit-risk analysis. This simply means to outline the benefits and risks of outsourcing and assess whether the benefits outweigh the risks. After the benefit-risk analysis, if the decision still stands to outsource the work, then stage two kicks in immediately.

- **Stage Two-Defining the Scope of the Outsourcing Transaction:** For some organizations, it is easy to define the general functions within the business process that will be outsourced.
- **Stage Three-Selection of a Vendor:** Once the scope of work has been properly defined, the next step is identifying the potential vendor or vendors that have the resources, capabilities, and requisite experience to provide the desired services. Vendor selection can be a very complicated and emotional undertaking. The main challenge is to ensure a vendor is chosen that delivers quality services at a reasonable price point, one that reduces risks, and one that can trust. Choosing the right vendor is much like choosing a good partner; the chances are that if make the right decision from the onset will have a potentially lasting relationship while choosing the wrong vendor could damage and thwart a well-intentioned outsourcing project. Therefore, after a list of potential vendors have been drawn, conducting due diligence on the targeted vendors is key to selecting the best fit for organization.
- **Stage Four-Negotiation and Contract Procurement :** Once proposals are received from the vendors, the outsourcing team within organization will need to take some time to review each one and evaluate which vendor or vendors are best suited to provide the desired services. To facilitate the evaluation process, it is helpful to prepare a list of key criteria on which to judge the vendors and their proposals. Once organization has

selected the preferred vendor or vendors, final negotiations may then begin, and the contract drawn.

- **Stage Five-Project Initiation and Transitioning:** After the contract is signed, the two companies will begin transitioning resources and responsibilities from the business to the service provider. This represents the official launch of the project, and the focus of this stage is to transition work, decision rights and knowledge to the vendor organization, so that it can conduct the work effectively and, for the most part, independently from organization.

At this stage we put in considerable effort to ensure that our clients understand the uniqueness of this phase and not get too excited, instead we help them focus their energies on getting the working relationship in order. We also encourage them to be accommodating and flexible rather than rigid. The salient activities at this stage include continuous evaluation of the relationship, problem resolution, communications management, knowledge management and process management. Even in the best outsourcing deals, things are bound to get a bit rough during the initial phase. But experience has shown us that a little healthy friction at the start of the relationship is a good thing, as it means that both parties care enough about the business relationship to do their part in making it work. Think of it this way: when two individuals sign a contract to rent an apartment, this does not mean that the first few days will be frictionless.

- **Stage Six: Managing the Service Delivery :** This stage is typically the longest because it involves maintaining a working relationship throughout the contract. Relationship management includes the continuous monitoring of the outsourcing engagement to ensure that expected levels of operation are being met, and also conducting routine audits on the processes.
- **Stage Seven: End of the Contract / Transfer :** Although it has been experience that once mutual trust is established, outsourcing relationships last for years at a time; Nevertheless, the purpose of an Exit Management Plan (EMP) is to agree on a set of procedures which is fair to both sides, and the best time to do this is at the drafting of the contract, the time when the relationship is healthy.

In the final analysis, only two factors will contribute to the success of outsourcing **event:** The first is the quality of vendor chooses. And the second is the commitment of organization to do the work that it takes to get the results that desire.

16.4.4 Benefits of Outsourcing :

- **Reduce labor costs:** The single most significant cost for most businesses is labor. Salaries are constantly increasing, and the weekly paycheck doesn't include the cost of total compensation, such as training, health care, travel, and other perks. Infrastructure, technology, and equipment costs can also impact in bottom line. However, outsourcing can significantly reduce or eliminate many of these expenses. Contractors don't require a desk or office space; they generally do not receive additional employee benefits. It's also easier to onboard them as they are typically specialists hired for specific roles or purposes.
- **Improve team efficiency through outside expertise:** Turning to an independent contractor allows hiring someone with many years of experience. They will bring expertise to and may even improve business functions while introducing new initiatives. That way, banking won't have to break in a rookie or develop a new division within, which takes time and money. The experts will help bank be more efficient out of the gate, boosting productivity and efficiency.

- **Grow on a budget:** Outsourcing can help entrepreneurs grow their businesses without breaking their budgets. Take public relations, for example. Some companies, especially small and medium-sized businesses, do not need a full-time PR or communications department. However, they still need these professionals to help run social media campaigns or handle news media requests on a one-off basis. Outsourcing to a cost-effective firm that specializes in public relations might make more sense than building in-house PR team from scratch. It can apply this strategy to human resources, bookkeeping, legal, or other departments that become more important as business grows.
- **Focus on what's important:** As an entrepreneur, customer has a goal and vision for company. Customer an expert in the product built or the service developed. So focus should be on doing whatever it takes to grow the business rather than administrative tasks. Outsourcing services allows to keep focus on the core business. By contracting out time-consuming non-core areas of the company, like IT or administration, can concentrate on more meaningful work that will significantly impact business operations.
- **Access to global talent:** It's a competitive market for skilled labor as companies crank up their recruiting efforts to fill workforce shortages. Both startups and established businesses are struggling with this challenge. Scaling up right now is incredibly difficult, and outsourcing can play a critical role in filling this void, particularly in the short term. Instead of recruiting candidates to relocate to, can tap into companies and freelancers worldwide that specialize in the skills require. Even if customer eventual goal is to have a complete in-house team, outsourcing can help get there quicker by helping save until can make more permanent hires. Read about differences between in house and outsourcing.
- **International expansion:** In some cases, outsourcing can help expand company's reach overseas or into neighboring countries. Taking advantage of a remote and global workforce makes gaining access to new markets more accessible and less expensive, especially if can bypass many infrastructural challenges needed to set up a physical location. By outsourcing, customer can avoid the cost of relocation packages for employees and other expenses, like equipment and rent, when setting up a new office.
- **24-hour production:** A global talent pool means can overcome the eight-hour workday. A traditional work environment often runs only from 9-5 in time zone. By outsourcing tasks and with proper planning, there is no reason production, IT, or customer support has to shut down. By hiring freelancers in other time zones, customers have the opportunity to create a 24-hour production cycle. This means managers can have completed work waiting for them in their inbox when they start the day, and get projects back to clients faster than ever before.
- **Increase productivity:** When team gets slammed, outsourcing can be a lifeline. Some businesses go through predictable busy seasons, and other times they cannot expand their permanent workforce fast enough to keep pace with demand. Outsourcing can help employees stay on task when their workloads increase. There are contractors or freelancers to handle just about every type of work. They can be brought on to pick up responsibilities outside the core scope of work. For example, suppose business is ramping up for a social media campaign. In that case, customer can outsource this work rather than adding it to the plate of an already-busy communications team. This setup allows professionals to focus on their best work. Especially in anticipated demand surges, going outside the company can help cut human resources and benefits administration costs while reducing reliance on full-time transient team members.

- **Gain a competitive edge:** Outsourcing can help small businesses punch above their competitive weight. Companies can maintain a smaller core of employees while accessing resources around the country (or around the globe) that allow them to tap into a higher level of experienced talent or offer more services at a better price than their competitors. When profit margins are tight, providing better customer service or quicker turnarounds on projects can make a huge difference in client retention or attracting new work.
- **Third-party contractors are motivated:** Outside contractors are motivated to keep happy. All employees should be motivated but third-party providers have no security beyond the project they have been hired for or the end of the contract. If they do sub-par work, they'll lose out on potential client referrals and testimonials. So it's in their best interest to perform at their best.
- **Internal staff development:** On-site outsourcing can pay dividends beyond just getting a project completed. When bring in outside experts, it's an opportunity for core staff to pick up new skills and perspectives just by working alongside more experienced hires. Outsourcing is beneficial if have a younger or developing team.

16.4.5 Types of Outsourcing :

- **Professional Outsourcing:** The category of professional outsourcing encompasses all specialized services, including accounting, purchasing, administration, legal, CAD, digital marketing, and anything else that's too complex for team. Many of the services included under the umbrella of professional outsourcing require a license or several years of training. With professional outsourcing, customer can access a wide range of services, paying just for those needs. This is excellent for scaling business as well as for receiving one-off services. For instance, it may need legal support just when setting up business. If have already established a business, the likelihood is business outsourcing at least some professional services. Customer may not even think of it as outsourcing because these services are essential.
- **Multi-Sourcing:** Another way to combine the services outsource is through multi-sourcing. Typically, multi-sourcing provides with a mix of IT and other business functions. It's usually more suitable for large companies that want to outsource a variety of IT operations and infrastructure to different vendors. However, multi-sourcing is also a good option for any business that wants access to top specialists, is looking for an outcome-based approach, and wants transparency around its IT projects. Bear in mind, though, that need to have to have a strategy in place before get started with multi-sourcing. For instance, need to know what metrics matter to business and will need to have a system of governance.
- **IT Outsourcing:** It's also possible to contract a provider just for IT. If customers have specific IT needs or for are a small business, this could be a better option. Even startups need some IT support to maintain security, keep licenses up to date, and manage their networks, and this is an affordable way to receive those services. With IT outsourcing, can receive support with anything from infrastructure to app development.
- **Process-Specific Outsourcing:** With process-specific outsourcing, contract a provider for a specialist service. It can even be something quite niche. There are three types of process-specific outsourcing. The first is knowledge process outsourcing (KPO). This is for improving products and services through research and data analysis. The second is legal process outsourcing (LPO), which can cover regulatory compliance, litigation, and other legal needs. Finally, there's recruitment process

outsourcing (RPO), covering everything related to recruitment. It can receive support for job postings, short listing applications, and evaluating candidates.

- **Business Process Outsourcing:** One of the most common types of outsourcing is business process outsourcing (BPO). Customer can use BPO to handle more mundane business activities, such as administration, correspondence, and scheduling**.** Can also receive customer service and lead generation through BPO.
- **Manufacturing Outsourcing:** Manufacturing products in house can be out of reach for small businesses, particularly when demand starts to increase. In fact, outsourcing is often the only way to compete with large companies that have more resources, can afford to hire large teams, and have the funds to upgrade equipment on a regular basis. Besides, even large corporations like Apple outsource manufacturing to reduce the costs of paying for a factory, workers, equipment, infrastructure, and raw materials. As product life cycles in many industries continue to shrink, manufacturing outsourcing is becoming a necessity for companies of all sizes. The good news is, since manufacturing outsourcing is so widespread, it's easy to find a specialist in industry. This is important for speeding up production times while retaining high quality.
- **Project Outsourcing:** It's possible to outsource all aspects or even just a portion of a project to a provider. This is a common strategy when a business lacks the time, skills, or funds to complete a project. Some types of project outsourcing include website redesign, creation of a large piece of content and marketing campaigns.
- **Operational Outsourcing:** Operational outsourcing is particularly common in the manufacturing industry, as it covers services like equipment repairs. However, service-based companies can also benefit from operational outsourcing for tasks like landscaping and delivery.
- **Local Outsourcing:** Contracting a provider within country is called local outsourcing or onshore outsourcing. A benefit of this option is that speak the same language, have the same cultural background, and are in a similar (if not the same) time zone. It is also much easier to meet in person on occasion. A major disadvantage of local outsourcing is that have likely spend more than outsourcing to another country. This is true for companies based in the U.S., Canada, and most of Western Europe. Plus, customer cannot assume that, just because the provider charges more, the quality will be higher**.**
- **Offshore Outsourcing:** Another option is offshore outsourcing. These types of contracts mean working with a provider some distance away. It's often the best way to save on labor and material costs. In addition, offshore outsourcing can enable to access a specific skill set that is better in a particular country than anywhere else in the world. Finally, may be able to avoid regulations imposed in home country. The problem with offshore outsourcing is a lack of reliability, particularly when choose a budget provider. This is avoidable by reading reviews of the provider before agreeing to a contract. However, may find that end up paying more for the services than the low rates initially saw. Distance can also be a big issue. For instance, it may take a long time to communicate with the provider: if customers send a message after early morning, the work day where provider lives will be long over.
- **Near shore Outsourcing:** Somewhere in the middle of local outsourcing and offshore outsourcing is near shore outsourcing. This involves contracting to a provider who is out of the country but still nearby. If the U.S., near shore outsourcing would be to Latin America, whereas offshore outsourcing would likely be to Asia. Near shore outsourcing allows gaining the advantages of both onshore and offshore outsourcing while, at least to an extent, diminishing their disadvantages. For instance, be in a

similar time zone, but benefit from the lower costs of running business in the other country. Plus, there is a lower risk of delays when shipping products. Lastly, near shore outsourcing is useful for entering neighboring markets, which is often the logical next step for businesses.

16.5 PROBLEMS OF OUTSOURCING :

Based on in-depth experience, a list of the problems that might face when outsourcing:

- **Lack of Experience with Outsourcing:** When first start working with someone or at something, it might be overwhelming. Are not familiar with best practices, common concepts, and the workflow. To convey vision to another group of people, especially someone have never worked with before is a difficult task that should not be underestimated.
- **Lack of Expertise with the Outsourced Task:** Another problem with outsourcing is a lack of competence. When customer do not have enough expertise in JavaScript software development or Big Data analytics and delegate these tasks to a third-party service, probably will not be able to assess the results of their work adequately. Without having a clear understanding of the differences in technologies and solutions, customer are at risk of mis-hiring or misjudging.
- **Poor Cost Estimate:** Although we did say that outsourcing will save a good portion of budget, it may go south if not thoroughly planned. And can't estimate costs without establishing precise requirements, timelines, resources, etc. This brings us to one of the most challenging issues with outsourcing – calculating accurate cost estimation.
- **Choosing the Right Vendor:** Among other problems of outsourcing, it might face difficulty looking for a vendor of the right size. A small outsourcing company will leave no room for growth as it will not easily scale up or down. An enterprise-sized outsourcing firm might take a less personal approach and charge too much for project.
- **Lack of Cultural Context:** If have never worked in a culturally diverse and dedicated development team, might not realize it, but the cultural context and the national differences matter. Although diversity is proved to drive innovation and financial results in the long-term, in the beginning, it might lead to miscommunications and misunderstandings. On top of that, since it will be reaching out to the global market, customer might have to get used to working with people from different time zones.
- **Contractual and Legal Processes:** Unlike the in-house hiring process, the outsourcing legal process is not as standardized and depends a lot on the vendor's location. From country to country, might need to sign various additional papers that are not part of location's legal process. The outsourcing issues begin after the contracts have been signed and the work has started small misunderstandings in the agreement might lead to serious outcomes that poison the entire dynamic between and vendor.
- **Poor Knowledge Transfer:** Poor knowledge transfer delves into two outsourcing problems: the first one is from customer perspective; the other is from the vendor's point of view. Might experience a negative outcome when dealing with the project results after the relationship with the vendor has been terminated. If they did not keep clear documentation, might stumble upon some features or scripts unclear to. On the other hand, if the vendor inherits an ongoing project from with no transparent knowledge transfer procedure, they might fail to meet the expectations.

- ❖ **Poor Team Management and Communication:** It might sound like a broken record, but communication is the key to success. It might think that customer are being understood the way to planned, but people come from different backgrounds, educations, and experiences and will have their own perceptions. If customers do not wish to be misinterpreted and agree that an adequate communication level will smooth many rough edges, here are our solutions to outsourcing jobs.
- ❖ **Finding a Trustworthy Vendor:** One of the most common reasons for outsourcing gone wrong is partnering up with an unsuitable agency. We have mentioned several times the importance of tracking a trustworthy vendor. But what does it really mean? How do you tell one from another?
- ❖ **Selecting the Appropriate Outsourcing Approach:** There are three common outsourcing models. Time and material model, Fixed-price contracts and dedicated development teams. Depending on goals, requirements, scope, duration, budget, and other criteria, may choose one of the models.

16.6 GOLDEN RULES TO AVOID PROBLEMS OF OUTSOURCING :

- Keep track of the documentation
- Establish direct communication channels
- Be aware of cultural differences
- Always conduct thorough research before deciding on a vendor
- Clearly define the requirements, duration, and costs of the project
- Make sure to understand the risks and find the company that trust.

16.7 SUMMARY :

In this lesson briefly given the concept related to risk management and outsourcing e-banking. To manage risk effectively, the right information needs to be presented to the right people at the right time. Risk reports based on risk data should be accurate, clear and complete. Risk management reports should communicate information in a clear and concise manner. Risks arise out of many factors like, PESTEL factors, Micro and Macroeconomic policies, ineffective internal control systems, speculation etc., Risks can be identified by means of using various analysis like financial, technical, trend and sensitivity analysis based on probability, trend , etc., BASEL II-The Second Accord brought in significant changes in risk management in banks. The minimum capital requirement should be calculated based on three risks viz., (a) Credit Risk (b) Operational Risk and (c) Market Risk

Outsourcing banking-related services can bring more sustainability, agility, and value addition to banks. For example, banks can outsource processes such as customer service, data entry operations, and entire business functions such as risk management and IT support. It will help them manage these core functions more effectively and efficiently with better control over cost and timelines without compromising on quality. Outsourcing is the practice of using outside firms to handle work normally performed within accompanies and is a familiar concept to many entrepreneurs. Small companies routinely outsource their payroll processing, accounting, distribution, and many other important functions often because they have no other choice. Outsourcing can help entrepreneurs grow their businesses without breaking their budgets. Take public relations, for example. Some companies, especially small and medium-sized businesses, do not need a full-time PR or communications department.

However, they still need these professionals to help run social media campaigns or handle news media requests on a one-off basis. The category of professional outsourcing encompasses all specialized services, including accounting, purchasing, administration, legal,

CAD, digital marketing, and anything else that's too complex for team. Many of the services included under the umbrella of professional outsourcing require a license or several years of training. With professional outsourcing, customer can access a wide range of services, paying just for that need. And the lesson also highlighted the reasons for choosing to outsource and Stages of outsourcing process, benefits of outsourcing and it types. Finally, the lesson concludes to know the problems of outsourcing with taking suitable actions for outsourcing.

16.8 KEY WORDS :

- **Risk management:** To manage risk effectively, the right information needs to be presented to the right people at the right time. Risk reports based on risk data should be accurate, clear and complete.
- **Identification of risks:** Identify the types of risks are associated with the banking business and operations. Define the types of risk, with special reference to the goals and objectives of the organization. Based on the past experience and future forecasts, risks can be identified and classified in to different levels like High, Medium and Low levels.
- **BASEL II:** The Second Accord brought in significant changes in risk management in banks. Minimum Capital Requirements: The minimum capital requirement should be calculated based on three risks viz., (a) Credit Risk (b) Operational Risk and (c) Market Risk
- **Management of Credit risk:** Credit risk arises when one of the counter parties fails to fulfill the obligation to settle the payment or repay the borrowed amount. It is also called as default risk and/or settlement risk. The identification of credit risk is to close monitoring of operations in operating loan account like working capital finance, cash credit and overdraft accounts would assist the bank to identify the risk based on the signals and warnings from the manner in which the account is being operated.
- **Information Technology Risk:** Banks in India are well supported by the Information Technology to carry out their banking business and operations. This has increased the banks' operational risk. The risks associated with IT are Error Risk, Fraud Risk, and Interruption Risk etc.
- **Outsourcing banking:** Outsourcing banking-related services can bring more sustainability, agility, and value addition to banks. For example, banks can outsource processes such as customer service, data entry operations, and entire business functions such as risk management and IT support. It will help them manage these core functions more effectively and efficiently with better control over cost and timelines without compromising on quality.
- **Reduced risks with** Outsourcing**:** Every business and business investment carries a certain amount of risk. Markets, competition, financial conditions, government regulations and technologies all change very quickly. Outsourcing the business functions to the right providers, assume and manage this risk for and they generally are much better at deciding how to avoid risk in their areas of expertise.
- **Multi-Sourcing:** Another way to combine the services outsource is through multi-sourcing. However, multi-sourcing is also a good option for any business that wants access to top specialists, is looking for an outcome-based approach, and wants transparency around its IT projects. Typically, multi-sourcing provides with a mix of IT and other business functions. It's usually more suitable for large companies that want to outsource a variety of IT operations and infrastructure to different vendors.
- **Choosing the Right Vendor:** Among other problems of outsourcing, might face difficulty looking for a vendor of the right size. A small outsourcing company will

leave no room for growth as it will not easily scale up or down. An enterprise-sized outsourcing firm might take a less personal approach and charge too much for project.

16.9 SELF-ASSESSMENT QUESTIONS :

1. Define risk management? What are the importance features of risk management?
2. Elaborate the risk management process?
3. What is risk management in banking? Discuss various types of risk management?
4. Explain the concept of outsourcing in banking management?
5. What is outsourcing? Why banks need to choose outsourcing?
6. Explain the different stages in outsourcing?
7. Discuss the various problems of outsourcing and give suitable it suggestions?

16.10 FURTHER READINGS :

- Principles & Practices of Banking, by Abinash Kumar Mandilwar (Author) Ramesh Publishing House; Third edition (20 June 2022)
- E-Banking by Vasu Deva (Author) Commonwealth Publishers (1 January 2007)
- Information Technology and digital banking by IIBF (Author) Macmillan; First Edition (17 January 2023);
- E Banking ,R. Kumar, M. Deshpande,Pacific Books International
- Security in Electronic Banking, by Indian Institute of Banking and Finance (Author) Macmillan Publishers India Private Limited; Third edition (1 January 2017)

Dr. SADHIK SAYYED

LESSON - 17

LEGAL AND REGULATORY COMPLIANCE

OBJECTIVES :

- To understand the legal and regulatory compliance
- To focus on E-Banking legal compliance
- To explain the role of Compliance Officer

STRUCTURE :

17.1 Concept of legal and regulatory compliance
17.1.1 The Banking Regulation Act (1949)
17.1.2 The Reserve Bank of India (RBI) Act (1934)
17.1.3 Foreign Exchange Management Act (1999)
17.1.4 Information and Technology (IT) Act (2000)
17.1.5 Prevention of Money Laundering Act (2002)
17.1.6 Indian Penal Code (1860)
17.1.7 Other Legislations
17.2 Reserve Bank of India standards on e-banking
17.3 Benefits of good compliance
17.4 Role of Chief Compliance Officer (CCO)
17.5 Banking Compliance Challenges
17.6 Legal Remedies and solutions to E-Banking
17.7 Summary
17.8 Key words
17.9 Self-Assessment Questions
17.10 Further Readings

17.1 CONCEPT OF LEGAL AND REGULATORY COMPLIANCE :

Briefly put, legal compliance is the act of a banking adhering to laws and policies that are pertinent to the sector within which they do business. Those laws can be requirements that a company needs to attain before it can trade or carry out its services, as well as ethical standards it should meet.

A large part of legal compliance is having a robust procedure in place to monitor a banking business continually to ensure that it remains legally compliant. In practice, this means that audits of departments repeatedly take place in addition to the company staying up to date with any changes in the law which impacts them. The basic idea behind legal compliance is to minimize legal risk in addition to minimizing negligence that could cause undue harm to a person or group of people.

Compliance is defined as the act of following laws, rules, regulations, and various codes of conducts including the voluntary ones. Although most of these arise from external requirements, following the organization’s own internal rules, policies, and procedures, acting in accordance with ethical practices is equally important. A strong compliance culture should also ensure adherence to fair practice codes, manage conflicts of interests, and treat customers fairly, with the larger objective of delivering efficient customer service. Thus, compliance shall go beyond what is legally binding and embrace broader standards of integrity and ethical conduct.

Banking regulatory compliance describes the set of standards and practices banking institutions must adopt to remain in compliance with industry regulations and other relevant legislation.

Regulatory compliance in banking applies to a range of industry factors, including:

- Security
- Risk management
- Information processing
- Data reliability
- Ethical conduct

The purpose of regulatory compliance in banking is to prevent deviations or illegalities and address these and other issues within the company's operations. Regulatory compliance in the banking sector is constantly evolving, which is a reflection of the financial industry itself. New technology has emerged within the last several years, and with it has come new processes.

Since the banking industry is considered high risk for criminal activity, compliance measures are critical for protecting not only banking clients but banking organizations themselves. That's why most banks have an entire department dedicated solely to compliance to ensure that each bank operates according to the law and industry regulations.

These departments are responsible for any potential security concerns, such as flagging and freezing accounts at risk of possible fraud. Such actions serve to help avoid or minimize both financial and administrative losses. Compliance departments also work to prevent illicit activities like tax evasion, money laundering, and other actions that are out of compliance with the ethical and legal obligations of the bank. The RBI is the central bank of India and the primary regulatory authority for banking. An entity intending to carry out banking business in India must obtain a license from the RBI. The RBI has wide-ranging powers to regulate the financial sector, including prescribing norms for setting up and licensing banks.

Banking regulation imposes various requirements, restrictions, and guidelines on banks. Although legal requirements differ from country to country, banking regulations pursue similar objectives, such as reducing systemic risk by, for example, creating unfavorable trading conditions for banks or preventing bank fraud.

Bank regulation is the process of setting and enforcing rules for banks and other financial institutions. The main purpose of a bank regulation is to protect consumers, ensure the stability of the financial system, and prevent financial crime. Banking regulations are also designed to promote safe and sound banking practices by ensuring banks have enough capital to cover their risks, preventing them from engaging in unfair or deceptive practices, and ensuring that consumers have access to information about their rights and options. For example, regulations may ban certain types of fees or limit the amount of interest that banks can charge on loans. By promoting competition, bank regulation helps to keep prices low for consumers and spurs innovation in the banking sector.

Furthermore, bank regulators also supervise the activities of banks and enforce compliance with regulations. By doing so, bank regulators help to ensure that banks operate in a safe and sound manner and those consumers are protected from fraud and abuse. Bank regulation is the process by which a government or other institution supervises the activities of banks. Common bank regulations include reserve requirements, which dictate how much money banks must keep on hand; capital requirements, which dictate how much money banks can lend; and liquidity requirements, which dictate how easily banks can convert their assets

into cash. In addition, bank regulators often impose restrictions on bank activities, such as limitations on lending to related parties or investments in certain types of assets.

17.1.1 The Banking Regulation Act (1949) :

The Banking Regulation Act, 1949 controls the banking institutions from their birth to death. If any bank has to start business, it cannot do so unless it has obtained a licence under the provisions of Banking Regulation Act, 1949 and if it has to close down business, the winding of operations will be as per the provisions of the Banking Regulations Act,1949. Even for the day today banking business, the Banking Regulation Act, 1949 lays down defined areas including provisions for penalties in case of violation by the concerned banks. The Banking Regulation Act came into effect on 16 March 1949 and it applies to the whole of India. The act was amended by Banking Laws Amendment Act, 1983, The Banking Public Finance Institutions and Negotiable Instrument Laws Amendment Act, 1988 and the Banking Regulation Amendment Act, 1994. The purpose of enacting the Banking Regulation Act, 1949 was twofold:

1. To consolidate and amend the law related to banking companies.
2. To check the abuse of powers by managers of banks and also to safeguard the interest of depositors and the interest of the country in general.

17.1.2 The Reserve Bank of India (RBI) Act (1934) :

Regulation is a regulation put forth by the Federal Reserve Board that outlines rules and procedures for electronic funds transfers (EFTs) and provides guidelines for issuers of electronic debit cards. The regulation is meant to protect banking customers who use electronic methods to transfer money.

The Reserve Bank of India and the Government of India exercise control over banks from the opening of banks to their winding up by the virtue of powers conferred under the statutes. All the regulatory provisions are not uniformly applicable to all the banks. The applicability of the provisions of the three acts to a bank depends upon its constitution, which is whether it is a statutory corporation, a banking company or a cooperative society. To understand this further, let us first explore the types of banks in India.

The key RBI regulations which are important in connection with the regulation of banks are as follows:

- **Capital Adequacy and Provisioning:** RBI Master Circular dealing with capital adequacy and provisioning requirements, Prudential Guidelines on Capital Adequacy and Market Discipline and New Capital Adequacy Framework (NCAF) on July 1, 2015
- **BASE Norms:** RBI taken amendments to Basel I Framework and a Basel III Capital Regulations in time to time. The Master Circular for BASE Norms Capital Regulations on July 1, 2015
- **Regulations on Private Sector Banks:** RBI directions dealing with ownership of banks being Master Direction to the ownership in Private Sector Banks amended from time to time as, on May 12, 2016.
- **Regulations on foreign Banks** RBI circular dealing with setting up of branches and subsidiaries by foreign banks, being the Scheme for Setting up of WOS by foreign banks in India issued on November 2013, as amended from time to time.
- **Licensing:** RBI circular dealing with setting up of new banks, being the Guidelines for ‘on tap’ Licensing of Universal Banks in the Private Sector as on August, 2016.

- **Small Finance Banks:** RBI circular dealing with setting up of small finance banks, being the Guidelines for Licensing of 'Small Finance Banks' in the Private Sector as on November 27, 2014.
- **Payments Banks:** RBI circular dealing with setting up of payment banks, being the Guidelines for Licensing of 'Payments Banks' as on November 27, 2014.
- **Borrowing and Lending:** RBI circular on external commercial borrowings, being the Master Direction to External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorized Dealers and Persons other than Authorized Dealers as on January , 2016, as amended from time to time (ECB Regulations).
- **RBI restrictions:** In relation to banking operations, there are certain restrictions applicable to end use of the loans and advances provided by banks, including in relation to funding real estate and capital market transactions and speculative transactions, as well as for on-lending to other financial institutions, which use the funds for any of these purposes.

Further, one key requirement for the licensing of banks in India is that each bank has to have adequate exposures to the 'priority sector'. The term 'priority sector' comprises activities which have national importance and have been assigned priority over other sectors for the development of India and includes categories like agriculture, micro, small and medium enterprises, education and housing. By ensuring that one of the most important pillars of the economy, being the banking system, is engaged with the priority sector, the government hopes that the economy itself is moulded in a direction which serves all sections of society.

To reinforce the ability of the lender to deal with distressed assets, the Reserve Bank of India has issued guidelines and norms on distressed asset resolution by lenders. The RBI has issued a notification on "Guidelines on Sale of Stressed Assets by Banks" as a part of the already existing "Framework for Revitalizing Distressed Assets in the Economy". The framework and guideline have been created as a part of the enforcement of and regulations under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). The Insolvency and Bankruptcy Code, 2016 (IBC) seeks to consolidate the existing framework by creating a single law for insolvency and bankruptcy. The bankruptcy code is a one-stop solution for resolving insolvencies which at present is a long drawn process and fails to offer an economically.

17.1.3 Foreign Exchange Management Act (1999) :

The Foreign Exchange Regulation Act (FERA) is legislation that was passed by the Indian Parliament in 1973 and came into effect on January 1, 1974. The Reserve Bank vide its Notification No. FEMA.29/ RB-2000 dated 26th September 2000 has granted general permission to a resident, being a principal debtor to make payment to a person resident outside India, who has met the liability under a guarantee.

The procedure for opening/ holding and maintenance of Exchange Earners' Foreign Currency (EEFC) accounts is given in the Foreign Exchange Management (Foreign Currency Accounts by a Person Resident in India) Regulations, 2000. Regulation (9) of the Regulations indicate the forms of deposits viz. current, saving or term deposits permissible under the EEFC Accounts Scheme and paragraph 1 (1) of Schedule to the Regulations indicate the limits up to which inward remittances could be credited to the EEFC accounts.

The captioned Notification was issued amending the said Regulation (9) and prohibiting opening of EEFC accounts in the form of term deposits. Regulation (7) of the Foreign Exchange Management (Borrowing and Lending in Rupees) Regulations, 2000 enables an authorized dealer to grant loans in India to a non - resident Indian for the borrower's personal or business requirements. Since the loan is to be utilized in India, the amendment is made to proviso (d) of Regulation (7) enabling credit of the loan amount to the Non-Resident Ordinary account of the borrower.

17.1.4 Information and Technology (IT) Act (2000) :

Cyber crime has as of late turned into a snappy term for a gathering of safety issues in cyberspace. Cyber crime alludes to movements of every kind finished with criminal plan in cyberspace or utilizing the vehicle of internet. These could be either the crimes in the traditional faculties or exercises, recently advanced with the development of the new medium. Any movement, which essentially insults human sensibilities, can be remembered f0r the ambit of cybercrimes. There are huge issues to be tended to in bringing out online transactions through E-Banking like, Security Issues, Phishing, Pharming, Hacking, Identity Theft, Spooing, Password Cracker and Cookies ect.,

Banks Cyber security for E-Banking is:

- ❖ **Application security:** Apparatuses and methods to protect applications after deployment by observing, resolving, and enhancing applications' security with antivirus projects, firewalls, and encryption
- ❖ **Infrastructure security:** Answers for pr0tect the corporate infrastructure, for example, network correspondences, server ranches, IT stages, and connected devices
- ❖ **Information security:** Apparatuses to protect confidential, private, and sensitive information or informati0n from misuse, unauthorized access, disclosure, damage, adjustment, and disturbance.
- ❖ **Cloud security:** Apparatuses include security procedures and technology to secure distributed registering envir0nments against both external and internal cyber attacks.
- ❖ **Identity and access management security:** An architecture or security policies enforced to define and manage the roles and access privileges of individual network users, and protect essential and sensitive information.
- ❖ **Regulatory center:** Agreeing with the RBI guidelines on the cyber security framework that focuses on three areas: Cyber security and resilience, Cyber security operations Center (C-SoC), Cyber security Incident Reporting (CSIR)
- ❖ **End-user education:** Involves educating employees and outsider services on the importance of protecting sensitive information and security measures to keep away from cyber assault.

The Provisions of the Act, widely deals regarding the Management in offering of E-Banking Services by the Bank Channels along-with dealing to specific provisions for curbing the E-Banking Frauds and other ancillary Cyber Crimes.

- ❖**The Section 3(2):** it provides specific provisions for a particular technology as a means of authenticating the records, like the Servers of Banks and other virtual platforms by virtue of which the Banks provide us the E-Banking Services.
- ❖**The Section 4:** the act says regarding the security and privacy of a customer's information that any matter which shall be in writing or in a type-written form/printed form, then notwithstanding anything contained in such law, such requirement shall be deemed to have been satisfied as true, if such information is

rendered and certified in an electric form and is accessible so as to be usable for the subsequent references.

❖ **The Section 72 and Section 79:** it provides the liability for Breach of Privacy of the Customers on the Service Providing Agency or the Intermediary which is responsible for providing the Data Service travelling through their servers on certain terms and conditions.

17.1.5 Prevention of Money Laundering Act (2002) :

India has passed the Prevention of Money Laundering Act, 2002 (15 0f 2003) and the RBI, SEBI and IRDA art brought under the Act and thus all the financial institutions, banks, mutual funds, insurance companies and their financial intermediaries are also covered by it. The Act has since been amended in 2005, 2009 and 2012.

- ❖ The offence of money laundering: Anyone who, directly or indirectly, is a party or is involved in any activity related t0 the proceeds of crime, including its concealment, possession, acquisition, use, and projection as untainted property, is said to commit the offence of "money laundering.
- ❖ Guilty of money laundering: S. 3 as amended in 2012, anyone found guilty of money laundering will face rigorous imprisonment for up to three years, which can be extended to seven years, as well as a fine.
- ❖ Extend of punishment: But if the proceeds of crime relate to para 2 of Part A 0f the Schedule, then the punishment may extend up to seven years. [S. 4]
- ❖ Proceeds of crime: The term "proceeds of crime" means any property obtained or derived as a result of any criminal activity of any scheduled crime [S. 2(u)].
- ❖ Scheduled crime: The term "scheduled crime" is understood to mean crimes which are listed under Part A and Part B 0f the Schedule to the Act. Part C has been added to the original Act by the Prevention of Money Laundering Amendment Act, 2009 which includes the phrase offences having "cross-border implications."

17.1.6 Indian Penal Code (1860) :

As in E-baking infractions the topic is fundamentally money, thus, certain offenses under the Penal Code given in Section XVII 0f the said Act can likewise be applied where the infringer commits specific offenses gave in that in Internet banking. Hence, the accompanying segments are material in such a circumstance:

- ❖ Theft.
- ❖ Extortion.
- ❖ Criminal misappropriation of property.
- ❖ Criminal breach of trust.
- ❖ False electronic record
- ❖ Cheating etc.

The main provisions relating to dealing with the E-Banking Frauds in India are as follows:

- **Punishment of Extortion (Section 383):** Whosoever intentionally and illegally puts a person in fear to deliver any property or valuables to him, otherwise he will defame that person by posting some defamatory statement or Article against the said person shall be punished with imprisonment which may extend to three years, or fine, or both.
- **Punishment of Theft (Section 379):** Whosoever dishonestly take away the goods or any electronic record illegally from the possession of it's rightful owner

without his express consent shall be punished with imprisonment which may extend to three years or with fine or both.

- **Punishment of Criminal Breach of Trust (Section 406):** Whosoever misappropriates any movable property like computer device or any electronic device which was entrusted to him for a lawful purpose, causing wrongful damages to its owner shall be punished with imprisonment which may extend to three years or with fine or both.
- **Punishment of Cheating (Section 417):** Whosoever impersonates some other person whom he is not or knowingly substitutes such person, and causes wrongful losses to the innocent victim shall be punished with imprisonment which may extend to one year, or fine or both
- **Using as genuine a forged document or electronic record(Section 471):** Whosoever fraudulently or dishonestly uses as genuine any document or electronic record which he knows to be forged shall be punished with an imprisonment which may extend to two years or fine, or with both.
- **Punishment of Defamation (Section 500):** Whosoever knowingly publishes without any justification or reasonable cause any statement, image or document on social platforms, believing and knowing it to be false against any person, firm, company were such imputation will definitely lower the image and intellect of him in front of the general public, shall be punished with simple imprisonment which may extend to two years or fine or with both.
- **Punishment of Criminal Intimidation(Section 506):** Where a person's threatens other person to harm his reputation, life or property via an electronic means which induces that person to commit an illegal act or prevent him doing an act which is legally obligatory on him shall be punished with imprisonment which may extend to two years, or fine or both.

17.1.7 Other Legislations :

- ❖ Negotiable Instrument Act (1881): Section 6: The concept of Truncated Cheque and e-cheque was added. These cheques are negotiable instruments in electronic format which are a part of internet banking. All of these instruments are required to maintain minimum safety requirements with the use of digital signatures (which may be linked with biometric).
- ❖ Consumer Protection Act (1986): This act aims to protect the interests of the consumers. It is also applicable to Banking Services as well. The issues such as privacy, the secrecy of consumer's accounts and the rights and liabilities of customers and banks, etc. in respect of internet banking are protected through this act.

17.2 RESERVE BANK OF INDIA STANDARDS ON E-BANKING :

E-Banking or Internet Banking has eliminated the need for paper and physical financial instruments because funds, money and capital can be easily accessed and transferred to the beneficiary on this online platform, therefore Internet Banking has reduced problems like geographical barriers, lack of infrastructure, cost, difficulty in obtaining loans and time consumption. Therefore, it is important to know the existing legal structure of e-banking and the challenges that lie therein.

On 17th October 2000 the Ministry of Information Technology issued a notification exercising its authority under the Information Technology Act, 2000. Pursuant to this notice the Reserve Bank of India (hereafter referred to as "**RBI**") issued a notification dated 14.06.2001 and formed the S.R. Mittal Working Group Committee and subsequently the previous notification of 14th June 2001 was amended by RBI notification dated 20.07.2005,

where the need for the approval of RBI was scrapped off, the following were the minimum benchmarks of security set up by the RBI:

- **Security policy:** Highly encoded 128 Bit Security Socket Layer based digital signatures for authentication purposes. Every bank should have Security Officer solely dealing with information technology and shall work towards the execution of the rules made under the IT Act, among other things, the Board of Directors shall approve the security policy that is adopted by the bank.
- **Internet and Digital Banking System**: At that time login id, password, biometric verification were new notions, hence the banks were asked to adapt to such new concepts wherein the bank must make sure that Internet and Digital Banking System respects the security and privacy by maintaining a line of proxy server-based firewall. All the security structures were to be tested before any kind of Internet Banking facility was available, whereas the up gradation, bug removal and other security software were deemed necessary to be installed.
- **Security fissures:** Any security fissure which might open up during the E-banking must be reported and taken care of at the earliest possible opportunity and future policies should be framed while keeping in mind security fissures that are incurred from time to time. Meanwhile, the burden lies upon the bank to keep both encoded and decoded records of all the transactions and messages received during e-transactions.

E-banking offers a higher level of convenience for managing one’s finances. However, it continues to present challenges to financial security and personal privacy. Many people have had their account details compromised, as a result of online banking. Thus, if one is going to use it for financial transactions, he should be aware of the risks involved. Awareness of the risks and problems enables him to take precautions for a more secure online banking experience. The e-Banking system is not only popular nationally, but also internationally, where a person can transfer money through any part of the world. The e-banking system is useful for bankers as well as customers of banks.

17.3 BENEFITS OF GOOD COMPLIANCE :

Benefits of good compliance culture it is very important for banks to demonstrate a good compliance culture to maintain their reputation and win the trust of customers, investors and regulators. The economic policies in India, including regulation of the banking system, are also influenced due to its membership of international economic organizations such as BRICS, the G20 summit and treaties and agreements entered into on account of India is a member of the General Agreement on Trade in Services (GATS) under the World Trade Organization (WTO). Such culture is important for banks to avoid poor conduct and loss of trust. A good compliance culture can benefit banks in several ways which include:

- Low organizational and individual risk
- Low reputational risk
- Less hesitance and more confidence among employees while performing their jobs
- Helps attract and retain talent and ensure employee engagement
- Improved transparency which enables better decisions
- Enhanced relationship with regulators and other stakeholders
- Enhanced valuation among investors.

Other compliance requirements

- Section 29 – Every bank needs to publish its balance sheet as on March 31st

- Section 30(i) – Audit of Balance sheet by qualified auditors
- Section 35 gives powers to RBI to undertake inspection of banks

Other various sections deal with important returns which are to be submitted by banks to Reserve Bank of India

– Return of bank's liquid assets and liabilities (Monthly)
– Return of bank's assets and liabilities in India (Quarterly)
– Return of unclaimed deposits of 10 years and above (Yearly)

With changing time and requirements from time to time, various other compliance issues which need to be handled by banks, have been amended/incorporated relating to:

– Nomination facilities
– Time period for preservation of bank books/records

17.4 ROLE OF CHIEF COMPLIANCE OFFICER (CCO) :

Banks need to ensure compliance to all applicable statutory provisions, rules and regulations, various codes of conducts (including the voluntary ones) and their own internal rules, policies and procedures. It is, however, reiterated that compliance is a shared responsibility of the business units and the compliance function. Therefore, adherence to applicable statutory provisions and regulations needs to be the responsibility of each staff member of the bank and it is the work of the compliance function to ensure the same.

In some banks, there may be separate departments looking after compliance to different statutory and other requirements while the compliance function may be responsible for monitoring compliance with the regulations, internal policies and procedures and reporting to Management. The concerned departments would hold the prime responsibility for their respective areas, which should be clearly outlined, while compliance function would need to ensure overall oversight. If serious gaps are observed in such compliances, the compliance function should take necessary action to correct the compliance culture. There should also be appropriate mechanisms for co-operation among departments and with the Chief Compliance Officer.

The objective of ensuring that the responsibilities associated with CCO are treated as a specialized and core function. Keeping in view the above principle, if a person identified as CCO is above the age of 55 years, however, she/he has had continuous association with the compliance function either as CCO or otherwise, the age limit of 55 years may be taken as the date from when the continuous association with the compliance function started for the identified CCO. Illustratively, if a person identified for CCO role has age more than 55 years but she/he has been continuously associated with the compliance function prior to completing the age of 55 years, the person would be eligible for such appointment.

The principle behind this requirement is that the identified CCO is a well experienced official so that she/he discharges the mandated functions independently and effectively. Accordingly, in line with the above, Risk Management functions shall also include control functions within the business lines. Therefore, if a regional/zonal/business head had the requisite responsibility/experience on the control functions of the business lines for 5 years or more, she/he shall be eligible for the post of CCO under this condition. The provisions relating to process of selection / removal / qualification, etc. would be fully applicable to foreign banks operating under the branch model (FBOBM).

CCO is to be selected through a suitable process with an appropriate 'Fit and Proper' evaluation/selection criteria. 'Fit and Proper' criteria may be examined and reported from the

perspectives of competency, integrity and conflict of interest, among others. In view of the difficulties expressed by banks, they may follow the indicated processes for selection of CCO within a period of nine months from the date of the appointment.

To reinforce the ability of the lender to deal with distressed assets, the Reserve Bank of India has issued guidelines and norms on distressed asset resolution by lenders. The RBI has issued a notification on "Guidelines on Sale of Stressed Assets by Banks" as a part of the already existing "Framework for Revitalizing Distressed Assets in the Economy". The framework and guideline have been created as a part of the enforcement of and regulations under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). The Insolvency and Bankruptcy Code, 2016 (IBC) seeks to consolidate the existing framework by creating a single law for insolvency and bankruptcy. The bankruptcy code is a one-stop solution for resolving insolvencies which at present is a long drawn process and fails to offer an economically.

17.5 BANKING COMPLIANCE CHALLENGES :

For at least the past two decades, banking compliance has been more than a check-the-box activity for financial services institutions. These days, it's more important than ever. Compliance standards are adapting and evolving to meet the current challenges. That's why it's essential for banks to stay on top of the latest regulatory challenges to avoid stiff fines and to maintain goodwill among valued customers with regulations like those regarding anti-money laundering (AML) and know bank customer (KYC) etc. In the face of process automation, digitalization and mounting competitive pressures, the execution of strong banking compliance standards is a business imperative. Banks and credit unions have a legal, as well as an ethical, obligation to stem the flow of dirty money and to ensure that they know who they're dealing with.

Setting up an account in the bank may take time though the E-Banking facility is provided by the banks. Banking sites can be difficult to navigate at first by the customers who do not have knowledge of computer and internet so getting acquitted with the banking sites software may require some time to read the tutorials in order to become comfortable in persons virtual lobby. There may be some difficulties to the customer for learning these activities of E-Banking. Some alterations or changes made in the banks sites due to technological advancement may lead to a problem to customers who have to provide all the personal information once again through online transaction.

E-Banking is time consuming for the customers, though there is option of online transactions, in the end customers have to run to the ATM for withdrawing the cash. No personal contact with any of the bank staff, and if talk to any bank staff through the telephone, there is no guarantee to the customers that they had talked with a right person or not. "Hackers" who may access customer's bank account is the main disadvantage to the customers who takes E-Banking facility very casually. Security concern is the important issue as cybercrimes activities are clutching up which decreases the number of customers to avail the benefit of e- banking. Technical breakdowns where online banking websites sometimes go down. If this happens then, if customer wishes to close his bank account then he will definitely go penniless.

Switching banks due to technical faults can be a major disadvantage of using E-Banking system to the customer. Increasing online frauds and attacks i.e. Trojan horse (Remote Attacker) are a major disadvantage of using E-Banking. However, in the case of Internet banking, one will find oneself making endless calls to the customer service department. There have been cases, where the person is put on hold or has been passed

around from one person to another. Hackers and crackers attack on the bank account of customer by stealing passwords or using fake credit cards to cheat a person which will cause loss to the customer's wealth.

Reserve Bank of India being the highest authoritative bank and main head of all the nationalized banks in India, had set up a 'Working Group on Internet Banking' to examine different aspects of Electronic Banking (E-banking). The Group had focused on three major areas of E-banking, i.e.

- ❖ Technology and Security Issues
- ❖ Legal Issues and
- ❖ Regulatory and Supervisory Issues.

Accordingly, the following guidelines are issued for implementation by banks. Banks are also advised that they may be guided by the original report, for a detailed guidance on different issues. These issues can be defined as:

- ❖ **Technology and Security Issues:** Banks should designate a network and database administrator with clearly defined roles as indicated in the Group's report. Banks should have a security policy duly approved by the Board of Directors. There should be a segregation of duty of Security Officer exclusively with information systems security and Information Technology Division which actually implements the computer systems. Further, Banks should also adopt and implement some new policies relating to security check ups and should inform customers about new technologies concerning E-Banking. Banks should also take steps to.
- ❖ **Legal Issues:** There is always an obligation on the parts of banks to keep the proper records of its customers manually as well as electronic. While opening an account of customer by internet a complete identification documents must be collected by the customer and a physical verification need to be done so that it will assist bank to avoid any legal risk. From a legal prospective, security procedure adopted by banks for authenticating users needs to be recognized by law as a substitute for signature. There must be strict rules regarding instructions by the customers for stop-payment and banks should clearly state the consequences in which stop-payment instruction could be accepted by the bank.
- ❖ **Regulatory and Supervisory Issues:** Only such banks which are licensed and supervised in India and have a physical presence in India will be permitted to offer Internet banking products to residents of India. The products and schemes of the bank should be limited to the account holders only but not to the extra territorial jurisdictional account holders. Indian overseas banks must be permitted to offer internet services. A supervisory authority need to be appointed so that it will assist in avoiding any illegal transactions.

17.6 LEGAL REMEDIES AND SOLUTIONS TO E-BANKING :

There are various issues in e-banking which the existing legal structure has failed to address; hence the following are some of the remedies and solutions to the existing cyber problems faced during e-banking:

- ❖ **Secrecy and confidentiality:** The duty which is imposed on the Banks and NBFC's to maintain the secrecy and confidentiality for the sensitive information of the customers must be statutorily recognized for giving it a legal status and imposing penalty on the Banking Authorities on its violation, so that its enforcement can be ensured more stringently than it is there presently.

- **Jurisdiction and enforceability**: Since the internet is a borderless world and cybercrimes threaten the sanctity of e-banking, herein cyber-attacks can take place from any computer either located in India or abroad hence Section 75 of the IT Act gives universal jurisdiction whenever any sort of cyber attack takes place on any computer located within the territory of India. Such crimes are investigated and prosecuted by cyber cells which are located across various districts in India.
- **The Trust Factor:** Trust is the biggest hurdle to online banking for most customers. Conventional banking is preferred by the customers because of a lack of trust in online security. They have a perception that online transaction is risky due to which frauds can take place. While using e-banking facilities lot of questions arises in the mind of customers such as: Did the transaction go through? Did I push the transfer button once or twice? Trust is among the significant factors which influence the customers‟ willingness to engage in a transaction with web merchants.
- **Mandatory to all Banks:** Some concrete measures like Biometric Authentication at the ATM Machines, or before logging in the E-Banking Website Portal which has started being opted by certain Banks in the Country must be made mandatory for all Banks by the Reserve Bank of India.
- **Foreign cyber attack:** If a cyber attack is foreign state sponsored, then compensation by means of attachment of property existing in India of that foreign state can be claimed by the Republic of India.
- **Section 43A and 72 of the IT Act:** Seeking Compensation, Penalty, and prosecution by Cyber Cells- under Section 43A and 72 of the IT Act any theft, breach of confidential data, cheating or offences of the same nature are liable to be penalized and the victim shall be compensated in case any fraud takes place during E-Banking transactions.
- **Cyber Grievance Redressal Cell:** Each Banks should incorporate one In-House Cyber Grievance Redressal Cell, who could directly deal with the Banking Frauds happening in their Banks, they must analyze their functions and affairs annually and send their Annual Report to the concerned State Cyber Cell or the District Cyber Cell for their Expert Advice and Guidance in this reference.
- **Banker's Book Evidence Act:** It is also pertinent to note that the Banker's Book Evidence Act mandates that bank records in digital format can also be appreciated by the Court as it can be treated as documentary evidence under Sections 65A and 65B of the Indian Evidence Act, 1872.
- **The Consumer Forum:** Disputes regarding the privacy of consumer accounts, rights, deficiency in E-banking services, liabilities of banks towards its customers, and the rights of consumers can be enforced by the Consumer Forum having the relevant pecuniary jurisdiction under the Consumer Protection Act, 2019.
- **Special Court for Money Laundering cases:** Under Section 11 of the Prevention of Money Laundering Act, 2002, any money laundering taking place through E-Banking can be prosecuted and prevented under the aegis of this Act and Section 11 also casts a burden upon the Bank to maintain a record of each and every transaction occurring through its electronic payment gateway.
- **Customer Awareness:** Awareness among consumers about the e-banking facilities and procedures is still on the lower side in the Indian scenario. Banks are not able to disseminate proper information about the use, benefits, and facility of internet banking. Less awareness of new technologies and their benefits is among one of the most ranked barriers in the development of e-banking.

- **Availability of Personnel services:** In present times, banks are to provide several services like social banking with financial possibilities, selective up gradation, computerization and innovative mechanization, better customer services, effective managerial culture, internal supervision and control, adequate profitability, strong organization culture etc. Therefore, banks must be able to provide complete personnel service to the customers who come with expectations.
- **Handling Technology:** Developing or acquiring the right technology, deploying it optimally, and then leveraging it to the maximum extent is essential to achieve and maintain high service and efficiency standards while remaining cost-effective and delivering sustainable returns to shareholders. Early adopters of technology acquire significant competitive advances Managing technology is, therefore, a key challenge for the Indian banking sector.

17.7 SUMMARY :

E-banking in India will not flourish until areas of strength for a framework in this field are established. In India, there is no explicit E-Banking Regulation. Despite the fact that the RBI has issued various instructions in this regard, and that Information Technology Act, 2000 provides some indirect and implicit provisions for Internet or E-Banking, and it require a separate and dedicated regulation in this area. Despite the fact that the RBI has mandated cyber due diligence for banks in India, particularly due diligence for banks under the IT Act 2000, banks must nevertheless maintain their capabilities as a whole. Indian banks do poorly in terms of cyber security.

Compliance is defined as the act of following laws, rules, regulations, and various codes of conducts including the voluntary ones. Although most of these arise from external requirements, following the organization's own internal rules, policies, and procedures, acting in accordance with ethical practices is equally important. Banking regulation imposes various requirements, restrictions, and guidelines on banks.

The Banking Regulation Act came into effect on 16 March 1949 and it applies to the whole of India. The act was amended by Banking Laws Amendment Act, 1983, The Banking Public Finance Institutions and Negotiable Instrument Laws Amendment Act, 1988 and the Banking Regulation Amendment Act, 1994. The Reserve Bank of India and the Government of India exercise control over banks from the opening of banks to their winding up by the virtue of powers conferred under the statutes. All the regulatory provisions are not uniformly applicable to all the banks.

And the lesson also highlighted various compliance challenges. Reserve Bank of India being the highest authoritative bank and main head of all the nationalized banks in India, had set up a 'Working Group on Internet Banking' to examine different aspects of Electronic Banking (E-banking). The Group had focused on three major areas of E-banking. These are technology and security issues, legal issues and regulatory and supervisory issues. The Government of India and various government agencies are making an effort to make e-banking more safe, secure, and reliable with the convenience of digital channels. Finally, the lesson concludes that most of the customers are visiting branches less often and they use online and mobile technology for their banking needs more often.

17.8 KEY WORDS :

- **Banking regulatory compliance:** Banking regulatory compliance describes the set of standards and practices banking institutions must adopt to remain in compliance with industry regulations and other relevant legislation. Regulatory compliance in

banking applies to a range of industry factors, including: security, risk management, information processing, data reliability and ethical conduct etc.

- ❖ **Legal compliance:** legal compliance is having a robust procedure in place to monitor a banking business continually to ensure that it remains legally compliant. In practice, this means that audits of departments repeatedly take place in addition to the company staying up to date with any changes in the law which impacts them. The basic idea behind legal compliance is to minimize legal risk in addition to minimizing negligence that could cause undue harm to a person or group of people.
- ❖ **The Banking Regulation Act, 1949:** The Banking Regulation Act came into effect on 16 March 1949 and it applies to the whole of India. The act was amended by Banking Laws Amendment Act, 1983, The Banking Public Finance Institutions and Negotiable Instrument Laws Amendment Act, 1988 and the Banking Regulation Amendment Act, 1994. The purpose of enacting the Banking Regulation Act, 1949 was to consolidate and amend the law related to banking companies and to check the abuse of powers by managers of banks and also to safeguard the interest of depositors and the interest of the country in general.
- ❖ **Application security:** Apparatuses and methods to protect applications after deployment by observing, res0lving, and enhancing applications' security with antivirus projects, firewalls, and encryption.
- ❖ **Prevention of Money Laundering Act, 2002:** India has passed the Prevention of Money Laundering Act, 2002 (15 0f 2003)xiv and the RBI, SEBI and IRDA art brought under the Act and thus all the financial institutions, banks, mutual funds, insurance companies and their financial intermediaries are also covered by it.
- ❖ **Punishment of Cheating (Section 417):** Whosoever impersonates some other person whom he is not or knowingly substitutes such person, and causes wrongful losses to the innocent victim shall be punished with imprisonment which may extend to one year, or fine or both
- ❖ **Consumer Protection Act (1986):** This act aims to protect the interests of the consumers. It is also applicable to Banking Services as well. The issues such as privacy, the secrecy of consumer's accounts and the rights and liabilities of customers and banks, etc. in respect of internet banking are protected through this act.
- ❖ **Legal Issues:** There is always an obligation on the parts of banks to keep the proper records of its customers manually as well as electronic. While opening an account of customer by internet a complete identification documents must be collected by the customer and a physical verification need to be done so that it will assist bank to avoid any legal risk. From a legal prospective, security procedure adopted by banks for authenticating users needs to be recognized by law as a substitute for signature. There must be strict rules regarding instructions by the customers for stop-payment and banks should clearly state the consequences in which stop-payment instruction could be accepted by the bank.
- ❖ **Cyber Grievance Redressal Cell:** Each Banks should incorporate one In-House Cyber Grievance Redressal Cell, who could directly deal with the Banking Frauds happening in their Banks, they must analyze their functions and affairs annually and send their Annual Report to the concerned State Cyber Cell or the District Cyber Cell for their Expert Advice and Guidance in this reference.
- ❖ **Customer Awareness:** Awareness among consumers about the e-banking facilities and procedures is still on the lower side in the Indian scenario. Banks are not able to disseminate proper information about the use, benefits, and facility of internet

banking. Less awareness of new technologies and their benefits is among one of the most ranked barriers in the development of e-banking.

17.9 SELF-ASSESSMENT QUESTIONS :

1. What are the legal and regulatory compliances in E-Banking?
2. Explain Reserve Bank of India standards on E-Banking?
3. What are the benefits of good compliances to E-Banking customers?
4. Discus the role of chief compliance officer?
5. Give a note on banking compliance challenges?
6. What are the legal remedies and solutions to E-Banking?

17.8 FURTHER READINGS :

1. Digital Banking by Indian Institute of Banking & Finance, Taxmann Publications, 2019
2. Internet Banking 1St Edition 2017 by Dr Ajimon George, New Age International (P) Ltd Publishers, January 2017
3. e-Bankingby Kumar R (Author), Pacific Books International (4 April 2016)
4. E-Banking Management: Issues, Shah Mahmood, Clarke SteveSolutions, and Strategies, Information science reference
5. E Banking Author: R. Kumar, M. Deshpande, Pacific Books International

Dr. SADHIK SAYYED

(414CO21)

Model Question Paper
M.Com (Banking)
Semester-IV Paper–IV
BANK MANAGEMENT

TIME: 3Hours **MAX MARKS: 70**

SECTION A ---- (4x5= 20 Marks)

Answer any **FOUR** of the following

1. Cash Reserve Ratio
   a) Advantages of Chain Banking
   b) Importance of Banking System in India
   c) Significance of Asset Liability Management
   d) Consumer goods
   e) Frame work for Multimedia Systems
   f) Importance of Manpower Planning
   g) Types of outsourcing

Section B — (5x10=50 marks)

Answer all following questions

Unit - 1

1. Explain Cash Reserve Ratio (CRR) & Statutory Liquidity Ratio (SLR)

Or

2. Explain the Important Provisions of the Banking Regulation Act, 1949

Unit- 2

3. Distinguish between Advantages and Disadvantages in Branch Banking

Or

4. Discus about Functions of Commercial Banks

Unit – 3

5. What do you mean by deposit management? Discuss various steps in deposit management ?

Or

6. Describe the Sources of Income of Banks?

Unit – 4

7. Explain Steps in Employee Selection Process?

Or

8. What are steps in Recruitment process of Banking in India?

Unit – 5

9. What are the E-Banking methods and explain the elements involved in E-Banking?

Or

10. What is outsourcing? Why banks need to choose outsourcing?