FINANCE

TEXTBOOK FOR HIGHER SECONDARY FIRST YEAR

ASSAM HIGHER SECONDARY EDUCATION COUNCIL

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Chapter-16	Payment in Due Course, Holde and Holder in Due Course	Dr. Amarendra Talukdar Prof. Dilip Kumar Sharma

FOREWORD

The field of commerce is one of the most influential and strongest social institutions. As a branch of knowledge, commerce education imparts experience in the field of business world and in all its manifestations. It equips students with a number fo specialised skills that help them in excelling different functional areas of trade, industry and commerce. the growing phenomenon of privatisation, globalisation and liberalisaton has an immense impact ont he commerce education.

In the context of globalization of the economy, emergence of information technologies and application of new technologies in business and commerce, the national Council of Educational Research and Training proposed the national Curriculum Framework (NCF-2005) for class I-XII. This framework, which addresses the emerging development issues and other social concerns, provides a basis for the state to design their own curricula, syllabi, teaching learning materials etc.

To maintain the uniformity of the council text books with the national level, the Assam Higher secondary Education Council has developed its curricula and syllabi on the basis of NCF-2005. Accordingly the textbook FINANCE has been developed and revised completely with the inclusion of project works to be implement from 2022-23 session.

this textbook is designed for conceptual accessibility to the students of Higher Secondary level. It will help the students to learn how to manage successfully the finance of all types of business. The authors of the book have rendered sincere effort t offer the most comprehensive picture and the freshest insights to provide a broad perspective on the economy and commerce which will help students to make better financial choices.

The AHSEC expresses sincere gratitude to the editorial committee for their sincere and hard work in developing this textbook. AHSEC sincerely hopes that the book will meet the needs of the students. Although sincere effort has been made to develop an error free book, some inadvertent error might have crept in AHSEC also welcomes positive comment and suggestion from the stakeholders so that further development of the textbook could be made in the interest of students and other stakeholder.

Date : 16-8-2022

Secretary
Assam Higher Secondary Education Council
Bamunimaidam, Guwahati-21

CONSTITUTION OF INDIA

Preamble

WE, THE PEOPLE OF INDIA, having solemnly resolved to constitute India into a **SOVEREIGN SOCIALIST SECULAR DEMOCRATIC REPUBLIC** and to secure to all its citizen :

JUSTIC, social, economic and political;

LIBERTY of thought, expression, belief, faith and worship;

EQUALITY of status and of opportunity; and to promote among them all;

FRATERNITY assuring the dignity of the individual and the unity and intergrity of the Nation'

IN OUR CONSTITUENT ASSEMBLY this twenty-sixth day of November, 1949, do HEREBY ADOPT, ENACT AND **GIVE TO OURSELVES THIS CONSTITUTION.**

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FINANCE

SYLLABUS FOR HIGHER SECONDARY FIRST YEAR COURSE

Theory : 80 Marks Time : 3 Hours.

Project : 20 Marks

Total : 100 Marks

Unit-wise distribution of Marks and Periods

Unit	**Topics**	**Marks**	**Periods**
Unit-I	Finance	16	30
Unit-II	Meaning and Different Types of banks	16	30
Unit-III	Commercial Banking in India	16	30
Unit-IV	Different types of Bank Accounts and Customers	16	30
Unit-V	Negotiable Instruments	16	30
	Total (Theory)	**80**	**150**
	Project works :	**20**	
	Total (Theory + Project)	**100**	**150**

Unit-wise distribution of course contents

Unit-I : Finance :

Finance : Meaning, features, functions, types and sources.

Financial System : Meaning and components. Role of financial system in economic development.

Unit-II : Meaning and Different Types of Banks :

Bank: Meaning, definition and features.

Different Types of Banks– Central Bank : Meaning, features and functions. Commercial Bank : Meaning, primary functions, secondary functions and modern functions. Exchange Bank/Foreign Bank : Meaning and functions. Regional Rural Bank : Meaning, objectives and functions. Investment Bank : Meaning and functions. Development Bank : Meaning, features and functions. Export-Import Bank : Meaning and functions. Co-operative Bank : Meaning and features. Agricultural Bank : Meaning and functions. Meaning of Land Development Bank, Savings Bank, International Bank. Differences between (i) Commercial and Development Bank, (ii) Central and Commercial Bank, (iii) Commercial and Co-operative Bank.

Unit-III : Commercial Banking in India :

Evolution and Growth of Bank in India : Presidency Banks, Imperial Bank – functions and causes of nationalization. State Bank of India – functions. Scheduled and Non-Scheduled Banks, Private and Public Sector Banks. Differences between Scheduled and Non-Scheduled Banks and Private and Public Sector Banks.

Nationalisation of Banks : Objectives and progress of bank nationalisation in India, Criticisms against nationalisation of banks.

Lead Bank Scheme : Objectives and functions, progress of lead bank scheme, weakness of lead bank scheme.

Banking Systems : Meaning, advantages and disadvantages of Branch Banking System. Meaning, advantages and disadvantages of Unit Banking System. Meaning, advantages and disadvantages of Group Banking System. Meaning of Chain Banking System and Correspondent Banking System. Differences between Branch Banking and Unit Banking System and differences between Group Banking and Chain Banking.

Unit-IV : Different Types of Bank Accounts and Customers

Different Types of Bank Accounts : Savings Bank Account- meaning, features and advantages. Current Deposit Account- meaning and features. Fixed Deposit Account- meaning, features and advantages. Recurring Deposit Account- meaning and features. Opening of Savings Bank Account and Current Deposit Account. Differences between Savings Bank Account and Current Deposit Account, differences between Savings Bank Account and Fixed Deposit Account. Pay in Slip Book, Pass Book, Cheque Book, ATM Card.

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Unit- V : Negotiable Instruments :

Negotiable Instruments :– Meaning and features of Negotiable Instrument, Types of negotiable instruments, Meaning and Features of Promissory Note, Bill of Exchange and Cheque. Differences between Promissory Note and Bill of Exchange, Promissory Note and Cheque, and Bill of Exchange and Cheque. Types of cheques : Open cheque-Bearer cheque and Order cheque; Crossed cheque.

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Endorsements : Meaning, significance and kinds.

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UNIT-I

FINANCE

Meaning, Features, Functions, Types and Sources of Finance.

Meaning and Components of Financial System, Role of Financial System in Economic Development.

LEARNING OBJECTIVES

After the study of this unit, the student will be able to-

- ✓ Know the concepts of finance.
- ✓ Know the features of finance.
- ✓ Know the functions of finance in an economy.
- ✓ Get ideas about the different types of finance.
- ✓ Understand the different sources of finance.
- ✓ Know the meaning of Financial System.
- ✓ Know the features of Financial System.
- ✓ Know the functions of Financial System.

- ✓ Familiarize themselves about the different sub-components of financial system.
- ✓ Know about the Financial Market.
- ✓ Know about the Financial Institutions.
- ✓ Know about the Financial Instruments.
- ✓ Know about the Financial Services.
- ✓ Know about the Regulatory bodies of the Financial System.
- ✓ Understand the role of the financial system in the economic development.

CHAPTER-I

BASICS OF FINANCE

INTRODUCTION:

Finance is called the life blood of a business concern. If adequate blood does not flow to a part of our body, then that part of the body becomes paralyzed. Similarly, if adequate finance does not flow to a business concern, then that firm becomes ineffective as a business concern. It adversely affects the normal workings of the firm. Profitability, growth and expansion programmes are also affected.

Finance assists in the formation of new businesses, and allows businesses to take advantage of opportunities to grow and expand to new areas. Thereby, finance contributes in creating employment opportunities, raise income and investment levels in the economy. This in turn, supports other businesses and also contributes to government exchequer.

MEANING AND DEFINITION:

(Let us have a clear idea about the terms **'money', 'credit' and 'finance'.** The financial system is concerned about money, credit and finance. The three terms are though interrelated but are somewhat different from each other.

‘Money’ refers to the current medium of exchange or means of payment.

‘Credit’ or loan is a sum of money to be returned, normally with interest; it refers to a debt of economic unit.

‘**Finance’ is monetary resources comprising debt and ownership funds of the State, company or person).**

As per the dictionary meaning, finance is the management of large amounts of money, especially by governments or large companies. In common parlance, **finance** refers to the process of raising funds or capital for any kind of expenditure. Savers and investors, accumulate funds in the form of savings deposits, insurance claims, provident fund, pension fund etc. Finance is the process of channeling these funds in the form of credit, loans, or invested capital to those economic entities that needed them most or can put them to the most productive use.

The terms ‘Finance’ and ‘Money’ are closely associated with each other. Finance is defined as the provision of money at the time it is needed. An example will make the concept clear for the students. Suppose Mr. Barua has Rs. 100 crore in his bank account. This is referred to as savings or monetary asset. When Mr. Saikia borrows this money from Mr. Barua for setting up an industry, it becomes finance for Mr. Saikia. Finance is the lifeline of all activities; economic, social, and administrative.

Given below are some commonly understood definitions of finance:

Howard and Upton:

“Finance is that administrative area or set of administrative functions in an organisation which relate the arrangement of cash and credit so that the organisation may have the means to carry out its objectives as satisfactorily as possible”.

Bonneville and Deway:

"Business finance consists of the raising, providing, managing of all the money, capital or funds of any kind to be used in connection with the finance".

Guthmann and Dougall:

"Business finance can be broadly defined as the activity concerned with planning, raising and administering of funds used in the business".

Again, the term finance has been defined in different perspectives. In economics, finance has been defined as "a branch of economics concerned with resource allocation as well as resource management, acquisition and investment."

In the business world, finance refers to the "process of raising money through the issuance and sale of debt and/or equity".

Scientific view explains, finance as "the science that describes the management, creation, and study of money, banking, credit, investments, assets, and liabilities".

FEATURES OF FINANCE

The following are some of the important features of finance-

1. **A branch of the economics:** Basically, finance as a subject forms a part of economics. It is a branch of economics concerned with resource allocation as well as resource management, acquisition and investment.
2. **Finance is a process:** Finance is the process of raising funds or capital for any kind of expenditure. It is the process of channeling various funds in the form of credit, loans, or invested capital to those economic entities that needed them most or can put them to the most productive use.
3. **Money and finance:** The concepts of money and finance are closely associated with each other. Finance is the provision of money at the time it is needed.

4. **Composing elements**: The concept of finance encompasses a wide range of institutions, market, instruments and services that facilitate movement of finance from savers to investors. Basic financial concepts are based on micro economic and macro economic theories.

5. **Flow of finance**: Finance always flow from surplus areas to deficit areas. This flow is facilitated by the various components of financial system.

6. **Forms:** Depending upon the suppliers, users, duration and other factors, finance can be classified as corporate finance, private finance, Government finance, short term finance, long term finance etc.

7. **Sources:** Sources of finance may be short term, long term or medium term. Finance can also be procured from internal as well as external sources.

8. **Purpose**: The purpose of finance is to help people save, manage, and raise money.

9. **Finance and exchange**: Finance is nothing but an exchange of available resources. It is not only limited to exchange or management of money. A barter trading system is also based on the concept of finance.

10. **Optimal Mix of funds:** Finance is concerned with the best optimal mix of funds in order to obtain the desired and determined results respectively.

FUNCTIONS OF FINANCE:

1. **Acquisition, allocation and utilization of funds:**

   Finance is concerned with acquisition, allocation and utilization of funds. For proper functioning of a business firm, uninterrupted flow of fund to all parts of the business must be ensured from the right sources at the right cost at the right time. The concept of finance includes deciding the mode of raising fund, allocation to various projects and services and finally, effective and efficient utilization of allocated funds. Proper utilization of funds is based on sound investment decisions, proper control and asset management policies and efficient management of working capital.

2. Channelization of funds:

Financial system is a critical element of any economy. The different components of financial system like financial institutions, markets, instruments and services perform the essential function of channeling funds from people who have saved surplus funds by spending less than their income to people who have a shortage of investible funds.

3. Optimal mix of funds:

Finance is concerned with the best optimal mix of funds in order to obtain the desired and determined results respectively. Primarily, funds are of two - owned funds (promoters' contribution, equity shares, etc.) and borrowed funds (bank loan, bank overdraft, debentures, etc). A proper mix of the different sources ensures maximum profit for a business firm at minimum cost and risk.

4) Creation of investment opportunities:

Finance creates investment opportunities i.e. it ensures utilization of fund for profit or returns. With available funds in hand, a person or institution can make investments by-

- creating physical assets such as development of land, acquiring commercial assets, etc.
- carrying on trading, manufacturing or other business activities
- acquiring financial securities such as shares, bonds, units of mutual funds etc.

5. Internal controls:

Finance is concerned with internal controls maintained in the organisation or workplace. Internal financial controls include policies and procedures adopted by a firm for ensuring the orderly and efficient conduct of its business, including regulatory compliance and prevention and detection of frauds and errors. These policies and procedures are monitored from time to time keeping in view the changing requirements of the business and regulatory measures.

6. Maximization of profit:

Profit maximization is the capability of a business or company to earn the maximum profit with low cost which is considered as one of the main objectives of any business. In realizing this objective of a business, finance plays a very important role. Timely and adequate flow of finance helps a firm to take the advantages of business opportunities arising from time to time. The benefits of maximizing profit include: Profit can be used to pay higher wages to owners and workers.

7. Future decision making:

Finance is concerned with the future decision of the organisation. From evaluating different types of loans, choosing whether to rent or buy, or deciding whether to invest in stock or bond, it's important to understand the different aspects associated with finance. A sound knowledge on finance helps managers create budgets, understand public perception, track efficiency, analyze product performance, and develop short- and long-term strategies.

8. Helps increase cash flow:

Finance can help in increasing the cash flow in a firm. Keeping a track of the expenditures and spending patterns enables the firm to increase its cash flow. Tax planning, spending prudently, and careful budgeting ensure that the firm does not lose its hard-earned money on unnecessary and unproductive expenses.

TYPES OF FINANCE:

Finance can be of different types- it can be procured from different sources and for different duration. A clear knowledge about these different types of finance is important for a successful financial manager. Each finance type has its own pros and cons. Choosing right type of finance at the right time and for right type of business activity can contribute enormously to the profitability of a firm.

Finance can be broken into four different sub-categories as under-

Types of Finance

- On the basis of duration
  1. Short term
  2. Medium term
  3. Long term
- On the basis of users
  1. Public finance
  2. Private finance
  3. Corporate finance
- On the basis of source
  1. Equity finance
  2. Debt finance
- On the basis of mode of delivery
  1. Direct finance
  2. Indirect finance

A. Classification on the basis of duration:

1. Short-term finance:

The period of this type of finance is less than one year. Short-term finance is basically required to meet the working capital requirements of a firm – that is the expenditures connected with daily business activities such as paying wages to the staffs or getting raw materials. Cash credit, overdraft, bill discounting are some of the important sources of short term finance. Commercial banks are the main providers of short term finance.

2. Medium-term finance:

The period of this type of finance is one year to five years. Hire purchase finance, lease finance, Commercial banks and Development Finance Institutions are the main sources of medium term finance. A business firm requires medium term finance to purchase equipment, fixed assets and the like.

3. Long-term finance:

Finance required for a period of more than 5 years is called **long-term finance**. This type of finance is mostly needed for buying plant, land, restructuring offices or buildings, etc. for a business. Issue of bonds/debentures, issue of preference shares, issue of equity shares, long-term loans from government, financial institutions or investment banks, venture funding or funds from investors, are other examples of long-term finance.

B. Classification on the basis of users:

1. Public Finance:

Public Finance is that part of economics which deals with the study of the state's income and expenditure. It describes and analyses the expenditures of governments and the techniques used by governments to finance these expenditures. The scope of public finance includes the collection of funds and its allocation among different sectors of state economy that are considered as essential functions or duties of the government.

Public finance can be classified into three types– **public expenditure, public revenues and public debt**

2. Corporate Finance:

Corporate finance is concerned with raising of funds and its judicious allocation for the different activities of a corporate house. Corporate finance aims at studying the funding of assets from various sources like the market, the general public, or various financial institutions. The primary concern of corporate finance is the maximization of shareholder value through short-term and long-term financial planning and different strategies' implementation.

3. Private Finance:

Private finance is the study of income and expenditure, borrowings, etc. of individuals, households and business firms. Personal finance deals with the process of optimizing finances by individuals such as people, families and single consumers. Business Finance involves the process of optimizing finances by business organizations. It involves asset acquisition and proper allocation of funds in a way that maximizes the achievement of set goals- maximizing profit at minimum cost.

C. Classification on the basis of mode of delivery

On the basis of mode of delivery, finance could be of two types:

1. Direct Finance:

Direct financing is done directly through a lender. In this case, the borrower directly borrows funds from the lender in the financial markets by selling them securities. An example is an individual who buys a newly issued government bond through the services of a broker, when the bond is sold by the broker in its original state. Another good example for direct finance is a business which directly buys newly issued commercial papers from another business entity.

2. Indirect Finance:

Indirect finance refers to a financing system where borrowers borrow funds from the financial market through indirect means, such as through a financial intermediary. In this case, the role of channelizing the funds from the savers to borrowers is done through financial intermediaries like commercial banks.

D. Classification on the basis of source

On the basis of source, finance can be divided as equity finance and debt finance.

1. Equity finance:

Owned capital brought in by the promoters or the businessman himself is referred to as equity finance.

2. Debt finance:

Debt finance refers to the borrowed fund. Debt reflects money owed by the company towards another person or entity. It is the money advanced by outside agencies like banks, financial institutions, etc. generally in the form of loans.

SOURCES OF FINANCE

Source of finance refers to a place or an institution or a process from which a firm can procure its required capital. There are different sources of finance. Every source has its own merits and limitations. A business firm, while procuring finance, has to take into account the merits and demerits of the different sources. Apart from that, the firm has to take into account the nature of its financial requirements, duration, cost of finance etc. while selecting a particular source of finance.

Different sources of finance can be classified as follows-

Sources of Finance

A. On the basis of duration	**B. On the basis of ownership**	**C. On the basis of source of generation**
Long term sources	Sources of owned capital	Internal sources
Medium term sources	Sources of debt capital	External sources
Short term sources.		

A. On the basis of duration

On the basis of duration or time period for which the money is raised, sources of finance can be classified as long term, medium term and short term sources of finance.

1) Long-Term Sources of Finance

Long-term sources fulfill the financial requirements of a business for a period more than 5 years to 10, 15, 20 years or even more depending on other factors. Such financing is generally required for the procurement of fixed assets such as plant, equipment, machinery etc. Part of working capital which permanently stays with the business is also financed with long-term sources of funds.

Long-term financing sources can be in the form of any of the following:

- **Equity share**: These shares are issued to the general public and are non-redeemable in nature. Investors in such shares hold the right to vote, share profits and claim assets of a company.
- **Preference shares**: Preference shares are those shares which get preferential rights to dividend announced by a company. This means that a company has to pay dividend to preference shareholders first and then to equity shareholders. In case a company is winding up, the final payment will be made to preference shareholders first and then equity shareholders.
- **Retained Earnings**: Retained earnings are the portion of a company's cumulative profit that is held or retained and saved for future use.
- **Debenture/ Bonds**: A corporate house can raise fund from the capital market by issuing debentures and bonds. Debentures are unsecured debt instruments while bonds are secured by some form of collateral.

- **Term Loans from financial institutions**: Long term loans from financial institutions like IFCI, SFCs, commercial banks etc. is an important source of long term finance for commercial establishments.
- **Venture capital**: Venture capital is a form of private equity and a type of financing that investors provide to startup companies and small businesses that are believed to have long-term growth potential.
- **Asset Securitization**: Asset securitization is the structured process whereby interests in loans and other receivables are packaged, underwritten, and sold in the form of "asset-backed" securities.
- **International Financing**: Finance can be raised from foreign market by way of Euro Issue, Foreign Currency Loans, ADR (American Depository Receipt), GDR (Global Depository Receipt) etc.

2) Medium Term Sources of Finance

Medium-term sources are the sources where the funds are required for a period of more than one year but less than five years. Medium term financing is used generally for two reasons- firstly, when long-term capital is not available for the time being and secondly when deferred revenue expenditures like advertisements are made which are to be written off over a period of 3 to 5 years. Medium term sources of finance are as follows:

- **Preference share**: Preference shares can be issued for a shorter duration to raise medium term capital for a corporate house.
- **Debenture / Bonds**: While issued for a period of 5 years or less, they cater to the medium term fund requirements of a company.

- **Financial Institutions/DFIs**: Financial institutions including Development Financial Institutions extend medium term loan for setting up new units as also for expansion, modernization, and rehabilitation of existing units.
- **Lease finance**: This facility allows a business firm to buy asset on rental basis. It is a contractual agreement between the owner of the asset (Lessor) who grants the other party (Lessee) the right to use the asset in return for a periodic payment.
- **Hire Purchase finance:** Hire purchase refers to the arrangement between two parties in which one party agrees to buy an asset by paying the amount in various installments. Under this arrangement, the purchaser agrees to pay some amount (known as a down payment) to the supplier at the time of purchase and the balance amount is paid in various installments along with the interest that is charged at some fixed percentage.

3. Short Term Sources of Finance

Funds which are required for a period not exceeding one year are called short-term sources. The need for short-term finance arises to finance the current assets of a business like an inventory of raw material and finished goods, debtors, minimum cash and bank balance etc. Short-term financing is also named as working capital financing. Main sources of short term finance are the following-

- **Trade Credit**: Trade credit is a business-to-business agreement in which a customer can purchase goods without making immediate cash or cheque payments. Trade credit is a helpful tool for growing businesses.
- **Loan, Cash Credit and Overdraft**: Short Term Loans, cash credit and overdraft facilities provided by Commercial Banks

are the most popular sources of short term finance for the business community.

- **Advances received from customers:** Customer advances may be defined as the part of payment made in advance by the customer to the enterprise for the procurement of goods and services in the future. This source of finance is free from interest burden. That means, the enterprise does not require paying any interest on advances received from customers.
- **Creditors:** Trade credit facilitates the purchase of goods and services without making immediate payment and is commonly used by business organisations as a source of short-term financing.
- **Accounts Payables**: Accounts Payable financing allows a company to pay its supplier immediately without having to use their own working capital. This type of financing gives the company a longer term to pay back the creditor or when they sell the inventory.
- **Factoring Services**: Factoring is a financial service in which a business entity sells its bill receivables to a third party at a discount in order to raise funds. This is a type of business loan.
- **Bill Discounting:** Bill Discounting is a trade-related activity in which a company's unpaid invoices, which are due to be paid at a future date, are sold to a bank or other financial institution.

B. Classification on the basis of Ownership and Control:

On the basis of ownership and control, finance can be classified into two classes- owned capital and borrowed capital. Both these two forms of capital involves some cost. The cost involved in case of borrowed capital is the interest. While the cost involved in case of owned capital is the dilution of ownership rights in the business. These two factors must be considered by a business entity while selecting a source of fund.

Owned Capital

Owned capital is also known as equity capital. A corporate house mobilises owned capital mainly by issuing equity shares to the promoters of the company and the general public. Promoters are the individuals and institutions who promote the business by bringing in the required capital at the initial stage.

In spite of the problem of dilution of ownership right, equity capital is the most preferred source of capital for many business concerns mainly because of its following advantages -

- It is a long-term capital which means it stays permanently with the business.
- There is no burden of paying interest or installments like borrowed capital.
- Equity capital reduces the risk of bankruptcy.
- Investors are often prepared to **provide follow-up funding** as the business grows. Because of these advantages, Business firms in infancy stages always prefer equity capital.

Besides equity capital, there are some other sources of owned capital, which include-

- Capital raised by issuing Preference shares
- Retained earnings
- Convertible Debentures
- Venture Fund or Private Equity

Borrowed Capital

When a business concern expands, the various sources of owned capital may not be sufficient to meet its growing demand for funds. In that case the firm may decide to borrow fund to finance the cost of expansion of business. Borrowed or debt capital is the finance arranged from various external sources which include the following:

- Financial institutions like Developmental Financial Institutions,
- Commercial banks,
- External Commercial Borrowings (ECBs). The government has permitted Indian companies to raise funds from foreign financial institutions, which helps them to expand and quickly scale up their operations.
- The general public in the forms of bonds or debentures. In this type of capital, the borrower has a charge on the assets of the business which means the company will pay the borrower by selling the assets in case of liquidation. Another feature of the borrowed fund is a regular payment of fixed interest and repayment of capital. Certain advantages of borrowing are as follows:
  - i) There is no dilution in ownership and control of the business.
  - ii) The cost of borrowed funds is low since it is a deductible expense for taxation purpose which ends up saving on taxes for the company.
  - iii) It gives the business the benefit of leverage.

C. On the basis of source of generation:

Based on the source of generation, the different sources of finance can be classified as **internal and external sources of finance.**

Internal Sources

The internal source of capital is the one which is generated internally by the business. These are as follows:

- Retained profits
- Sale of assets etc.

The internal sources of finance have the same characteristics of owned capital. The main advantage of internal sources of finance is that the business grows by itself and does not depend on outside parties. Disadvantages of both equity and debt are not present in this form of financing. Internal sources of finance do not dilute ownership control over the business. Like debt financing, it does not generate fixed obligation or bankruptcy risk for the firm.

External Sources

An external source of finance is the capital generated from outside the business. The different sources of funds mentioned under the heading 'Borrowed Funds" are external sources of finance.

Deciding the right source of finance is a crucial business decision for a financial manager. We have mentioned above about the advantages and disadvantages of different sources of finance. A business firm should decide about the sources of finance keeping in view the following factors-

- The amount required,
- Type of expenditure/purpose for which the capital is required,
- The length of time for which the money is required,
- The size, status and ability of the business to borrow,
- The business's current level of gearing etc.

Improper match of the type of capital with business requirements may go against the smooth functioning of the business. The usage of the wrong source increases the cost of funds which in turn would have a direct impact on the profitability and feasibility of the project.

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SUMMARY

- Finance is called the life blood of a business concern. Finance assists in the formation of new businesses, and allows businesses to take advantage of opportunities to grow and expand to new areas. Thereby, finance contributes in creating employment opportunities, raise income and investment levels in the economy.
- **Meaning of finance: Finance is monetary resources comprising debt and ownership funds of the State, company or person.** As per the dictionary meaning, finance is the management of large amounts of money, especially by governments or large companies. In common parlance, **finance** refers to the process of raising funds or capital for any kind of expenditure.

The terms 'Finance' and 'Money' are closely associated with each other. Finance is defined as the provision of money at the time it is needed.

- **Definition of finance:**

Howard and Upton: "Finance is that administrative area or set of administrative functions in an organisation which relate the arrangement of cash and credit so that the organisation may have the means to carry out its objectives as satisfactorily as possible".

In the business world, finance refers to the "process of raising money through the issuance and sale of debt and/or equity".

Scientific view explains finance as "the science that describes the management, creation, and study of money, banking, credit, investments, assets, and liabilities".

- **Features of finance:**

  Some of the important features of finance are –

  (i) A branch of the economics

  (ii) Finance is a process

  (iii) Finance is the provision of money at the time it is needed

  (iv) Composing elements– The concept of finance encompasses a wide range of institutions, market, instruments and services

  (v) Flow of finance– Finance always flow from surplus areas to deficit areas

  (vi) Forms– Finance can be classified as corporate finance, personal finance, Government finance, short term finance, long term finance etc.

  (vii) Sources- Sources of finance may be short term, long term or medium term

  (viii) Purpose– The purpose of finance is to help people save, manage, and raise money

  (ix) Finance and exchange– Finance is nothing but an exchange of available resources and

  (x) Optimal Mix of funds– Finance is concerned with the best optimal mix of funds.

- **Functions of finance:**

1. **Acquisition, allocation and utilization of funds:** Finance is concerned with acquisition, allocation and utilization of funds.
2. **Channelization of funds:** The different components of financial system like financial institutions, markets, instruments and services perform the essential function of channelising funds.
3. **Optimal mix of funds:** Finance is concerned with the best optimal mix of funds in order to obtain the desired and determined results respectively.

4. **Creation of investment opportunities:** Finance creates investment opportunities i.e. it ensures utilization of fund for profit or returns.
5. **Internal controls:** Finance is concerned with internal controls maintained in the organisation or workplace.
6. **Maximization of profit:** In realizing the profit maximisation objective of a business, finance plays a very important role.
7. **Future decision making:** Finance is concerned with the future decision of the organisation.
8. **Helps increase cash flow:** Finance can help in increasing the cash flow in a firm.

- **Types of finance:**

  Finance can be of different types–

A. Classification on the basis of duration:

1. **Short-term finance:**

   The period of this type of finance is less than one year. Short-term finance is basically required to meet the working capital requirements of a firm.

2. **Medium-term finance:**

   The period of this type of finance is one year to five years. A business firm requires medium term finance to purchase equipment, fixed assets and the like.

3. **Long-term finance:**

   Finance required for a period of more than 5 years is called **long-term finance**. This type of finance is mostly needed for buying plant, land, restructuring offices or buildings, etc. for a business.

B. Classification on the basis of users:

1. Public Finance:

Public Finance is that part of economics which deals with the study of the state's income and expenditure.

2. Corporate Finance:

Corporate finance is concerned with raising of funds and its judicious allocation for the different activities of a corporate house.

3. Private Finance:

Private finance is the study of income and expenditure, borrowings, etc. of individuals, households and business firms.

C. Classification on the basis of mode of delivery

1. Direct Finance:

Direct financing is done directly through a lender. In this case, the borrower directly borrows funds from the lender in the financial markets by selling them securities..

2. Indirect Finance:

Indirect finance refers to a financing system where borrowers borrow funds from the financial market through indirect means, such as through a financial intermediary.

D. Classification on the basis of source

On the basis of source, finance can be divided as equity finance and debt finance.

1. Equity finance:

Owned capital brought in by the promoters or the businessman himself is referred to as equity finance.

2. **Debt finance:**

   Debt finance refers to the borrowed fund. Debt reflects money owed by the company towards another person or entity.

- **Sources of finance:**

Source of finance refers to a place or an institution or a process from which a firm can procure its required capital. Different sources of finance are–

A. On the basis of duration:

1) Long-Term Sources of Finance

(i) Equity share

(ii) Preference shares

(iii) Retained Earnings

(iv) Debenture/ Bonds

(v) Term Loans from financial institutions

(vi) Venture capital

(vii) Asset Securitization and

(viii) International Financing.

2) Medium-Term Sources of Finance:

(i) Preference share

(ii) Debenture / Bonds

(iii) Financial Institutions/DFIs

(iv) Lease finance,

(v) Hire Purchase finance

3) Short-Term Sources of Finance:

(i) Trade Credit

(ii) Loan, Cash Credit and Overdraft

(iii) Advances received from customers

(iv) Creditors

(v) Accounts Payables

(vi) Factoring Services

(vi) Bill Discounting

B. On the basis of ownership and control:

(i) Owned Capital

(ii) Borrowed Capital

C. On the basis of source of generation:

(i) Internal Sources

(ii) External Sources

CHAPTER-2

FINANCIAL SYSTEM

MEANING AND DEFINITION

One of the most important institutional and functional vehicles for economic transformation is financial system. It is a vehicle which supplies the necessary financial inputs to the vital sector of the economy and in turn promote the well being and standard of living of the people of a country. Financial system is a set of interrelated activities which facilitate the transfer of money from surplus areas to deficit areas.

In simple words, financial system facilitates transfer of funds from investors to borrowers. The term "system" in "Financial System" indicates a group of complex and closely linked institutions, agents, procedures, markets, transactions, claims and liabilities within an economy.

According to Christy, the financial system "supply funds to various sectors and activities of the economy in ways that promote the fullest possible utilization of resources without the destabilizing consequence of price level changes or unnecessary interference with individual desires."

According to Robinson, the primary function of the system is "to provide a link between savings and investment for the creation of new wealth and to permit portfolio adjustment in the composition of the existing wealth.

FEATURES OF FINANCIAL SYSTEM

The features of a financial system are as follows

1. **Component of the national economy**: Financial system is a component of the national economy which helps in the movement of funds from surplus areas to the deficit areas.
2. **Dichotomy:** Another important feature of financial system is 'financial dichotomy'. In the financial system, there are two main segments- formal and informal financial system.
3. **Sub-systems**: A financial system is a complex, well integrated set of sub-systems of financial institutions, financial market, financial instruments and financial services. All these sub-systems facilitate transfer and allocation of funds.
4. **Establish linkage**: A financial system establishes linkage between savers and investors, thus encouraging both savings and investments in the economy.
5. **Financial assets:** The basic product of any financial system is the financial asset. A financial asset is one, which is used for production or consumption or for further creation of assets.
6. **Liquidity:** All activities in a financial system are related to liquidity- either provision of liquidity or trading in liquidity.
7. **Allocation of financial resources**: Financial system mobilizes funds from surplus areas and promotes efficient allocation of financial resources in the various productive sectors of the economy.
8. **Contribution to economic development**: Financial system is the backbone of the national economy. This is because the efficiency with which the financial system works plays a very important role in the economic development of a nation. Financial system influences both the quality and the pace of economic development.

FUNCTIONS OF FINANCIAL SYSTEM

Financial resources are scattered across the economy. Financial system assists in mobilizing these scattered resources and channelizing them to the productive sectors of the economy. A vibrant financial system can enable the timely deployment of these resources across different parts of the economy at the right time and enhance productivity in the different segments of the economy. In this process, financial system performs variety of functions which are as follows-

1. **Establish linkage between savers and investors:** One of the important functions of financial system is to link the savers and investors and thereby help in mobilizing and allocating the savings effectively and efficiently. In this way, financial system plays a vital role in transferring the financial resources from surplus and wasteful areas to deficit and productive areas, thus increasing the productivity and prosperity of the country.

2. **Promotion of liquidity:** The major function of financial system is to promote liquidity and safety of funds. It has to make adequate provision of money and monetary assets for the production of goods and services. There should not be any shortage of money for productive ventures.

3. **Facilitating Payments:** An efficient payment mechanism ensures timely and smooth transfer of goods and services. The payment system can be viewed as a subset of the financial system. It is composed of several institutions, such as banks, depository institutions, and private companies.

4. **Allocation of risk:** An efficient and vibrant financial system aims at containing risk within acceptable limit. It limits, pools, and trades the risks involved in mobilizing savings and allocating credit.

5. **Managing Information:** The financial system makes available a lot of important information, which is important for the well-being

of the economy as a whole. One of the most important information provided by the markets is about prices. The price information is the basis on which all of the economic theory has been developed. It is the basis on which all economic decisions are made.

6. **Efficient Middleman:** The financial system plays the role of an efficient middleman. The various components of financial system like financial market, financial institutions, financial instruments and financial services allow the savings to be diverted towards productive activities with the least amount of transaction costs. The financial system consists of various systems that have been created, keeping in mind the needs of the specific markets.

7. **Helps in projects selection:** A financial system helps in selecting the right type of projects to be funded and also inspires the operators to monitor the performance of the investment. It provides a payment mechanism for the exchange of goods and services, and transfers economic resources through time and across geographic regions and industries.

8. **Reduce cost of transaction and borrowing:** A financial system helps in creation of financial structure that lowers the cost of transactions. This has a beneficial influence on the rate of return to the savers. It also reduces the cost of borrowings. Thus, the system acts as a motivating factor among the general public to save and invest more financial resources.

9. **Price discovery**: The financial market performs the function of price discovery of the different financial instruments traded in the financial market. These instruments include money market instruments, debt securities, equity securities, derivative instruments, and foreign exchange instruments. The prices of these financial instruments are determined by the market forces, i.e. demand and supply.

COMPONENTS OF FINANCIAL SYSTEM:

A **financial system** refers to a system which enables the transfer of money between investors and borrowers. In other words, financial system facilitated the movement of funds from surplus areas to deficit areas. This movement of fund in a financial system is facilitated by a group of complex and closely linked institutions, agents, procedures, markets, transactions, claims and liabilities within an economy. These are known as the components of financial system.

The different components of a financial system can be shown with the help of the following diagram-

Financial System

A. Financial Market
B. Financial Institutions
C. Financial Services
D. Financial Instruments
E. Regulatory Bodies

A. FINANCIAL MARKET

Financial market is one of the main components of a financial system which facilitate movement of funds from surplus areas to deficit areas. It is a market where funds and financial instruments of different durations are traded. It is a market in which individuals, government, semi government and corporate bodies can trade in fund, financial assets, commodities and other fungible items at prices determined by the demand and supply conditions.

Various types of products are traded in a financial market which includes financial assets, securities or other type of financial instruments. Financial Assets or Financial Instruments represent a claim to the payment of a sum of money sometime in the future and / or periodic payment in the form of interest or dividend. There is a wide range of securities in the markets since the needs of investors and credit seekers are different.

Financial markets can be divided under different categories. Broadly financial market can be divided as follows–

i) **Money Market**: Money market is the sector of the financial market that includes financial instruments having a maturity or redemption period of one year or less at the time of issuance. It is mainly a wholesale market. Money market has many submarkets like Call Money Market, Collateral loan Market, Commercial Bill Market, Treasury Bill Market etc.

ii) **Capital Market**: Capital market is the sector of the financial market where long-term financial instruments issued by corporations and governments are traded. Here "long-term" refers to a financial instrument with an original maturity greater than one year and perpetual securities that is the securities with no maturity. There are two types of capital market securities viz. ownership securities and debt securities.

Capital market can be further subdivided as Government Securities Market, Industrial securities Market and Long Term Loan Market.

B. FINANCIAL INSTITUTIONS.

Any institution that accepts public savings and utilize it into assets such as stocks, bonds, bank deposits, or loans is considered a financial institution. Financial institutions facilitate smooth working of the financial system by providing a common platform to the investors and borrowers. They mobilize the savings of investors either directly or indirectly via financial markets. They offer services to individuals and organizations looking for advice on different problems including restructuring to diversification strategies. They offer wide range of services to the organizations who want to raise funds from the markets and take care of financial assets for example deposits, securities, loans, etc.

Financial institutions can be divided into the following two broad categories-

i) Banking Institutions

Bank is a financial institution that facilitates transfer of money from one person or business to another person or business. Basically, banking is a business activity which involves accepting money from public in the form of deposits and lending it as loans for earning profit. Banking institutions mainly serve two purposes viz. safeguarding public deposits and catering to their financial requirements by providing loan facilities.

The Banking Regulation Act, 1949 defines banking company as "a company which transacts the business of banking in India" and the word 'Banking' has been defined as 'accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise."

Banking institutions are of different types like central bank, commercial bank, cooperative bank, industrial bank, foreign exchange bank etc. Central bank is the apex monetary institution in a country. The Reserve Bank of India is the central bank in our country.

ii) Non-Banking Financial Institutions

A non banking financial institution (NBFI) is a financial institution whose liabilities cannot be used as means for settlement of debt. Like the banking institutions, NBFIs can accept deposit from the public and provide loan. However, the RBI has imposed following restrictions on the workings of the NBFIs.

i. NBFIs cannot accept demand deposits;

ii. NBFIs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;

iii. Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFIs, unlike in case of banks.

An NBFI can engage in the business of loans and advances, acquisition of shares, stocks, bonds, debentures and securities issued by Government or local authority or other marketable securities of a like nature. They can also engage in the activities like leasing, hire-purchase, insurance business, chit business. However, institutions whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale, purchase and/ or construction of immovable property are not included under the category of NBFIs.

The following are the main points of difference between banks and NBFIs.

Basis of Comparison	Banks	NBFIs
Meaning	Bank is a financial institution that accepts deposit of money from public for the purpose of lending or investment. Deposits are repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise.	A non bank financial institution (NBFI) is a financial institution that does not have a full banking license and can engage in restricted deposit taking activities.
Regulated under	The Banking Regulation Act, 1949	The Companies Act, 2013

Basis of Comparison	Banks	NBFIs
Regulatory authority	RBI	RBI/ SEBI
Acceptance of Deposit	Can accept all types of deposit.	Cannot accept demand deposit.
Cheque facility	Can provide cheque facility.	Can not provide cheque facility.
Foreign Investment.	Allowed up to 74% in Private Sector Bank.	Allowed up to 100%
Payment and Settlement system.	Banks are an integral part of the payment and settlement System.	NBFIs are not a part of the System.
Maintenance of Reserve Ratios.	Maintenance of reserve ratios are mandatory under the RBI Act and the B. R. Act.	Not Required to maintain reserve ratios.
Deposit Insurance Facility.	Available	Not available
Credit Creation	Banks can create credit.	NBFIs can not create credit.

C. FINANCIAL INSTRUMENTS:

In a financial system the transfer of available funds takes place through the buying and selling of financial instruments. In other words, as a component of the financial system, financial instruments facilitate movement of funds from surplus areas to deficit areas. A financial instrument is a written legal obligation of one party to transfer something of value, usually money, to another party at some future date, under certain conditions. The term 'instrument' is used in wider sense. It refers to tradeable assets of any kind- either cash, evidence of an ownership interest in an entity, or a contractual right to receive or deliver cash or another financial instrument. There are a wide range of securities in the markets since the needs of investors and credit seekers are different. Equity shares, debentures, bonds, etc. are some examples.

FEATURES OF FINANCIAL INSTRUMENTS:

Generally speaking, financial instruments posses the following characteristic features:

1. **Enforceable contract:** Financial instrument is a binding, enforceable contract under the rule of law, protecting potential buyers.
2. **Transfer of value:** There is transfer of value between two parties, where a party can be a bank, insurance company, a government, a firm, or an individual.
3. **Near money asset:** Financial instruments can perform some of the functions of money like a means of payment or a store of value. They are considered better stores of value since they allow for greater increases in wealth over time, but with higher levels of risk.
4. **Risk Transfer:** Some financial instruments facilitate risk transfer. In case of certain instruments, buyers are shifting risk to the seller, and are basically paying the seller to assume certain risks. Insurance policies are a prime example of this.
5. **Standardization:** Most financial instruments are standardized in that they have the same obligations and contract for buyers.
6. **Easy transferability:** Most of the instruments can be easily transferred from one hand to another without many cumbersome formalities.

7. **Ready market:** Financial instruments have a ready market. They can be bought and sold frequently and thus trading in these securities is made possible.

8. **Possess liquidity:** They possess liquidity i.e. some instruments can be converted into cash readily. For instance a bill of exchange can be converted into cash readily by means of discounting and rediscounting.

9. **Possess security value:** Most of the financial instruments possess security value i.e. they can be offered as security for the purpose of raising loan from banks and other financial institutions.

10. **Enjoy tax status:** Some financial instruments enjoy tax status i.e. investments in these instruments are exempted from income tax, wealth tax etc. subject to certain limits. For example some of the bonds issued by the PSUs, government securities like NSC enjoy tax status.

11. **Carry risk:** They carry risk in the sense that there is uncertainty with regard to payment of principal or interest or dividend as the case may be.

12. **Facilitate futures trading:** These instruments facilitate futures trading so as to cover risks due to price fluctuations, interest rate fluctuations etc.

13. **Less handling costs:** These instruments involve less handling costs since expenses involved in buying and selling these instruments are generally much less.

14. **Risk and return proportionate:** The return on these instruments is directly in proportion to the risk undertaken.

15. **Maturity period variation:** These instruments may be short term, medium term or long term depending upon the maturity period of these instruments.

CLASSIFICATION OF FINANCIAL INSTRUMENTS:

On the basis of nature of the financial instruments, they can be categorized under different heads which are as follows:

1. **Classification on the basis of determination of value:**

   i) **Cash instruments:** Cash instruments are financial instruments whose value is determined directly by the market. They can be divided securities and other cash instruments such as loans and deposits.

   ii) **Derivative Instruments:** Derivative Instruments are financial instruments which derive their value from underlying entities such as an asset, index, or interest rate.

2. **Classification on the basis of asset class:**

   i) **Equity instruments:** Equity instruments are claims on the earnings and assets of a corporation. Some equities securities entitle the owner to periodic payments known as dividends but these payments are not guaranteed. There is no maturity date for equity securities so they are considered long-term securities. Equity shares are best examples of equity securities.

   ii) **Debt instruments:** Debt instruments involve a promise by the borrower (the issuer of the debt instrument) to pay the lender (the buyer of the debt instrument) fixed payments after a specific period of time. Debentures, bonds are examples of debt instruments.

   iii) **Foreign exchange instruments:** The foreign exchange instrument is a legally enforceable (binding) agreement between two or more parties regarding a right to payment of foreign exchange..

3. **Classification on the basis of issuers:** On the basis of issuers of instruments, debt instruments can be classified as government instruments and industrial instruments.

i) **Government securities**: Government securities are fixed income securities issued by the Government or the RBI on behalf of the Government. They also include the securities issued by State Governments, quasi government bodies like local municipalities/corporations, electricity board. As these securities are issued by Government the risk is very minimum and the interest rate also low compared to many other private financial investment.

ii) **Industrial securities**: Industrial securities issued by the corporate sector to finance their long term and working capital requirements. The major instruments that fall under industrial securities are equity shares, preference shares, debentures, commercial papers etc.

4. Classification on the basis of maturity: On the basis of maturity period, financial instruments can be classified as money market instruments and capital market instruments.

i) **Money market instruments**: Money market instruments are short-term instruments having a maturity of up to 1 year. This part of the debt market includes both Government instruments and industrial instruments like treasury bills, commercial bills, commercial papers, certificate of deposits etc.

ii) **Capital market instruments**: Capital market instruments include long-term debt instruments having a maturity of 1 year or more. Debentures, bonds, Government instruments like NSC, KVP etc. are best examples of capital market instruments.

5. Classification on the basis of intermediaries involved:

On the basis of intermediaries involved in the process of issue of securities, financial instruments can be classified as primary instruments and secondary instruments.

i) **Primary instruments:** Primary instruments are also referred to as direct securities as they are directly issued by the ultimate borrowers of fund to the ultimate savers. Equity shares and debentures are best examples of primary instruments.

ii) **Secondary instruments:** Secondary instruments are also referred to as indirect securities as they are issued by the financial intermediaries to the ultimate savers. Units of mutual funds and insurance policies are secondary instruments.

D. FINANCIAL SERVICES:

Financial services refer to services provided by the finance industry. The finance industry encompasses a broad range of organizations that deal with the management of money. Among these organizations are banks, credit card companies, insurance companies, consumer finance companies, stock brokerages, investment funds and some government sponsored enterprises.

Financial service providers help to get the necessary funds and also make sure that they are efficiently deployed. They assist to determine the financing combination and extend their professional services upto the stage of servicing of lenders. They help with borrowing, selling and purchasing securities, lending and investing, making and allowing payments and settlements and taking care of risk exposures in financial markets. Services like credit rating, venture capital financing, mutual funds, merchant banking, depository services, book building, etc. are also made available to the corporate houses.

Important financial service providers include leasing companies, mutual fund houses, merchant bankers, portfolio managers, bill discounting and acceptance houses etc.

E. REGULATORY BODIES

The task of control and regulation of the various participants in the financial system has been entrusted to some statutory authorities formed under different statutes of the parliament. Hence these statutory bodies are considered as an important component of the financial system. There are two most important regulatory bodies in the country viz. Reserve Bank of India and Securities and Exchange Board of India (SEBI).

The Reserve Bank of India (RBI) regulates and supervises the major part of the financial system. The supervisory role of the RBI covers commercial banks, urban cooperative banks (UCBs), some financial institutions and non-banking finance companies (NBFCs). The capital market, mutual funds, and other capital market intermediaries are regulated by Securities and Exchange Board of India (SEBI).

Apart from these two, there are some other important regulatory bodies in the Indian Financial System. Regional Rural Banks and the Co-operative banks are supervised by National Bank for Agriculture and Rural Development (NABARD); and housing finance companies by National Housing Bank (NHB). Department of Company Affairs (DCA), Government of India regulates deposit taking activities of corporate entities other than NBFCS registered under the Companies Act. Insurance Regulatory and Development Authority (IRDA) regulates the insurance sector; and the Pension Funds Regulatory and Development Authority (PFRDA) regulates the pension funds.

ROLE OF FINANCIAL SYSTEM IN THE ECONOMIC DEVELOPMENT OF A COUNTRY

The financial system plays an important role in the economic development of a nation. The financial system is comprised of a network of various financial institutions like commercial banks, non-banking financial corporations, development banks, investment banks, insurance companies, etc. These financial institutions offer a variety of financial products and service that suit the requirement of the different categories of customers. As these financial institutions play a crucial role in the money market and capital market, their role in the economic development of a nation is inevitable.

The role of financial system in the economic development of a nation can be discussed under the following heads-

1. **Capital formation**: Capital formation is the process by which a community's savings are channeled into investments in capital goods such as plant, equipment, and machinery, which increases a country's productive capacity and worker efficiency, ensuring a greater flow of goods and services in a country. The financial system mobilizes excess funds or savings available in the hands of the citizens and thus helps in capital formation.
2. **Promoting investments**: An important role of the financial system in the economic development is that it encourages savings to flow into the various productive sectors of the economy. The level of investment determines the increase in output of goods and services, and incomes in the country. It is required to be noted that investment in productive segments are non-inflationary in nature which ultimately lead to the growth and development in the economy. The larger the investments in the economy, the greater are the scope for income generation, employment generation which ultimately lead to economic development.
3. **Allocating savings on the basis of national priorities**: The financial system allocates the savings in more efficient manner so that the scarce capital may be more efficiently utilized among various priority sectors as per national policy. While investing funds, some preferences are always given to certain social and economic sector on the basis of national priorities.
4. **Encouraging entrepreneurial talents**: Financial system encourages the growth of entrepreneurial talents by promoting

the spirit of enterprise and risk-taking capacity. Financial institutions like commercial and specialized banks act as the main driving force in the growth and development of entrepreneurship. They provide much needed financial resources to the entrepreneurs by different ways like overdraft, medium and long term loans, debt factoring, invoice discounting, asset finance including commercial mortgages and equity finance. Apart from providing financial assistance, financial system render variety of other non-fund based services to support and promote their enterprise.

5. **Financial deepening and broadening:** A well –functioning financial system helps in promoting the process of financial deepening and broadening. Financial deepening refers to an increase of financial assets as a percentage of the gross domestic product. Financial broadening refers to building an increasing number and a variety of participants and instruments.

6. **Interest rates stabilization:** A well-developed financial system promotes healthy competition among the different participants both in the demand and supply side. This means that members have to compete with each other by lowering their costs. As a result, the benefits of lower interest rates are passed on to the consumers. Further, the existence of the financial system ensures uniform interest rate across the country. In the absence of a financial system, each region would have its own interest rate based on the availability of capital. However, with the financial system in place, interest rates remain the same across the entire country.

7. **Growth of trade and commerce sector:** By providing an efficient payment mechanism, financial system ensures timely and smooth transfer of goods and services and which in turn contributes to development of trade and commerce sector in an economy. An efficient payment system comprising of several institutions, like

banks, depository institutions, and private companies, minimize the credit risk in business. With the advent of advanced technology, it is now possible to remit money to any part of the world within a few seconds. Thus, financial markets and institutions aid in expansion of trade and commerce and improve the gross domestic product of a country.

8. **Employment generation:** The financial system provides capital to entrepreneurs who want to start a business or expand their existing business. When these businesses come into existence, they, directly and indirectly, require the services of a wide variety of personnel. As a result, a lot of employment opportunities are generated in the economy.

9. **Expansion of international trade:** Financial system plays a very important role in the international trade process. In international trade, all payments for exports and imports are routed through the banking institutions. By issuing letter of credit on behalf of importers, banks simplify the process of import of goods and services from exporting country. As a result, neither party has to rely on each other. Instead, both of them can rely on the bank, which has a higher credit rating and therefore aids in the reduction of risk. The absence of financial markets and institutions will have negative impact on growth and volume of international tarde.

10. **Aids in attracting foreign capital:** Stable financial markets raise investor confidence. Investors from domestic as well as international markets start investing in the capital markets. As a result, more capital becomes available to domestic companies. They can then use this capital for the growth and expansion of their business, which makes them more competitive in the international market.

11. **Development of economic infrastructure:** Financial markets play a vital role in the development of economic infrastructure in a country. Key sectors like power generation, oil, and gas, transport, telecommunication and railways receive a lot of funding at

concessional rates. Development of these sectors contributes a lot to the economic development of a country.

12. **Assistance to Government:** Financial markets also allow governments to raise large sums of money. This enables them to continue deficit spending. In the absence of financial markets, governments would not be able to continue deficit spending, which is important to fund infrastructure projects in the short run.

13. **Developing backward areas**: Development of economic infrastructure, expansion of trade, commerce and industries create a conducive atmosphere for the development of hitherto backward areas and thus, they contribute for the uniform development of all regions of the country.

The above discussion makes it clear that a financial system is primarily responsible for the mobilization of domestic savings and the conversion of these funds into directly productive investments. A sound and robust financial system is a key contributing factor to financial stability in a country. Financial system- a subset of the economy is just like the foundation of a building. The whole structure of an economy rests on the foundation built by the different components of financial system.

SUMMARY

Meaning of Financial System:

Financial system is a set of interrelated activities which facilitate the transfer of money from surplus areas to deficit areas. In simple words, financial system facilitates transfer of funds from investors to borrowers. The term “system” in “Financial System” indicates a group of complex and closely linked institutions, agents, procedures, markets, transactions, claims and liabilities within an economy.

- **Features of a financial system are**: (i) Component of the national economy (ii) Dichotomy, (iii) Subsystems, (iv) Establish linkage, (v) Financial assets, (vi) Liquidity, (vii) Allocation of financial resources, and (viii) Contribution to economic development.
- **Functions of Financial System:** Various functions of Financial System are:
  - **(i) Establish linkage between savers and investors:** One of the important functions of financial system is to link the savers and investors. It helps in mobilizing and allocating the savings effectively and efficiently.
  - **(ii) Promotion of liquidity:** The major function of financial system is to promote liquidity and safety of funds.

(iii) **Facilitating Payments:** Financial System facilitates efficient payment mechanism for timely and smooth transfer of goods and services.

(iv) **Allocation of risk:** It limits, pools, and trades the risks involved in mobilizing savings and allocating credit.

(v) **Managing Information:** The financial system makes available a lot of important information, which is important for the well-being of the economy as a whole.

(vi) **Efficient Middleman:** The financial system plays the role of an efficient middleman.

(vii) **Helps in projects selection:** A financial system helps in selecting the right type of projects to be funded.

(viii) **Reduce cost of transaction and borrowing:** A financial system helps in creation of financial structure that lowers the cost of transactions.

(ix) **Price discovery**: The financial market performs the function of price discovery of the different financial instruments traded in the financial market.

Components of Financial System

The different components of a financial system are—

1. **Financial Market:**

Financial market is one of the main components of a financial system which facilitate movement of funds from surplus areas to deficit areas. It is a market where funds and financial instruments of different durations are traded.

Financial markets can be divided under different categories. Broadly financial market can be divided as follows-

(b) **Money Market**: Money market is the sector of the financial market that includes financial instruments having a maturity or redemption period of one year or less at the time of issuance.

(c) **Capital Market**: Capital market is the sector of the financial market where long-term financial instruments issued by corporations and governments are traded.

2. Financial Institutions:

Any institution that accepts public savings and utilize it into assets such as stocks, bonds, bank deposits, or loans is considered a financial institution. Financial institutions can be divided into the following two broad categories-

(i) Banking Institutions

Bank is a financial institution that facilitates transfer of money from one person or business to another person or business. The Banking Regulation Act, 1949 defines banking company as "a company which transacts the business of banking in India" and the word 'Banking' has been defined as 'accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise."

Banking institutions are of different types like central bank, commercial bank, cooperative bank, industrial bank, foreign exchange bank etc.

ii) Non Banking Financial Institutions

A non banking financial institution (NBFI) is a financial institution whose liabilities cannot be used as means for settlement of debt. Like the banking institutions, NBFIs can accept deposit from the public and provide loan.

3. Financial Instruments:

In a financial system the transfer of available funds takes place through the buying and selling of financial instruments. In other words, as a component of the financial system, financial instruments facilitate movement of funds from surplus areas to deficit areas.

Features of Financial Instruments:

Features of financial instruments are –

(i) Enforceable contract

(ii) Transfer of value

(iii) Near money asset

(iv) Risk Transfer

(v) Standardization

(vi) Easy transferability

(vii) Ready market

(viii) Possess liquidity

(ix) Possess security value

(x) Enjoy tax status

(xi) Carry risk

(xii) Facilitate futures trading

(xiii) Less handling costs

(xiv) Risk and return proportionate

(xv) Maturity period variation.

Classifications of Financial Instruments:

1. Classification on the basis of determination of value:

i) Cash instruments, ii) Derivative Instruments.

2. Classification on the basis of asset class:

i) Equity instruments

ii) Debt instruments,

iii) Foreign exchange instruments

3. Classification on the basis of issuers:

i) Government securities

ii) Industrial securities,

4. Classification on the basis of maturity:

i) Money market instruments

ii) Capital market instruments.

5. Classification on the basis of intermediaries involved:

i) Primary instruments

ii) Secondary instruments.

4. Financial Services:

Financial services refer to services provided by the finance industry. The finance industry encompasses a broad range of organizations that deal with the management of money. Among these organizations are banks, credit card companies, insurance companies, consumer finance companies, stock brokerages, investment funds and some government sponsored enterprises.

Financial service providers help to get the necessary funds and also make sure that they are efficiently deployed. Important financial service providers include leasing companies, mutual fund houses, merchant bankers, portfolio managers, bill discounting and acceptance houses etc.

5. Regulatory Bodies

The task of control and regulation of the various participants in the financial system has been entrusted to some statutory authorities formed under different statutes of the parliament. Hence these statutory bodies are considered as an important component of the financial system. There are two most important regulatory bodies in the country viz. Reserve Bank of India and Securities and Exchange Board of India (SEBI).

The Reserve Bank of India (RBI) regulates and supervises the major part of the financial system. The supervisory role of the RBI covers commercial banks, urban cooperative banks (UCBs), some financial institutions and non-banking finance companies (NBFCs). The capital market, mutual funds, and other capital market intermediaries are regulated by Securities and Exchange Board of India (SEBI).

Role of Financial System in the economic development of a country :

The role of financial system in the economic development of a nation can be discussed under the following heads–

1. **Capital formation**: The financial system mobilizes excess funds or savings available in the hands of the citizens and thus helps in capital formation.
2. **Promoting investments**: An important role of the financial system in the economic development is that it encourages savings to flow into the various productive sectors of the economy.
3. **Allocating savings on the basis of national priorities**: The financial system allocates the savings in more efficient manner so that the scarce capital may be more efficiently utilized among various priority sectors as per national policy.

4. **Encouraging entrepreneurial talents**: Financial system encourages the growth of entrepreneurial talents by promoting the spirit of enterprise and risk-taking capacity.
5. **Financial deepening and broadening:** A well –functioning financial system helps in promoting the process of financial deepening and broadening.
6. **Interest rates stabilization:** With the financial system in place, interest rates remain the same across the entire country.
7. **Growth of trade and commerce sector:** By providing an efficient payment mechanism, financial system ensures timely and smooth transfer of goods and services which in turn contributes to development of trade and commerce sector in an economy.
8. **Employment generation:** The financial system provides capital to entrepreneurs who want to start a business or expand their existing business. As a result, a lot of employment opportunities are generated in the economy.
9. **Expansion of international trade:** Financial system plays a very important role in the international trade process.
10. **Aids in attracting foreign capital:** Stable financial markets raise investor confidence. Investors from domestic as well as international markets start investing in the capital markets. As a result, more capital becomes available to domestic companies.
11. **Development of economic infrastructure:** Financial markets play a vital role in the development of economic infrastructure in a country.
12. **Assistance to Government:** Financial markets also allow governments to raise large sums of money.
13. **Developing backward areas**: Financial System helps in development of economic infrastructure, expansion of trade, commerce and industries to create a conducive atmosphere for the development of backward areas.

UNIT-I

QUESTIONS

A. Write the correct answer as directed: 1 Mark each

1) Which of the following regulates the money market in India?

i) RBI ii) SEBI iii) IRDA iv) Ministry of Finance

(Choose the most appropriate answer)

2) Development Financial Institutions are the main sources of short term fund for a business.

(State whether the statement is true or false)

3) Commercial paper is a money market instrument.

(State whether the statement is true or false)

4) Treasury bills are issued by .... (Fill up the gap)

B. Give brief answer to the following questions: 2 Marks each

1) Define finance?

2) What is private finance?

3) What is public finance?

4) What is corporate finance?

5) Write two sources of finance?

6) Give two examples of financial services.

7) Name any two capital market instruments.

8) What is Money Market?

9) What is Capital Market?

C. Answer the following questions in about 200 words each:

5 Marks each

1) Explain briefly about the various functions of finance.

2) Write a short note on the different types of finance.

3) Differentiate between banks and non-bank financial institutions.

4) State the functions of financial system.

D. Answer the following questions in about 400 words each:

8 Marks each

1) Elaborately discuss about the different sources of short term and long term finance for a business concern.

2) Discuss the various components of financial system.

3) Discuss the role of financial system in the economic development of a country.

UNIT-II

Meaning and Different Types of Banks

Meaning, Definition and Features of Bank.

DIFFERENT TYPES OF BANKS

Central Bank – meaning, features and functions.

Commercial Bank – meaning, primary functions, secondary functions and modern functions.

Exchange Bank / Foreign Bank – meaning and functions.

Regional Rural Bank – meaning, objectives and functions.

Investment Bank – meaning and functions.

Development Bank – meaning, features and functions.

Export-Import Bank – meaning and functions.

Co-operative Bank – meaning and features.

Agricultural Bank – meaning and functions.

Meaning of Land Development Bank, Savings Bank, International Bank.

Differences between (i) Commercial and Development Bank, (ii) Central and Commercial Bank, (iii) Commercial and Co-operative Bank.

LEARNING OBJECTIVES

After the study of this unit, the student will be able to :—

- Know the meaning, definition and features of bank.
- Understand the meaning and functions of various types of banks.
- Know the differences between commercial and development bank, central and commercial bank, and commercial and co-operative bank.

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CHAPTER-3

BANK

MEANING AND DEFINITION OF BANK :

Bank is a financial institution. It deals in money and credit. It also involves with the transaction of different monetary instruments like, cheque, bill of exchange, promissory notes, drafts etc. It is a profit seeking financial institution. Generally, the bank accepts deposits of money or equivalent of money from the public. The money so accepted is used for lending or investment purposes to the needy borrowers. The difference of rate of interest on deposit and loan is the profit of the bank.

It is very difficult to give the universally accepted definition on the term 'bank'. To have a clear understanding on the term bank the following definitions are presented.

According to section 5 (b) of the Banking Regulation Act, 1949 banking is defined as "accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise."

According to section 5 (c) of the Banking Regulation Act, 1949 "Banking company means any company which transacts the business of banking in India."

According to R.P. Kent "Bank is an institution which collects idle money temporarily from the public and lends to other people as per requirement."

Sir John Paget, the father of banking, defines the banker as "that no person or body corporate or otherwise can be a banker who does not

i. take deposit accounts,

ii. take current accounts,

iii. issue and pay cheques, and

iv. collect cheques crossed and uncrossed, for his customers."

According to Cairn Cross, "Bank is a financial intermediary institution which deals in loans and advances."

According to H.L. Hart, A banker is "one who in the ordinary course of his business, honours cheques drawn upon him by persons from and for whom he receives money on current accounts."

Use of the term bank banker, banking or banking company: As per section 7 of the Banking Regulation Act, 1949, no company other than the banking company shall use as part of its name any of the words 'bank' 'banker' or 'banking' and no company shall carry on the business of banking in India, unless it uses as part of its name at least one of such words.

From the above definitions as given by various economist and laws, it may be concluded that a bank is a financial institution which accepts various types of deposits from the public repayable on demand or otherwise and grants loans and advances to needy borrowers.

CHARACTERISTICS / FEATURES OF BANKS / BANKING

Various characteristics/features of bank are stated below:

(i) **Bank is a financial institution**: It is not a socio-economic institution.

(ii) **It deals in money**: The bank accepts deposits of money from the public and advancing them as loans to the needy people.

The deposits may be of different types- savings, current, fixed, recurring deposits, etc.

(iii) **Deposits must be withdrawable**: The deposits accepted from the public must be withdrawable by cheques, draft or otherwise.

(iv) **Deposits repayable on demand**: The deposits accepted from the public are repayable on demand or otherwise.

(v) **It deals in credit**: The banks are the institutions that can create credit. “The creation of credit is the unique feature of banking.”

(vi) **Commercial in nature**: Bank is a commercial institution. All the banking functions are carried on with the aim of earning profit.

(vii) **Nature of Agent**: Banks possess the character of an agent of its customer because of their various agency services.

(viii) **Banking nature**: The principal business of a banker must be of banking nature.

(ix) **Provides financial services**: The bank provides various financial services to its customers.

(x) **Name of the banking company**: The banking company must use at least one word out of the four words ‘bank’, ‘banker’, ‘banking’ or ‘banking company’ as a part of its name to consider as a bank.

(xi) **Use of approved instruments**: The banking transaction should be done through some approved instruments or any other method as mentioned in the agreement between banker and customer.

TYPES OF BANKS

Bank is a financial institution. It is indispensable part of the financial system. It has been playing an important role in economic development. Economic development is the result of the development of different sectors of the economy. The different sectors of the economy require different financial services for its development. As a result, different types of banks have been set up to provide the different services to different sectors of the economy. Some of these are – Central Bank, Commercial Bank, Exchange Bank, Regional Rural Bank, Investment Bank, Development Bank, Export-Import Bank, Co-operative Bank, Agricultural Bank, Land Development Bank, Savings Bank & International Bank. These are discussed in the Chapter-4,Chapter-5 and Chapter-6.

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SUMMARY

- **Meaning of bank:**

  Bank is a financial institution. It deals in money and credit. It also involves with the transaction of different monetary instruments like, cheque, bill of exchange, promissory notes, drafts etc. It is a profit seeking financial institution.

- **Definition of bank**

  According to section 5 (b) of the Banking Regulation Act, 1949 banking is defined as “accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise.”

  According to section 5 (c) of the Banking Regulation Act, 1949 “Banking company means any company which transacts the business of banking in India.”

- **Various characteristics/features of bank are :-**

  (i) Bank is a financial institution,

  (ii) It deals in money,

  (iii) Deposits must be withdrawable by cheque, draft, or otherwise,

  (iv) Deposits repayable on demand,

  (v) It deals in credit,

  (vi) Commercial in nature,

  (vii) Nature of Agent,

  (viii) Banking nature,

  (ix) Provides financial services,

  (x) Name of the banking company and

  (xi) Use of approved instruments

CHAPTER-4

CENTRAL BANK

MEANING AND DEFINITION OF CENTRAL BANK :

Central bank is the supreme monetary institution of a country. Its position is at the apex of the monetary and banking structure of a country. Central bank is the leader of the money market. It controls, regulates and supervises the activities of commercial banks operating in the country. Central bank is the central monetary authority. It manages the currency and credit policy of the country. It acts as a banker to the commercial banks and the government.

Every country has generally one central bank. Reserve Bank of India (RBI) is the central bank of India. Bank of England is the central bank of Great Britain, Goss Bank is Central bank to Russia. Similarly, Federal Reserve System is the central bank of USA.

There is no comprehensive and satisfactory definition of a central bank.

According to Hawtry " Central Bank " is the lender of last resort".

Similarly P.A. Samuelson defines it as "A bank of bankers."

W.A. Shaw also opines it as "a bank which control credit."

In this way we have some other definitions which are mainly based on some other functions of central bank. We can consider the central bank as an apex monetary institution with certain regulated power over the banking and monetary system of a country.

Characteristics of Central bank :

Some salient features of Central Bank are mentioned below -

a. It is a non-profit organisation. The objective of the bank is not to earn profit. It aims at national welfare.

b. Right of Note issue is an universal character of central bank for all the countries of the world. It circulates all types of currency notes in the country.

c. There is no direct relation between the central bank and the general public.

d. Central bank is a machinery of fund management of Central Government. It is a banker to the Government.

e. Central Bank is working as a custodian of foreign exchange. It has a right to control over the foreign exchange reserve.

f. Central bank has control over all the commercial banks and other financial and monetary institutions of a country.

g. Central bank does not compete with the member commercial banks in the country.

h) It is the apex banking institution.

Traditional Functions of Central Bank:

Generally, a central bank performs the following functions:

1) Issue of Currency Notes

The issue of the paper currency is the most important function of a central bank. In almost every country, the central bank issues currency notes. The central bank has the sole monopoly power of note issue. The currency notes printed and issued by the Central bank become unlimited legal tender throughout the country. In India, Reserve Bank of India issues currency notes.

The monopoly power of the note issue enjoyed by the central bank has some advantages:

a) It brings uniformity in note issue and note circulation.

b) The central bank can exercise better control over the money supply in the country.

c) It increases public confidence in the monetary system of the country.

d) It makes monetary management of the paper currency easier.

e) It helps the central bank to exercise control over undue credit expansion by the commercial banks.

2) Acts as Banker, Agent and Adviser to the Government:

A central bank acts as a banker, agent and financial adviser to the government of the country.

a) As a banker to government, the central bank-

(i) Maintains the accounts of the central and state government.

(ii) Receives deposits from the government.

(iii) Makes short-term advances to the government.

(iv) Collects cheques and drafts deposited in the government account.

(v) Provides foreign exchange resources to the government (for making various payments).

b) As an agent to the government, the central bank-

(i) Collects taxes and other payments on behalf of the government.

(ii) Raises loans from the public.

(iii) It undertakes the issue of treasury bills.

(iv) Represents the government in the international financial institutions and conferences.

c) As a financial adviser to the government, the central bank advises the government on financial, monetary, economic and fiscal matters.

3**) Acts as Banker's Bank:**

A central bank acts as the bankers' bank on three capacities:

(i) As a Custodian of the Cash Reserve of the commercial banks:

A central bank maintains cash reserve of the commercial banks. The commercial banks in the country have to keep a certain percentage of its cash balances as deposits with the central banks. These cash reserve can be utilized by the commercial banks during emergency.

The centralization of cash reserves in the central bank has the following advantages:

(a) It inspire/instill confidence of the public in the banking structure.

(b) It can serve/provide as the basis of a larger and more elastic credit structure.

(c) It enables the central bank to provide additional funds to those banks which are in temporary difficulties.

(ii) As a Lender of Last Resort:

The central bank acts as the lender of the last resort. The central bank gives financial accommodation to the commercial banks, mostly, by rediscounting their eligible securities and exchange bills. This accommodation is given at the request of the commercial banks.

The advantages of the central bank's acting as lender of last resort are:

a) It increases the elasticity and liquidity of the entire credit structure.

b) It provides financial help to the commercial banks in time of difficulties.

c) It helps the central bank to exercise its control over banking system of the country.

(iii) Clearing House:

As the custodian of the cash reserves of the commercial banks, the central bank acts as the clearing house (for these banks). As all banks maintain their accounts with the central bank, the claims of banks against one another are settled by simple transfers from and to their accounts.

The main advantages of clearing house function of the central bank are:

a) It provides economy in the use of money / cash in banking operations.

b) It reduces the withdrawals of cash.

c) It tends generally to strengthen the banking system of a country.

4) **Custodian of Gold and Foreign Exchange Reserves:**

The central bank also acts as the custodian of country's gold and foreign exchange reserves. **A central bank holds reserves of gold and foreign currencies mainly for two purposes:**

a) To overcome the balance of payments difficulties and

b) To maintain stability in the exchange rates.

5) **Controller of Credit:**

The control of credit is considered to be the main function of a central bank. Uncontrolled credit causes economic fluctuations in the economy.

By controlling the credit effectively, the central bank establishes:

a) Stability in the internal prices, and

b) Stability in the foreign exchange rates.

For economic growth and smooth functioning of the economy (i) stability in the internal price and (ii) stability in the foreign exchange rates is necessary.

SUMMARY

- **CENTRAL BANK:**

  Central bank is the supreme monetary institution of a country. Its position is at the apex of the monetary and banking structure of a country. It controls, regulates and supervises the activities of commercial banks operating in the country. It manages the currency and credit policy of the country.

  Characteristics of Central bank :

  (i) It is a non-profit organization,

  (ii) Right of Note issue is an universal character of central bank,

  (iii) There is no direct relation between the central bank and the general public,

  (iv) It is a banker to the Government,

  (v) Central Bank is working as a custodian of foreign exchange,

  (vi) Central bank has control over monetary system,

  (vii) Central bank does not compete with the member commercial banks in the country and

  (viii) It is the apex banking institution.

- **Traditional Functions of Central Bank:**

  (i) Issue of currency Notes,

  (ii) Acts as Banker, Agent and Adviser to the Government,

  (iii) Acts as Banker's bank - As a Custodian of the Cash Reserve of the commercial banks, As a Lender of Last Resort and As a Clearing Agent/House,

  (iv) Custodian of Gold and Foreign Exchange Reserves and

  (v) Controller of Credit.

CHAPTER-5

COMMERCIAL BANK

MEANING OF COMMERCIAL BANK :

Commercial Bank refers to the financial institution which accepts, for the purpose of lending or investment, deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise. It mobilises savings from the surplus-spending sector and lend these funds to the deficit-spending sector. Funds are lent by commercial banks in the form of loan, cash credit, overdraft and discounting of bills. Besides the primary functions of mobilising deposits and lending funds, commercial banks provide a range of ancillary services, including transfer of funds, collection of foreign exchange, safe deposit locker, merchant banking, etc. Examples of commercial banks are State Bank of India, Central Bank of India, Union Bank of India, Allahabad Bank, etc.

Functions / Services of Commercial Banks :

The various functions / services of commercial bank are discussed in details in the following heads.

A) Primary functions,

B) Secondary functions and

C) Modern functions.

Let us now discuss the functions one by one in the following ways

A) **Primary functions of Commercial Banks**

The primary functions of a commercial bank are basically divided into two groups.

1. Accepting deposits of money
2. Granting loans and advances

1. Accepting deposits :

Acceptance of deposit is an important primary function of a commercial bank. A bank accepts money / deposits from its customers. Deposits of banks are classified into mainly two categories :

(i) Demand Deposits : This type of deposits is repayable on customer's demand. Demand deposits mainly comprise the following:

a) Savings deposits

b) Current deposits

(ii) Term Deposits : This type of deposits is repayable on maturity dates as agreed between the banker and the customers. Term deposits comprise the following:

a) Recurring deposits

b) Fixed deposits

The details of various types of accounts maintained by commercial banks are given in the unit 4 of this book. Here, the short details on various types of accounts are mentioned below –

Savings Bank Account :

Savings Bank Account is primarily for small scale savers. The important objective of savings bank account is to encourage saving habits of the people. Savings account can be opened by Individuals, Guardians (on behalf of their minor children/wards), Karta of Hindu Undivided family, Associations, Trusts, Clubs, etc. The rate of interest on saving account is lower than the fixed and recurring deposit accounts. The deposits in these accounts are repayable on demand of the depositors.

Current Deposit Account :

The current account is generally opened by businessmen, individuals, firms, companies, entrepreneurs, professional, contractors, institutions, Government bodies/departments, Societies, liquidators, trusts, etc. It is a running account. Money can be deposited and withdrawn at any time. Current accounts provide overdraft facilities to holder of accounts. Usually, a banker does not give any interest on this account. Rather the bank may charge incidental charge or fee for maintaining the account of the customer. The purpose of current account is to help account holder to run the frequent business or financial transactions.

Recurring Deposit Account (RD)

In recurring deposit account, a fixed amount of savings are required to be compulsorily deposited by the customer at specific intervals for a specific period. It intended to encourage/inculcate regular and compulsory savings habit among the low/middle income group people for meeting their future specific needs e.g. higher education or marriage of children, purchase of vehicle, etc. Generally, the rate of interest on RD account is higher than savings bank account but lesser than fixed deposit account.

Fixed Deposit Account

In this account bank accepts deposits for a fixed period of time. The period may range from 45 days, 90 days, 180 days, 1 year to 5 years etc. Fixed deposits are repayable on the maturity date along with interest at an agreed rate for the period. Banks pay higher interest rates on fixed deposits as compared to savings bank deposits. Longer period of deposits generally gain higher rate of interest than the shorter period of deposits. Generally, fixed deposits cannot be withdrawn before the expiry of maturity period. Fixed deposits are also known as term deposits.

In addition to the above types of accounts different bank also provides various other schemes of deposit considering the need of the different customers. Daily savings schemes, insurance linked deposit, monthly income scheme (MIS), cash certificate schemes, retirement or annuity deposit etc. The details of these accounts are discussed in unit IV of this book.

2. Granting loans and advances

Granting loan and advances is another primary function of a commercial bank. There are different modes or ways of granting loans to the customer. These are discussed below –

(i) Loans

Loan is a lump sum amount of advances sanctioned by a bank to the customer for a certain period at an agreed rate of interest. The entire amount is paid on one occasion. The interest is charged for the full amount sanctioned. The loan may be repaid in predetermined installment or at the expiry of a specific period. The loan may be sanctioned with or without security.

Loan may be categorized into

(a) short-term loan, (b) medium-term loan and

(c) long term loan.

(a) Short-term loans :

Short-term loans are given for a period of not exceeding

1 year. It is usually granted to meet working capital requirements of the borrower/industries.

(b) Medium-term loans :

Medium-term loans are granted for a period ranging from 1 year to 5 years. It is usually granted for the purchase of various tools and equipments, tractors, vehicles, etc.

(c) Long-term loans :

Long-term loans are granted for capital expenditure. It is granted for construction of factory building, purchase of land, purchase of new machinery and modernization of plant.

ii) Overdraft

Overdraft is a credit arrangement, whereby, a customer is allowed to withdraw over and above his credit balance in the current account up to a specified limit. Overdraft is a short term credit arrangement. It is purely a temporary arrangement. Overdraft is granted by the bankers against collateral security or personal guarantee of the borrower. The borrower is permitted to draw and repay any number of times.

The account holder has to pay interest only on the amount actually over drawn and only for the period during which it is utilised. As per the terms of the overdraft agreement an incidental charge or commitment charge may be imposed on the customer on the unutilised overdraft limit.

(iii) Cash Credit

A cash credit is an arrangement by which a customer of a bank is permitted to borrow money up to a particular limit. A separate account is opened for this purpose. Cash credit is a permanent arrangement. Cash credits are usually provided against sufficient securities (pledge or hypothecation of goods, and personal security).

The customer need not draw the sanctioned amount at a time. He can withdraw money from this account as and when he needs it. He can deposit any surplus amount into this account and borrow again.

In cash credit, interest is charged only on the actual amount withdrawn. If the customer does not utilize the sanctioned cash credit limit in full, a commitment charge is made by the bank. This commitment charge is imposed only on the unutilized portion of the cash credit.

Cash credit is an active and running account. Though cash credit is generally sanctioned for a period of one year, it can be renewed year after year.

iv) Bill discounting

Commercial Banks can also lend money by discounting bills of exchange. In case the holder of a bill needs money immediately, he can get his bills discounted by a commercial bank. The bank charges a commission for discounting of bills. The bills can also be re-discounted at the Central Bank. This method is very popular because of its self liquidity character.

v) Money at call or call loan

Call loan is a very short term advance. Generally the participants involved in this market are different financial institutions, dealers, broker of stock exchanges etc. This loan is given for a period of 1 day to 14 days. This loan can be called back by the bank at a very short notice. The rate of interest is comparatively very high in call loan. Brokers, Dealers etc are given this loan against their collateral securities such as equity shares, debentures etc.

vi) Consumer Credit

Consumer credit is one type of term loan. It is basically provided by the bank to the customer for purchasing T.V., Washing Machine, Air Cooler, Air Conditioner and some other household goods. In addition to these it is also granted for some personal needs, such as payment of medical bills and other household liabilities. This loan is provided in a lump sum basis which is repayable in installment within a short period. Hence it is a short term loan.

B. Secondary Functions of Commercial Banks

The secondary functions / services of a commercial bank can be classified into the following two categories.

1) Agency functions / Services.
2) General utility or Public Utility Services.

1) Agency functions / services

Banks also perform some agency functions / services for and on behalf of their customers. They are as follows:

i) Remittance of fund

Banks help their customers in transferring fund from one place to another place or one account to another account. Funds are transferred through cheques, drafts, mail transfer or telegraphic transfer or any other modern techniques of fund transfer. Banks charge a minimum service charge or fee from the customers for providing such type of agency services.

ii) Making payment on behalf of customers

As per the instruction of the customers, bank makes various kinds of payment like payment of electricity bill, municipality tax, coupons, draft, promissory notes, interest, rent, insurance premium, dividend warrants, bill of lading, etc.

iii) Collection of Cheques, etc

Collection of cheques and other negotiable instruments on behalf of customers and crediting the proceeds to their account is an another important agency function rendered by the bank.

iv) Buying and Selling of Stocks, Securities etc

Banks undertake buying and selling of shares, stocks, other securities, foreign exchanges including foreign bank notes. Moreover, banks buy and sell of different units of Mutual funds under various schemes of investment plan as per the instruction of the customer. All these are executed as per the instruction of customers against a nominal fee.

v) Acting as trustee, executors, etc

The commercial banks act as trustee, executors, administrators on behalf of customers. As a trustee, bank takes care of the assets of the customers. Bank also helps in the administration of the trust. As an executor, the bank preserves the wills of their customers and executes them after their death.

vi) Other agency Services

In addition to the above functions, commercial banks also provide some valuable advice to the customers on matters relating to income tax calculation, payment of tax and submission of tax return to the concerned authority. Moreover banks are also working as financial advisor to his customers.

2) General Utility Functions / services

In addition to agency services, modern commercial banks provide many general utility services as given below.

i) Safe deposit locker facility

Providing locker facility to the customer is an important utility service rendered by a commercial bank. The banks provide this facility of locker or safety vaults to keep the valuable articles of customers in safe custody.

Under this facility, the banks provide one or more locker boxes to the customers on hire or payment of charges. There are two keys to open the locker box. One is with the customer and other is with the bank. The locker box can be opened if the two keys are used.

ii) Safe custody of valuable articles

In addition to the safe deposit locker facility, bank also provides the services of safe custody of valuable articles. Under this facility, the customer can handover some valuable articles / documents such as negotiable instruments, securities, documents of title, will, trust deed etc. to the bank.

For keeping these valuable documents / articles banks charge a fee from the customer. The charges or fee depend on the period of safe keeping and value of goods kept under safe custody.

iii) Issue of gift Cheques

Issue of gift cheque is also an important public utility services. Bank issue this cheque in various denominations to be used on auspicious occasions.

iv) Issue of letter of credit

Letters of Credit is a document issued by the banker to its customer regarding the creditworthiness of customers. This document is generally used in foreign trade.

v) Collection and Supply of Statistics

As a part of utility service, commercial banks collect and publish different information and statistics relating to trade, commerce and industry. Banks advise customers on financial matters relating to growth and development, modernisation, diversification of business.

vi) Underwriting of shares, debentures etc

Banks act as underwriter of capital issue of different companies and government bodies. Commercial banks purchase and sell the shares, debentures of companies as underwriter to raise the capital of the corporate bodies. Banks charge a certain amount of commission against performing the underwriting services.

vii) Acting as referee

Bank also acts as referee regarding the financial position, business reputation and respectability of their customers.

C. Modern functions of Commercial Banks

In addition to the traditional functions, a commercial bank performs various modern functions / services. The following are some of the important modern functions generally performed by a commercial bank.

i) Automated Teller Machine (ATM) cum Debit Card

Automated Teller Machine is a computerized telecommunications device. It facilitates the customers of a bank with access to withdraw and deposit their money. Modern ATMs identify the customer through a plastic ATM card with a magnetic strip or a plastic smart card with a chip.

Almost all the banks have introduced ATM to assist their customers to withdraw and deposit cash without any waiting time. Debit and Credit Card holders of the bank can withdraw the cash in urgency from the ATM at any time.

ii) Credit Card facility

Credit Card is a plastic money which acts as an instrument of credit and it replaces the paper money. The credit card holder may purchase goods from many authorised dealers by using the credit cards.

Card holder can also withdraw cash from ATM, up to a certain limit, maintained by bank throughout the country. After certain intervals the customers have to pay certain service charges to the bank along with interest on the outstanding balances.

iii) SWIFT Message facility

Remittance of funds can be done by method of SWIFT message. SWIFT means the 'Society for Worldwide Inter-bank Financial Tele communication.' The transfer of funds from one country to another can be effected by SWIFT Messages which are prompt and cost effective to a customer.

iv) Mail and Telegraphic Transfer

The customer of a bank has a choice to transfer money from one place to another through mail transfer or telegraphic transfer.

In this process the customer requests the bank to transfer a part of balance in the payees' account kept in different place in the same bank for a nominal commission. After receiving the instruction from the customer, the bank official arranges to send an advice to the concerned bank manager through a mail telegram to credit the payee's account with certain sum as per the instruction of the customer.

v) Tele Banking Services

It is one of the methods of delivering banking services to customers. It is increasingly used as delivery channel for marketing of banking services.

Under this method generally non-cash related banking services are performed over the phone anywhere and anytime. Automatic Voice Recorders (AVR) or ID numbers are used for rendering tele banking services which is considered as an added advantage to customers.

vi) S.M.S (Short Messaging Service) :

It is a mobile application based banking service. Under this service the banks send the standard text message to the account holder immediately after the banking transaction occurred through the mobile number registered with that account. For this services bank charges a nominal fee yearly.

vii) Internet banking

Internet banking is a platform for electronic delivery of banking services to the customers. Internet has enabled banking at the click of a mouse.

Through internet banking facility a customer can avail different banking services from anywhere and at anytime. Some of the internet banking services are stated below:

a) Retail and corporate internet banking

The retail or personal internet banking assists the customer to have an online access to bank account anytime and anywhere for the banking transaction. Similarly, corporate internet banking facilitates the online fund transfer, trade finance management, fund management, global access with unmatched benefits, etc.

b) Electronic Clearing and Electronic Fund Transfer (EFT)

Internet banking assists the customers in electronic clearing service for quick movement of funds in a paperless mode. Internet banking helps Electronic Fund Transfer (EFT) to ensure a quick transfer of funds by using electronic media.

c) RTGS / NEFT Service

Instant remittance by customer himself now made possible from one bank to another bank at different places on the same day with the help of online Real Time Gross Settlement (RTGS) or National Electronic Fund Transfer (NEFT) at modest charges.

d) Online Shopping and Bill Payment, etc.

The service of online shopping facilitates the customers to book hotel, buy gift, buy books and a lot of activities by making online payment. Now the customers need not make a queue to pay different kinds of bills. They can pay their telephone bill, mobile bill, electricity bill, insurance premium and several others bill at anytime and anywhere from the desktop of customers.

SUMMARY

- **COMMERCIAL BANK:**

  Commercial Bank refers to the financial institution which accepts, for the purpose of lending or investment, deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise. It mobilises savings from the surplus- spending sector and lend these funds to the deficit-spending sector.

- **Functions / services of Commercial Banks:**

  The various functions / services of commercial bank are classified in to-

  (i) Primary functions,

  (ii) Secondary functions and

  (iii) Modern functions.

- **Primary Functions:**

  (a) Accepting deposits of money,

  (b) Granting loans and advances.

  (a) **Accepting deposits :-** Deposits of banks are classified as follows **:**

  Savings deposit accounts: Savings deposit accounts are primarily for small scale savers. The important objective of savings bank account is to encourage saving habits of the people.

Current deposit accounts: The current account is generally opened by businessmen, individuals, firms, companies, entrepreneurs, professional, contractors, institutions, Government bodies/departments, Societies, liquidators, trusts, etc. It is a running account. Money can be deposited and withdrawn at any time.

Recurring deposit accounts (RD): In recurring deposit account, a fixed amount of savings are required to be compulsorily deposited by the customer at specific intervals for a specific period.

Fixed deposit account: In this account bank accepts deposits for a fixed period of time. The period may range from 45 days, 90 days, 180 days, 1 year to 5 years etc.

(b) **Granting loans and advances:** There are different modes or ways of granting loans to the customer.

Loans:

Loan is a lump sum amount of advances sanctioned by a bank to the customer for a certain period at an agreed rate of interest. The entire amount is paid on one occasion.

Loan may be categorized in to (i) short-term loan, (ii) medium-term loan and (iii) long term loan.

Overdraft:

Overdraft is a credit arrangement, whereby, a customer is allowed to withdraw over and above his credit balance in the current account up to a specified limit.

Cash Credit: A cash credit is an arrangement by which a customer of a bank is permitted to borrow money up to a particular limit. A separate account is opened for this purpose.

Bill discounting : Commercial Banks can also lend money by discounting bills of exchange. In case the holder of a bill needs money immediately, he can get his bills discounted by a commercial bank. The bank charges a commission for discounting of bills.

Money at call or call loan : Call loan is a very short term advance. Generally the participants involved in this market are different financial institutions, dealers, broker of stock exchanges etc. This loan is given for a period of 1 day to 14 days.

Consumer Credit : Consumer credit is one type of term loan. It is basically provided by the bank to the customer for purchasing T.V., Washing Machine, Air Cooler, Air Conditioner and some other household goods.

- **Secondary Functions:**

  The secondary functions / services of a commercial bank can be classified into –

  (i) Agency functions or Agency Services. And

  (ii) General utility or Public Utility Services.

  (i) Agency functions / services—

  (a) Remittance of funds,

  (b) Making payment on behalf of customers,

  (c) Collection of Cheques, etc,

  (d) Buying and Selling of Stocks, Securities etc,

(e) Acting as trustee, executors, etc, and

(f) Other agency Services.

(ii) General Utility Functions / services—

(a) Safe deposit locker facility,

(b) Safe custody of valuable articles,

(c) Issue of gift cheques,

(d) Issue of letter of credit,

(e) Collection and Supply of Statistics,

(f) Underwriting of shares, debentures etc. and (g) Acting as referee.

- **Modern functions / services:** —

(i) Automated Teller Machine (ATM) cum Debit Card,

(ii) Credit Card facility,

(iii) SWIFT Message facility,

(iv) Mail and Telegraphic Transfer,

(v) Tele Banking Services,

(vi) S.M.S (Short Messaging Service),

(vii) Internet banking –

(a) Retail and corporate internet banking,

(b) Electronic Cleaning and Electronic Fund Transfer (EFT),

(c) RTGS / NEFT Service and

(iv) Online Shopping and Bill Payment etc.

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CHAPTER-6

OTHER BANKS

EXCHANGE BANK / FOREIGN BANK:

Exchange Banks are those banks which are foreign in origin, i.e., they have their head offices located outside the country. Exchange banks deal in foreign exchange. It is specialised in financing the international trade. Since the banks are engaged in foreign exchange transaction, they are also known as foreign exchange bank. The main function of exchange banks is to make settlement with transaction of foreign exchange and to finance and facilitate the foreign trade.

Nowadays, the commercial banks themselves undertake the foreign exchange business. In India, State Bank of India and all the foreign banks are dealing in the business of foreign exchange.

Exchange banks solve the problem of exchanging currency by converting home currency into foreign currency and vice-versa. So these banks are working as businessman in buying and selling of foreign currencies or claims to foreign exchange. The following are some of the important functions/services provided by exchange bank.

1) Exchange banks encourage the flow of foreign investment into India.
2) It is engaged in discounting of foreign bills of exchange.
3) It provides the services of foreign remittances.

4) Purchasing and selling of gold and silver is another important function of exchange bank.

5) Exchange banks issue letter of credit in the foreign trade.

6) It facilitates and finances international Trade.

7) It provides necessary assistance in obtaining various clearances regarding transactions in foreign currency.

In fact international trade is not possible without exchange bank. Exchange bank in India buy Indian Export Bills usually maturing after three months. They are sent to foreign centre's like London or Newyork Money Market immediately for discounting.

4) REGIONAL RURAL BANKS (RRBs):

As per the recommendation of M. Narasimham Committee which was formed to study the flow of institutional credit specially to rural sector of the economy, RRBs was established in 1975 as a state-sponsored, regionally based and rural oriented bank. According to an ordinance passed on 26th Sept, 1975, the five RRBs were set up on October 2, 1975 as a special rural financial institution. In 1976 Regional Rural Banks Act was passed.

RRB is rural based public sector commercial bank. The share capital of RRBs is subscribed by Central government, State government and Sponsored bank in the ratio of 50:15:35 respectively. The authorised and issued capital of RRBs was originally fixed at Rs. One crore and Rs. 25 lakhs respectively. In 1988 RRBs Act was amended to raise the authorised and issued capital to Rs. 5 crores and 1 crore respectively. As sponsored bank, necessary fund, guidance and directions are provided by the commercial bank for the smooth functioning of RRBs. RRBs raise its necessary resources through owned capital, deposits from the Public, borrowings from sponsored bank and refinance from NABARD.

Objectives of RRBs

Ultimate aim of RRBs is to assist in rural development of India. The main objectives of RRBs are stated below.

I. The main objective of setting up of RRBs was to fill up the credit gap prevailing in the rural area.

II. RRBs are to act as an alternative credit agency to provide institutional credit to rural people to make them free from the clutches of village money lenders.

III. The banks are to assist in the development of rural economy by providing credit and other facilities to small and marginal farmers, agricultural laborers', small entrepreneurs, artisans, cottage industries, weavers etc.

IV. To create a new class of entrepreneurs for employment generation in rural area.

Functions of RRBs

RRBs perform the functions of commercial banks as permitted by section 5 (b) and 6 (i) of Banking Regulation Act, 1949. RRBs are included in the second schedule of RBI Act. Like other commercial banks it performs almost all the functions of commercial banks. Following are some of the important function performed by RRBs.

1) RRBs accepts deposits of money from the public through different types of accounts such as Savings Deposits Account, Current Deposits Account, Recurring Deposits Account,, Fixed Deposits Account, etc.

2) It grants loans and advances to people particularly small and marginal farmers, artisans etc. in rural and semi urban area.

3) It performs the functions like disbursement of wages of different government programmers such as MGNEGA, distribution of Pensions etc.

4) It also provides some agency and public utility services to the public. For example collection and payment of bills on behalf of customers, remittance of funds from one place to another, Locker facility to public, etc.

5) It provides some important modern banking facilities such as services of Debit and Credit card, mobile banking, internet banking etc.

In addition to the above, RRBs gives Priority to undertake the special business of -

a. Granting loans and advances to small and marginal farmers, agricultural labourers and different co-operative societies-such as marketing Society, agricultural processing society, primary agricultural credit society (PACS), farmers service society, etc.

b. Granting loans to small artisans, small entrepreneurs and persons of small means engaged in trade, commerce, industries and other productive activities within its area of operation.

5) INVESTMENT BANK / INDUSTRIAL BANK:

Investment bank is involved directly or indirectly for the development of industrial sector through the investment in shares, debentures and underwriting of capital issue, etc. of industries. Since the investment bank is related with the promotion and development of industries through its various modes of investment, it is also known as industrial bank.

The investment banks arrange medium and long term finance for business and industry. Generally, it works both as financiers as well as underwriters. As financiers it provides long term funds to business and industry. As underwriters it works as middlemen between business Corporation and investors. Investment banks undertake the responsibility of selling shares or debentures of the business Corporation to the public for commission. In absence of failure of the public to subscribe in full, they take the unsubscribed portion of the shares or debentures underwritten by them.

Functions

Investment bank performs several complex financial transactions such as intermediary between a security issuer and investor, underwriting of securities, merger and acquisition and acting as broker or consultant for individual and institutional customers. Some of the functions generally performed by an investment bank are stated below.

i) Investment bank accepts long term deposits only from the public as it provides long-term finance to meet the fixed capital needs of the industries.

ii) It provides long term loans to industries for purchasing land and buildings and other fixed assets. Medium term loans are also provided to meet the working capital need of industries.

iii) It helps the industries by underwriting of issue of securities of large industrial organisation.

iv) Investment banks play an important role in management and control of the company by subscribing its shares and debentures.

v) It provides advisory and technical guidance for the efficient management of the industries.

vi) It acts as advisor or consultant in matters of merger and acquisition deals of different industrial houses.

vii) It assist a company to manage financial risk in term of currency, loans, liquidity, etc.

viii) It also performs the functions of research in the field of management of equity and debt, fixed income, macroeconomic aspects etc. for the benefits of its clients.

Some examples of investment or industrial banks operating in India are IFCI, SBI Capital Markets Ltd., IDBI Capital Market Services Ltd, ICICI Securities Ltd. etc.

6) DEVELOPMENT BANK:

A development bank is a multipurpose financial institution. It provides all types of financial assistance (medium as well as long term) to business units, in the form of loans, underwriting, investment and guarantee operations, and promotional activities. Basically, a development bank is a term lending institution. Its outlook is development oriented.

Unlike commercial banks, it does not accept deposits from the public. It provides financial assistance not only to the public sector but also to the private sector undertakings. It encourages new and small entrepreneurs and seeks balanced regional growth.

William Diamond and Shirley Boskey consider industrial finance and development corporations as “development banks”.

Dr. S. Desai defines development bank as “a financial institution concerned with all types of financial assistance to enterprises in the form of loan, underwriting, investment, guarantee operations and promotional activities to accelerate the process of sustainable socio-economic development and fosters growth and co-operation.”

Development banks are the kingpin in the process of economic development of a country. After independence, the Industrial Finance Corporation of India, the first development bank of the country was established in the year 1948. Thereafter, a number of development banks were established for assisting the development of large, medium and small industries by providing financial and various other promotional assistances.

Characteristics or Features of a Development Banks

The main characteristics or features of a development banks are as follows :

i) It is a multipurpose financial institution. They provide development finance and also perform other functions.

ii) Development banks are mainly development oriented. It promotes economic development by promoting-

a) Investment and

b) Entrepreneurial activity in a developing economy.

iii) Its main motive is to serve public and national interests rather than profit.

iv) Development bank does not accept demand deposits from the public.

v) It provides medium and long term finance to industrial units.

vi) It is a specialised financial institution which provides loans for industrial development.

vii) Development banks encourage industrial development in backward areas by assisting new entrepreneurs and small scale units.

viii) Development banks provide financial assistance to both public and private sector undertakings.

ix) Development banks help in promoting investment and saving habits in the people.

Functions of Development Bank

Development banks are functioning with heterogeneous character. It performs a diversified function for development of the different sectors of the economy. In addition to the financial and promotional services, it is associated with some other related services which may bring growth and development to the economy. Some of the important functions of development bank are stated as under.

1. **Provide development assistance**

   The most important function of development banks is to provide development assistance for various development activities such as industries, agriculture, trade and transport, etc.

2. **Balance regional development**

   Development banks provide financial assistance on priority basis to the units set up in backward and forest areas.

3. **Assistance to small entrepreneurs**

   Development banks provide financial assistance to small entrepreneurs to prevent concentration of economic powers in few hands.

4. **Helps promote new entrepreneurs**

   Development banks help in promoting new entrepreneurs and small scale units by providing assistance on priority basis.

5. **Accepts deposits of money**

   Development bank accepts deposits of money for long term only which is repayable after the expiry of fixed period. Like commercial bank, it does not accept demand deposit which is repayable on demand.

6. **Provides medium and long term credit**

   It provides medium and long term credit to industries to meet the cost of land and building, plant and machinery, its expansions, renovations and modernization, etc.

7. **Helps in raising Capital**

   As underwriter and guarantor, development banks help the corporate sector to raise the capital from the market in respect of issue of shares, debentures, bonds etc.

8. Offers multipurpose services

It offers promotional, technical, managerial and consultancy services for the promotion, growth and smooth functioning of industrial units.

9. Discovers investment project

It discovers the various investment projects for development of the economy.

10. Preparation of project reports

It undertakes the preparation of project reports of various developmental projects.

11. Raises foreign capital

It raises the foreign capital from different sources and allocates it according to the priority of the different sectors of the economy.

12. Undertakes market and investment research

Development banks undertake the market and investment research for development of industrial and other sectors of the country.

7) EXPORT IMPORT BANK OF INDIA (EXIM BANK)

To give undivided attention, each sector of the economy should have a separate and specialised financial institution. In the field of foreign trade of our country there was no specialized financial institution in this sector till 1982. Industrial Development Bank of India (IDBI) provided the financial and other assistance to export-import business before setting up of EXIM Bank in India.

According to the recommendation of Alexander Committee (1977) and Tendon Committee on export (1980), EXIM bank was established on January 1, 1982 as per the provisions of the Export-Import Bank of India Act, 1981 for financing foreign trade of India. It is the apex banking institution in the field of financing foreign trade of our country. It is a statutory corporation organized under special act of parliament (Act, 28 of 1981). It works as a lead bank in the matters of export-import financing. After its establishment it has taken over the entire business relating to export-import financing from IDBI.

EXIM bank is a bank that ensures the growth and development of foreign trade of the country. It provides financial and other assistance to exporters and importers. It brings co-ordination among the different agencies involved in financing export and import of goods and services to promote international trade.

Objectives

The Principal objectives of the EXIM Bank are-

1) To provide financial assistance to exporters and importers.
2) To act as apex financial institution for coordinating the working of institutions engaged in financing export and import of goods and services for promotion of international trade.
3) To assist the various parties connected with foreign trade for solution of complex issues of international trade.

Functions of EXIM Bank

Some of the principal functions of EXIM bank are as follows-

1) It works as an apex institution for assisting and supporting development of such financial institutions which are engaged in financing export and import.
2) It is involved in financing of export and import of goods and services within India and abroad.

3) It provides finance for joint ventures in foreign countries.

4) It brings co-ordination among the different financial institutions and other parties engaged in export-import business.

5) It provides the services as underwriter relating to the issue of shares, debentures, bonds etc, of companies involved with the foreign trade.

6) EXIM bank provides technical, financial, managerial and administrative services to the parties engaged in export-import business.

7) It provides refinance facilities to the commercial banks and other financial institutions engaged in financing export and import.

8) It provides the services of funded and non-funded assistance for export bid and ongoing projects of foreign trade.

9) EXIM bank gives the advance information and counseling services to Indian exporters in respect of multilaterally funded projects overseas.

8) CO-OPERATIVE BANK:

Co-operative Bank is an institution established on the cooperative basis and dealing in ordinary banking business. Co-operative banks are formed on the principles of cooperation. Co-operation means voluntary association on the basis of equality and for some common purpose. The basic principle of co-operation is 'each for all and all for each'.

Co-operative banks are organised and managed on co-operative principles and regulated by its special legislative provisions. They are expected to provide institutional credit to rural areas for the development of agriculture and its allied activities. It is an important constituent of Indian Financial system. It forms an integral part of the banking and credit system in India.

In India, Co-operative banking was initiated mainly after the enactment of (first co-operative legislation in India) “The Co-operative Societies Act, 1904”.

There are two types of co-operatives. They are credit co-operative and non-credit co-operative. Credit co-operative are formed according to the provisions of “The Co-operative Societies Act 1904”. After the enactment of Co-operative Law in 1912, the non-credit co-operatives such as Consumers’ Co-operative, Marketing Co-operative, Service Co-operative, etc. are formed according to the provisions of Co-operative Law of 1912. Co-operative banks are regulated by the RBI and governed by the Banking Regulation Act, 1949 after its amendment in 1965. Like commercial banks Co-operative banks accepts deposits from the public and grants loan to members and non members. Presently the co-operative banks, specially the state level co-operative banks, are competing with the commercial banks as scheduled bank.

Features of Co-operative Bank

Co-operative banks are different from other form of banking organisation in certain aspects. Some of the important features of co-operative banks are mentioned below. –

i) Co-operative banks are organised and managed on the principles of co-operation, self help and mutual help.

ii) Its motto is “One member one vote” irrespective of number of shares held by member.

iii) They are foster child of the government as these are sponsored, supported and subsidised financial institutions.

iv) It is most favored banking sector since the RBI plays promotional role rather than regulatory in case of cooperative banks. RBI gives certain relaxation to co-operative banks particularly in case of maintaining CRR, SLR by the co-operative bank.

v) Another feature of co-operative banks is that it works on the Principles of “No profit no loss.”

vi) Three tier set-up is another feature of Co-operative banking in India. Three tier set-up is Primary Co-operative Society at village level, Central Co-operative Bank at district level and State Co-operative Bank at state level.

vii) Liabilities of the members are unlimited particularly in case of village level Primary Co-operative Society.

viii) Co-operative banks provide short term as well as long term loan to borrowers. Co-operative banks are for short term loan and Land development banks are for long term loan.

ix) Sources of Co-operative banks come from central and State Government, RBI, NABARD, Membership fee, deposits from public, etc.

x) There are scheduled as well as non-scheduled Co-operative banks. Non-scheduled Co-operative banks are Primary Co-operative banks and State Co-operative banks are scheduled bank.

9) AGRICULTURAL BANK:

Agricultural banks are those banks which provide all types of credit facilities to agriculture and its allied activities of the economy. Agriculturist requires short as well as long term loans for the development of agricultural sector. Short-term funds are required to meet the cost of seeds, fertilizers, manures, payment of wages etc. Similarly long-term loans are needed by the farmers for acquisition and improvement of agricultural land, purchase of heavy machineries, etc. Since the commercial banks and industrial banks are not specialised in the field of agricultural finance, it has been realised the importance of separate and specialised agricultural bank.

Functions of Agricultural Bank

The primary objective of agricultural banks is to promote all around development of agriculture and allied sectors of economy. They are working for the better standard of living of the agricultural community. Some of the important functions of agricultural banks are stated below.

1) Agricultural banks give short, medium and long-term loan to agricultural sector of the country.

2) It assists and arrange in buying heavy farm machineries etc.

3) NABARD refinances agricultural bank, provides refinance facilities to the short-term and long-term agricultural banks.

4) It performs the role of co-ordinator and supervises the grant of credit from the public fund for agricultural purposes.

5) It mobilises the demand and time deposit from the public and channelise them into productive use in the agricultural field.

6) Agricultural banks specially the PACS supplies agricultural inputs and provides marketing facilities for agro products.

7) PACS as agricultural bank, in rural area, serves as a link between ultimate borrowers and higher financing agencies such as NABARD.

8) Under the various government schemes agricultural banks offers financial aids in the form of grants and subsidies which are usually meant to protect the farmers in an event of crops damage or loss of crops due to various reasons.

10) LAND DEVELOPMENT BANK

Land Development (LDB) Banks are organised on co-operative basis in India. Farmers require both short as well as long-term loan. LDBs provide long-term loans to agriculturists for buying tools and equipments, cattle and making permanent improvement on land.

Originally, LDB was known as Land Mortgage Bank (LMB). Initially, long-term loans were given to agriculturist against the mortgage of agricultural land. In course of time it creates some problem when the borrower farmers may not be able to give agricultural land as mortgage for their loan. Later on, long-term loans to agriculturist are given without the mortgage of agricultural land. This practice was followed by all the Land Mortgage Banks (LMBs) and there after the name has been changed from Land Mortgage Bank to Land Development Bank.

The Primary objective of LDB is to develop the agriculture and allied activities by providing long term loans to agriculturists. LDBs are registered organisation under the Co-operative Societies Act. They are the association of borrowers and non borrowers. They are running with the principles of limited liability. These banks raise their funds in the form of debentures and by issuing long term securities. The proceeds collected are utilised for long term loans to farmers. LDBs have been playing a vital role in the growth and development of agriculture and rural sector of the economy.

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11) SAVINGS BANK

A Savings Bank is a financial institution whose primary purpose is accepting savings deposits and paying interest on those deposits. Savings bank encourages low-income people to save money and have access to banking services.

Savings banks are specialized financial institution to raise the saving from the poor and middle income group of people of the society. The Primary objective of savings bank is to encourage habits of thrift and savings among the people with low income. The depositors are allowed to withdraw the amount of deposit as per their requirement. But there are restrictions on the number of withdrawals to be made in a month. Savings bank provide interest on deposit and it encourage the depositors to save money and help create saving habit of the people.

Separate Savings banks are organised in various countries. In India, Government runs savings bank and they are managed by the postal department.

In India Saving banks is popularly known as Post Office Savings Bank (POSB). It has the advantage of operating at most of the post offices and sub-post offices throughout the country. Another advantage of POSB is the direct guarantee of central government to depositors in case of failure of payment.

12) INTERNATIONAL BANK

The banks which have crossed the international border in respect of their banking business are called international bank. It has worldwide scope of banking activities. It assists to solve the problems of international finance. The individual and the corporate body may be the customer of international bank. Business practices of this bank are governed by the international rules and regulations. Moreover it has its own business policy regarding the selection of customers from different parts of the globe. In most of the cases the government of the respective customers is required to give guarantee for repayment of loan. International banks help the businessman to expand their business activities to the international level.

International banks are the active member of foreign exchange market and help its client in dealing with foreign exchange transaction. They also provide some advisory services to its customers in some critical international issues. Usually the international banks provide long term loan to customer against the minimum rate of interest.

It is to be mentioned here that there is a difference between international bank and international banking. When the scope of banking business spreads to different countries of the world, it is called international banking. But international banks are established with the common goal and objectives by the different nations of the world.

Some of the international banks are -

(1) International Bank for Reconstruction and Development (IBRD), popularly known as the World Bank.

(2) International Monetary Fund (IMF)

(3) Bank for International Settlement (BIS)

(4) International Finance Corporation (IFC)

(5) International Development Association (IDA)

(6) Multilateral Investment Guarantee Agency (MIGA), etc.

DIFFERENCES BETWEEN CENTRAL BANK AND COMMERCIAL BANK

Both the Central bank and Commercial banks are the financial institution. Though they are doing the banking business yet there is a difference between the two banks. The following points clarify the difference between central bank and commercial banks.

Basis	**Central Bank**	**Commercial Bank**
Meaning	Central bank is an independent financial institution which is responsible for overseeing the entire monetary, banking and economic policy of a nation.	But a commercial bank is a part of banking and economic system which is related with the normal banking services to business, trade and commerce.
Organisation	Central bank is formed by the special statute of the country. (RBI was established under the RBI Act, 1934).	Commercial banks are formed as per the provisions of common banking law of the country.

Basis	**Central Bank**	**Commercial Bank**
Objectives	The primary objective of a central bank is not to earn profit. It aims at national welfare.	The primary objective of a commercial bank is to earn profit.
Note issue	Usually, the central bank of every country has the monopoly power of note issue.	Commercial bank has no power of note issue.
Position	Central bank is the apex financial institution of a country.	Commercial banks are subordinate to the central bank.
Dealings with Public	Central bank does not directly deals with the public.	Commercial banks directly deal with the public.
Area of Operation	Usually, the scope of operation of central bank is within a country.	A commercial bank can extend banking services to different countries of the world.
Credit Control and Credit Creation	Central bank controls credit.	Commercial bank creates credit.
Monetary policy	Central bank prepares/ introduces monetary policy of the country.	Commercial bank executes the monetary policy prepared by the central bank.
Regulation and Control	Central bank is the regulatory and controlling authority of the entire banking system of the country.	Commercial bank has no such authority.

DIFFERENCES BETWEEN COMMERCIAL BANK AND DEVELOPMENT BANK

Development banks are different from the commercial bank on the following points.

Basis	**Commercial Bank**	**Development Bank**
Acceptance of Deposits	Commercial bank accepts deposits from the public repayable on demand.	Development bank accepts deposits repayable after the expiry of specified time.
Liabilities	Liabilities of commercial banks (i.e. demand deposits withdrawal by cheque) are widely accepted as a means of payment or money.	Liabilities of development bank are not accepted as money.
Method of Mobilisation of Savings	Commercial banks mobilise savings from the public through the different accounts of banks such as Savings Deposits Account, Current Deposits Accounts, Recurring Deposits Accounts, Fixed Deposits Accounts, etc.	Development banks mobilise savings from the public through the different schemes or against the issue of long term instruments such as debentures, bonds, etc.
Credit Creation	Commercial banks can create credit.	Development banks can not create credit.

Basis	**Commercial Bank**	**Development Bank**
Term of Loan	Commercial banks usually deals in short term loans in the money market.	Development banks deals in medium and long term funds in the capital market.
Nature of functions	Commercial banks are homogeneous group by nature and perform same types of business.	Development banks are covered by heterogeneous group and perform diverse business.
Cash Reserve Ratio	Commercial banks are required to maintain cash reserve ratio with the central bank.	Development banks are not required to maintain cash reserve ratio with the central bank.
Purpose of Deposit	Generally, people deposit money with the commercial banks with the objectives of safety, liquidity and convenience.	People invest their surplus money with the development bank for earning income.
Purpose of Loan	Usually, commercial banks provide short term loan to meet the working capital need of trade, commerce and industries.	Development banks grant loans to meet the fixed capital need of business community.
Control and Regulation	Commercial banks are controlled and regulated by Reserve Bank of India (as per the provisions of Banking Regulation Act, 1949).	Development banks are regulated by the Special Act of their own.

DIFFERENCES BETWEEN COMMERCIAL BANK AND CO-OPERATIVE BANK

Under the organized sector commercial banks and co-operative banks are working as the banking institution in the country. Both of them are providing banking services to the public. The operation and working of commercial bank and co-operative banks are different from each other on the following points.

Basis	**Commercial Bank**	**Co-operative Bank**
Formation	Commercial banks are formed under the provisions of common banking law of the country. They are formed and guided under the Banking Regulation Act, 1949, and The Reserve Bank Of India Act, 1934.	Co-operative banks are formed under the Co-operative Societies Act, 1904.
Scope of Operation	The area of operation of commercial bank is very large. It may be extended to the whole country and even outside the country.	The area of operation of co-operative bank is limited to a particular area or mostly within the state.
Motive	The profit motive is the primary objective of commercial bank.	Co-operative banks are running their banking business with service motive.
Structure	Generally, commercial banks are organized under the unitary structure.	Co-operative banks have three tier set up. (State level, District level and Local/Village level).
Members	In India, minimum seven members can form a commercial bank as a joint stock public company.	Minimum ten members can form a cooperative bank with co-operative principles.

Basis	Commercial Bank	Co-operative Bank
Term of Loan	Commercial banks provide mostly short term loan to meet the working capital needs of the business community.	Co-operative bank provides short, medium and long-term loan to agriculture and rural sector of the country.
Voting Rights	In commercial banks, borrowers have no voting rights.	In co-operative banks, borrowers are also the shareholders and so they have voting rights.
Liability	In case of commercial bank, liability of members are limited to the extent of shareholdings.	In case of co-operative bank, the liability of members is unlimited particularly at the village level co-operatives such as Primary Agricultural Co-operative Credit Societies.
Control	Commercial banks are controlled by Reserve Bank of India Act, 1934 and Banking Regulation Act, 1949.	Co-operative banks are mainly controlled by the Co-operative Societies Act, 1904.
Orientation	Commercial banks are basically urban-oriented.	Co-operative banks are basically rural-oriented.
Re-finance from the RBI	All scheduled commercial banks are entitled to re-finance facilities from the RBI.	State Co-operative Banks only are entitled to re-finance facilities from the RBI.

SUMMARY

- **EXCHANGE BANK / FOREIGN BANK:**

  Exchange Banks are those banks which are foreign in origin, i.e., they have their head offices located outside the country. Exchange banks deal in foreign exchange. It is specialised in financing the international trade.

- **Functions/services of Foreign Exchange Bank are:-**

  Exchange banks encourage the flow of foreign investment into India.

  It is engaged in discounting of foreign bills of exchange.

  It provides the services of foreign remittances.

  Purchasing and selling of gold and silver is another important function of exchange bank.

  Exchange banks issue letter of credit in the foreign trade.

  It facilitate and finance international Trade.

  It provides necessary assistance in obtaining various clearances regarding transactions in foreign currency.

- **REGIONAL RURAL BANKS (RRBs):**

  RRB is rural based public sector commercial bank. The share capital of RRBs is subscribed by Central government, State government and Sponsored bank in the ratio of 50:15:35

respectively. As sponsored bank, necessary fund, guidance and directions are provided by the commercial bank for the smooth functioning of RRBs.

- **Functions of RRBs:**

  RRBs accept deposits of money from the public through different types of accounts.

  It grants loans and advances to people particularly small and marginal farmers, artisans etc. in rural and semi urban area.

  It performs the functions like disbursement of wages of different government programmers such as MGNEGA, distribution of pensions etc.

  It also provides some agency and public utility services to the public.

  It provides some important modern banking facilities such as services of Debit and Credit card, mobile banking, internet banking etc.

- **INVESTMENT BANK / INDUSTRIAL BANK:**

  Investment/industrial bank is involved directly or indirectly for the development of industrial sector through the investment in shares, debentures and underwriting of capital issue, etc. of industries.

  Functions :

  i) Investment bank accepts long term deposits only from the public

  ii) It provides long term loans to industries for purchasing land and buildings and other fixed assets.

  iii) It helps the industries by underwriting of issue of securities of large industrial organisation.

iv) It provides advisory and technical guidance for the efficient management of the industries.

v) It assists a company to manage financial risk in term of currency, loans, liquidity, etc.

- **DEVELOPMENT BANK:**

A development bank is a multipurpose financial institution. It provides all types of financial assistance (medium as well as long term) to business units, in the form of loans, underwriting, investment and guarantee operations, and promotional activities. Basically, a development bank is a term lending institution. Its outlook is development oriented.

- **Characteristics or Features of a Development Banks:**

a) It is a multipurpose financial institution.

b) Development banks are mainly development oriented.

c) Its main motive is to serve public and national interests rather than profit.

d) Development bank does not accept demand deposits from the public.

e) It provides medium and long term finance to industrial units.

f) It is a specialised financial institution.

- **Functions of Development Bank:**

(i) Provide development assistance,

(ii) Balance regional development,

(iii) Assistance to small entrepreneurs,

(iv) Helps promote new entrepreneurs,

(v) Accepts deposits of money for long term only,

(vi) Provides medium and long term credit,

(vii) Helps in raising Capital,

(viii) Offers multipurpose services,

(ix) Discovers investment project,

(x) Preparation of project reports,

(xi) Raises foreign capital and

(xii) Undertake market and investment research.

- **EXPORT IMPORT BANK OF INDIA (EXIM BANK):**

  EXIM bank was established on January 1, 1982 for financing foreign trade of India. It is the apex banking institution in the field of financing foreign trade of our country.

  EXIM bank is a bank that ensures the growth and development of foreign trade of a country. It provides financial and other assistance to exporters and importers

- **Functions of EXIM Bank:**

  Some of the principal functions of EXIM bank are as follows -

1) It works as an apex institution for assisting and supporting development of such financial institutions which are engaged in financing export and import.

2) It is involved in financing of export and import of goods and services within India and abroad.

3) It provides finance for joint ventures in foreign countries.

4) It brings co-ordination among the different financial institutions and other parties engaged in export-import business.

5) It provides the services as underwriter relating to the issue of

shares, debentures, bonds, etc. of companies involved in the foreign trade.

- **CO-OPERATIVE BANK:**

  Co-operative Bank is an institution established on the cooperative basis and dealing in ordinary banking business. Co-operative banks are formed on the principles of cooperation. Co-operation means voluntary association on the basis of equality and for some common purpose. The basic principle of co-operation is 'each for all and all for each'.

- **Features of Co-operative Bank**

  i) Co-operative banks are organised and managed on the principles of co-operation, self help and mutual help.

  ii) Its motto is "One member one vote"

  iii) It works on the Principles of "No profit no loss."

  iv) Three tier set-up is another feature of Co-operative banking in India.

  v) Liabilities of the members are unlimited.

  vi) Co-operative banks provide short term as well as long term loan to borrowers.

- **AGRICULTURAL BANK:**

  Agricultural banks are those banks which provide all types of credit facilities to agriculture and its allied activities of the economy.

- **Functions of Agricultural Bank :**

  1) Agricultural banks give short, medium and long term loan to agricultural sector of the country.

  2) It assists and arrange in buying heavy farm machineries etc.

3) NABARD refinances agricultural bank, provides refinance facilities to the short term and long term agricultural banks.

4) It performs the role of co-ordinator and supervises the grant of credit from the public fund for agricultural purposes.

5) It mobilises the demand and time deposit from the public and channelise them into productive use in the agricultural field.

- **LAND DEVELOPMENT BANK:**

Land development (LDB) banks are organised on co-operative basis in India. LDBs provide long-term loans to agriculturists for buying tools and equipments, cattle and making permanent improvement on land. Originally, LDB was known as Land Mortgage Bank (LMB). The Primary objective of LDB is to develop the agriculture and allied activities by providing long term loans to agriculturists.

- **SAVINGS BANK:**

A Savings Bank is a financial institution whose primary purpose is accepting savings deposits and paying interest on those deposits. Savings bank encourages low-income people to save money and have access to banking services.

Savings banks are specialized financial institution to raise the saving from the poor and middle income group of people of the society

- **INTERNATIONAL BANK:**

The banks which have crossed the international border in respect of their banking business are called international bank. It assists to solve the problems of international finance. The individual and the corporate body may be the customer of international bank. Business practices of this bank are governed by the international rules and regulations.

Some of the international banks are -

(1) International Bank for Reconstruction and Development (IBRD), popularly known as the World Bank.

(2) International Monetary Fund (IMF)

(3) Bank for International Settlement (BIS)

(4) International Finance Corporation (IFC)

(5) International, Development Association (IDA)

(6) Multilateral Investment Guarantee Agency (MIGA), etc.

UNIT-II

QUESTIONS

A. Write very short answer : 1 Marks each

1. Write the name of the apex institution of the banking structure of a country.
2. Which Bank is called the lender of the last resort?

B. Short Answer Questions : 2 Marks each

1. What is Central bank?
2. What is Commercial bank ?
3. What is savings bank ?
4. What is investment / industrial bank ?
5. What is development bank?
6. What is exchange bank?
7. What is co-operative bank?
8. What is international bank?
9. What is EXIM bank?

C. Long Answer Questions (Type-1) : 5 Marks each

1. What are the main functions of Exchange Bank ?

2. What are the main objectives of Regional Rural Banks ?
3. State the functions of RRBs.
4. What are the various functions of Investment Bank ?
5. What are the various functions of Development Bank ?
6. What are the features of Co-operative Bank ?
7. Write five functions of EXIM Bank.
8. What are the differences between Central Bank and Commercial Bank ?
9. What are the differences between Commercial Bank and Co-operative Bank ?
10. What are the differences between Commercial Bank and Development Bank.

D. Long Answers Questions (Type-2) : 8 marks each

1. Discuss the different functions of Central Bank ?
2. Discuss the primary functions of commercial bank.
3. Discuss the secondary functions of commercial bank.
4. Discuss the modern functions of a commercial bank.
5. Discuss the functions of development bank.
6. Briefly state the functions of a commercial bank.

UNIT-III

Commercial Banking in India

Evolution and Growth of Bank in India : Presidency Banks, Imperial Bank : functions and causes of nationalization. State Bank of India – functions.

Scheduled and Non-Scheduled Banks, Differences between Scheduled and Non-Scheduled Banks. Private and Public Sector Banks, Differences between Private and Public Sector Banks.

Nationalisation of Banks : Objectives and Progress of Bank Nationalisation in India, Criticisms against Nationalisation of Banks.

Lead Bank Scheme : Objectives and Functions, Progress of Lead Bank Scheme, Weaknesses of Lead Bank Scheme.

Banking Systems : Meaning, advantages and disadvantages of Branch Banking System. Meaning, advantages and disadvantages of Unit Banking System. Meaning, advantages and disadvantages of Group Banking System. Meaning of Chain Banking System and Correspondent Banking System. Differences Between Branch Banking and Unit Banking System and Differences Between Group Banking and Chain Banking System.

Learning Objectives

After the Study of this unit, the student will be able to :-

- Know the evolution and growth of Commercial Bank in India.
- Have an idea about Presidency Banks and Imperial Bank of India.
- Know about the State Bank of India and its functions.
- Know about Scheduled and Non-Scheduled Bank.
- Know about Private and Public Sector Banks.
- Know about Nationalisation of Commercial Banks in India.
- Know about Lead Bank Scheme.
- Know about the various Banking Systems.

CHAPTER-7

Evolution and Growth of Bank in India

Banking industry in India has passed a long journey to secure its present position. The evolution and growth of Indian Banking can be studied over three periods:

1. Ancient period
2. Pre-Independence period and
3. Post-Independence period.

1. Ancient period:

The origin of Indian Banking dates back to very ancient times.

(a) Vedic period:

The ancient Hindu scriptures refer to the money lending activities in the Vedic period. During the era of Ramayana and Mahabharata, banking had become a full-fledged activity.

(b) Smrity period:

During the Smrity period, the business of banking was largely carried on by the members of Vaish community. The authoritative records of taking and giving credits are found as early as between 2000 and 1400 B.C. The banks in this period performed many of the functions which modern commercial banks perform now-a-days, viz., accepting deposits, granting of advances, acting as banker to the state, managing currency of the state, etc.

2. Pre-Independence period:

Banking institutions during pre-independence period primarily consisted of money lenders, indigenous banks, nidhis, loan offices, etc. These institutions are to some extent still popular in rural and semi-urban areas.

(a) **The Bank of Hindustan:** The origin of banking on modern lines in India can be traced only to the beginning of the East India Company's trade relation with India. The expanding trade relations of the English merchants compelled many Agency Houses to carry out the business of banking in India in the last quarter of the 18th century. For example, 'Alexander and Company' (one of the Agency Houses) established its first bank — 'The Bank of Hindustan' in 1770. But, as supported by the Central Banking Enquiry Committee, the first bank was ' The First Bank of Madras', established in 1683.

(b) **Presidency Banks:** Modern commercial banking made its beginning in India with the setting up of the first Presidency Bank - The Bank of Bengal in Calcutta. Actually, the Bank of Calcutta was established in 1806 as a joint stock bank with limited liability, which was brought under the Royal Charter in 1809 and renamed as Bank of Bengal. Two other Presidency Banks were set up in Bombay and Madras in 1840 and 1843 respectively.

(c) **The Joint Stock Companies Act, 1850:** In India, the Joint Stock Companies Act, 1850 was the first legislative enactment in the country which permitted the corporate sector to come into the banking business. The passing of this Act greatly helped in the establishment of many commercial banks. The first bank established under this Act, was the Oudh Commercial Bank in 1881 followed by Punjab National Bank in 1885 and People's Bank in 1901.

(d) **Swadesi Movement (1905):** A large number of banks came into existence since the advent of Swadesi movement. A few of the banks floated during this period include Bank of India, Central Bank of India, Bank of Baroda, Punjab and Sind Bank, Indian Bank, etc.

(e) **Imperial Bank of India:** In 1921, the three Presidency Banks i.e., Bank of Bengal, Bank of Bombay and Bank of Madras, were amalgamated and a single bank was formed namely, 'Imperial Bank of India' under the Imperial Bank of India Act,1920.

(f) **Reserve Bank of India:** It must be mentioned that during this period, the Reserve Bank of India (RBI) was established in 1935 as the Central bank of India under the RBI Act, 1934.

3. **Post-Independence Period:** The post-independence period has witnessed a massive growth in the Indian banking system. The Indian banking system had gone through a series of crisis and thus its growth was quite slow during the first half of the 20th century. When India became independent in 1947, the banking structure was very weak. There were a total of 640 banks of which only 96 were scheduled banks. Since 1947, the Indian banking system has recorded a tremendous progress. This is due to planned economic growth, increase in money supply, growth of banking habit, control and guidance by the RBI, etc.

(a) **Nationalisation of Reserve Bank of India:** The Reserve Bank of India was nationalized on 1st January,1949 under the Reserve Bank of India (Transfer to Public ownership) Act,1948. The nationalization of the Reserve Bank of India was the first and one of the most remarkable developments in the banking industry during the post-independence period.

(b) The Banking Companies Act,1949: In order to have balanced growth of banking business in India, the Banking Companies Act was passed in 1949.The Act was passed to provide safeguard to the interest of depositors and also to ensure the development of commercial banks on sound lines. In 1966, the Act was renamed as Banking Regulation Act, 1949. In 1950-51, there were 430 commercial banks in India but the number of banks declined rapidly due to RBI's policy of merger and amalgamations of small banks with big banks as a measure of strengthening the banking system.

(c) Formation of State Bank of India: In 1955, Imperial Bank of India, which was established in 1921, was nationalised and renamed as 'State Bank of India'. In 1959, the State Bank of India (Subsidiary Bank) Act was passed enabling SBI, to take over 8 princely state associated banks, as the subsidiaries.

(d) Social control: The scheme of social control was initiated by the Government in 1968 for more equitable and purposeful distribution of bank credit.

(e) Nationalization of commercial banks: It has undergone a major structural transformation after the nationalization of 14 major commercial banks in 1969. In 1980, six more commercial banks were taken over by the Government. During the last five decades of nationalization, there has been tremendous growth of commercial banks particularly in case of branch network in the hitherto under-banked rural areas.

(f) Establishment of Regional Rural Banks: In 1975, a new category of banks known as Regional Rural Banks (RRBs) had been set up to focus more on the development of rural and agricultural sector. During the post 1975 period, a large number of RRBs have been established jointly by the central government, sponsoring commercial bank and the state government concerned.

(g) Licenses to Private Sector Banks: After nationalization in 1969, it was almost over two decades that no banks have been allowed to set up in the private sector. Keeping in view, the recommendations of the Narasimham Committee and to introduce greater competition and improve the profitability and efficiency of the banking system, the RBI has been empowered to issue licenses to private sector banks as part of the liberalization process.

(h) Various Financial Institutions: Besides these developments, various financial institutions for meeting specialized financial needs were also established. They include IDBI, ICICI, SIDCs, SIDBI, IRBI, NABARD, LDBs, EXIM Bank, ECGC, NHB, DFHIL, LIC, GIC, UTI, etc. The setting up of all these institutions has brought the Indian Banking System to a stage where it can be compared with the finest banking set up anywhere in the world.

PRESIDENCY BANKS

The East India Company laid the foundation for modern banking in India. In the first- half of the 19th century the following three banks were established:

A) Bank of Bengal in 1809

B) Bank of Bombay in 1840

C) Bank of Madras in 1843

These three banks are known as 'Presidency Banks'.

Though 'The Bank of Calcutta' began its banking business in the year 1806, the Government of India did not realise the need for banks till 1809 and in that year only, a Royal Charter redesigned the 'The Bank of Calcutta' as the 'The Bank of Bengal'. It was the first joint stock bank of British India sponsored by the Government of Bengal. It was established with a capital of Rs. 50 lakhs, one-fifth of which was contributed by the Government, which shared the privilege of voting and direction. However, the power to issue currency notes was not given to the Bank till 1823. In 1939, the Bank was given the power to open branches and to deal in inland exchange.

Two other Presidency Banks, namely, 'Bank of Bombay' and 'Bank of Madras' were formed in April 1840 and July 1843 with a capital outlay of Rs. 52.25 and Rs. 30 lakhs respectively. The Government had subscribed Rs. 3 lakhs as capital in each of these banks.

The three Presidency Banks were governed by a Royal Charter, which was revised periodically. The member of each of the Board of Directors, which managed the affairs of each bank, were mostly proprietary directors representing the large European managing agencies in India. The rest were Government nominees, most were civil servants. Banking business of the three Presidency Banks was initially confined to discounting of bill of exchange or other negotiable instruments, keeping cash accounts and seeking deposits. Loans were restricted to Rs. one lakh and the period of accommodation was limited to three months. They were given the right to issue notes in their own regions. The first legal tender money was issued by these Banks.

In 1921, by amalgamating the three Presidency Banks of India, The Imperial Bank of India was established under the Imperial Bank of India Act, 1920.

IMPERIAL BANK

The Imperial Bank of India was established in 1921 under the Imperial Bank of India Act, 1920, by amalgamating three Presidency Banks of India. The three Presidency Banks were Bank of Bengal (1809), Bank of Bombay (1840) and Bank of Madras (1843).

The Imperial Bank of India was mainly a commercial bank owned by private shareholders. But it was simultaneously performing some of the functions of Central Bank such as, the banker to the Government, bankers' bank, national clearing house, etc. It was not given the power to issue notes or to engage in foreign business.

Initially, the British Government had an intention to convert the Imperial Bank into a full-fledged Central Bank. But owing to the establishment of the Reserve Bank of India in 1935, the Imperial Bank remained as a privileged commercial bank only.

After Independence, the demand was made for the nationalization of Imperial Bank of India. In Feb. 1948, though the national government agreed in principle to do so, it somewhat did not take any positive action in this direction.

The All India Rural Credit Survey Committee in its Report (1954) once again raised the issue of nationalization of the Imperial Bank. The Committee suggested that by a statutory provision, the Imperial of India should be converted into State Bank of India, with the object of extending banking facilities in rural areas. Accepting the recommendation of the Committee the Government of India enacted the State Bank of India Act, 1955.

Consequently, on July 1, 1955, the Imperial Bank of India and ten other banks were nationalised and renamed as State Bank of India. July 1, 1955, is, thus, considered as a Red- Letter Day and a new chapter of state ownership in the history of commercial banking in India.

FUNCTIONS OF IMPERIAL BANK

The Imperial Bank performed both the commercial and central banking functions:

A) Commercial Banking Functions:

i) Receiving different kinds of deposits and making advances against securities.

ii) Receiving valuables for safe custody.

iii) Remittance of funds from one place to another place.

iv) Investing funds in gilt-edged securities.

v) Accepting bills of exchange.

B) Central Banking Functions:

i) Bankers to the Government

a) Receiving the Government dues and making disbursement on behalf of the Government.

b) Issuing the Government loans and receiving funds for the Government.

c) Managing public debts.

d) Acting as custodian of Government funds.

ii) Bankers' Bank

a) Keeping the balances of commercial banks.

b) Providing remittance facilities to the commercial banks and public.

c) Maintaining clearing houses.

d) Keeping a unique position in the money market.

The establishment of the Reserve Bank of India in 1935, brought about a change in the status and working of the Imperial Bank. It ceased to function as the banker to the government. The ban on certain commercial banking functions on it was removed. It was appointed only as the agent of the RBI and authorized to transact government banking business at places where the RBI had no office of its own. Accordingly, the Imperial Bank was permitted on behalf of the government to pay, receive and remit money on behalf of the RBI. Thus, it maintained a special position in the banking sector.

NATIONALISATION OF IMPERIAL BANK OF INDIA / STATE BANK OF INDIA

The Imperial Bank was mainly in the hands of the non-Indians who discriminated Indians in appointments, emoluments, loan facilities, etc. Proposals for nationalisation of the Imperial Bank were under consideration ever since the attainment of independence of India in 1947. In 1948, the Government accepted the policy of nationalisation of the Imperial Bank, however, it was postponed indefinitely in 1949. The All India Rural Credit Survey Committee recommended that the Government should establish a strong government owned commercial bank, which would undertake rapid expansion of banking facilities in rural areas. For this purpose, it suggested the government to nationalise the Imperial Bank with ten other state associated banks. According to the recommendations of All India Rural Credit Survey Committee, Imperial Bank was nationalised in 1955 and renamed as State Bank of India.

The basic reasons for the nationalisation of the Imperial Bank can be summed up as follows:

1) **Already functioning as a semi-government bank:** The Imperial Bank had enjoyed a number of privileges and was functioning as a semi-government bank. It was established under a separate Act of Parliament—The Imperial Bank of India Act 1920. It acted as the agent of Reserve Bank of India in the places where the RBI did not have its branches. Hence, it was considered more appropriate to nationalise the Imperial Bank.

2) **Transfer of profits to the government:** The Imperial Bank earned huge profits because of the public confidence on it and because of its association with the government. The government considered that it was necessary to transfer the profits arising out of government funds to the government account.

3) **Promotion of agriculture and rural development:** In order to increase the agricultural produce there was a need to extend credit facilities to the rural areas. To promote agriculture in all respects, the government considered that it was necessary to nationalize the Imperial Bank.

4) **Implementation of the monetary policy of the government:** The government required strong commercial base for the implementation of its monetary policy and five year plans. It was also the root cause for the nationalisation of the Imperial Bank.

STATE BANK OF INDIA (SBI)

The State Bank of India is a statutory institution like the Reserve Bank of India (RBI) and is governed by the State Bank of India Act, 1955. SBI was formed on July 1, 1955, with the passing of the SBI Act, 1955, by taking over the assets and liabilities of the Imperial Bank of India, with the main objective of facilitating the extension of banking in the rural and semi- urban areas.

The State Bank of India together with its subsidiaries (popularly known as 'State Bank Group') is the largest commercial bank in India, in terms of branch network, resources and manpower. On the basis of the number of its branches, it has the largest office network of its kind in the whole world. In the world setting, it is the only Indian bank which finds a place within the hundred big banks in the world in terms of assets.

ASSOCIATE BANKS (OR SUBSIDIARY BANKS) OF STATE BANK OF INDIA

In 1959, the State Bank of India (Subsidiary Bank) Act was passed enabling SBI, to take over 8 princely state associated banks, as the subsidiaries. The associate or subsidiary banks of State Bank of India were:

i) State Bank of Bikaner *,

ii) State Bank of Hyderabad,

iii) State Bank of Indore,

iv) State Bank of Jaipur*,

v) State Bank of Mysore,

vi) State Bank of Patiala,

vii) State Bank of Saurashtra and

viii) State Bank of Travancore

(These two banks were merged into one bank as State Bank of Bikaner and Jaipur in 1964)*

At Present, State Bank of India has no Associate or Subsidiary Banks because all the above associate or subsidiary banks were merged with the State Bank of India.

FUNCTIONS OF STATE BANK OF INDIA

The functions of State Bank of India can be grouped under two categories, viz. Central banking functions and General banking functions:

A. Central banking functions: The SBI acts as an agent of the RBI at the places where the RBI has no branch. Accordingly, it renders the following functions:

1. **Banker to the government:**

   The SBI functions as the banker to the central and state governments. It receives and pays money on behalf of the governments. It renders the following functions as directed by the RBI in this regard:

   a) collection of charges on behalf of the government, e.g., collection of the tax and other payments

   b) grants loans and advances to the governments

c) advises the government regarding economic conditions, etc.

2. Bankers' Bank:

Generally, all commercial banks have accounts with the SBI. When other commercial banks face financial shortage, the SBI provides assistance to them as it is considered a big brother in the banking industry. It discounts the bills of the other commercial banks. Due to the functions on this line the SBI is considered in a limited sense as the bankers' bank.

3. Currency chest:

The RBI maintains currency chests at its own offices. But RBI offices are situated only in big cities. SBI, by its wide network of branches operate in urban as well as rural areas. RBI, therefore, in such places keeps money at currency chests with SBI. Whenever the need arises, the currency is withdrawn from these chests under proper accounting and reporting to the RBI.

4. Acts as a clearing house: In all the places, where RBI has no branch, the SBI renders the functions of clearing house. Thus, it facilitates the inter-bank settlements. Since, all the banks in such places have accounts with SBI, it is easy for the SBI to act as a clearing house.

5. Renders promotional functions: SBI also renders various promotional functions. It provides various facilities to the following priority sectors:

i) Agriculture

ii) Small-scale Industries

iii) Weaker sections of the society

iv) Co-operative sector

v) Small traders

vi) Unemployed youth, etc.

B. General banking functions:

The SBI renders the following general banking functions under section 33 of the SBI Act:

1) Accepting deposits from the public under current, saving, fixed and other deposit accounts.
2) Advancing and lending money upon the security of stocks, securities, etc.
3) Drawing, accepting, discounting, buying and selling of bills of exchange and other negotiable instruments.
4) Investing funds in specified kinds of securities.
5) Issuing and circulating letters of credit.
6) Acting as administrator, executor, trustee or otherwise.
7) Selling and realising the movable or immovable properties that come into the banks in satisfaction of claims.
8) Buying and selling of gold and silver.
9) Provides merchant banking facilities.
10) Provides Leasing finance and Project finance facilities, etc.

SCHEDULED AND NON-SCHEDULED BANKS

Section 42(6) of the Reserve Bank of India Act,1934 has classified all banks into (A) Scheduled Banks and (B) Non scheduled Banks.

A) Scheduled Banks:

Scheduled Banks are those banks which are listed in the Second Schedule of the Reserve Bank of India Act, 1934. The Banks satisfying the following conditions are only included in the Second Schedule:

a) that the Bank's paid-up capital plus free reserves are not less than Rs. 5.00 lakhs, and

b) that the affairs of the Bank are not conducted to the detrimental interest of the depositors.

The Reserve Bank of India also has the power to de-schedule a bank, when the above mentioned conditions are not satisfied.

B) Non-scheduled Banks:

The commercial banks, not included in the Second Schedule of the RBI Act, 1934, are known as Non-scheduled Banks. They are not entitled to get facilities like refinance and rediscounting of bills, etc. from RBI. They do not get the prestige like Schedule Banks. They are mainly engaged in lending money, discounting and collecting bills and various agency services. They insist higher security for loans. RBI currently does not encourage the opening of non-schedule banks.

Differences between Scheduled and Non-Scheduled Banks

Basis	**Scheduled Banks**	**Non-scheduled banks**
1. Capital and Reserves and Surplus	1. Paid up capital and reserves cannot be less than Rs. 5 lakhs in aggregate.	1. Paid up capital and reserves can be less than Rs. 5 lakhs in aggregate.
2. Control of RBI	2. It is enlisted in the Schedule 'A' of the RBI and under its direct control.	2. It is enlisted in the Schedule 'B' of the RBI and not under its direct control.
3. Cash deposits	3. It must have to keep a fixed percentage of deposits with the RBI.	3. It need not require to keep any type of deposit with the RBI.

Basis	Scheduled Banks	Non-scheduled banks
4. Public confidence	4. It earns greater public confidence.	4. It earns lesser public confidence in comparison to Scheduled Banks.
5. Refinancing facilities	5. All Scheduled banks are entitled to refinance facilities from the RBI.	5. Non-scheduled banks are not entitled to refinance facilities from the RBI.
6. Statements	6. It must submit reports of its weekly activities to RBI.	6. It need not submit reports of its weekly activities to RBI.

PRIVATE AND PUBLIC SECTOR BANKS

From the angle of ownership and control, there are two types of commercial banks. They are:

(A) **Private sector banks:** The banks which are owned, managed and controlled by the private concerns, i.e., by individuals and companies are known as Private sector banks or Private banks. These banks may be Scheduled or Non-scheduled banks. In India, HDFC Bank, AXIS Bank, ICICI Bank, IDBI Bank, etc. are the examples of Private sector banks. Though these banks are established by the private ownership, but they are fully controlled by the RBI. Like Public sector banks, they also play a vital role in the economic development of a country.

(B) **Public sector banks:** The banks which are owned, managed and controlled by the Government are known as Public sector banks or Public banks. In India, all public sector banks are Scheduled banks. Examples of public sector banks are State Bank of India, Union Bank of India, Central Bank of India, Dena Bank, etc. Though public sector banks function as independent units, but their credit policy is formulated by the Government in accordance with the national plans, policies and priorities. They are controlled by the RBI. They play a more vital role in the economic development of a country in comparison to private sector banks. All public sector banks are entitled to refinance facilities from the RBI. They also earn greater public confidence.

Differences between Private and Public Sector Banks

Basis	Private Sector Banks	Public Sector Banks
1. Meaning	1. The banks which are owned, managed and controlled by the private concerns, i.e., by individuals and companies are known as private sector banks.	1. The banks which are owned, managed and controlled by the government are known as public sector banks.
2. Example	2. HDFC Bank, AXIS Bank, ICICI Bank, IDBI Bank, YES Bank etc. are the examples of private sector banks.	2. State Bank of India, Union Bank of India, Central Bank of India, Bank of Baroda, Punjab and Sind Bank etc., are the examples of public sector banks.
3. Status	3. Private sector banks may be scheduled or non-scheduled banks.	3. All public sector banks are scheduled banks.

Basis	Private Sector Banks	Public Sector Banks
4. Public confidence	4. It earns lesser public confidence in comparison to public sector banks.	4. It earns greater public confidence.
5. Refinancing facility	5. Non-scheduled private sector banks are not entitled to refinance facilities from the RBI.	5. All public sector banks are entitled to refinance facilities from the RBI.

SUMMARY

- **Evolution and Growth of Commercial Bank in India:**

  Banking industry in India has passed a long journey to secure its present position. The evolution and growth of Indian Banking can be studied over three periods:

1. **Ancient period:** The origin of Indian Banking dates back to very ancient times.

   (a) Vedic period:

   The ancient Hindu scriptures refer to the money lending activities in the Vedic period. During the era of Ramayana and Mahabharata, banking had become a full-fledged activity.

   (b) Smrity period:

   During the Smrity period, the business of banking was largely carried on by the members of Vaish community.

2. **Pre- Independence period:**

   Banking institutions during pre-independence period primarily consisted of money lenders, indigenous banks, nidhis, loan offices, etc.

   (a) The Bank of Hindustan:

   The expanding trade relations of the English merchants compelled many Agency Houses to carry out the business of banking in India in the last quarter of the 18th century. For example, 'Alexander and Company' (one of the Agency Houses) established its first bank — 'The Bank of Hindustan' in 1770.

(b) Presidency Banks:

Modern commercial banking made its beginning in India with the setting up of the Presidency Banks - The Bank of Bengal in 1809, Bank of Bombay in 1840 and Bank of Madras in 1843.

(c) The Joint Stock Companies Act, 1850:

In India, the Joint Stock Companies Act, 1850 was the first legislative enactment in the country which permitted the corporate sector to come into the banking business.

(d) Swadesi Movement (1905):

A large number of banks came into existence since the advent of Swadesi movement.

(e) Imperial Bank of India:

In 1921, the three Presidency Banks i.e., Bank of Bengal, Bank of Bombay and Bank of Madras, were amalgamated and a single bank was formed namely, 'Imperial Bank of India' under the Imperial Bank of India Act,1920.

(f) Reserve Bank of India:

It must be mentioned that during this period, the Reserve Bank of India (RBI) was established in 1935 as the Central bank of India under the RBI Act, 1934.

3. Post-Independence Period:

The post-independence period has witnessed a massive growth in the Indian banking system.

(a) Nationalisation of Reserve Bank of India:

The Reserve Bank of India was nationalized on 1st January,1949 under the Reserve Bank of India (Transfer to Public ownership) Act,1948.

(b) The Banking Companies Act, 1949:

In order to have balanced growth of banking business in India, the Banking Companies Act was passed in 1949. In 1966, the Act was renamed as Banking Regulation Act, 1949.

(c) Formation of State Bank of India:

In 1955, Imperial Bank of India, which was established in 1921, was nationalised and renamed as 'State Bank of India'. In 1959, the State Bank of India (Subsidiary Bank) Act was passed enabling SBI, to take over 8 princely state associated banks, as the subsidiaries.

(d) Social control:

The scheme of social control was initiated by the Government in 1968 for more equitable and purposeful distribution of bank credit.

(e) Nationalization of commercial banks:

It has undergone a major structural transformation after the nationalization of 14 major commercial banks in 1969. In 1980, six more commercial banks were taken over by the Government.

(f) Establishment of Regional Rural Banks:

In 1975, a new category of banks known as Regional Rural Banks (RRBs) had been set up to focus more on the development of rural and agricultural sector.

(g) Licenses to Private Sector Banks:

Keeping in view, the recommendations of the Narasimham Committee, the RBI has been empowered to issue licenses to private sector banks as part of the liberalization process.

(h) Various Financial Institutions:

Besides these developments, various financial institutions for meeting specialized financial needs were also established.

They include IDBI, ICICI, SIDCs, SIDBI, IRBI, NABARD, LDBs, EXIM Bank, ECGC, NHB, DFHIL, LIC, GIC, UTI, etc.

- **Presidency Banks:**

  The East India Company laid the foundation for modern banking in India. In the first- half of the 19th century the following three banks were established:

  A) Bank of Bengal in 1809,

  B) Bank of Bombay in 1840,

  C) Bank of Madras in 1843

  These three banks are known as 'Presidency Banks'.

- **Imperial Bank:**

  The Imperial Bank of India was established in 1921 under the Imperial Bank of India Act, 1920, by amalgamating three Presidency Banks of India. The three Presidency Banks were Bank of Bengal (1809), Bank of Bombay (1840) and Bank of Madras (1843).

  The Imperial Bank of India was mainly a commercial bank owned by private shareholders. But it was simultaneously performing some of the functions of Central Bank such as, the banker to the Government, bankers' bank, national clearing house, etc. It was not given the power to issue notes or to engage in foreign business.

- **Nationalisation of Imperial Bank of India / State Bank of India:**
  According to the recommendations of All India Rural Credit Survey Committee, Imperial Bank was nationalised in 1955 and renamed as State Bank of India.

  The basic reasons for the nationalisation of the Imperial Bank were-

1) Already functioning as a semi-government bank
2) Transfer of profits to the government
3) Promotion of agriculture and rural development and
4) Implementation of the monetary policy of the government.

- **State Bank of India (SBI):**

  SBI was formed on July 1, 1955, with the passing of the SBI Act, 1955, by taking over the assets and liabilities of the Imperial Bank of India, with the main objective of facilitating the extension of banking in the rural and semi- urban areas.

  The State Bank of India together with its subsidiaries (popularly known as 'State Bank Group') is the largest commercial bank in India, in terms of branch network, resources and manpower.

- **Associate banks (or subsidiary banks) of State Bank of India:** In 1959, the State Bank of India (Subsidiary Bank) Act was passed enabling SBI, to take over 8 princely state associated banks, as the subsidiaries. The associate or subsidiary banks of State Bank of India were:

  i) State Bank of Bikaner,*

  ii) State Bank of Hyderabad,

  iii) State Bank of Indore,

  iv) State Bank of Jaipur,*

  v) State Bank of Mysore,

  vi) State Bank of Patiala,

  vii) State Bank of Saurashtra and

  viii) State Bank of Travancore

  (* In 1964, these two banks merged into one bank as State Bank of Bikaner and Jaipur).

- **Functions of State Bank of India:**

  The functions of State Bank of India can be grouped under two categories, viz. Central banking functions and General banking functions:

A. Central banking functions-

1. Banker to the government,
2. Bankers' Bank,
3. Currency chest,
4. Acts as clearing house and
5. Renders promotional functions.

B. General banking functions:

The SBI renders the following general banking functions under sections 33 of the SBI Act:

1) Accepting deposits from the public under current, saving, fixed and other deposit accounts.
2) Advancing and lending money upon the security of stocks, securities, etc.
3) Drawing, accepting, discounting, buying and selling of bills of exchange and other negotiable instruments.
4) Investing funds in specified kinds of securities.
5) Issuing and circulating letters of credit.
6) Acting as administrator, executor, trustee or otherwise.
7) Selling and realising the movable or immovable properties that come into the banks in satisfaction of claims.
8) Buying and selling of gold and silver.
9) Provides merchant banking facilities.
10) Provides Leasing finance and Project finance facilities, etc.

- **Scheduled Banks and Non-scheduled Banks:**

A) Scheduled Banks: Scheduled Banks are those banks which are listed in the Second Schedule of the Reserve Bank of India Act, 1934.

B) Non-scheduled Banks: The commercial banks, not included in the Second Schedule of the RBI Act, 1934, are known as Non-schedule Banks.

- **Private and Public sector banks:**

From the angle of ownership and control, there are two types of commercial banks. They are:

(A) Private sector banks:

The banks which are owned, managed and controlled by the private concerns, i.e., by individuals and companies are known as Private sector banks or Private banks. These banks may be Scheduled or Non-scheduled banks. In India, HDFC Bank, AXIS Bank, ICICI Bank, IDBI Bank, etc. are the examples of Private sector banks.

(B) Public sector banks:

The banks which are owned, managed and controlled by the Government are known as Public sector banks or Public banks. In India, all public sector banks are Scheduled banks. Examples of public sector banks are State Bank of India, Union Bank of India, Central Bank of India, Dena Bank, etc.

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CHAPTER-8

NATIONALISATION OF BANKS

Meaning of Nationalisation of Banks

Nationalisation of banks refer to the transfer of ownership of banks from the hands of private individuals to the hands of the government. In India, on 1st January, 1949, the Reserve Bank of India was nationalized, i.e., from 1st January, 1949, RBI began to function as a government owned institution.

Nationalisation of commercial banks is an important development in the field of banking in India. In India, 29 key banks were nationalized in four stages: State Bank of India on 1-7-1955, 8 associate banks of SBI in 1959, 14 major commercial banks on 19-7-1969 and 6 major commercial banks on 15-04-1980. Due to merger of 17 banks, there are at present 12 commercial banks in the public sector.

Objectives of Bank nationalization in India

1. **Preventing concentration of economic power:**

   Initially, a few leading industrial and business houses had close association with the commercial banks. The directors of these banks happened to be the same industrialists who established monopoly control on the bank finance. They exploited the bank resources in such a way that new business units could not enter in any line of business in competition with their business houses. Nationalization of banks, thus, prevented the spread of the monopoly enterprises.

2. Social control was not adequate:

The 'social control' measures of the government did not work well. Some banks did not follow the regulations given under social control. Thus, the nationalization was necessitated by the failure of social control.

3. Channel the bank finance to plan priority sectors:

Bank collect savings from the general public. If it is in the hand of private sector, the national interest may be neglected. Besides, in Five Year Plans, the Government gives priority to some specified sectors like agriculture, small industries etc. Thus, nationalization of banks ensures the availability of resources to the plan priority sectors.

4. Greater mobilization of deposits:

The public sector banks open branches in rural areas where the private banks have failed. Because of such rapid branch expansion there is possibility to mobilize rural savings.

5. Balanced Regional Development:

In India, certain areas remain backward for lack of financial resources and credit facilities. Private banks have neglected the backward areas because of poor business potential and profit opportunities. Nationalization helps to provide bank finance in such a way as to achieve balanced inter-regional development and remove regional disparities.

Criticisms against nationalization of the Banks:

The various criticisms against nationalization of banks can be summarized as follows:

1. **Political purpose rather than for Productive purpose**:

   The government has acquired the strength of a giant and there is the danger of using the financial resources for political purposes rather than for productive purpose.

2. **Beginning of state capitalism:**

   Such a drastic step of nationalization of about 90% of the Banking resources is wholly unnecessary, especially if we take into consideration the enormous powers vested in the Reserve Bank of India for controlling bank's resources. It is considered as the beginning of state capitalism and not socialism in India.

3. **Low level of functioning:**

   Some are of the opinion that after nationalization banks will degenerate to the level of agricultural co-operatives, which are known for their inefficiency and corrupt practices. Some fear that the officers who manage these big banks also have to bow down to the politicians in course of time.

4. **Less attractive customer's services:**

   The nationalized banks are sure to join the rank of other public undertaking which are known for their working to losses. Indecision, corruption, and of responsibility are the evils with which the government undertakings are suffering. A government bank may not care to give due importance to the customer services.

5. **Promises may not materialize**:

   Nationalization cannot convert the commercial banks overnight into agricultural banks. Similarly, the hopes raised among the poor and middle-class people about the bank loans may ultimately prove to be false.

Nationalization of Banks and its Progress

The nationalization of 14 major commercial banks with deposits of Rs. 50 crores or more in July, 1969 was a historic and momentous event in the history of India. Since nationalization of 14 banks in 1969 and 6 banks in 1980, their policies and working have undergone a drastic change. The Indian banking system has recorded rapid progress due to planned economic growth, increase in money supply, growth of banking habit, control and guidance by the RBI and above all, nationalization of banks.

Achievements/Performances/Progress of Nationalized Banks/Public Sector Banks

1. **Branch expansion:**

   Before nationalization, the banks were conservative and opened branches mainly in metropolitan cities and other major cities. Branch expansion gained momentum after the nationalization of banks. The present network of commercial banks is the result of deliberate policy of massive branch expansion pursued by the public sector banks during the post-nationalization period.

2. **Deposit mobilization**:

   The post-nationalization period has shown a substantial rise in the rate of deposit mobilization. Public sector banks have contributed greatly to the development of banking habit among people through sustained publicity, extensive branch banking and relatively prompt service to the customers. Bank nationalization gives a great fillip to deposit nationalization, due partly to the expansion of a network of bank branches and partly to the incentives given to the savers.

3. **Expansion of bank credit:**

   There has been a tremendous expansion of bank credit reflecting the rapid expansion of industrial and agricultural output.

Nationalized banks are making the credit requirements of industry, trade and agriculture on a much larger scale than before. In recent years, bank credit has placed up smartly by around 20 percent per year.

4. **Advances to priority sectors:**

   Soon after nationalization, the commercial banks were asked to be specially concerned with the financing of priority sector of agriculture, small industry and business and small transport operators. In course of time, retail trade, professional and self-employed persons, education, housing loans for weaker sections and consumption loans were also added to priority sectors. The public sector banks took priority lending enthusiastically and the rate of progress was quite rapid soon after nationalization but later progress was more modest.

5. **Diversification in banking:** The changes which have been taking place in India since 1969 have necessitated banking companies to give up their conservative and traditional system of banking and take to new and progressive functions. In accordance with the national plans, politics and priorities, banks have now taken up major responsibilities for development and diversifying the Indian economy, enter new field of activity such as merchant banking and underwriting, mutual fund, portfolio management, leasing and housing finance, etc.

6. **Investment in Government Securities:** The nationalized banks were also expected to provide finance for economic plans of the country through the purchase of government securities.

7. **Change in composition of Deposits:** The relative proportions of demand and time deposits have also changed after the nationalization of banks. The proportion of time deposits has increased continuously from 50% in 1969. This has a clear indication of a shift in favour of fixed deposits of the commercial banks.

8. Differential Rate of Interest Scheme: With a view to provide bank credit to the weaker sections of the society at a concessional rate, the government introduced this scheme from April 1972. Under this scheme, the public sector banks have been providing loans at 4% rate of interest to the weaker sections of the society who do not have any tangible security to offer, but who can improve their economic condition with the financial support from the bank.

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SUMMARY

- **Nationalisation of Banks:**

  Nationalisation of banks refer to the transfer of ownership of banks from the hands of private individuals to the hands of the government.

  Nationalisation of commercial banks is an important development in the field of banking in India. In India, 29 key banks were nationalized in four stages: State Bank of India on 1-7-1955, 8 associate banks of SBI in 1959, 14 major commercial banks on 19-7-1969 and 6 major commercial banks on 15-04-1980.

- **Objectives of Bank nationalization in India were—**

  1. Preventing concentration of economic power,
  2. Social control was not adequate,

  (3) Channel the bank finance to plan priority sectors,

  (4) Greater mobilization of deposits and

  (5) Balance Regional Development.

- **Criticisms against nationalization of the Banks:**

  The various criticisms against nationalization of banks can be summarized as follows:

  (1) Political purpose rather than for Productive purpose,

(2) Beginning of state capitalism,

(3) Low level of functioning,

(4) Less attractive customer's services and

(5) Promises may not materialize.

- **Nationalization of Banks and its Progress**

The Indian banking system has recorded rapid progress due to planned economic growth, increase in money supply, growth of banking habit, control and guidance by the RBI and above all, nationalization of banks.

The nationalization of commercial banks have made a remarkable progress in regards to—

(i) Branch expansion,

(ii) Deposit mobilization,

(iii) Expansion of bank credit,

(iv) Advances to priority sectors,

(v) Diversification in banking,

(vi) Investment in Government Securities,

(vii) Change in composition of Deposits and

(viii) Differential Rate of Interest Scheme.

CHAPTER-9

LEAD BANK SCHEME

Meaning of Lead Bank Scheme:

Lead bank scheme refers to the scheme which was introduced by the Reserve Bank of India in December, 1969 with the objective of enabling the commercial banks to assume the role of leadership district wise. The scheme was introduced to formalize the concept of 'area approach' for the development of banking and credit facilities throughout the country. Under this scheme all the districts in the country have been allotted to the State Bank Group, nationalized banks and private Indian banks.

A particular bank known as lead bank is assigned the role of a catalytic agent of economic development through the expansion of bank branches and diversification of credit facilities in the district allotted to it. It is made responsible for surveying the resources and potential for banking development in the district.

Objectives of Lead Bank:

(a) To specify suitable areas to open branches of the lead district.

(b) To extend maximum credit facilities for development in the district.

(c) To mobilize deposits and to promote investment among the local people through various financial schemes.

(d) To co-ordinate the activities of co-operative banks, commercial banks and other financial institutions in the district.

(e) To assess major hurdles in the development of the district and to take remedial action for the same, etc.

Functions of Lead Bank:

The following are the main functions of a lead bank:

(a) To survey the resources and potential for banking development by identifying unbanked centres in the allotted districts.

(b) To survey the number of industrial and commercial units and other establishment which do not have bank accounts.

(c) To set up branches in a phased manner.

(d) To identify and study local problems.

(e) To evolve an integrated credit plan by examining the shortage of marketing facilities for agricultural produce and industrial output.

(f) To survey the facilities for storing of fertilizers and other agricultural inputs and other services catering to local needs.

(g) To maintain contacts and liaison with government and semi-government agencies.

(h) To provide assistance to other primary lending agencies.

(i) To recruit and train banking staff for counseling the small borrowers and farmers in the priority sectors and follow-up and inspection of the endless of bank credit.

(j) To chalk out schemes and implement area planning.

(k) To integrate bank schemes with district plans for an effective distribution of credit along with the expanded banking facilities as per local needs, etc.

Progress/Working/Effects of Lead Bank Schemes (LBS):

The Lead Bank Scheme was introduced by the RBI in 1969. From the very beginning there was inadequate understandings, and even serious misunderstandings. The confusion as to the real meaning and content of the lead bank scheme naturally hampered the progress of the scheme in the initial years. Yet by 1973-74, surveys had been completed in 380 districts to be covered under lead bank scheme. The surveys covered 90 percent of the districts in the under developed states of Assam, Bihar, West Bengal, Orissa, Madhya Pradesh and Uttar Pradesh. The Lead Banks had also constituted district level cumulative committees comprising representatives of scheduled commercial banks and the financial institutions operating in the district, state Government officials, etc. The committees were set up to help in identifying remarkable schemes, in evolving methods for exchanging information about borrowers, lending to priority sectors, etc.

RBI set up a High Power Committee (HPC) in March 1976 to watch the overall progress of LBS and to issue guidelines for the effective functioning of the scheme. On the basis of the directives given by HPC, the Lead Banks had to formulate district credit plans for the three year period at a time. Again, under the directions of the Govt. of India, commercial banks adopted from April, 1989, the Service Area Approach as part of the LBS for improving the qualities of rural lending by them.

The lead bank scheme has brought together financial institutions and development agencies on a common platform to work for the economic upliftment of the rural poor. The scheme has brought home the importance of district credit plan and the necessity of its formation and implementation. It has also emphasized the necessity of corporation and concerted action on the part of various banking, financial and development agencies in the district.

Under this scheme, the following committees were set up for the implementation of the credit plans:

(a) District Consultative Committee (DCC)

(b) District Level Review Committee (DLRC)

(c) Block Level Bankers Committee (DLBC)

(d) State Level Bankers Committee (SLBC)

(e) State Level Review Committee (SLRC)

(f) Standing Committee (SC)

The Lead Bank Scheme improves the tempo of economic growth of the country by providing gainful employment to the people, particularly the small borrowers and by uplifting the weaker sections of the society. This scheme helps in reducing regional, economic and also, special and functional disparities in the country and thereby correcting the sectoral imbalance in the country.

But it must be mentioned that the progress of implementation of the district credit planning or the other terms of the functioning of the Lead Bank Scheme is not uniform among different states and there are considerable shortfall in the implementation of the scheme due to various reasons.

Weaknesses or Limitations of Lead Bank Scheme:

(a) No uniform methodology has been adopted in formation of the plans.

(b) Credit plans are not formulated in accordance with the development programme of the government.

(c) Some banks are allotted districts where they have no foothold, which result supervision and guidance difficulty.

(d) The lead bank scheme becomes ineffective in those districts which lack basic infrastructure etc.

SUMMARY

- **Lead Bank Scheme:**

  Lead bank scheme refers to the scheme which was introduced by the Reserve Bank of India in December, 1969 with the objective of enabling the commercial banks to assume the role of leadership district wise. The scheme was introduced to formalize the concept of 'area approach' for the development of banking and credit facilities throughout the country. Under this scheme all the districts in the country have been allotted to the State Bank Group, nationalized banks and private Indian banks.

Objectives of Lead Bank:

(a) To specify suitable areas to open branches of the lead district.

(b) To extend maximum credit facilities for development in the district.

(c) To mobilize deposits and to promote investment among the local people through various financial schemes.

(d) To co-ordinate the activities of co-operative banks, commercial banks and other financial institutions in the district.

(e) To assess major hurdles in the development of the district and to take remedial action for the same, etc.

Functions of Lead Bank:

The following are the main functions of a lead bank:

(a) To survey the resources and potential for banking development by identifying unbanked centres in the allotted districts.

(b) To set up branches in a phased manner.

(c) To identify and study local problems.

(d) To maintain contacts and liaison with government and semi-government agencies.

(e) To provide assistance to other primary lending agencies.

(f) To chalk out schemes and implement area planning.

Progress/Working/Effects of Lead Bank Schemes (LBS):

The lead bank scheme has brought together financial institutions and development agencies on a common platform to work for the economic upliftment of the rural poor.

The scheme has brought home the importance of district credit plan and the necessity of its formation and implementation.

It has also emphasized the necessity of corporation and concerted action on the part of various banking, financial and development agencies in the district.

The Lead Bank Scheme improves the tempo of economic growth of the country by providing gainful employment to the people, particularly the small borrowers and by uplifting the weaker section of the society.

This scheme helps in reducing regional, economic as also, special and functional disparities in the country and thereby correcting the sectoral imbalance in the country.

Weakness or Limitations of Lead Bank Scheme:

(a) No uniform methodology has been adopted in formation of the plans.

(b) Credit plans are not formulated in accordance with the development programme of the government.

(c) The lead bank scheme becomes ineffective in those districts which lack basic infrastructure etc.

CHAPTER - 10

BANKING SYSTEM

The systems of banking differ from country to country because of difference in economic, social and political conditions and the traditions prevailing in different countries. We can study the system of banking from two angles. First, we can classify them on the basis of their operations, viz., pure banking or deposit banking or commercial banking and investment banking. Secondly, we can classify them on the basis of their organizations, viz., branch banking, unit banking, group banking, chain banking and correspondent banking.

Forms of Banking System:

On the basis of organization, banking systems can be divided into the following types:

1. **Branch Banking System**:

   Branch banking system is a system of banking where a big bank as a single institution and under single ownership operates through a network of branches spread all over the world. In other words, when a bank carries on banking business in different places with a number of branches, the system is called branch banking system or delocalized banking system. In this case the bank has a head office in a big city and branches in different parts of the country or outside the country. The head office of the bank and all its branches are under single ownership and management.

For instance, State Bank of India has more than 13,000 branches spread throughout the world.

2. Unit Banking System:

Unit banking system is a system of banking where a bank operates with a single office or place of business. It has its own branch of directors and stockholders. The area of operation of a unit bank is localized and is for more limited as compared to branch banking. The size of a unit bank is much smaller as compared to those of a bank under branch banking system. Unit banking system originated and grew in the U.S.A.

3. Group Banking System:

Group banking is the system in which two or more independently incorporated banks are brought under the control of a holding company. The holding company may or may not be a banking company. Under group banking, the individual banks may be unit banks, or banks operating with branches or a combination of the two.

4. Chain Banking System:

Chain banking is a system of banking under which a number of separately incorporated banks are brought under the common control by a device other than holding company. This may be:

(a) Through some group of persons owing and controlling a number of independent banks.

(b) Each bank retains its separate entity.

(c) Each one carries out its operations without the intervention of any central organization.

5. Correspondent Banking System:

It is the system under which unit banks are linked with bigger banks. The big correspondent banks are linked with still bigger banks in the financial centres. The smaller banks deposit their cash reserve with bigger banks. The bigger banks with whom such deposits are so made are called correspondent banks.

Advantages of Branch Banking System:

(i) Benefits of large-scale operations:

A branch bank has all the advantages of large scale operations. It has large resources when compared to a unit bank. It can appoint experts paying high scale and it can use modern mechanical devices in its offices for efficient working.

(ii) Wider spreading of risks:

A branch bank operates over a wide area with different types of economic development. The losses of branches of one region, if any, can be set off against the profit of branches in other regions. In this way the risks are distributed geographically. Thus, its capacity to withstand times of depression is more than that of unit banks.

(iii) Efficient Management:

The branch banking system makes for greater efficiency in management. The staff members of a branch bank are more efficient and more experienced when compared to those of a unit bank. Each staff member has the opportunity to work in various branches, understanding men and matters of different localities.

(iv) Economy in Remittance:

Branch banking has the benefit of economy in remittance of funds. As it has branches in different localities, it need not physically transfer cash from one place to another. It can provide remittance facilities to its customers by more transfer entries in the books of its branches. It makes the operation easy, quick and cheap.

(v) Economy of Cash Reserves: Branch banking has the merit of economy of cash reserves. Cash can be transferred from one branch to another whenever necessary. Therefore, branch can operate with lower cash balances and they avoid large amount of idle reserves/balances.

(vi) Diversification of Deposits and Assets: Under branch banking system, there is greater diversification of deposits and assets because of wider geographical coverage. Diversification means that a bank need not specialize in any particular area or particular industry. Deposits are mobilized from the area where savings are in plenty and loans are extended in the areas where funds are scarce and interest rates are high.

Disadvantages of Branch Banking System:

(i) Difficulty in Management and Control:

Since the bank has many branches, spread over different places, supervision, management and control becomes more difficult.

(ii) Less Initiative:

The branches of the bank are not allowed to make their independent decision. They have to follow the directives of the head office. Besides they have to refer to the matters to the head office for approval. Therefore, the branch managers cannot take initiatives.

(iii) Adjustment of Losses:

In branch banking the losses of one branch may be adjusted against the profit earned by another branch. This will affect the profitability of the organization as a whole, as loss making branch will continue to eat into the profits of efficient branches.

(iv) Concentration of economic power:

Under branch banking system, the financial resources may accumulate in the hands of a few who control big banks with large number of branches. This will cause concentration of economic powers in few big banks. It leads to monopoly.

(v) Continuance of inefficient branches:

Under unit banking system, the inefficient branches cannot survive. But in the case of branch banking, the inefficient branches may continue to operate because the losses of those branches are compensated by the profits of some other strong branches. In this way, under this system, inefficiency is protected.

(vi) Unhealthy Competition:

Under branch banking many banks may operate their branches in a particular locality where business prospects are very bright. It may create unhealthy competition among various branches of banks.

Advantages of Unit Banking System:

(i) Easy Establishment:

The unit bank operates on small scale basis. Hence, it requires less capital to promote a unit bank. Besides, the formalities, rules and regulations are comparatively easy with that of branch banking.

(ii) Easy Management and Control:

The size and operations of the bank under unit banking system will be small. Therefore, management, supervision and control will be easier.

(iii) Quick Decisions:

Under unit banking system, the manager can take quick decisions regarding loan sanctioning, etc., and he need not wait for the instructions and approval from the head office.

(iv) Satisfaction of Local Needs:

Unit banking is the localized banking. The entire operations of the unit bank are confined to a particular area. Therefore, banks have the specialized knowledge of the local problems, their requirements, etc., and can serve to fulfill those needs. In this way, local needs are better satisfied than branch banking.

(v) Personalized Services:

The unit banking gives an opportunity for the bankers to intimately know his customers. The manager has personal knowledge of each of his customers and establishes greater personal contact. This ensures personalized service which is not possible in the case of branch banking where the staffs are frequently transferred.

(vi) No Chance for Monopoly:

Under unit banking, the size of the bank will be small and limited to a small area. Each bank is independent by itself. Therefore, monopolistic trend in banking cannot arise.

Disadvantages of Unit Banking System:

(i) No ability to face crisis:

Limited area of operation and non-diversification of investments reduce the ability of unit banks to withstand losses. They cannot face any financial crisis.

(ii) No Geographical Distribution of Risk:

Under unit banking system the area of operations of a bank is limited to a particular place only. If there is any business depression in that place, the bank also suffers losses. Because of its localized operations, the unit bank cannot distribute the risk over a wider area.

(iii) Variation of Interest Rate:

There may not be uniformity of interest rates under unit banking. Different banks may charge different rates of interest, since there is no possibility for the transfer of funds to other areas, the availability of funds influence the rates of interest.

(iv) Not able to provide Adequate Banking Facilities:

Because of its restricted areas of operations and limited financial resources, unit banks are not able to provide the entire range of banking facilities as provided by branch banking.

(v) Inconvenience in Remittance of Funds:

The unit banks have no branches in other places. Therefore, transfer of funds from one place to another becomes costly and inconvenient.

(vi) Weaker Sections may be Neglected:

Even in the towns and cities where the unit banks are operating, the weaker sections of the society i.e., poor people may be neglected because of limited resource of the banks.

Advantages of Group Banking System:

(i) Enhancement of Operational Efficiency:

Under group banking system, the operational efficiency of participant banks is enhanced through shared knowledge and experience.

(ii) Broader Market:

Group banking offers market to the small banks for their excess resources. Thus, their earning capacity and network improve.

(iii) Mobility and Transfer of Resources:

In case of crisis, funds are transferred among participating banks. This helps them to face the financial crisis more effectively.

(iv) Large Scale Operation:

Group banking paves the way for large scale operation. The member banks can get the economies of large-scale operation.

Disadvantages of Group Banking System:

(i) Lack of Effective Managerial Control:

Under group banking system the managerial control is not effective because the control is indirect and more flexible. It cannot offer specialized management.

(ii) Inefficiency of Member Banks:

The inefficiency of one participating bank affects the other participating banks.

(iii) Less Facilities:

The system cannot provide all the facilities offered by branch banking.

(iv) Cannot Mobilize Funds:

Group banking does not have the capacity to mobilize funds as in the case of branch banking. Hence, it cannot offer the same economy of operations as are offered by branch banking.

Differences between Branch Banking and Unit Banking

Basis	Branch Banking	Unit Banking
1. Meaning	It is that system under which a large bank carries on banking business through a large number of branches spread all over the world.	It is that system where an individual bank undertakes banking business either through a single office or through a few branches operating within a limited area.
2. Large-scale Operations	A big bank possessing huge financial resources and having a number of branches, can enjoy many advantages of large-scale operations.	A unit bank with only one office or a few branches located in a particular area and having limited financial resources cannot enjoy the advantages of large-scale operations.
3. Economy of Cash Reserves	Branch banking results in an economy of cash reserves.	A unit bank has to use sufficient cash reserves to meet the requirement of its depositions.
4. Banking facilities	Under branch banking, the banking facilities can be made available to all the cities and even backward areas.	It is difficult to set up unit banks in smaller towns and under-development areas on economic grounds.

Basis	Branch Banking	Unit Banking
5. Public confidence	A bank, with huge financial resources and a number of branches, can command greater public confidence.	A small unit bank, with limited resources and one or a few offices located in a particular area, cannot command greater public confidence.

Differences between Group Banking and Chain Banking

Basis	Group Banking	Chain Banking
1. Meaning	It is a system where two or more banks are controlled by a holding company.	It is a system where an individual or group of individuals or members of a family control the operations of two or more banks.
2. Agreement	Group banking is necessarily the result of agreement.	Chain banking is not necessarily the result of agreement.
3. Control	The control of member banks is less direct and more flexible.	The control of member banks is more direct and less flexible.

SUMMARY

- **Banking System:**

  We can classify the banking system on the basis of their organizations, viz., branch banking, unit banking, group banking, chain banking and correspondent banking.

1. **Branch Banking System**:

   When a bank carries on banking business in different places with a number of branches, the system is called branch banking system or delocalized banking system. In this case, the bank has a head office in a big city and branches in different parts of the country or outside the country.

2. **Unit Banking System**:

   Unit banking system is a system of banking where a bank operates with a single office or place of business. The area of operation of a unit bank is localized and is of more limited as compared to branch banking.

3. **Group Banking System:**

   Group banking is the system in which two or more independently incorporated banks are brought under the control of a holding company. The holding company may or may not be a banking company. Under group banking, the individual banks may be unit banks, or banks operating branches or a combination of the two.

4. Chain Banking System:

Chain banking is a system of banking under which a number of separately incorporated banks are brought under the common control by a device other than holding company.

5. Correspondent Banking System:

It is the system under which unit banks are linked with bigger banks. The big correspondent banks are linked with still bigger banks in the financial centres.

- **Advantages of Branch Banking System** —
  - (i) Benefits of large-scale operations,
  - (ii) Wider spreading of risks,
  - (iii) Efficient Management,
  - (iv) Economy in Remittance,
  - (v) Economy of Cash Reserves and
  - (vi) Diversification of Deposits and Assets.

- **Disadvantages of Branch Banking System—**
  - (i) Difficulty in Management and Control,
  - (ii) Less Initiative,
  - (iii) Adjustment of Losses,
  - (iv) Concentration of economic power,
  - (v) Continuance of inefficient branches and
  - (vi) Unhealthy Competition.

- **Advantages of Unit Banking System**—
  - (i) Easy Establishment,
  - (ii) Easy Management and Control,

(iii) Quick Decisions,
(iv) Satisfaction of Local Needs,
(v) Personalized Services and
(vi) No Chance for Monopoly.

- **Disadvantages of Unit Banking System**—
  (i) No ability to face crisis,
  (ii) No Geographical Distribution of Risk,
  (iii) Variation of Interest Rate,
  (iv) Not able to provide Adequate Banking Facilities,
  (v) Inconvenience in the Remittance of Funds and
  (vi) Weaker Sections may be Neglected.

- **Advantages of Group Banking System—**
  (i) Enhancement of Operational Efficiency,
  (ii) Broader Market,
  (iii) Mobility and Transfer of Resources and
  (iv) Large Scale Operation.

- **Disadvantages of Group Banking System**—
  (i) Lack of Effective Managerial Control,
  (ii) Inefficiency of Member Banks,
  (iii) Less Facilities and
  (iv) Cannot Mobilize Funds.

UNIT-III

QUESTIONS

A. Very Short answer Questions: 1 mark each

1. In which year the Imperial Bank was established?
2. In which year 14 Indian Commercial Banks were nationalized?
3. In which year 6 Indian Commercial banks were nationalized?
4. In 1980 how many commercial banks were nationalized?
5. In which year the Lead Bank Scheme was introduced?
6. In which year the State Bank of India was established?
7. Name the three Presidency Banks.
8. What was the previous name of the State Bank of India?
9. In which year Imperial Bank of India was nationalized and renamed as State Bank of India?

B. Short Answer Questions: 2 marks each

1. What is a private sector bank?
2. What is a public sector bank?
3. What is branch banking?
4. What is unit banking?
5. What is chain banking?
6. What is group banking?
7. What is scheduled commercial bank?

8. Name two Private Sector banks in India.
9. Give two examples of public sector banks.
10. Name any two central banking functions performed by State Bank of India.
11. Name any two general banking functions performed by State Bank of India.
12. Give two functions of Lead Bank.
13. State two differences of scheduled and non-scheduled banks.
14. Explain the meaning of lead bank scheme.
15. State two major achievements of the nationalized banks in India.
16. Write two advantages of branch banking system.
17. State two differences between group banking and chain banking.
18. State two differences between public sector and private sector banks.
19. State two objectives of lead bank.

C. Long answer questions (Type-1): 5 marks each

1. Discuss the objectives of nationalization of commercial banks.
2. Mention clearly five differences between branch banking and unit banking.
3. Explain briefly about the growth of commercial banks in India during the post-independence period.
4. State the functions of Lead Bank.

D. Long answer questions (Type-2): 8 marks each

1. Discuss the evolution and growth of commercial banking in India.
2. Discuss the advantages and disadvantages of Branch Banking System.
3. Discuss the advantages and disadvantages of Unit Banking System.
4. What is Lead Bank Scheme? State the effects of this scheme.
5. Write a brief note on the State Bank of India.
6. Discuss the functions of the State Bank of India.
7. Discuss the performances of Commercial Banks after nationalization.
8. Discuss the main objectives and achievements of bank nationalization in India.
9. What were the causes of nationalization of some Indian Banks? How does it help the country?

UNIT–IV

Different Types of Bank Accounts and Customers

Different Types of Bank Accounts:

Savings Bank Account :– Meaning, Features, Advantages.

Current Deposit Account :– Maening and Features.

Fixed Deposit Accounts :– Meaning, Features, Advantages.

Recurring Deposit Account :– Meaning and Features.

Opening of Savings Bank Account and Current Deposit Account.

Differences between Savings Bank Account and Current Deposit Account, Differences between Savings Bank Account and Fixed Deposit Account.

Pay in Slip Book, Pass Book, Cheque Book, ATM Card.

Bank Customers :

Bank Customer– Meaning. Special Types : Minor, Illiterate Persons, Joint Account, Partnership Firm and Company.

Precautions to be taken by banker in opening and operation of accounts in their names.

Meaning, powers and duties of Banking Ombudsman.

Learning objective :–

After the study of this unit the student will be able to :-

- Know about the various types of Bank Accounts.
- Know the formalities to be carried out on opening of different types of bank accounts.
- Know the differences between Savings Bank Account and Current Deposit Account.
- Know the differences between Savings Bank Account and Fixed Deposit Account.
- Know about the bank customers.
- Understand about the special types of bank customers.
- Understand about Banking Ombudsman.

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CHAPTER-11

DIFFERENT TYPES OF BANK ACCOUNTS

Different Types of Bank Accounts

In modern times, banks perform varieties of functions. Acceptance of deposit is the most important function of a commercial bank. The deposits are the main source of funds for commercial banks. People consider to deposit their savings in a bank because by doing so they can earn interest. The deposits accepted by the banks are repayable either on demand or at the expiry of a specific period of time. To attract savings from all class of individuals, the banks maintain different types of bank accounts. We can classify the bank account into two categories-

A) Demand Deposit Account :

This type of deposit accounts is repayable on demand. The depositors have the right to withdraw money from such accounts by means of cheque or otherwise. Such deposit accounts comprise-

i) Savings Bank Account and

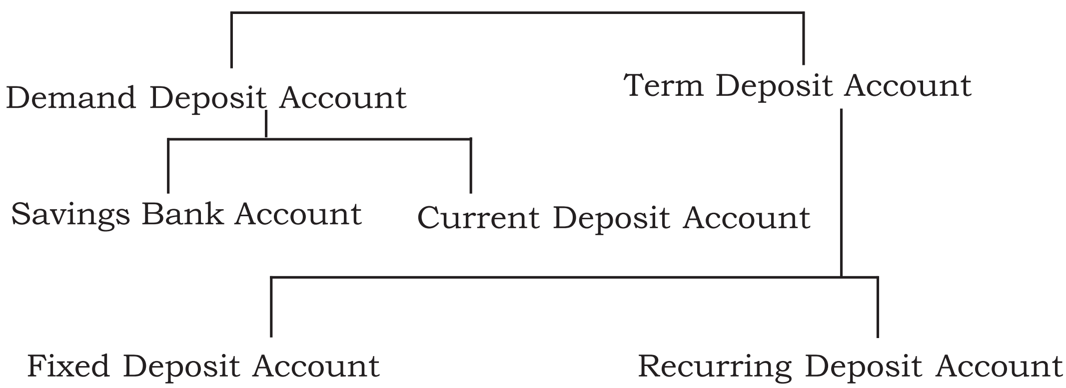
ii) Current Deposit Account

B) Term Deposit Account :

This type of accounts is accepted by bank for a stipulated period. These deposits are withdrawn only after the expiry of that stipulated time and such deposits cannot be withdrawn by means of cheques or otherwise. Term deposit accounts include -

i) Fixed Deposit Account

Different types of Bank Accounts



ii) Recurring Deposit Account

Customarily, the bank accounts are classified as following categories :–

i) Savings Bank Account

ii) Current Deposit Account

iii) Fixed Deposit Account

iv) Recurring Deposit Account

i) **Savings Bank Account:**

Savings bank accounts are meant for individuals to keep their savings for meeting their future monetary needs. The income source of every person in our society is not equal. Savings bank accounts are provided by the banks to encourage the people to save money especially among small and medium income groups for future needs.

If they deposit their small savings in the saving bank account, then it helps them to avail economic relief. This type of account is so popular among all classes of people. The commercial bank desires to collect money from such classes of people to execute working capitals. Any individual can open such kind of deposit account after filling up the specific application form related to that bank. With the extension of banking facilities day by day and the growth of banking habit amongst the people, the savings deposits of all scheduled commercial banks have gone up substantially. Savings bank accounts are opened with a minimum deposit varies from bank to bank on the basis of areas. There is no limitation to deposit money in a bank but certain restrictions are imposed by the bank on the right of the depositor to withdraw money from such type of account. Banks also offer a nominal rate of interest on their deposit with a view to encourage saving habits. The bank provides a Pass-Book after the account is opened as well as the bank issues cheque book and ATM card to the customer on request. The customer can deposit in his account by filling up pay-in-slip and withdraw money by means of cheque or debit card as and when required. The account holder may also withdraw cash from the bank by using a withdrawal form.

The main features of Savings Bank Accounts are as follows :–

1) A Savings Bank Account may be opened by -

   i) an individual in his own name

   ii) two or more persons in their joint names

   iii) a minor in his/her own name after attainment of certain ages between 10-14 years through their guardians

   iv) a club or association of person not engaged in business

   v) a charitable and religious institutions

   vi) a trustee

vii) an educational institution not related to profitable business.

2) The savings bank accounts are not allowed to open in the name of any trading or business concern whether sole trading, company, firm or any association.

3) A savings bank account can be opened by depositing certain amount of money. There is no limitation of deposit everyday and number of deposits.

4) There are restrictions on the number and amount of withdrawals from savings bank account. The banks may restrict the number of withdrawals up to 150 times in a year. But rule of restrictions are modified from time to time. The bank should issue a prior notice to the account holder to withdraw money beyond a specific maximum amount.

5) The rate of interest payable on savings bank account is lower than that of the fixed deposit and recurring deposit account.

6) The interest on savings bank account is calculated by the banks on daily basis. The RBI guidelines provided for adoption of the daily average method for calculating interest on savings bank account w.e.f. 1st April, 2010.

7) The pass books are provided to all savings bank account holders. Moreover, the depositors may be provided with a cheque book also.

8) The savings bank account holders may withdraw money from their accounts with the help of the withdrawal form or cheque or ATM.

Advantages of Savings Bank Account:

In savings bank account, both the bankers and customers can enjoy the following advantages:-

i) The bank ensures the security to the account holders on their deposits.

ii) The account holders earn a certain amount of interest on this type of deposits. As a result, the public interest is enhanced towards such account.

iii) The bank invests the funds in various fields to develop our country economically in addition to earn an amount of interests.

iv) The account holder can withdraw money when required. The bank provides facilities viz. withdrawal form, cheque and ATM to the account holders.

ii) Current Deposit Account:

A current account is a running account and also known as demand deposit account maintained solely or jointly for carrying out large volume of transaction on a regular basis. Current accounts relate to liquid deposits and unlike savings account, it normally does not provide interests. Current accounts are primarily opened by businessmen. Such as proprietors, partnership firms, trust, association of persons, public and private companies etc. It allows customer to deposit and withdraw money any number of times during a working day without giving any notice. The main objective of the current account is to enable the businessman to carry out the financial business transactions smoothly. A current account is meant for convenience of his customers who are relieved of the task of handling cash themselves and to take the risk inherent therein.

The features of Current Deposit Account are given below –

1) The current deposit account can be opened by an individual, businessman, firm, company etc. But a minor is not allowed to open such type of account.

2) The account holders are allowed to deposit and withdraw money

as and when required. There is no restriction on it.

3) Generally, no interest is allowed on the credit balance in a current account, because the bank has to maintain a more liquid fund against this account.

4) The bank provides pass-book, cheque book and ATM facilities to all current account holders.

5) The current account holders can avail of overdraft facilities. The customer intimates to the bank for this purpose.

6) The bank collects third party cheques and cheques with endorsement on behalf of current account holders.

7) In a current account, the banker does not provide cash credit directly rather loans and advances are granted to the account holders.

8) Penalty or incidental charges are levied, if minimum balance is not maintained in the current account.

9) In current account, the bank accepts bills of exchange, bank draft, cheque, etc. on behalf of customers besides deposits.

iii) Fixed Deposit Account:

Fixed deposit account is regarded as time or term deposit account. A certain sum of money is deposited for a certain period of time chosen by the account holder himself at the time of opening the account. The bank pays a higher rate of interest in this type of account. The account holder cannot withdraw money before maturity of the period. Of course, the bank may permit the account holder to withdraw money on or before maturity on the basis of the prior notice made by the account holder. The bank of course does not pay interest as agreed. The bank issues a fixed deposit receipt in this account. The depositor's name, rate of interest, maturity of the period and the amount to be paid by the bank on maturity are well mentioned in the receipt.

The features of a fixed deposit account are as follows:-

1) The fixed deposit account may be opened in the name of an individual or by two or more persons jointly or in the name of a minor through guardian.
2) A certain sum of money is deposited for a certain period of time in this account with an agreed rate of interest.
3) The bank issues an acknowledgement fixed deposit receipt after receiving the amount of money from the account holder. But the bank does not provide a pass-book or cheque book to such an account holder.
4) It is notable that in case a customer loses the fixed deposit receipt, then the customer will be provided another duplicate receipt after the submission of the authenticated proofs in this regard.
5) As compared to other deposit accounts, the rate of interest is higher in this type of account, because the bankers can invest the funds profitably for a long period.
6) The account holder cannot withdraw money from such account till the maturity time is not over. Of course, the bank may make a process to provide loan against his deposit.
7) Generally, interest on fixed deposit account is paid on maturity. The bank provides accrued interests to the depositors monthly, quarterly or half yearly in his savings account or current account on request.
8) The customer is liable to pay income tax where yearly interest exceeds to Rs. 10,000/-

Advantages of Fixed Deposit Account:

In fixed deposit account, the bank and customers enjoy the following advantages :-

1) In this type of account, the depositor get chance to invest their funds without any worry. The bank ensures security to the investor's funds as there is no chance of forgery.

2) The depositor enjoys higher rate of interest than other deposit accounts. So, the public are more interested to such deposit.

3) Since the depositors deposit the amount of money for a certain period, the bank avails the facility to invest funds for loans, advances and earn interest.

4) The depositors can avail loan from the bank as and when required against the deposits.

5) The depositors can withdraw accrued interests on the deposit monthly, quarterly or half-yearly.

6) Minimum period of fixed deposit is 7 days as per directive of Reserve Bank of India.

iii) **Recurring Deposit Account:**

Recurring deposit account is almost like fixed deposit account. Here a certain amount of money is deposited at a regular interval for a fixed period of time. The purpose of these accounts is to encourage regular savings by the public, particularly by the fixed income group. Money in these accounts is generally deposited on monthly basis for a fixed period and is repaid to the depositors along with interest on maturity by means of account payee cheque or by crediting the amount to the savings or current deposit account. The bank pays almost same rate of interest as that of fixed deposit and high rate of interest than other deposit accounts. The bank provides a Pass-book to such account holder. The depositor can deposit the amount of money through pay-in-slip in this respect. The notable matter is that in case the depositors desires to close the account before maturity, then the bank pays less interest than the agreed rate of interest.

The main features of Recurring deposit account are stated as follows:–

1) This account may be opened by-

    a) a person in his own name.

    b) two or more persons in their names jointly

    c) a minor jointly with his/her guardian.

    d) a minor in his/her own name provided he/she has attained certain minimum age between (10-14) years through guardian.

2) The depositors will have to deposit a fixed sum of money at regular intervals chosen by him monthly, quarterly and half-yearly.

3) If the account holder fails to deposit money in a specific period, then the bank levies a charge at a pre-determined rate.

4) The rate of interest in this type of account is almost equal to the rate of interest of fixed deposit account.

5) The bank provides a pass-book to the account holder to record every deposit.

6) The account holder can avail the loan facility up to 75% on his total deposits.

7) The account holder can transfer his recurring deposit from one branch to another branch of the same bank without paying any charges.

8) The account holder can withdraw the principal amount along with interest after maturity.

Procedures of Opening of Savings Bank Account and Current Deposit Account :-

1) **Application on the prescribed form :**

    The person or institution desiring to open an account makes a request on the prescribed form of the bank concerned. The bank provides application form to individuals, firms and companies. The applicant has to fill-up the relevant form and provides the requisite information to the bankers. The applicant has to provide the following particulars clearly in the application form:-

a) Name of the applicant

b) Date of birth of the applicant

c) Nationality of the applicant

d) Type of account to be opened

e) Occupation of the applicant

f) Full address of the applicant

g) Declaration form to obey rules relating to maintain the accounts imposed by the bank from time to time.

2) Photograph :

The applicant has to enclose at least two (2) copies of the latest passport size photographs. The photographs are pasted on the application form and on the specimen signature card.

3) Identification and address proof :

The applicant will have to produce a valid proof of his identity and residential address. As an identity, the applicant can submit passport, pan card, voter card, identity card of Government employee, driving license, electricity bill etc. along with the application form to the concerned bank.

4) Introductory References :

The bank pays attention to the applicant about his character, economic condition, integrity and responsibility to open an account for him. The applicant is required to be introduced to the banker by a referee. The applicant may be introduced to the banker by an existing customer of the bank or by any respectable person of the society or by a person known to the banker. The introducer will have to mention his name, signature, address, occupation and his account number.

5) Permanent Account Number :

The applicant has to cite Permanent Account Number (PAN) issued by the Income Tax Authority. In case, the application has no such number, he has to fill-up a prescribed form which is sent to the Income Tax Department by the bank. Permanent Account Number is compulsory to open a deposit account.

6) Specimen Signature :

The applicant is required to put his two or more specimen signature. The bank preserves such specimen signature for future reference. Now-a-days the specimen signature and photos are scanned and stored in the computer. Whenever a cheque is issued by the customer and presented to the banker then the bank compares the signature and photos and arranges to make payment of the cheque to avoid the risk of forgery.

7) Mode of operation of the account :

The applicant can operate his account himself. In case of joint accounts, mode of operation of the account has to be specified to the banker. The mode of operation in joint account of, say, two individuals, can be any of the following:

a) jointly by both the account holders

b) former account holder or survivor

c) latter or survivor

d) either or survivor

In case the applicant desires to operate his account with the help of a third person, then the account holder is required to give a mandate in this regard to the banker. The banker will obtain the specimen signature of the concerned third person or agent to operate the account in that regard.

8) Nomination :

The applicant is required to fill up the nomination form with the name/names of the nominee/nominees to receive the amount of the deposits in an event of an un-expected death of that account holder. The applicant is also required to put the name of the nominee with address, age, date of birth relationship with the depositor etc. If the nominee is minor, then guardian's name, relationship with the nominee, address etc. are required to be provided to the bank.

9) Opening the Account :

The bankers agree with the applicant to open an account in his name after the observance of these formalities. The applicant is then required to deposit a certain amount through pay-in-slip in his new account. The amount of initial deposit varies from account to account and bank to bank. The bank provides a Pass-Book, a cheque book, a Pay-in-slip book and ATM card to the account holder to operate the account smoothly.

Differences between Savings Bank Account and Current Deposit Account

The differences between savings bank account and current deposit account are mentioned below:–

1) In case of objective :

The preliminary objective of savings bank account is to make a habit of savings. On the other hand, the preliminary objective of current deposit is to provide facilities to deposit and withdraw money as and when required

2) In case of Nature :

Generally, all classes of people can open the savings bank account whereas the current deposit accounts are opened by businessman, firm, company etc.

3) In case of Interest:

Generally, the bank pays a certain interest to the savings bank account holders. But, no interest is paid generally to the current deposit account.

4) In case of Overdraft:

The bank does not provide any kind of overdraft facility against the savings bank account. But, the bank provides overdraft facility to the current account holders.

5) In case of withdrawal:

There are some restrictions on withdrawal from savings bank account. The banker may fix the maximum number of withdrawals during a certain period of time. But there is no limitation on withdrawals from current deposit account. Money can be withdrawn as desired by the account holder.

6) In case of Incidental charges:

The bank does not impose any incidental charges on savings bank account. But, the incidental charges are levied to the current deposit account holder.

Differences between Savings bank account and Fixed deposit account:

The differences between savings bank account and fixed deposit account are as follows:–

1) **In case of objective :**

   The preliminary objective of a savings bank account is to make a habit of savings and to get economic relief in future. In the matter of fixed deposit account, the preliminary objective is to invest funds for a long period to earn high rate of interest for some specific purpose like education of children etc.

2) **In case of period of deposit :**

   There is no fixed period of time of deposits in savings bank account. Whereas in fixed deposit account the depositors invest funds for a fixed period of time.

3) **In case of Nature of deposit**: The depositors can make several transactions in a year during banking hours in his savings bank account. But the depositor can deposit for one time only in his fixed deposit account.

4) **In case of rate of interest:**

   The rate of interest is very low in a savings bank account. But the rate of interest is higher in a fixed deposit account.

5) **In case of withdrawal:**

   There are some restrictions on withdrawal from savings bank account. The banker may fix the maximum number of withdrawals in a financial year. But in the matter of fixed deposit account, the depositor can withdraw the principal along with interests after maturity.

6) In case of Pass-Book:

The bank issues a pass-book to the savings bank account holder. On the other hand, no pass-book is provided to the fixed deposit account holder. But the bank issues a fixed deposit receipt in this regard.

7) In case of Cheque Book:

Cheque book facilities are provided to savings bank account holder who undertakes to maintain a certain minimum balance in the account. But, cheque book facility is not provided to the fixed deposit account holder. No transaction is operated by means of cheque.

8) In case of collection of cheques and payment:

The banks collect only those cheques which are in the name of the savings bank account holders. But the banks do not collect any cheques in fixed deposit account.

9) In case of fixed deposit receipt:

The bank does not issue fixed deposit receipt to the savings bank account holder. The bank issues a pass-book to record the transactions to the accountholders. But the bank issues a fixed deposit receipt comprising in the details in a fixed deposit account.

PAY IN SLIP BOOK

The bank provides the pay-in-slip book to the account holders to deposit cash, cheques, bills and bank drafts etc. into his account. There are two parts of the printed slips in the book with perforated counterfoils. The account holder has to fill-up both sides of the pay-in-slip by himself or through other agent at the time of deposit.

The bank provides a single pay-in-slip in-lieu of separate pay-in-slips for all types of bank accounts at the time of deposit nowadays. On the upper part of the pay-in-slip, it is mentioned in short forms for all types of accounts. The size and design of pay-in-slips are seen different and vary from bank to bank. However, the contents of the slips are basically the same. In pay-in-slip, the customer is required to mention date of deposit, name of the account holder, the account number, amount of deposits with words and figure, denomination of currency note, signature of depositors mobile no, PAN no etc. to deposit the amount in the bank.

In the two parts of pay-in-slip, the account holder must write these distinctly to deposit his cash or cheque in the cash counter of the bank. Then the bank keeps the right part of the pay-in-slip and returns the left part (small part) with date, banker's seal with signature. The signed left part signifies that the cash or cheque is received by the bank. The bank credit the deposits in the customer's account based on this slip. In case, the customer deposits the cheque of other bank for collection then the bank will deposit or credit in the customer's account after collections.

PASS BOOK

A pass book is important small book that is issued by the banker to the customer after an account is opened. Pass Book, contains the complete address of a customer, address of the bank branch and customer's account number, mobile no, Pan no. Pass-Book is provided to the customer with a view to record every transaction between a customer and the bank smoothly. After every transaction, the bank records every entry in the bank's ledger against customer's account. In the same way, the bank records the transaction in the pass-book and returns it to the customer. The customer is able to know about the deposit or withdrawal amount with the help of a pass-book. The customer is able to know up-to-date balance in his account. So, it is important for the customer to send the pass-book periodically to the banker for updation. Then the bank made the up-to-date entries in the pass-book. The serial number of every cheque is also recorded in the pass-book, if a customer transacts by means of a cheque. In case, there is any discrepancy of transaction, the customer should inform the bank as soon as possible to take necessary action in this respect. The bank should be careful in recording the transaction of the customer pass-book. Reflection of wrong entry in pass-book will show more or less balance. If a customer lost his pass-book or the pages of it are finished, then he should inform the bank about it to provide a duplicate pass-book for him.

Importance of Pass-Book :

The importance of a pass-book is as follows :-

a) The transaction between the bank and the customer are known in details through a pass-book. The amount of deposit and withdrawal are known with other transactions through it.

b) Through a pass-book the up-to-date total balance of deposits are known.

c) The up-to-date total balance helps the customer to issue a cheque for making payments.

d) The Pass-Book must be accompanied to draw the money with the withdrawal form. Otherwise, the bank will not be agreed to make payment.

CHEQUE BOOK

The bank provides cheque book to its customer to withdraw money and to make payment from the accounts. The cheque book contains printed blank cheque. The cheque book is issued to all current account holders. Of course, the bank provides the cheque book to the savings deposit account holders as per demands on the basis of certain minimum balance in their accounts. Generally, a cheque book contains from 10 to 50 leafs. Every cheque book also contains one requisition slip to facilitate the account holders to obtain a new cheque book from the bank. It is notable that whereas pay-in-slips are supplied by the banker free of cost, the banker may levy a charge for supplying cheque book. In case, a customer wants to withdraw money, he fills up the cheque and presents it in the bank counter. In case the savings bank account holders are not provided cheque-book facility, the account holder can withdraw money by means of withdrawal Form available in the bank's counter.

ATM CARD

The full form of "ATM" is "Automated Teller Machine", which was introduced in New York city of America in 1930 in the beginning. Its popularity increased among the Western countries. However, Hongkong bank provided "ATM" facility in India. The bank provides ATM facility to savings deposit account and current deposit account holders only. This is a modern facility. People can withdraw money with the help of ATM card at any time during 24 hours as well as can have status of account. The ATM card is also known as "Any Time Money". To utilize this card, a customer will have to follow some strict rules made by the bank. The bank provides four digit secret number to the holders which is known as Personal Identification Number (PIN). In case, the PIN is leaked, the deposits may be led to forgery. So, the ATM card holder should take precaution in utilization of the card. If the account holder lost the ATM card, he should inform the bank immediately. The ATM card holder can withdraw money as specified by the bank during 24 hours. Moreover, the account holder can deposit as well as withdraw money by using this card anywhere and anytime.

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SUMMARY

- The term customer of bank refers to a person who opens a deposit account in a bank and undertakes banking transactions with the banker.

- The deposit account in a bank may be classified into two categories :-

  i) Demand Deposit Account and

  ii) Time or Term Deposit Account.

- The Demand Deposits Accounts include :-

  a) Savings Bank Account and

  b) Current Deposit Account

- The Term Deposit Accounts include :–

  a) Fixed Deposit Account and

  b) Recurring Deposit Account

- Loans and advances are provided by banks through current account.

- A minor may open all types of deposit accounts except current deposit account.

- Fixed Deposit Receipt is issued to the fixed deposit account holder. It is not a negotiable instrument and can be transferred by way of assignment.

A depositor may operate his account by using -

i) Pay-in-Slip Book

ii) Cheque Book

iii) Pass Book

iv) ATM Card

- ATM is an electronic banking outlet that allows bank customers to complete basic transaction without the aid of a branch representative or human teller. The facilities include withdrawal and deposit of cash.

CHAPTER-12

BANK CUSTOMER AND BANKING OMBUDSMAN

Meaning of Bank Customer:

The term customer originates from the English word **"Custom."** A person is regarded as customer if he buys goods or avails the services. But the meaning of customer is different in case of Banking. There is no statutory definition of the term **'Customer'** in relation to the bank. In general, a person who has an account in a bank is considered its customer**.** A person must have some kind of account with the bank in his own name for transaction from time to time in this respect. Then the person or institution is treated as a real customer of the bank. The moment a person opens an account with a bank, he or she become its customer.

As stated by **Sir John Paget** "to constitute a customer there must be some recognizable course or habit of dealing in the nature of regular banking business."

To be a customer of a bank the following two conditions must be satisfied :–

i) there should be a regular habit of transactions between the bank and the customer.

ii) the transaction should be of banking nature.

This definition of a customer of a bank put more emphasis on the duration of the dealings between the banker and the customer and hence this view is called as **“duration theory”.**

According to **Dr. H.L. Hart,** “a customer is one who has an account with a banker or for whom a banker habitually undertakes to act as such.”

But this conception is changed extensively at present. Globally, the bank customer is such a person who transacts frequently with banks and where the customer can avail a number of facilities provided by the bank.

To constitute a bank customer the following requisite conditions must be fulfilled:

(i) a bank account (e.g. savings, current, recurring or fixed deposit account) must be opened in his name by making necessary deposit of money.

(ii) the dealings between the banker and the customer must be of the nature of banking business. If an individual does not open any type of bank account, then he can not avail any utility services provided by bank.

A customer of a bank need not necessarily be a person. A firm, joint stock company, a society or any separate legal entity may be a customer.

Special Types of Bank Customer:

The primary objective of a commercial bank is to collect deposit communicating with the public. So, the bank appeals to customer to open different types of bank accounts. The customers will have to follow the rules and regulations imposed by the bank at the time of opening accounts. Generally, the customers of a bank can be categorized into two classes:-

(1) General Customer and

(2) Special Customer

General customers are those who are competent to enter into contract under Indian Contract Act. The banker does not face any problem in opening accounts in the name of general customer. But as regards to special customers the banker has to take necessary precautions while dealing with them. Some of the special types of bank customer can be discussed as follows-

1. Minor
2. Illiterate person
3. Joint account
4. Partnership firm
5. Company

MINOR

One who does not attain the age of 18 years is generally regarded as minor. According to Section 3 of Indian Majority Act, 1875, a minor is a person who has not completed the age of 18 years. Of course, a person for whom the court has appointed a guardian or whose property is managed by the court of wards during the period of his minority, the person shall become major on completion of the age of 21 years. According to Section 11 of the Indian Contract Act, 1872, a minor is not capable of entering into a valid contract and a contract entered into by a minor is void except a contract for supply of necessaries of life which is regarded as a valid contract. From the above discussion it seems that a minor cannot open an account with a bank as the minor cannot enter into a valid contract. A bank may open an account in the name of a minor with utmost care and should therefore be very careful in dealing with a minor and take following precautions.

Precautionary Measures

(i) Nature of accounts:

The banker may open a savings bank account in the name of a minor. It will not be advisable to open a current account in the name of the minor, because in case of an overdraft in current account, the minor does not have any personal liability. The savings bank account may be opened as follows:-

a) in the name of the minor himself/herself

b) in the joint names of the minor and his/her guardian.

c) in the name of the guardian to be operated by the guardian.

The bank can also open fixed deposit account and recurring deposit account in the name of a minor through their father/mother/guardian.

(ii) Date of birth of the minor:

The banker should record the date of birth of the minor as disclosed by his/her guardian at the time of opening the account in the application form.

(iii) Death of the guardian:

In case the death of the guardian before the minor attains majority and the account is a joint account or to be operated by the guardian only, the deposit money should be paid by the bank to the minor on attaining majority or to some person appointed by the court as his/her guardian.

(iv) Death of the minor:

In the unfortunate death of a minor the money will be payable to his or her guardian.

(v) Minor as a Partner:

Generally, a minor can not be a partner in a firm but the minor may be admitted to the benefits of partnership in case all the partners of the firm agree in this respect. In such cases, the minor can not be held liable for the debts of the firm during his/her minority. A minor's liability is limited to the extent of his share in profits and property of the funds.

(vi) Minor as an agent:

A minor acts as an agent. But the banker should collect a written authority from the principal regarding the powers. The principal should be a major one. Otherwise the contracts would be invalid with third parties.

ILLITERATE PERSON

Every person has equal right to open a bank account in his own name. Though an illiterate person does not know how to read and write then also an illiterate person may be a customer of a bank. After opening an account of such customer a relationship grows between bank and the customer and the responsibility enhances gradually to that type of customer. Of course, the authorized bank officer imparts person about the rules and regulations clearly. The banker should take the following precautions while opening and operating an account in favour of an illiterate person.

Precautionary Measures :

(i) Thumb impression :

In the application form, the banker should obtain left hand thumb impression of the depositor in the specimen signature sheet in the presence of an authorized bank officials.

(ii) Identification mark :

At the time of opening an account of an illiterate person the banker should also obtain physical identification mark and note it down in the account opening form and the specimen signatures sheet. This identification mark to be certified as true mark by any responsible officer of the bank.

(iii) Photograph :

The bank should obtain three copies of recent passport size photographs of the depositor. One copy of photograph will be affixed in the account opening form and the other in the specimen signature sheet and the third in the pass-book.

(iv) Operation of the account:

An illiterate person can deposit money with the help of any other person. For withdrawing money he has to attend personally with the pass-book to the bank. He has to affix his thumb impression in presence of a bank official on the withdrawal form. If the person is unable to attend personally in the bank for withdrawal of cash, he can send a messenger with an authorization letter which should contain the signature of two witnesses authorizing by his left hand thumb impression. Usually, cheque book facility is not provided to such person.

JOINT ACCOUNT

When two or more persons open an account jointly in their names, it is called joint account. Generally, such accounts are opened for the sake of convenience of operation of account holders. For examples, husband and wife, and business partners may open a joint account, where any one of them can operate the account according to their convenience. The banker should get the specific instructions from the joint account holder regarding bill transactions, loans and advances etc. and it must be in writing and be signed by all of them.

Precautionary Measures:

The banker while opening joint account should take the following precautions:-

i) The application form duly completed in all respects mentioning details of joint account holders and must be signed by all persons intending to open a joint account.

ii) The banker must get specific instructions in writing signed by all the joint account holders regarding the operation of the account.

iii) Any joint account holder has right to stop payment of a cheque issued on a joint account. The banker has to obey such order.

iv) The full name of the account holder should be given in all the documents furnished to the banker even in case the account is to be operated upon by any one or a few of the joint account holders.

v) The banker must ascertain whether the persons operating the joint account are also authorized to make transaction, overdraw, loans and advances and Bills transactions etc.

vi) The banker must be given clear instructions regarding the withdrawal of securities in the joint account and the power conferred upon the person operating the joint account to pledge the securities.

vii) In the case of death of one or more joint account holders, the balance in the account will vest with the survivor or survivors. On the death of all the joint account holders any balance in the account is payable to the legal representative of the joint account holder who dies last.

PARTNERSHIP FIRM

According to the Indian Partnership Act of 1932, Section 4 defines partnership as "the relation between persons who have agreed to share profits of the business, carried on by all or any of them acting for all." Thus, as per definition, a partnership firm is established by an agreement amongst the partners. The partners formulated a partnership deed which contains the details of the agreement.

The person who have entered into partnership with one another to carry on a business are individually called as "Partners", and collectively called as a "Partnership Firm", and the name under which their business is carried on is called the "Firm Name". A partnership firm is not a separate legal entity distinct from its member. It is merely a collective name given to the individuals composing it.

Precautionary Measures :

A banker while opening an account in the name of a partnership firm should take the following precautions :-

i) Titles of the firm's account :

The banker should always open an account in the name of the firm and not in the name or names of the individual partner or partners.

ii) Application of opening of an account :

The banker should open an account in the name of the firm on receiving application from one or more partners. Signatures and specimen signatures of all the partners should be taken on the account opening form.

iii) Copy of partnership deed :

A copy of the "Partnership Deed" is a must for the banker and should thoroughly examine of its various clauses.

iv) The partnership letter or mandate :

The banker should take a letter signed by all the partners mentioning the following particulars :–

a) the names and address of all the partners

b) the nature of the business undertaken by the firm

c) the name or names of the partner or partners authorized to operate the account in the name of the firm, including the authority to draw, endorse and accept cheques and bills and mortgage and sell property belonging to the firm.

v) Revocation of authority to operate the account:

Any partner may serve notice in writing to the banker to revoke the authority given to any other partner regarding operation of the firm's account. Similarly, any partner can stop payment of cheque issued by any other partner on the firm's account. The banker will be bound to obey such instructions.

vi) Delegation of authority to operate the account:

The partner who is authorised to operate the firm's account can not delegate his authority to any other partner without due consent in writing of all other partners.

vii) Personal account and firm's account:

A partner may have his personal account in the same bank branch. In such a situation the banker should act with utmost care in respect of transactions relating to partnership business. All funds and cheques which are in the name of the firm must be invariably credited to the firm's account and not to the personal account of the partners.

viii) Admission of a new partner:

A new partner can be admitted into the firm only with the consent of all the existing partners. Unless otherwise agreed upon with the admission of a new partner, the partnership firm is reconstituted and a new agreement is entered into to carry on the business of the firm. So, the banker should obtain a new mandate signed by all the partners including the new partner.

ix) Liability of the partners in respect of firm's debt:

The liability of the partners of a partnership firm is unlimited. Every partner is liable to pay the obligations and debts of the firm to an unlimited extent. The liability is unlimited which means that the partner's private assets can be disposed of for the purpose of paying the debts of the firm. Therefore, the banker should get the documents signed by all the partners as well as individual capacities.

x) In case of retirement, death or Insolvency of a partner:

On receiving a notice of retirement, death or insolvency of a partner, the banker should operate the firm's account according to "Partnership Deed".

COMPANY

A company is a form of business organisation wherein a group of persons form an association in order to perform business activities together. It is considered to the most superior form of business organisation. A company is regarded as an artificial person. It is created by law with a separate legal entity distinct from its member and enjoys a perpetual succession, therefore, can carry out business in its own name. According to the Companies Act, 2013, a company means, **"company incorporated under the Companies Act, 2013 or any previous companies' law."**As the company has a separate legal entity, it can enter into a contract in its own name. Therefore, the banker may open an account in the name of a company with precautions.

Precautionary Measures:

The banker should take the following precautions at the time of opening an account in the name of a company –

i) Examination of documents:

As the company is an artificial person, its constitution, powers and objectives, rules and regulations are contained in the following documents. The banker should thoroughly and carefully examine these documents to determine legal existence of the company.

(a) Certificate of incorporation:

It is most important document in the formation of a company. This certificate is issued by the Registrar of Companies. This certificate provides conclusive evidence of registration that the company is a duly incorporated body.

(b) Certificate of commencement of business:

This certificate is also issued by the Registrar of Companies. This document provides clearance to public companies to commence their business activities and is an evidence for the banker that the company is legally entitled to start business operation.

(c) Memorandum of Association:

A memorandum of association represents the Charter or constitution of the company. It defines the objects and lays down the fundamental conditions upon which the company is to be formed. It contains in detail regarding the name of the company, objectives, liability and capital etc. The banker has to particularly observe the objects of the company. Because, anything done beyond the scope of the objects of the company will not be binding on the company even if all the members agree for it.

(d) Articles of Association:

The articles of association contain rules and regulation or bye-laws for governing the internal affairs of the company. It contains in detail all matters which are concerned with the conduct of day-to-day business of the company. The banker has to go through the Articles to find out the powers of directors regarding borrowing, mortgaging company's assets, drawing, accepting and endorsing negotiable instruments and the procedure to be followed in all such cases.

(e) Copies of annual accounts:

The banker should carefully study the internal financial condition of the company. The banker should insist upon the company to supply the copies of annual accounts of the preceding few years.

ii) Copy of the Board of Director's resolution:

The banker must insist upon the company to submit a copy of the Board's resolution appointing bank as the banker of the company. The resolution should be signed by the chairman and secretary of the meeting. The resolution should also specify about the following matters:-

a) The names of the persons who are authorized to operate the bank account on behalf of the company can borrow.

b) The names of the persons who are authorized to execute documents title deeds with the bank on behalf of the company.

c) Authorizing the advance and stating all details of such advance e.g. the limit of advance, its security, rate of interest etc.

iii) Borrowing Powers of the Company:

All trading companies enjoy implied borrowing powers for the purpose of carrying of their business. So far as non-trading companies are concerned, they can not borrow unless it is expressly stated in their memorandum and articles that they are authorized to do so. The power to borrow is generally exercised by the director's with the authority of the Articles. Where the memorandum of a company has stated the limit of a company's right to borrow money, any borrowing beyond such limit is beyond the authority of the company. So, the total borrowings of the company should not exceed the aggregate of the paid-up capital and free-reserves of the company.

The banker must ascertain that the company borrows on the basis of Memorandum and within the limits, if any specified therein. The banker should ask for a certified copy of the Board's resolution that the borrowing are within the limits authorized by the share holders at a general meeting.

iv) Registration of Charges:

Whenever companies fall short of capital and to increase the capital, the simplest way for the company is to borrow money from banks keeping its assets as collateral security. In this event charge is created for securing loans by way of pledging or mortgage on the assets of the company.

The main purpose of registration of charge is to give notice to the Registrar of Companies and also to the person who advance money to the company about the encumbrance created on the assets of the company. The banker should ensure that the company has got such charge registered with

Registrar of Companies within 30 days of the creation of the charges.

v) Companies Account and Personal Account:

The company's account and the personal account of the person authorized to operate account should be maintained separately. The banker should not allow transferring of funds from the company's account to the personal account of the person who is authorized to operate the account on behalf of the company.

MEANING, POWERS AND DUTIES OF BANKING OMBUDSMAN

The Banking Ombudsman Scheme was introduced in India by the Reserve Bank of India on 14th June 1995 under Section 35- A of the Banking Regulation Act- 1949. The Scheme is introduced with the object of enabling of resolution of complaints relating to certain services rendered by Banks and to facilitate the satisfaction or settlement of such complaints. The Reserve Bank of India directs that all Commercial Banks, Regional Rural Banks, and Scheduled Primary Co-operative Banks shall comply with the Banking Ombudsman Scheme. The services of the Banking Ombudsman are now very important.

Appointment

The Reserve Bank may appoint one or more persons to be known as Banking Ombudsman to carry out the functions entrusted to him by or under the scheme. The Banking Ombudsman shall hold office during the pleasure of the Governor, Reserve Bank of India. As on date (Twenty Two) 22 Banking Ombudsman have been appointed with their offices located mostly in state capital.

Qualification:

The Banking Ombudsman will be a person of high standing in the legal, banking, financial services and public administration or management sectors.

Tenure :

The Banking Ombudsman will be appointed for a period not exceeding three years and be eligible for extension for further period not exceeding two years subject to an overall age limit of 65 years.

Powers and Duties of Banking Ombudsman :

General

The Banking Ombudsman's powers and duties will be:-

(a) to receive complaints relating to the provision of banking services.

(b) to consider such complaints and facilitate their satisfaction, or settlement by agreement, by making a Recommendation, or Award in accordance with this scheme.

Specific ambit of Authority

As regards banking services, the Banking Ombudsman's authority will include:-

(a) All complaints concerning deficiency in service such as:-

(i) non-payment/inordinate delay in the payment or collection of cheques, drafts/bills etc.;

(ii) non-acceptance, without sufficient cause, of small denomination notes tendered for any purpose, and for charging of commission in respect thereof;

(iii) non-issue of drafts to customers and others;

(iv) non-adherence to prescribed working hours by branches;

(v) failure to honour guarantee/letter of credit commitments by banks;

(vi) claims in respect of unauthorised or fraudulent withdrawals from accounts;

(vii) complaints pertaining to the operations in any savings, current or any other account maintained with a bank, such as delays, non-credit of proceeds to parties accounts, non-payment of depositor non-observance of the Reserve Bank directives, if any, applicable to rate of interest on deposits.

(viii) complaints from exporters in India such as delays in receipt of export proceeds, handling of export bills, collection of bills, etc. provided the said complaints pertain to the bank's operations in India; and

(ix) complaints from non-resident Indians having accounts in India in relation to their remittances from abroad, deposits and other bank-related matters.

(b) Complaints concerning loans and advances only in so far as they relate to:-

(i) non-observance of Reserve Bank directives on interest rates,

(ii) delays in sanction/non-observance of prescribed time schedule for disposal of loan applications and

(iii) non-observance of any other directions or instructions of the Reserve Bank, as may be specified for this purpose, from time to time.

(c) Such other matters as may be specified by the Reserve Bank from time to time in this behalf.

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SUMMARY

- A person who has not complete 18^{th} years of age is known as minor.
- The banker may open Savings Bank Account, Fixed Deposit Account and Recurring Deposit Account in the name of a minor.
- The banker should not grant loans and advances to a minor.
- The Account in the name of two or more person is called Joint Account.
- Cheque book facility is not provided to an illiterate customer generally.
  - i) The illiterate person should put his thumb impression to the banker in lieu of signature.
  - ii) An illiterate bank customer has to come personally to the bank to withdraw money or by a messenger with an authorisation letter.
- The Firm's account and the Personal account of the partner should not be mixed by the banker.

- In case of retirement, death or insolvent of a partner the banker should stop the operation of the account.
- While granting loans and advances to a company the banker should ascertain its borrowing powers and consult with the Registrar of Companies to determine the existence of any prior charge over the assets given as security.
- The Banking Ombudsman settles the disputes between the bank and its customer.
- The Banking Ombudsman Schemes applies to all scheduled and co-operative banks operating in India.
- The recommendations and award of the Ombudsman is subject to the acceptance of both the banker and the customer.

UNIT-IV

QUESTIONS

A) Very Short Answer Questions:- *1 mark each*

1) Write the meaning of bank customer.
2) In which account overdraft is granted by a bank?
3) Write the full form of ATM.
4) Who is known as minor?
5) Can an illiterate person open a bank account?
6) What is the meaning of the term "Banking Ombudsman"?
7) In which year Banking Ombudsman scheme was introduced in India?

B) Fill in the blanks:- *1 mark each*

1. The rate of interest on ………………account is higher than that on other types of deposit account.
2. Generally no interest is paid to …………account.
3. Accepting the deposit and lending of money are …………functions of the bank.
4. A minor ……………… a customer of a bank.

5. Every company ....be a customer of bank.

6. An illiterate person cannot open a .... in a bank.

C) Short Answer Type Questions:- *2 marks each*

1. What are the different types of Bank accounts?

2. What is Current account?

3. What do you mean by Recurring deposit account?

4. What is Joint Account?

5. State the uses of ATM Card.

6. What is Pay-in-Slip book

7. What is Banking Ombudsman Scheme?

8. What is Pass Book?

(D) Long Answer Questions (Type-1):- *5 marks each*

1. Distinguish between Savings Bank Account and Current Deposit Account.

2. Distinguish between Savings Bank Account and Fixed Deposit Account.

3. Mention the main features of Savings Bank Account

4. Mention the essential features of Current deposit account.

(E) Long Answer Questions (Type-2):- *8 marks each*

1. Discuss the process of operation of Savings Bank Account

and Current Deposit Account.

2. What is Recurring deposit account? What are the essential features of recurring deposit account?

3. Discuss the Procedures of opening an account in the name of a minor :-

4. Discuss the Procedures of opening an account in the name of an Illiterate person :-

5. Discuss the Procedures of opening an account in the name of a joint account :-

6. Discuss the Procedures of opening an account in the name of a partnership Firms :-

7. Discuss the Procedures of opening an account in the name of a company :-

8. Explain Banking Ombudsman Scheme in India.

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UNIT-V

Negotiable Instruments: Meaning and features of Negotiable Instrument, Types of negotiable instruments, Meaning and features of Promissory Note, Bill of Exchange and Cheque. Differences between Promissory Note and Bill of Exchange, Promissory Note and Cheque, and Bill of Exchange and Cheque.

Types of Cheques : Open Cheque - Bearer Cheque, Order Cheque. Crossed Cheque.

Types of Crossing and their Significance: General and Special Crossing, Not Negotiable and Account payee Crossing.

Endorsements: Meaning, Significance and Kinds.

Meaning and essential features of Payment in due course, Meaning of Holder, Meaning of Holder in due course, differences between Holder and Holder in due course, Rights and privileges of a Holder in due course.

Learning Objectives :-

After the study of this Unit, the student will be able to :-

- Know the meaning and features of negotiable instruments.
- Know the types of negotiable instruments.
- Meaning and features of promissory note, bill of exchange and cheque.
- Know the differences among promissory note, bill of exchange and cheque.
- Know the various types of cheques: open cheque–bearer cheque and order cheque; crossed cheque.
- Know the meaning and types of crossing
- Know the meaning, significance and kinds of endorsements.
- Know the meaning and features of payment in due course.
- Know the meaning of a holder, holder in due course and privileges of a holder in due course.

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CHAPTER-13

NEGOTIABLE INSTRUMENTS

Introduction:

Various types of documents are used in modern business world. But, certain documents are commonly used in commercial transactions to transfer money from one person to another person which are called Negotiable Instruments. Negotiable instruments have great significance in the modern business world. These instruments have gained prominence as the principal instruments for making payment and discharging business obligations.

In India, the law relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881, which deals with Promissory notes, Bills of exchange and cheque and also Hundis (a bill of exchange in a vernacular language).

The Negotiable Instruments Act, 1881, came into force on 1st March, 1882.

2. Title free from defects:

The transferee of a negotiable instrument gets a good title which is free from all defects. If a person transfers a bearer cheque after it is stolen, the transferee of such a stolen cheque becomes a holder in due course even though the cheque is stolen. A person who takes delivery of a negotiable instrument for value, in good faith and before maturity (i.e. a Holder in due course) gets a better title than that of the transferor.

3. Right to sue:

The holder of a negotiable instrument can sue in his own name and he can recover the amount of the instrument from the party liable to pay thereon. If a cheque is wrongfully dishonoured by a drawee bank, the holder of such a cheque can file a suit against any endorser or against the drawer of the cheque directly.

4. No notice to transfer:

The transferor of a negotiable instrument can simply transfer the document to the transferee. There is no need of serving any notice of transfer to the party who is liable on the instrument to pay.

5. Presumptions:

Following legal presumptions are made with regard to a negotiable instrument until the contrary is proved (Sec 118 and 119) :

i) Every negotiable instrument is drawn, accepted and endorsed, made or transferred for consideration.

ii) The date it bears on it, is the date on which the negotiable instrument is drawn or made.

iii) The instrument is accepted within a reasonable time after being made and before its maturity.

PROMISSORY NOTE

According to Sec 4 of the Negotiable Instruments Act, 1881, ‘ a promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of , a certain person or to the bearer of the instrument’.

Illustrations

Alia Bhatta signs instruments in the following terms:

(a) “I promise to pay Balia or order Rs.5,00,000.”

(b) “I acknowledge myself to be indebted to Balia in Rs. 5,00,0000, to be paid on demand, for value received.”

The instruments given above are promissory notes.

But, the following instruments are not negotiable instruments, if, Alia Bhatta signs in the following terms:

(a) “Mr.Balia, I.O.U. Rs. 5,00,000”

(b) “ I promise to pay Balia Rs. 5,00,000 and all other sums which shall be due to him”.

(c) “I promise to pay Balia Rs. 5,00,000, first deducting there out any money which he may owe me”.

(d) “I promise to pay Balia Rs. 5,00,000 seven days after my marriage with Kalia”.

(e) “I promise to pay Balia Rs. 5,00,000 on Dalia’s death, provided Dalia leaves me enough to pay that sum”.

(f) “I promise to pay Balia Rs. 5,00,000 and to deliver to him black horse on 1st January next”.

4. **Signed by the maker:** The promissory note must be signed by the maker of the instrument. In the case of an illiterate person, he may fix his thumb mark.

5. **Payee must be certain:** The payee of the promissory note must be certain.

6. **Promise to pay money:** The promise contained in the promissory note should be to pay money only.

7. **Amount should be certain:** The promise to pay must be a certain sum of money in legal tender.

8. **Properly stamped:** A promissory note must be properly stamped as required by law.

Parties of a Promissory Note:

1. **Maker:** Maker is the debtor who makes and signs the promissory note (promising to pay a certain sum of money after the expiry of a certain duration of time) and who promises to pay.

2. **Payee:** The person named in the instrument, to whom or to whose order the money is to be paid is called the ' Payee'.

BILL OF EXCHANGE

According to Sec-5 of the negotiable instruments Act, 1881, "A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument."

4. **Payee to be certain person:** A bill of exchange is drawn payable to a certain person or to his order (or to the bearer) of the instrument. Thus, the payee is certain.

5. **Signed by the drawer:** A bill of exchange must be duly signed by the drawer.

6. **A certain sum of money:** The sum of money payable must be certain.

7. **Properly stamped:** A bill of exchange should be properly stamped.

8. **Payable on demand or after a certain date:** A bill of exchange may be payable at sight (demand bill) or after the expiry of a certain period specified therein (time bill).

Parties to a Bill of Exchange:

1. **Drawer:** The person who draws or makes the bill of exchange is called the drawer. The drawer is the creditor.

2. **Drawee:** The person on whom the bill of exchange is drawn, is called the “drawee” or “acceptor”.

3. **Payee:** The person to whom the amount of the bill of exchange is payable is called the “payee”.

CHEQUE

According to Section 6 of the Negotiable Instruments Act, 1881, as amended by the Negotiable Instruments (Amendment) Act, 2002, “a cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.”

5. **Specified sum of money:** A cheque is always drawn for a specified sum of money.

6. **Payee to be certain:** The payee of a cheque is the person to whom the amount of the cheque is payable. The payee must be certain. Drawer himself may be the payee. Payee may be a human being or an artificial person, etc.

7. **Signed by the drawer:** The cheque must be signed by the drawer, i.e., the customer of the bank. The signature of the drawer on the cheque must tally with the specimen signature in the bank.

8. **Payable to order or bearer:** The cheque may be payable to order or to bearer.

9. **Delivery:** The delivery of a cheque is a must. A cheque payable to bearer is negotiable by the delivery thereof.

Differences between Promissory Note and Bill of Exchange:

Basis	Promissory Note	Bill of Exchange
1.Promise and order	A promissory note contains an unconditional promise to pay.	A bill of exchange contains an unconditional order to pay.
2. Parties	In a promissory note, there are only two parties- maker and payee.	In a bill of exchange, there are three parties- drawer, drawee and payee.
3. Acceptance	In case of promissory note, acceptance is not required.	In case of bill of exchange, acceptance by the drawee is required.

Basis	Promissory Note	Cheque
3. Payment	A promissory note may be payable on demand or after a certain period of time.	A cheque is always payable on demand.
4. Payee	In case of promissory note, the maker cannot be the payee.	The drawer of a cheque can be the payee.
5. Stamping	A promissory note requires stamping.	A cheque does not require stamping.
6. Crossing	A promissory note cannot be crossed.	A cheque can be crossed.

Differences between Bill of Exchange and Cheque:

Basis	Bill of Exchange	Cheque
1. Drawee	A bill of exchange may be drawn on any person including a bank.	A cheque is always drawn on a bank.
2. Payment	A bill may be drawn on demand or the expiry of a certain period of time.	A cheque can only be drawn payable on demand.
3. Printed Form	A bill is not usually drawn on a printed form.	A cheque is always drawn on a printed form.
4. Acceptance	In case of bill of exchange, acceptance by the drawee is essential.	In case of cheque, acceptance by the drawee (bank) is not essential.
5. Crossing	A bill of exchange cannot be crossed.	A cheque can be crossed generally or specially.

Specimen of an Open Cheque

CHANDMARI (13248) Date..........................

Pay .... OR BEARER

Rupees .... Rs. ....

A/c No.90125629123

State Bank of India
CHANDMARI
M.G.ROAD, KAMRUP Pradyumna Kotoky

21369 782510261 0044490 10

MAIN FEATURES OF OPEN CHEQUE:

1. **Parallel lines or name of bank:** An open cheque requires no parallel transverse lines or the name of a banker.

2. **Encashment:** It can be encashed over the counter of the bank by presentation and through bank also.

3. **Use:** It can be used to make direct payment to the payee without any reservation.

4. **Nature:** It may be bearer or order cheque.

5. **Conversion:** It can be converted by any holder into a crossed cheque.

MAIN FEATURES OF BEARER CHEQUE:

1. **Identity:** The printed words 'OR BEARER' must be mentioned at the end of the payee's name.
2. **Payee**: It is payable to any person who holds it.
3. **Encashment:** The holder of a bearer cheque can encash it in the bank counter without even identifying himself.
4. **Endorsement:** It does not need endorsement. In other words, it can be transferred to any person merely by delivery.

Advantages of Bearer Cheque:

1. **Encashment:** The holder of a bearer cheque can encash it in the bank counter without even identifying himself.
2. **Endorsement:** It does not need endorsement, i.e., it can be transferred to another person merely by delivery.
3. **Use:** It can be used to make direct payment to the holder without any reservation.

Disadvantages of Bearer Cheque:

1. **Lost or stolen:** If this cheque is lost or stolen, the possibility of losing money is maximum.
2. **Payment:** It cannot be used when direct payment to the holder is not desired

MAIN FEATURES OF ORDER CHEQUE:

1. **Identity:** The printed words 'OR ORDER' must be mentioned at the end of the payee's name.
2. **Payee:** It is payable to a particular person or to his order.
3. **Encashment:** The holder of an order cheque cannot encash it in the bank counter. It can be encashed through current or savings account of the holder.
4. **Endorsement:** It needs endorsement. In other words, it can be transferred to another person by endorsement and delivery.

Advantages of Order Cheque:

1. **Lost or stolen:** If this cheque is lost or stolen, the possibility of losing money is minimum.
2. **Use:** It can be used when direct payment to the holder is not desired.

Disadvantages of Order Cheque:

1. **Encashment**: The holder of an order cheque cannot encash it in the bank counter.
2. **Endorsement:** It needs endorsement, i.e., it can be transferred to another person only by endorsement and delivery.

Distinction between Bearer cheque and Order cheque

Basis	Bearer cheque	Order cheque
1. Meaning	It is a cheque which is payable to any person who holds it.	It is a cheque which is payable to a particular person or to his order.
2. Identity	The printed words 'OR BEARER' must be mentioned at the end of the payee's name.	The printed words 'OR ORDER' must be mentioned at the end of the payee's name.

by presentation. It can be encashed only through some bank, this is a special peculiarity of such a cheque.

3. **Use:** It can be used when direct payment to the payee is not desired.

4. **Object:** The object of crossed cheque is to protect the owner against loss, theft or forgery.

5. **Conversion:** It can be converted into an open cheque only by the drawer by withdrawing the parallel lines or the name of the bank, with an order to pay cash.

Differences between Open cheque and Crossed cheque:

Basis	Open Cheque	Crossed Cheque
1. Parallel lines or name of bank	An open cheque requires no parallel transverse lines or the name of a bank.	A crossed cheque requires two parallel transverse lines or the name of a bank.
2. Encashment	It can be encashed over the counter of the bank by presentation and through bank also.	It cannot be encashed over the counter of the bank by presentation. It can be encashed only through some bank.
3. Use	It can be used to make direct payment to the payee without any reservation.	It can be used when direct payment to the payee is not desired.
4. Conversion	It can be converted by any holder into a crossed cheque.	It can be converted into an open cheque only by the drawer by withdrawing the parallel lines or the name of the bank, with an order to pay cash.

SUMMARY

- In India, the law relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881, which deals with Promissory Notes, Bill of Exchange and Cheque, as also Hundis (a bill of exchange in a vernacular language).
- The Negotiable Instruments Act, 1881, came into force on 1st March, 1882.

Meaning of Negotiable Instruments:

According to Section 13 of the Negotiable Instruments Act,1881, Negotiable Instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer, whether the words 'order' or 'bearer' appear on the instrument or not.

Thus, negotiable instruments recognised by statute comprise of (a) promissory note, (b) bill of exchange and (c) cheque.

In addition to these, there are certain other instruments which are recognised by custom or usage as negotiable instruments. They are: (a) Hundis, (b) Share warrants, (c) Dividend warrants, (d) Banker's draft, (e) Circular notes, (f) Bearer debentures, (g) Railway receipts, (h) Interest warrants (i) Postal orders, etc.

Promissory Note:

According to Sec 4 of the Negotiable Instruments Act, 1881, 'a promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of , a certain person or to the bearer of the instrument'.

In simple words, a promissory note is a written promise by the debtor to the creditor to pay a certain sum of money after a certain period of time. A promissory note is always drawn by the debtor. He is called the 'maker' of the instrument.

Features of a Promissory Note—

1. Instrument in writing,
2. Promise to pay,
3. Unconditional promise,
4. Signed by the maker,
5. Payee must be certain,
6. Promise to pay money,
7. Amount should be certain and
8. Properly stamped

Parties of a Promissory Note:

1. **Maker:** Maker is the debtor who makes and signs the promissory note (promising to pay a certain sum of money after the expiry of a certain duration of time) and who promises to pay.

called the drawer. The drawer is the creditor.

2. **Drawee:** The person on whom the bill of exchange is drawn, is called the "drawee" or "acceptor".

3. **Payee:** The person to whom the amount of the bill of exchange is payable is called the "payee".

Cheque:

According to Section 6 of the Negotiable Instruments Act, 1881, as amended by the Negotiable Instruments (Amendment) Act, 2002, "a cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form."

A cheque is a document of great importance in the business world. It is an instrument which is used to withdraw money from the bank by the account holders. A cheque is also used to make payment to third parties.

Features of a cheque:

1. It is an Instrument in writing,
2. Contains an unconditional order,
3. Drawn only on a specified banker,
4. Payable on demand,
5. Drawn for a specified sum of money,
6. Payee to be certain,

CHAPTER-14

CROSSING OF CHEQUE

Meaning of Crossing:

A crossing of a cheque is a direction by the drawer to the paying banker to pay the money generally to a banker or a particular banker, as the case may be, and not to the holder at the counter of the bank. Bearing two parallel transverse lines or the name of a bank on the left hand top corner of a cheque with or without any words, is known as crossing of a cheque.

The payment of a crossed cheque can be collected only through a bank. Therefore, crossing of a cheque protects the holder of the cheque and reduces the possibilities of wrong payments. The main purpose of crossing of a cheque is to ensure the payment of the cheque to the right owner.

Who can cross a cheque:

1. **Drawer :** The drawer of a cheque can cross it at the time of issuing it.

with or without the words 'Not Negotiable', that addition shall be deemed to be a crossing, and the cheque shall be deemed to be crossed generally."

Essentials of General crossing:

(i) Two lines are of a paramount importance in crossing.

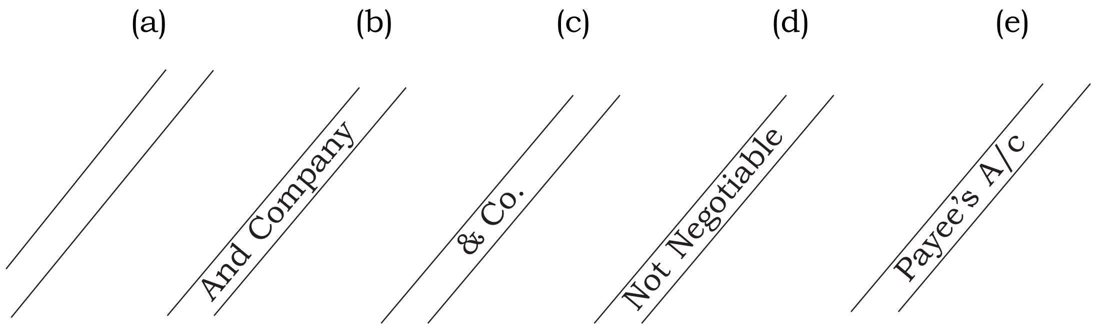
(ii) The lines must be drawing parallel and transverse. Transverse means, that, they should be arranged in a crosswise direction.

(iii) The lines are generally drawn on the left hand side so as not to obliterate or alter the printed number of the cheque.

(iv) The words 'And Company' or its abbreviation may be written in between the lines. They themselves are not essential and so, they do not constitute crossing, without two parallel transverse lines.

(v) The words 'Not Negotiable' may be added to a crossing. But they themselves do not constitute a crossing.

Forms of general crossing:

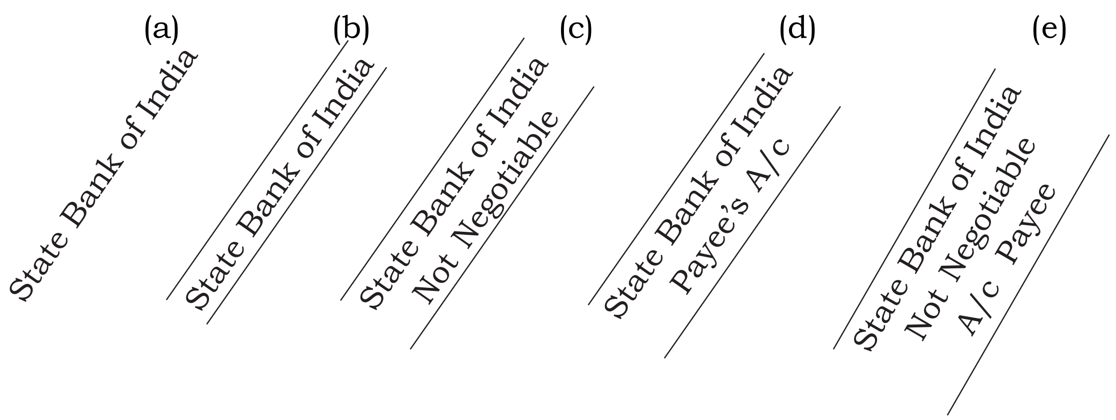


shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be crossed to that banker."

Essentials of special crossing:

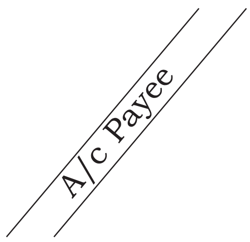
1. For a special crossing, two parallel transverse lines are not at all essential.
2. The name of a banker must be necessarily stated across the face of the cheque. The name of the banker itself constitutes special crossing.
3. It must appear on the left hand side, preferably on the top corner, so as not to obliterate the printed number of the cheque.
4. The two parallel transverse lines and the words 'Not Negotiable' may be added to a special crossing.

Forms of special crossing:



4. If a collecting banker collects an account payee cheque for any person other than the payee, it will constitute negligence on the part of the collecting banker, and so he will lose the statutory protection given under section 131 of the Negotiable Instruments Act, 1881.

Specimen of Account payee crossing:



(iv) Not Negotiable crossing:

When a crossing bears the words ‘Not Negotiable’, then it is termed as Not Negotiable crossing.

According to section 130 of the Negotiable Instruments Act, 1881, “A person taking a cheque crossed generally or specially in either case bearing the words ‘Not Negotiable’, shall not have and shall not be capable of giving a better title to the cheque than that which the person from whom he took it had.”

A cheque which bears ‘Not Negotiable’ crossing can be negotiated as usual by endorsement and delivery.

Significance of Not Negotiable crossing:

1. ‘Not Negotiable’ does not mean not transferable. ‘Not Negotiable’ does not affect the transferability but it kills only the negotiability.

for collection.” This is called Double crossing.

Thus, if a cheque is crossed to two or more banks, the paying banker is put in a confused position as to whom he should pay. Such ambiguity renders the cheque invalid. But a banker in whose favour a cheque is crossed can cross it again in favour of another banker for the purpose of collection. It does not render the cheque invalid.

(iii) Account Payee crossing,

(iv) Not Negotiable crossing and

(v) Double crossing

(i) **General crossing:** When a cheque simply bears two parallel transverse lines with or without any word is known as general crossing.

ii) **Special crossing:** Where a cheque bears across its face the name of a bank, then, it is known as special crossing.

(iii) **Account payee crossing:** When the words, 'A/c Payee' are added to a crossing, it is known as Account payee crossing.

(iv) **Not Negotiable crossing:** When a crossing bears the words 'Not Negotiable', then it is termed as Not Negotiable crossing.

(v) **Double Crossing:** Section 125 of the Negotiable Instruments Act, 1881 provides that "where a cheque is crossed specially, the banker to whom it is crossed, may again cross it specially to another banker, his agent for collection." This is called Double crossing.

Requirements or Essentials of a Valid Endorsement

Following are the main requirements or essentials of a valid endorsement:

1. The endorsement must be done on the instrument or on a slip of paper annexed thereto.
2. Endorsement must be made by the holder of the instrument. A stranger cannot endorse an instrument, unless he is a holder in due course.
3. Signature of the endorser with or without adding any word is essential. The endorser must sign his name in the same spellings as appearing on the face of the cheque.
4. Endorsement must be made for the entire amount of the instrument. Endorsement cannot be made for a part of the amount of the instrument.
5. Endorsement is complete only when the instrument is delivered. The delivery must be made by the endorser himself.

Significance of Endorsement

By endorsing, the endorser of a negotiable instrument signifies to his endorsee and to any subsequent holder, that, when the instrument left his hands -

i) He had a good title to it.

ii) It was genuine in all its particulars at the time of his endorsement.

iii) All the previous endorsements were genuine.

iv) An endorsement carries with a right of further negotiation to the endorser, along with the right of ownership.

v) By his act of endorsing, the endorser promises to indemnify the endorsee or any subsequent holder for any loss suffered converted into a special endorsement by any holder. The holder can do this by specifying the name of an endorsee and putting his signature. A bearer cheque can be converted into an order cheque, by means of a full endorsement.

For example: 'Pay to Bhaben Sarma'

Umesh Alamyan

22-02-2022

3. Restrictive Endorsement:

When further negotiation of the instrument is prohibited, it is termed as restrictive endorsement. The endorsee in such cases cannot further endorse it. In this endorsement, generally the word 'only' is added after the endorsee's name.

For example: ' Pay to Praneet Kishore only'

Umesh Alamyan

22-02-2022

Only Praneet Kishore can obtain the fund. He further cannot endorse it to anybody.

4. Conditional Endorsement:

It is an endorsement under which the endorser lays down some condition to be fulfilled by the endorsee before making the payment. The endorsee's right to receive money is subject to the fulfilment of a particular event.

For example:

(a) ' Pay to Bhaben Sarma on arrival of Haren Gogoi'

Umesh Alamyan

22-02-2022

For example:

‘ Pay to Bhaben Sarma or order. Notice of dishonour waived.’

Umesh Alamyan

22-02-2022

(iv) Partial Endorsement: A partial endorsement is an endorsement whereby only a part of the amount of the instrument is endorsed. A partial endorsement is not valid.

For example: A cheque for Rs. 1,000 is endorsed by Umesh Alamyan as follows :

‘Pay to Bhaben Sarma Rs. 500 only’.

Umesh Alamyan

22-02-2022

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v) By his act of endorsing, the endorser promises to indemnify the endorsee or any subsequent holder for any loss suffered by them on the dishonour of the instrument.

Who Can Endorse?

1. The Holder of a negotiable instrument.
2. The Drawer or Maker of the instrument.
3. Payee or Endorsee or the authorised agent of them.

Kinds of Endorsement:

1. **General or Blank Endorsement:** When the endorser signs his name only on the back of the instrument, the endorsement is said to be 'General' or 'Blank 'endorsement.
2. **Special or Full Endorsement:** When the endorser adds a direction to pay the amount mentioned in the instrument to or to the order of a specified person, the endorsement is said to be 'in full'.
3. **Restrictive Endorsement:** When further negotiation of the instrument is prohibited, it is termed as restrictive endorsement. The endorsee in such cases cannot further endorse it.
4. **Conditional Endorsement:** It is an endorsement under which the endorser lays down some condition to be fulfilled by the endorsee before making the payment.

A conditional endorsement may take the following forms:

(i) **Sans Recourse Endorsement:** An endorsement which limits the liability of the endorser is known as Sans Recourse endorsement.

CHAPTER-16

PAYMENT IN DUE COURSE, HOLDER AND HOLDER IN DUE COURSE

Meaning of payment in due course:

According to Section 10 of the Negotiable Instruments Act, 1881, "Payment in due course means payment in accordance with the apparent tenor of the instrument, in good faith and without negligence to any person in possession thereof, under circumstances which do not afford a reasonable ground for believing, that, he is not entitled to receive payment of the amount therein mentioned".

To avail the statutory protection, the paying banker must make the payment in due course.

Essential Features of Payment in Due Course:

The essential features of payment in due course are as follows**:**

(i) Apparent tenor of the instrument: The payment must be in accordance with the apparent tenor of the instrument. The his own name and under a legal title.

(b) He must be entitled to receive or recover the amount from the parties concerned in his own name.

Meaning of Holder in Due Course:

According to Sec 9 of the Negotiable Instruments Act, 1881, "Holder in due course means any person who, for consideration, became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or endorsee thereof, if payable to order, before the amount mentioned in it became payable, and without having sufficient cause to believe that defect existed in the title of the person from whom he derived his title."

A person becomes a holder in due course of a negotiable instrument if the following conditions are satisfied:

(i) The negotiable instrument must be in the possession of the holder in due course.

(ii) The negotiable instrument must be regular and complete in all respects.

(iii) The instrument must have been obtained for valuable consideration, i.e., by paying its full value.

(iv) The instrument must have been obtained before the amount mentioned therein becomes payable.

(v) The holder in due course must obtain the instrument without having sufficient cause to believe that any defect existed in the title of the transferor.

2) **Purging of prior defects:** The defective title of the previous endorsers will not adversely affect his rights.

3) **Transfer of better title:** Once the instrument passes through the hands of a holder in due course, he can pass on a better title to others.

4) **Liability of prior parties to holder in due course:** Until the instrument is duly paid, every party to that instrument, i.e., its maker or drawer or acceptor or endorser is liable to a holder in due course.

5) **Estoppel against denying original validity of instrument:** The payment to a holder in due course cannot be denied on the ground that the instrument as originally drawn was not valid. In other words, even the drawer or acceptor of a negotiable instrument cannot claim invalidity of the instrument against holder in due course.

6) **Estoppel against denying capacity of payee to endorse:** The claim of holder in due course cannot be denied on the ground that the payee has no capacity to endorse.

7) **Estoppel against denying signature or capacity of prior party:** An endorser of an instrument is not permitted to deny the signature or capacity of prior party to the instrument in the case of a suit by a holder in due course.

8) **Right in case of fictitious bills:** If a bill of exchange is drawn on behalf of a fictitious person and payable to his order, the acceptor will be liable to the holder in due course because of such fictitious name.

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person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto."

Meaning of Holder in Due Course:

According to Sec 9 of the Negotiable Instruments Act, 1881, "Holder in due course means any person who, for consideration, became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or endorsee thereof, if payable to order, before the amount mentioned in it became payable, and without having sufficient cause to believe that defect existed in the title of the person from whom he derived his title."

Rights and privileges of a Holder in due course:

The rights and privileges enjoyed by a holder in due course are—

1. Better Title,
2. Purging of prior defects,
3. Transfer of better title,
4. Liability of prior parties to holder in due course,
5. Estoppel against denying original validity of instrument,
6. Estoppel against denying capacity of payee to endorsee,
7. Estoppel against denying signature or capacity of prior party and
8. Right in case of fictitious bills.

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b) facultative endorsement

c) partial endorsement

d) restrictive endorsement

(ii) Fill in the blanks with suitable word/words:

1. There are _______ parties to a promissory note.
2. There are______ parties to a cheque.
3. There are ______ parties to a bill of exchange.
4. A bearer cheque can be transferred by _______.
5. An order cheque can be transferred by endorsement and _____.

(iii) State whether the following statements are true or false:

1. Negotiable instruments are freely transferable.
2. A cheque needs acceptance.
3. A promissory note can be crossed.
4. A holder can cross a cheque.
5. Two parallel transverse lines are not essential for a special crossing.

B. Short Answers Type Questions: 2 marks each

1) What is a negotiable instrument?
2) What is a promissory note?
3) What is a bill of exchange?
4) What is a cheque?
5) Who are the parties to a promissory note?

28) What is Not Negotiable crossing?

29) Write two essentials of a general crossing.

30) Write two essentials of a special crossing.

31) Write two significances of a general crossing.

32) Write two significances of a special crossing.

33) What is endorsement?

34) Write two significances of endorsement.

35) Mention any two kinds of endorsements.

36) What is payment in due course?

37) Write two features of payment in due course.

38) Who is a holder?

39) Who is a holder in due course?

40) Who can make an endorsement?

41) Who can cross a cheque?

C. Long Answers Questions (Type-1): 5 marks each

1) What are the essential features of a negotiable instrument?

2) What are the various kinds of negotiable instruments?

3) Distinguish between promissory note and bill of exchange.

4) Distinguish between promissory note and cheque.

5) Distinguish between bill of exchange and cheque.

6) What are the various types of cheque?

7) What are the significances of general crossing?

8) What are the significances of special crossing?