# BANK MANAGEMENT

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## About the Tutorial

Bank management governs various concerns associated with banks in order to maximize profits and minimize risks. This is a basic tutorial that explains the methodologies applied in the rapidly growing area of bank management in commercial Indian banks.

## Audience

This tutorial is designed for students from management streams who aspire to learn the basics of bank Management. Professionals, especially managers, aspirants of banking regardless of which sector or industry they belong to, can use this tutorial to learn how to apply the methods of Bank Management in their respective enterprises.

## Prerequisites

The audience of this tutorial is expected to have a basic understanding of how a bank manager would deal with multiple banking functions and accomplish it without overshooting his resources.

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# 1. Bank Management — Introduction

A bank is a financial institution which accepts deposits, pays interest on pre-defined rates, clears checks, makes loans, and often acts as an intermediary in financial transactions. It also provides other financial services to its customers.

Bank management governs various concerns associated with bank in order to maximize profits. The concerns broadly include liquidity management, asset management, liability management and capital management. We will discuss these areas in later chapters.

## Origin of Banks

The origin of bank or banking activities can be traced to the Roman empire during the Babylonian period. It was being practiced on a very small scale as compared to modern day banking and frame work was not systematic.

Modern banks deal with banking activities on a larger scale and abide by the rules made by the government. The government plays a crucial role with its control over the banking system. This calls for bank management, which further ensures quality service to customers and a win-win situation between the customer, the banks and the government.

## Scheduled & Non-Scheduled Banks

Scheduled and non-scheduled banks are categorized by the criteria or eligibility setup by the governing authority of a particular region. The following are the basic differences between scheduled and nonscheduled banks in the Indian banking perspective.

Scheduled banks are those that have paid-up capital and deposits of an aggregate value of not less than rupees five lakhs in the Reserve Bank of India. All their banking businesses are carried out in India. Most of the banks in India fall in the scheduled bank category.

Non-scheduled banks are the banks with reserve capital of less than five lakh rupees. There are very few banks that fall in this category.

## Evolution of Banks

Banking system has evolved from barbaric banking where commodities were loaned to modern day banking system, which caters to a range of financial services. The evolution of banking system was gradual with growth in each and every aspect of banking. Some of the major changes which took place are as follows:

- Barter system replaced by money which made transaction uniform
- Uniform laws were setup to increase public trust
- Centralized banks were setup to govern other banks
- Book keeping was evolved from papers to digital format with the introduction of computers

- ATMs were setup for easier withdrawal of funds
- Internet banking came into existence with development of internet

Banking system has witnessed unprecedented growth and will be undergoing it in future too with the advancement in technology.

## Growth of Banking System in India

The journey of banking system in India can be put into three different phases based on the services provided by them. The entire evolution of banking can be described in these distinct phases:

### Phase 1

This was the early phase of banking system in India from 1786 to 1969. This period marked the establishment of Indian banks with more banks being set up. The growth was very slow in this phase and banking industry also experienced failures between 1913 to 1948.

The Government of India came up with the banking Companies Act in 1949. This helped to streamline the functions and activities of banks. During this phase, public had lesser confidence in banks and post offices were considered more safe to deposit funds.

### Phase 2

This phase of banking was between 1969 to 1991, there were several major decisions being made in this phase. In 1969, fourteen major banks were nationalized. Credit Guarantee Corporation was created in 1971. This helped people avail loans to set up businesses.

In 1975, regional rural banks were created for the development of rural areas. These banks provided loans at lower rates. People started having enough faith and confidence on the banking system, and there was a plunge in the deposits and advances being made.

### Phase 3

This phase came into existence from 1991. The year 1991 marked the beginning of liberalization, and various strategies were implemented to ensure quality service and improve customer satisfaction.

The ongoing phase witnessed the launch of ATMs which made cash withdrawals easier. This phase also brought in Internet banking for easier financial transactions from any part of world. Banks have been making attempts to provide better services and make financial transactions faster and efficient.

# 2. Bank Management — Commercial Banking

A commercial bank is a type of financial institution that provides services like accepting deposits, making business loans, and offering basic investment products. The term commercial bank can also refer to a bank, or a division of a large bank, which precisely deals with deposits and loan services provided to corporations or large or middle-sized enterprises as opposed to individual members of the public or small enterprises. For example, Retail banking, or Merchant banks.


A commercial bank can also be defined as a financial institution that is licensed by law to accept money from different enterprises as well as individuals and lend money to them. These banks are open to the mass and assist individuals, institutions, and enterprises.

Basically, a commercial bank is the type of bank people tend to use regularly. They are formulated by federal and state laws on the basis of the coordination and the services they provide.

These banks are controlled by the Federal Reserve System. A commercial bank is licensed to assist the following functions:

- **Accept deposits**: Receiving money from individuals and enterprises known as depositors.

- **Dispense payments**: Making payments according to the convenience of the depositors. For example, honoring a check.

- **Collections**: Bank plays as an agent to collect funds from another banks receivable to the depositor. For example, when someone pays through check drawn on an account from a different bank.

- **Invest funds:** Contributing or spending money in securities for making more money. For example, mutual funds.

- **Safeguard money**: A bank is regarded as a safe place to store wealth including jewelry and other assets.

- **Maintain savings:** The money of the depositors is maintained, and the accounts are checked and on a regular basis.

- **Maintain custodial accounts**: These accounts are maintained under the supervision of one person but are actually for the benefit of another person.

- **Lend money:** Lending money to companies, depositors in case of some emergency.

Commercial banks are apparently the largest source of financing for private capital investment in a nation, especially, like India. A capital investment can be defined as the purchase of a property with the purpose of either producing income from the property, increasing the value of the property over time, or both. Similar capital purchases made by enterprises may involve things like plants, tools and equipment.

## Present Structure

The current banking framework in India can be broadly classified into two. The first classification divides banks into three sub-categories — the Reserve Bank of India, commercial banks and cooperative banks.

The second divides the banks into two sub-categories — scheduled banks and non-scheduled banks. In both of these systems of categorization, the RBI, is the head of the banking structure. It monitors and holds all the reserve capital of all the commercial or scheduled banks across the nation.

Commercial banks are the foundations that receive deposits from individuals and enterprises and lend loans to them. They generate credit. Commercial banks in India are regulate under the Banking Regulation Act of 1949. These banks are further categorized as:

- Scheduled banks
- Non-scheduled banks

Scheduled banks are banks which are listed in the 2nd schedule of the Reserve Bank of India Act, 1934. Non-scheduled banks are those banks which are not listed in the second schedule of the Reserve Bank of India Act,1934.

## Scheduled Banks

In India, for a bank to qualify as a scheduled bank, it needs to meet the criteria as underplayed by the Reserve Bank of India. The following is a list of the criterions:

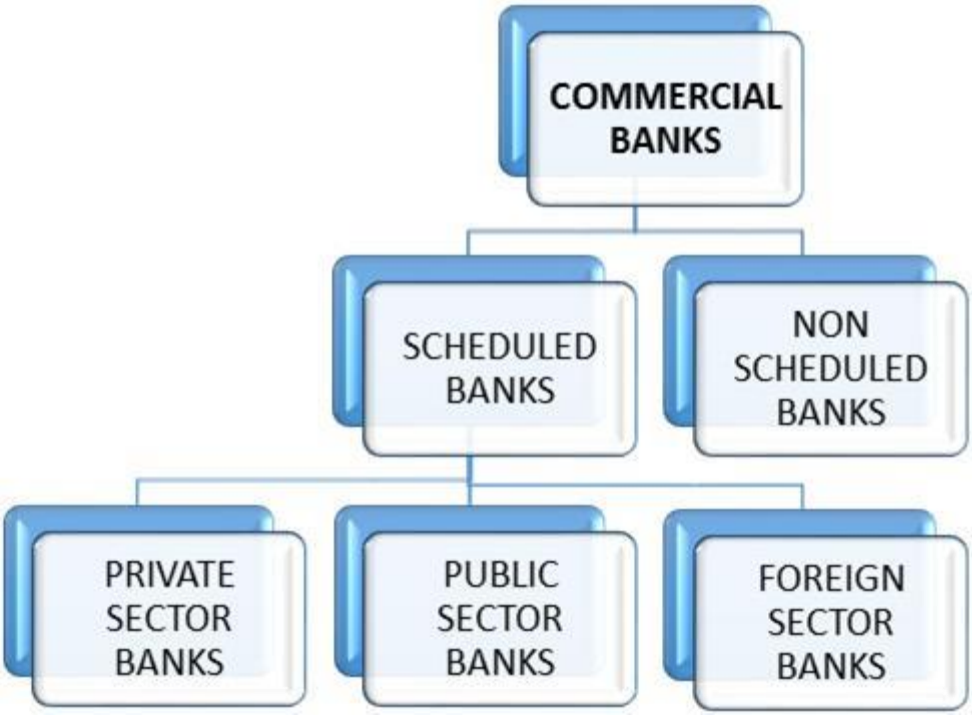
- The banks should carry all their business transactions in India.
- All schedule banks are bound to hold a capital of not less than rupees five lakhs in the Reserve Bank of India.
- In the year 2011, five lakhs rupees calculated in terms of dollars amounted to $11,156.

Thus, any commercial, cooperative, nationalized, foreign bank and any other banking foundation that accepts and satisfies these set conditions are termed as scheduled banks but not all schedule banks are commercial banks.

**The scheduled commercial banks** are those banks which are included in the second schedule of RBI Act, 1934. These banks accept deposits, lend loans and also offer other banking services. The major difference between scheduled commercial banks and scheduled cooperative banks is their holding pattern. Cooperative banks are registered as cooperative credit institutions under the Cooperative Societies Act of 1912.

**Scheduled banks are further categorized as:**

- Private-sector banks
- Public sector banks
- Foreign sector banks



## Private-Sector Banks

These banks acquire larger parts of stake or congruity is maintained by the private shareholders and not by government. Thus, banks where maximum amount of capital is in private hands are considered as private-sector banks. In India, we have two types of private-sector banks:

- Old Private-Sector Banks
- New Private-Sector Banks

### Old Private-sector Banks

The old private-sector banks were set up before nationalization in 1969. They had their own independence. These banks were either too small or specialist to be incorporated in nationalization. The following is a list of old private-sector banks in India:

- Catholic Syrian Bank
- City Union Bank
- Dhanlaxmi Bank
- Federal Bank ING
- Vysya Bank
- Jammu and Kashmir Bank
- Karnataka Bank
- Karur Vysya Bank
- Lakshmi Vilas Bank
- Nainital Bank
- Ratnakar Bank
- South Indian Bank
- Tamilnadu Mercantile Bank

From the above mentioned banks, the Nainital Bank is an auxiliary or branch of the Bank of Baroda, which has 98.57% stake in it. A few old generation private-sector banks merged with other banks. For example, in the year 2007, Lord Krishna Bank merged with Centurion Bank of Punjab. Sangli Bank merged with ICICI Bank in 2006. Yet again, Centurion Bank of Punjab merged with HDFC in 2008.

## New Private-sector Banks

Banks which started their operations after liberalization in the 1990s are the new private-sector banks. These banks were permitted entry into the Indian banking sector after the amendment of the Banking Regulation Act in 1993.

At present, the following new private-sector banks are operational in India**:**

- Axis Bank Development
- Credit Bank (DCB Bank Ltd)
- HDFC Bank
- ICICI Bank
- IndusInd Bank
- Kotak Mahindra Bank
- Yes Bank

In addition to these seven banks, there are two more banks which are yet to commence operation. They got the 'in-principle' licenses from RBI. These two banks are IDFC and Bandhan Bank of Bandhan Financial Services.

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