V Skills
Skills for a secure future

# Certified Commercial Banker

## Sample Material

V-Skills Certifications

A Government of India
&
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V-Skills

Skills for a secure future

# 1. INTRODUCTION

## 1.1 Definition of Banking

As per the Banking Regulation Act, (BR Act), 1949 Section 5(c), "a banking company is a company which transacts the business of banking in India." A bank is a financial institution and an intermediary that accepts money deposits and channels it to parties in need of funding i.e., lending procedures. This is done either directly by loaning or indirectly through capital markets.

The Banking Regulation Act, 1949, defines 'banking' 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, online or orders otherwise.

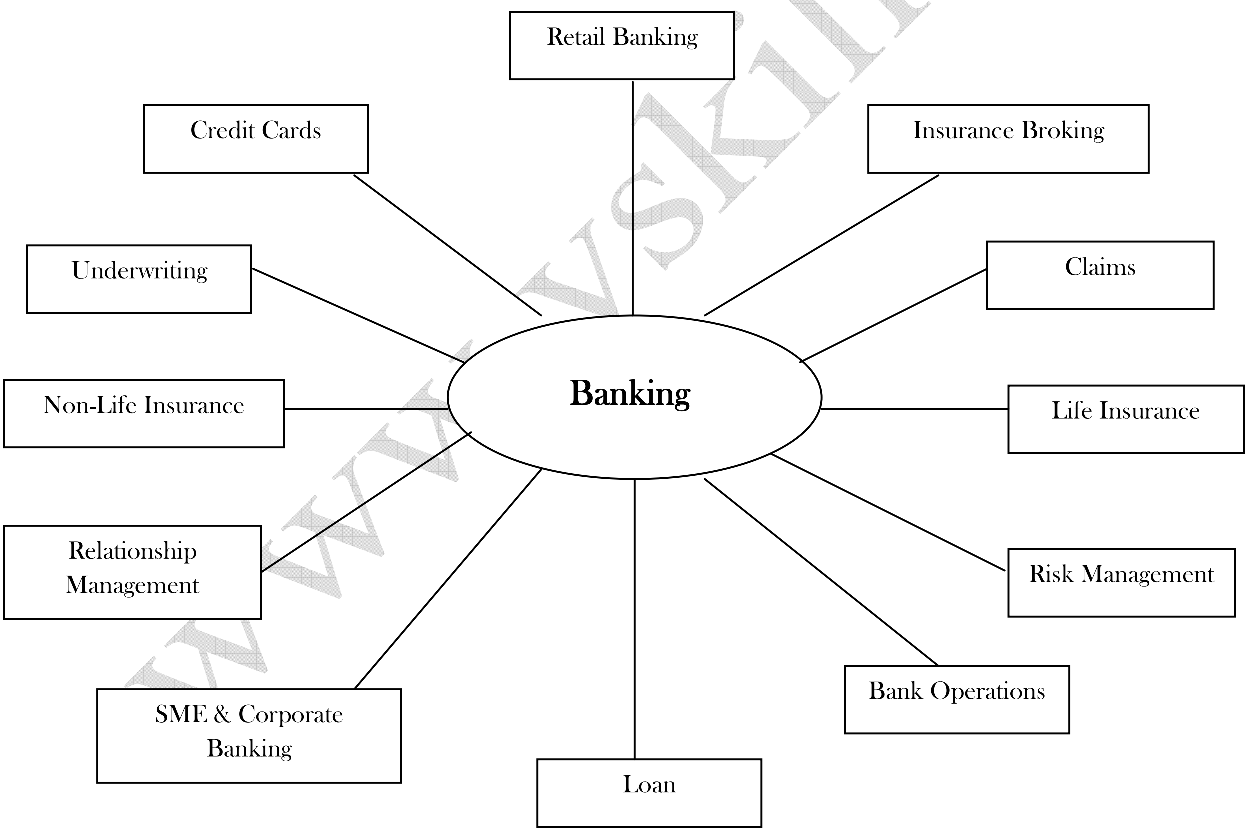


**Fig:** Undertakings of a Bank

## 1.2 Other Financial Institutions

Apart from banks, there are other institutions that carry out financial services and activities. These intermediaries play an important role in the economy. The various types of financial institutions that give banks competition are,

### 1.2.1 Term-Lending Institutions

Term lending institutions provide term loans to various industries, services and infrastructure sectors to help them with new projects and expansion of existing facilities. At a national level, these institutions are typically specialized, catering to the needs of specific sectors. These include the,

- ✓ Export Import Bank of India (EXIM Bank)
- ✓ Small Industries Development Bank of India (SIDBI)
- ✓ Tourism Finance Corporation of India Limited (TFCI)
- ✓ Power Finance Corporation Limited (PFCL)
- ✓ IFCI Ltd
- ✓ State Financial Corporations (SFCs)
- ✓ State Industrial Development Corporations (SIDCs)
- ✓ North Eastern Development Financial Institution Ltd. (NEDFI)

### 1.2.2 Non-Banking Finance Companies (NBFCs)

The principal activities of NBFCs include equipment-leasing, hire purchase, loan and investment and asset finance. NBFCs have been competing with and complementing the services of commercial banks for a long time. Housing-finance companies' form a distinct sub-group of the NBFCs. Some of the examples of NBFCs are,

- ✓ Housing Development Finance Corporation Limited (HDFC)
- ✓ Housing and Urban Development Corporation Limited (HUDCO)

### 1.2.3 Insurance Companies

Insurance/reinsurance companies provide substantial long-term financial assistance to the industrial and housing sectors. Such companies are,

- ✓ Life Insurance Corporation of India (LIC)
- ✓ General Insurance Corporation of India (GICI)

## 1.2.4 Mutual Funds

Mutual funds aid fund mobilization, in that they offer alternate routes of investment to households. Most of the MFs are standalone asset management companies. Banks have entered the asset management business either on their own or in joint venture with others. A few mutual fund organizations are,

- ✓ UTI Mutual Funds
- ✓ HDFC Mutual Funds
- ✓ Tata Mutual Funds
- ✓ SBI Mutual Funds
- ✓ Reliance Mutual Funds
- ✓ DSP BlackRock Mutual Funds
- ✓ Birla SunLife Mutual Funds

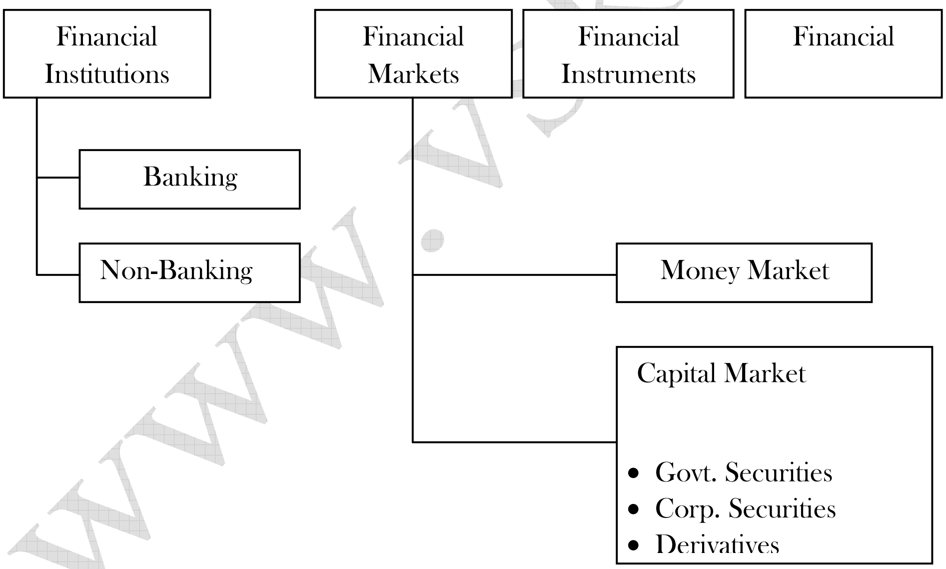


**Fig:** Structure of Indian Financial System

The three primary activities of a commercial bank that distinguishes it from other financial institutions are,

- ✓ Maintaining deposit accounts including current accounts
- ✓ Issue and pay cheques

- ✓ Collect cheques for the bank's customers

## 1.3 Evolution of Commercial Banking System

### 1.3.1 Origins of Banking & its Expansion

Italy is the birth place of modern day banking. After the commercial activities shifted to the Mediterranean, Atlantic and European cities, the Italian cities fell behind as new banking techniques spread to the new regions. Sweden introduced paper money that was accepted as legal tender by the state for tax payments. The concept of loans emerged as Britain started using paper money more than the bullion. The goldsmiths storing bullion for safe keeping started lending such coins and the people depositing coins were issued receipts. These receipts became a bank note that is currency notes, issued by and repayable on demand by the banker.

In America, the first bank the Bank of North America founded in 1782 in Philadelphia. Michigan led a free banking system where any person who met rather easy conditions could organize a bank and issue bank notes as well as take deposits.

### 1.3.2 Banking in Ancient India

Vedic literature has references to the existence of money lending operations. The literature of the Buddhist period, the Jatakas and archaeological discoveries contain evidence of existence of Sresthis (bankers). The rate of interest was prescribed by Hindu law givers Manu, Vasistha, Yajna Valkya, Gautama, Baudhayana and Kautilya which were linked to caste of borrowers. According to Chanakya the interest rate structure was risk weighed. It varied with the risk involved in the borrower's business. In Dharma Shastra, only Vaishyas could take up money lending business.

The indigenous banker provided finance for the agriculturist and village artisan and became an integral part of the village economy. They combined money lending and trading with banking operations by discounting 'hundis' or internal bills of exchange for financing trade. Money lending at the time was not based on an official system and the lack of supervision led to abuse of the system by the money lenders. The exorbitant interest charges as well as cultivator's meager income rendered to cultivator unable to repay the loan. With the indigenous bankers, repayments were regular and rates of interest were lower than those charged by money lender. This profession was inherited and functioned among a select few castes and communities.

The Bank of Hindustan was the first joint stock bank, set up at the beginning of 19th century under European management but it went on to fail. Commercial banking in India was ushered in 1806 with the setting up of three 'Presidency' Banks of Bengal, Bombay and Madras. The three presidency banks were amalgamated to form the Imperial Bank of India under the Imperial Bank of India Act, 1920. It performed the central banking functions until a separate central banking institution was introduced. It was the sole agent of the Reserve Bank of India for government Treasury business.

### 1.3.3 Banking in Modern India

As times have passed, banks have gained importance not only in terms of economic growth, but also financial stability. The banks have been developing financial intermediaries and markets, aiding the corporate sector to meet its financing needs from the capital market, and catering to the needs of a vast number of savers from the household sector. Banks have evolved with the needs of the economy through deregulation, technological innovation and globalization. Banks have grown to render numerous services and hence compete not only among themselves, but also with nonbank financial intermediaries.

## 1.4 Globalization of Banking Systems

The market for financial services and products is global in scope and dynamic. Growth of international banking has however been restricted to Euro currency and off-shore banking centers because of protectionist financial policies, restrictions on banking practices and unpromising financial environment. The worst causality of banking protectionism is efficiency and service. Banks want protection from competition while striving for a free hand abroad. This policy cannot be pursued indefinitely, because several governments insist on reciprocity in opening branches. Restrictions would slow down internationalization of banking system. Since banks abroad are relatively free of restriction, close regulation of banks in the past in France and Germany has stifled their growth.

### 1.4.1 Consolidated Supervision

While there is a uniform supervisory regime for both banks and NBFCs consisting of on-site supervision, off site monitoring, and periodic external auditing, DFIs are loosely defined. They have to be brought under a transparent framework as suggested by RBI.

RBI requires that banks and non-banks be supervised by the Board for Financial Supervision with the Deputy Governor as Chairman. For insurance it would be the Insurance Regulatory Authority and SEBI with its regulatory jurisdiction.

## 1.5 Different Financial Systems

### 1.5.1 Global Financial Systems

The financial system is vital for resource allocation. Through the financial system, household deposits flows in enterprises and capitals distribute among different enterprises. According to market and bank's different effects on financial resource allocation, the financial system can be sorted into the market-oriented financial system and the bank intermediary-oriented financial system.

*The market oriented financial system (Anglo Saxon)*

In market-based systems, securities markets share center stage with banks in getting society's savings to firms, exerting corporate control, and easing risk management. This type of system is characterized by a division of functions. Specialized financial institutions including banks, financial markets and market intermediaries cater to the different financial needs. For example, Britain represents a market oriented financial system.

*The bank oriented financial system (Central European)*

In bank-based systems banks play a leading role in mobilizing savings, allocating capital, overseeing the investment decisions of corporate managers, and providing risk management vehicles. This type of system is characterized by universal banking. Savings are largely transferred directly from those who generate them to those wishing to use them by the intermediation of banks. Germany has a bank oriented financial system.

## 1.5.2 Indian Financial System

A Financial System is a composition of various institutions, markets, regulations and laws, practices, money manager, analysts, transactions and claims and liabilities. A financial system functions as an intermediary and facilitates the flow of funds from the areas of surplus to the areas of deficit.

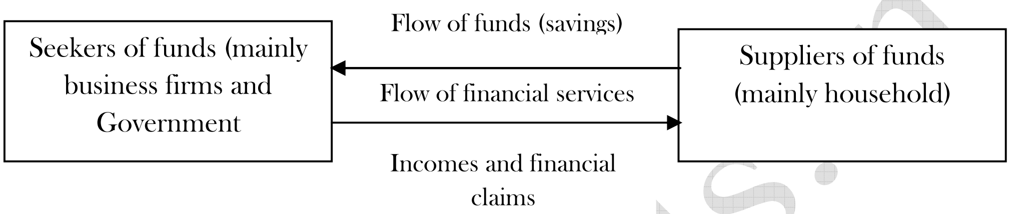


**Fig:** Indian Financial System

The financial system consists of a set of complex and closely connected or interlined institutions, agents, practices, markets, transactions, claims, and liabilities in the economy. Indian financial system consists of financial market, financial instruments and financial intermediation.

A Financial Market is the market in which financial assets are created or transferred. Unlike a real transaction that involves exchange of money for real goods/services, a financial transaction involves creation or transfer of a financial asset. The financial market is divided into 4 categories,

- ✓ **Money Market:** This is a wholesale debt market for low-risk, highly-liquid, short-term instrument. Funds are available in this market for periods ranging from a single day up to a year. This market is operated heavily by government, banks and financial institutions. Some important money market instruments are Call/Notice Money, Treasury Bills, Term Money, Certificate of Deposit, and Commercial Papers.
- ✓ **Capital Market:** The capital market helps to finance the long-term investments. The transactions taking place in this market are for long term periods that are over 12 months. In the equity segment Equity shares, preference shares, convertible preference shares, non-convertible preference shares etc. are the common

instruments used. In the debt segment debentures, zero coupon bonds, deep discount bonds etc. are predominant. Hybrid instruments have both the features of equity and debenture, for example convertible debentures, warrants etc.

- ✓ **Forex Market:** This is one of the most developed and integrated market across the globe. The Foreign Exchange market deals with the multicurrency requirements of individuals and companies. Depending on the exchange rate that is applicable, the transfer of funds takes place in this market.
- ✓ **Credit Market:** Here, the banks, FIs and NBFCs deal in short, medium and long-term loans to corporate and individuals.

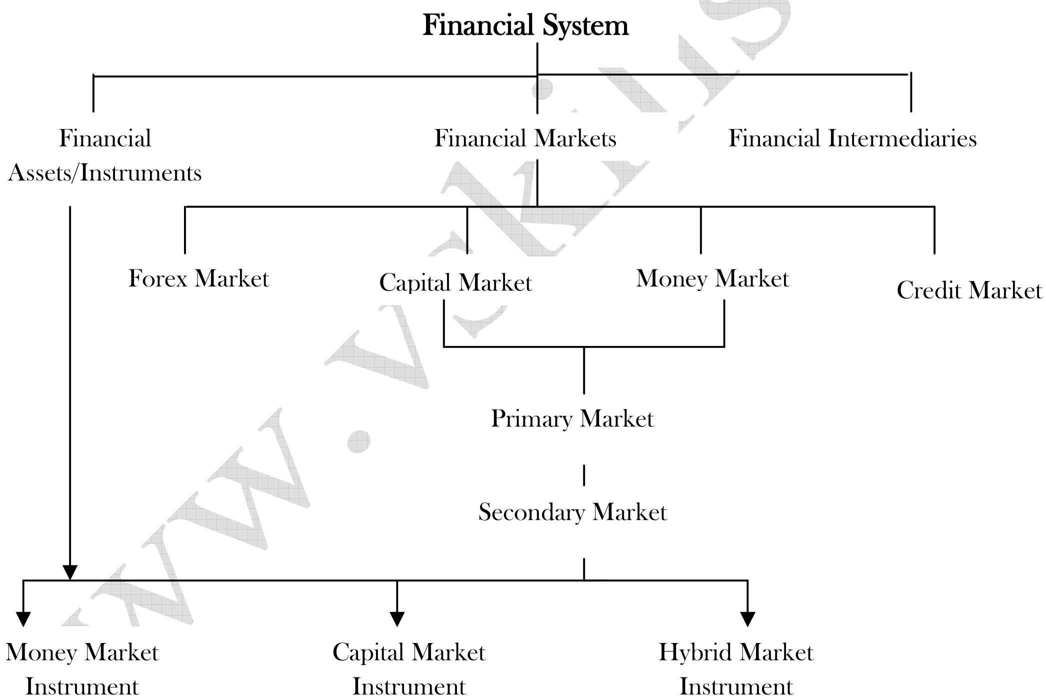


**Fig:** Constituents of a Financial System