CMR
INSTITUTE OF
TECHNOLOGY

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Internal Assesment Test - III

Sub:	Principles and Practices of Banking							Code:	16MBA FM301
		Duration:	90 mins	Max Marks:	40	Sem:	II	Branch:	MBA

			Marks	OBE	
				CO	RBT
	Part A -Answer Any Two Full Questions (16*02=32 Marks)				
1(a)	What is a commercial bank? Mention any 3products offered?		[02]	CO1	L1
(b)	Derive the structure of Indian banking system? Classify Commercial banks?		[06]	CO2	L2
(c)	Briefly describe evolution of banking in India?		[08]	CO1	L1
2 (a)	Define Banking?		[02]	CO2	L5
(b)	What are the primary and secondary functions of a commercial bank?		[06]	CO1	L2
(c)	Explain the role of commercial banks in the socio economic development?		[08]	CO3	L3
3(a)	What is a teller system?		[02]	CO3	L3
(b)	Write a brief note on: 1) Liquidity 2) Profitability 3) Safety and Security		[06]	CO2	L3
(c)	What are the limitations to creation of credit?		[08]	CO1	L3
	Part B - Compulsory (01*08=08 marks)				
4					
(a)	Describe the role of Reserve Bank and GOI as regulator of banking system?		[04]	CO1	L4
(b)			[04]	CO3	L4

Course Outcomes		PO1	PO2	PO3	PO4	PO5	PO6	PO7	PO8	PO9
CO1:	To discuss the Structure and System of Banking in India	2B	1B	2C	3C		2C	3B	4A	
CO2:										
CO3:										
CO4:										
CO5:										
CO6:										

Cognitive level	KEYWORDS
L1	List, define, tell, describe, identify, show, label, collect, examine, tabulate, quote, name, who, when, where, etc.
L2	summarize, describe, interpret, contrast, predict, associate, distinguish, estimate, differentiate, discuss, extend
L3	Apply, demonstrate, calculate, complete, illustrate, show, solve, examine, modify, relate, change, classify, experiment, discover.
L4	Analyze, separate, order, explain, connect, classify, arrange, divide, compare, select, explain, infer.
L5	Assess, decide, rank, grade, test, measure, recommend, convince, select, judge, explain, discriminate, support, conclude, compare, summarize.

PO1 - *Engineering knowledge*; PO2 - *Problem analysis*; PO3 - *Design/development of solutions*; PO4 - *Conduct investigations of complex problems*; PO5 - *Modern tool usage*; PO6 - *The Engineer and society*; PO7- *Environment and sustainability*; PO8 – *Ethics*; PO9 - *Individual and team work*; PO10 - *Communication*; PO11 - *Project management and finance*; PO12 - *Life-long learning*

1st Internal Assesment Test – Key Answers – PPB - 16MBA FM301

1) **a)** Commercial banks are those financial institutions which accept deposits from the public repayable on demand and lend them for short periods. They borrow money in the form of deposits at a lower rate of interest and lend it at a higher rate, and thereby make a profit for themselves.
   Products offered – Savings account, credit card, travellers cheques, home equity loans.

b) RBI

Scheduled Bank
Co-operative Banks
State Co-operative Banks
Urban Co-operative Banks
Commercial Banks
Public Sector – SBI and Nationalized Bank
Private Sector
Regional Rural Bank
Foreign Banks
Non-Scheduled Bank
Commercial banks are classified as below.
Public sector Banks – majority stake by government – SBI, Syndicate, Union Bank of India, PNB etc
Private sector Banks - majority stake by private individuals – ICICI, HDFC, AXIS
Foreign Banks – Head office is located outside the country in which they are located – Citi Bank, Standard chartered, Bank of Tokyo

c) Evolution of Indian Bank

Banking in India originated long ago. There are evidences of giving loans to others even during Vedic periods. Banking was synonymous with money lending. The Manusmrithi speaks of deposits, pledges, loans and interest rates. Money lenders and indigenous bankers played an important part in the Indian society as purveyors of money and credit from times immemorial. The money lenders provided loans to people in times of need mainly for consumption purposes while the indigenous bankers extended credit for financing trade and industry. The indigenous bankers were for long he trusted custodians of the deposits of the people and the royalty alike. Besides meeting the requirements of royal treasuries, they were the main source of finance for agriculture, industry and trade. But the importance of money lenders and indigenous bankers was reduced to some extent with establishment of agency house and presidency banks patronized by the East India Company towards the close of seventh century. It was considered to be the birth of the modern banking.

The modern banking system in India started with the establishment of General Bank of India in 1786. In the mid-nineteenth century the East India Company established the Bank of Bengal in 1809, the Bank of Bombay in 1840 and the Bank of Madras in 1843. The three banks merged in 1921 to form the Imperial Bank of India, which, upon India's independence, became the State Bank of India in 1955. For many years the presidency banks acted as quasi-central banks, as did their successors, until the Reserve Bank of India was established in 1935.

2) **a)** The Banking Regulation Act, 1949 defines a banking company as a "company which transacts the business of banking in India". The term '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 withdrawable by cheque, draft, order or otherwise"

b) The primary functions of a bank can be classified as:

Accepting Deposits - One of the most important primary functions of a commercial bank is accepting deposits. A major portion of the deposits accepted by the commercial banks are repayable on demand. But other types of deposits are also accepted by the modern commercial banks. Generally, the following three types of deposits are accepted:

Current deposits or demand deposits
Savings deposits and
Fixed or time deposits

Lending Money - Commercial banks not only accept deposits, but also lend money that they have obtained through deposits to those who want some money. They provide a channel through which the individual savings can be lent to commerce and industry. They mobilize the idle capital of the nation and make them available for productive purposes. The banks lend money in different forms. They can be either secured or unsecured. The most popular forms of lending are:
a) Overdrafts
(b) Cash credits
(c) Loans and advances and
(d) Discounting of bills of exchange

The secondary functions of a bank can be classified as:

1. Agency services - In many cases the banks act as agents of their customers. As an agent the banker renders the following services:
(a) Collection of cheques, drafts, bills and other obligations for their customers.
(b) The execution of standing orders. For example, payment of commercial bills, collection of dividend warrants and interest coupons, payment of insurance premia, rents, periodic subscription to clubs and societies.
(c) Conduct of stock exchange transactions such as purchase and sale of securities for the customers.
(d) Acting as executors and trustees
(e) Providing income tax services
(f) The conduct of foreign exchange business

2. General utility services - The banker, apart from the usual banking business comes forward to help the customers in a number of ways. In countries where banking has developed considerably. the banks render a number of services just to provide more facilities to the customers. Such facilities include safe keeping of valuables of the customers, issue of commercial letters of credit and travellers' cheques, collecting trade information from foreign countries for their customers, arranging business tours, providing suitable investment advice, etc. Sometimes, they even secure admissions for the children of their customers in foreign universities. Usually, all these services are rendered by the modem banker either free of charge or at a nominal charge. By rendering these services the banks are able to attract more and more new customers.

3) **a)** A large number of customers come to the bank for various purposes like deposit of money, encashment of cheques, purchase of drafts, encashment of travellers' cheques, gift cheques, etc. On such occasions waiting becomes a problem in any big branch of a bank. One of the most important methods of reducing the waiting time of customers at the counter is the adoption of the teller system. Under this teller system, a separate counter is opened through which transactions involving amounts not exceeding certain limits are settled. This counter is enclosed in a cubicle and one officer of the bank called the teller is put in charge of the counter.

b) Liquidity means the capacity of the banker to convert his assets into cash on demand. The banker gets his funds from deposits and these deposits are repayable on demand. The existence of a bank depends on the confidence that the public has in the bank. The public feels confident about the bank only when it is able to convert its assets into cash to meet the demands of the depositors. The customers make their demand by the issue of cheques and the banker has got a statutory obligation to honour cheques presented by its customers. These cheques are to be paid on demand and there is no question of postponing the payment. Therefore, a banker has to maintain enough reserves to honour every cheque presented for payment and as such he cannot lock up funds in securities which are of permanent nature.

Profitability is another important principle to be observed in determining the lending policy. Like every other business banking is also a business and should earn some profit for its shareholders. Therefore, the banker should channelize his resources through profitable investment. To earn more profit the funds should be invested in long-term assets. But the banker cannot lock up funds for long periods without affecting liquidity. Hence, the banker should strike a balance between liquidity and profitability by investing a portion of its funds in liquid assets and a portion in long-term assets.

Security or Safety - Every loan proposal under consideration of a bank involves an element of risk that the loan, if made, will not be repaid as per the terms of the agreement. To avoid the risk of loss, experienced bankers never lend money without sufficient security. Bankers prefer to invest their funds in assets which are less risky. Again the banker should draw a balance between liquidity, profitability and safety. if loans are granted only on the basis of security the banker can realize the amount by disposing of the security in case of failure of the borrower to repay the loan in time

c) Limitations to creation of credit

A bank cannot go on creating deposits without any limit. There are certain limits to the powers of the individual banks to create deposits. These limits are discussed below:

1. Reserve requirement: The first and the most important limit to the power of the bank to create deposit is due to the fact that the customers withdraw some hard cash every day and therefore, percentage of reserve that the banks are legally or customarily required to maintain sets a limit to the capacity of the bank to create credit.

2. Availability of primary deposits: The bank is able to create deposit only if it receives some cash in the form of primary deposit. Therefore, the total amount of cash in a country sets another limitation. The total supply of cash depends upon the policy of the Central Bank.

3. Availability of good securities: The bank creates more and more deposits by lending money. But the bank can lend money only if the borrowers are able to provide good securities. Therefore, the availability of good security sets another limit to the bank's power to create deposits.

4. Economic conditions: Business cycles also affect the bank's power to create deposits. During periods of prosperity businessmen may wish to borrow more and invest in business, which may increase the bank's power to create credit. But during periods of depression, they are reluctant to invest in business and therefore they borrow less. This will also affect the bank's power to create credit.

Part B

4) Role of RBI as regulator

Monetary Authority

Issuer of currency

Banker and debt manager to government

Banker to banks

Regulator of the banking system

Manager of Foreign Exchange

Maintaining financial stability

Regulator and supervisor of the payment and settlement systems

Developmental Role