**Unit-I : Banking-An Overview**

Banking - An Overview: Origin of Banking – Meaning - Banking System in India -Function of the Central Bank - Credit Control Measures - RBI and its functions

Banking has a long and varied history, and its evolution can be traced back to ancient civilizations. Here's an overview of the origin of banking, its meaning, and a brief look at the banking system in India.

## Origin of Banking:


**Ancient Civilizations:** The concept of banking can be traced to ancient civilizations such as Mesopotamia, where temples acted as early banks, providing safe storage for valuable items. In ancient Greece and Rome, moneylenders and bankers facilitated trade and financial transactions.

**Medieval Europe:** During the Middle Ages, banking activities started to emerge more formally in Italian city-states like Florence and Venice. The Medici family, for example, played a significant role in the development of modern banking.

**Goldsmiths and London:** In 17th century England, goldsmiths began offering safe storage for valuable items, including gold and silver. These goldsmiths issued receipts for deposits, which could be exchanged as a form of payment. Over time, these receipts evolved into banknotes, and goldsmiths transitioned into bankers.

## Meaning of Banking:

**Financial Intermediation:** At its core, banking involves financial intermediation, where banks act as intermediaries between those who have surplus funds (depositors) and those who need funds (borrowers). Banks provide a range of financial services, including accepting deposits, granting loans, and facilitating payments.

**Risk Management:** Banks also play a crucial role in managing risks by diversifying their portfolios, conducting due diligence on borrowers, and implementing various risk management practices.

**Money Creation:** Through the fractional reserve system, banks can create money by lending out a portion of the deposits they hold. This process contributes to the money supply in the economy.

## Banking System in India:

**Historical Perspective:** The history of banking in India dates back to the Vedic period, where indigenous bankers called "Shroffs" facilitated trade and provided financial services. The establishment of the Bank of Hindustan in 1770 and the Bank of Bengal in 1806 marked the formal beginning of banking in India during the British colonial era.

**Nationalization:** In 1969, the Indian government nationalized 14 major banks, aiming to enhance banking penetration and promote financial inclusion. This move led to the creation of large, state-owned banks.

**Liberalization:** In the early 1990s, India embraced economic reforms, liberalizing the banking sector. This period saw the entry of private and foreign banks, promoting competition and innovation.

**Modern Banking:** Today, India's banking system includes a mix of public sector banks, private sector banks, foreign banks, cooperative banks, and regional rural banks. The Reserve Bank of India (RBI) serves as the central banking authority, regulating and supervising the banking sector.

In summary, banking has a rich history that has evolved over centuries, and its role in facilitating economic activities and managing financial resources remains crucial in the modern era. The banking system in India has undergone significant changes, reflecting both historical developments and contemporary economic reforms.

## Function of the Central Bank:

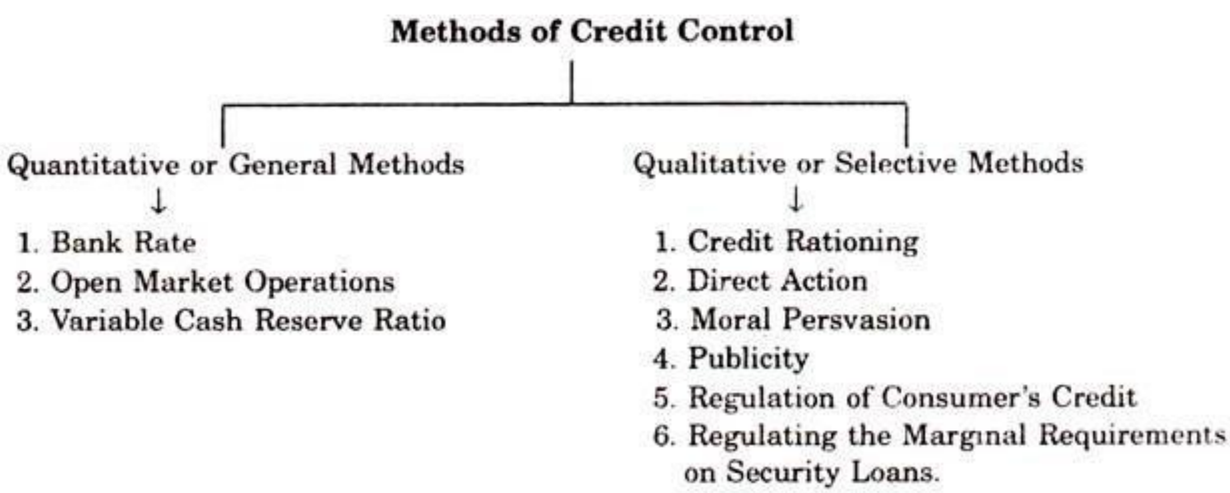
The central bank, often known as the "lender of last resort," plays a pivotal role in a country's financial and economic system. The functions of a central bank are multifaceted and can include:


1. **Monetary Policy Formulation:** The central bank is responsible for formulating and implementing monetary policy. This involves controlling the money supply, interest rates, and inflation to achieve economic stability and growth.

2. **Currency Issuance:** Central banks are typically the sole issuers of a country's currency. They manage the supply of money and are responsible for maintaining the integrity of the currency.
3. **Banker to the Government:** Central banks often act as the government's banker, handling its deposits, managing its borrowing, and facilitating transactions on its behalf.
4. **Banker's Bank:** Central banks serve as the bankers' bank, providing financial services to commercial banks, including maintaining their accounts, facilitating fund transfers, and serving as a lender of last resort during financial crises.
5. **Custodian of Foreign Exchange Reserves:** Central banks manage a country's foreign exchange reserves, ensuring stability in exchange rates and facilitating international trade.
6. **Supervision and Regulation:** Central banks oversee and regulate financial institutions to ensure the stability and integrity of the financial system. This includes setting prudential standards, conducting inspections, and taking corrective actions when necessary.
7. **Payment System Oversight:** Central banks are responsible for overseeing and ensuring the efficiency and safety of payment systems within the country.

## Credit Control Measures:

Central banks employ various credit control measures to influence the money supply and credit conditions in the economy. These measures include:

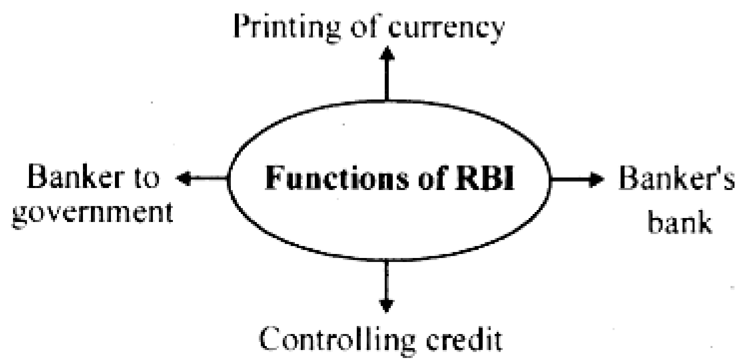



1. **Open Market Operations (OMO):** The central bank buys or sells government securities in the open market to influence the level of bank reserves, interest rates, and money supply.
2. **Bank Rate Policy:** The central bank sets the official interest rate at which it lends to commercial banks. Changes in the bank rate affect the cost of borrowing and, consequently, credit availability.
3. **Cash Reserve Ratio (CRR):** Commercial banks are required to maintain a certain percentage of their deposits as reserves with the central bank. Adjusting the CRR affects the amount of lendable funds in the banking system.

4. **Statutory Liquidity Ratio (SLR):** Similar to CRR, SLR mandates banks to maintain a percentage of their deposits in specified liquid assets like government securities. Adjusting SLR impacts the liquidity position of banks.
5. **Selective Credit Controls:** The central bank may impose restrictions on specific types of loans or credit to control inflation or address specific economic issues.

## Reserve Bank of India (RBI) and Its Functions:

The Reserve Bank of India (RBI) is the central banking institution in India. Its functions include:




1. **Monetary Policy:** Formulating and implementing monetary policy to achieve price stability and support economic growth.
2. **Currency Issuance:** Regulating and issuing the currency in India.
3. **Banker to the Government:** Acting as the banker and fiscal agent of the Government of India.
4. **Banker's Bank:** Serving as the lender of last resort to commercial banks, managing their reserves, and maintaining financial stability.
5. **Foreign Exchange Management:** Managing the country's foreign exchange reserves and influencing exchange rates.
6. **Regulation and Supervision:** Regulating and supervising financial institutions to ensure the stability and integrity of the financial system.
7. **Developmental Functions:** Undertaking various developmental functions to promote financial inclusion, economic development, and the efficient functioning of financial markets.

In summary, the central bank, such as the Reserve Bank of India, plays a crucial role in the formulation and execution of monetary policy, regulation and supervision of financial institutions, and maintaining overall stability in the financial system. It employs various credit control measures to achieve these objectives.