CHAPTER 1

INDIAN BANKING SYSTEM –
AN OVERVIEW
INDIAN BANKING SYSTEM – AN OVERVIEW

If there is one aspect in which we can confidently assert that India is ahead of China, it is in the robustness and soundness of our banking system.

Manmohan Singh

Banks have become an integral part of economic life in every field. The growth and development of any economy largely depends on the performance of the financial institutions of that country. A sound banking system is one which mobilizes the savings from the public and makes them available for various investment purposes. In this context, banks are assumed to be the engines for economic growth and progress of the country. Modern trade and trade related activities are purely based on these banking services. Now, the banking service has reached each and every corner of the country. In this regard, banks act as a conduit towards promoting nation’s economic development. Banking has also played an inevitable role in the modern life of people. The human life is fully associated with banks and banking related activities. The structure of banking system in India can be broadly categorized as organized sector and unorganized sector. The organized sector comprises of commercial banks, cooperative banks, development banks and regional rural banks. The unorganized sector includes money lenders and indigenous bankers.

In ancient times, an indigenous banking system prevailed in different parts of the country under different names. The important functions performed by these indigenous bankers are lending money to traders and agriculturists. In addition to this, they also grant funds to the kings for financing wars. In Madras, these
indigenous bankers are called as Nattukotta chettys and Kalladakurichi Brahmins; in northern part of India Sahukars, Mahajans and Khatnes; in Mumbai, Shroffs and Marwaris; and in Bengal, Seths and Bania. According to the Indian Central Banking Enquiry Committee, an indigenous banker or bank is defined as an individual or private firm which receives deposits, deals in hundies or engages itself in lending money. The indigenous bankers can be classified into three categories, which include indigenous bankers who deal only in banking business, indigenous banks who combine banking business with trade and indigenous banker with limited banking operations who mainly deal with trades. On the other hand, the moneylender is not a banker; his activity is only to give loans from his own funds. The moneylenders can be broadly categorized as professional moneylenders and non-professional moneylenders. The professional moneylenders are again classified into two namely, resident and itinerant. The non-professional money lenders did not take banking business as their money lending activity; instead they are utilizing surplus funds for disposal in the business of money lending.

Joint Stock Bank Company was initiated by British Agency Houses. The agency houses provide banking services along with general trading activity. The agent houses were organized by the foreigners employed in civil or military services in India. The first bank was “Bank of Hindustan” which started in the year 1770. Later on “The General Bank of India” was established in the year 1786. Further, three presidency banks were established. Firstly, “Bank of Calcutta” was set up in 2nd June 1806 with capital of Rs. 50 lakhs. Later on, “Bank of Bombay” and “Bank of Madras” were established on 15th April 1840 and 1st July 1843 with capital of Rupees 52 lakh and 30 lakh respectively. These three presidency banks were
established under the charters of the British East India Company. These presidency banks acted as quasi-contract banks for many years. In the meanwhile Imperial banks of India were formed by amalgamating these three presidency banks. It came into existence on 27th January 1921 by J.M Keynes. The Imperial bank of India did not have the power to issue currency notes in the country. But they have the right to manage both clearing house and hold government balances.

In 1839, Indian merchants took an effort to establish a bank namely “Union bank”. But it was a great failure. The Allahabad bank was established in 1865 and serving the customers for the last 151 years. It was the oldest public sector bank in India exclusively set up as a join stock bank by Indians. The Oudh Commercial bank was set up in the year 1881. It was the first commercial bank in India having limited liability and managed by Indian board of directors. There were no branches for this bank and its purpose was to serve for local needs. This bank was failed in 1958. The Punjab national bank was established in Lahore in 1895. It was the first bank which was purely manage by Indians. Now, it is one of the largest commercial bank in our country. The central bank of India which was set up in 1911 was the first Indian commercial bank and was wholly owned and managed by Indians. During the period of Swadeshi movement between (1906-1911) many banks were established such as Canara Bank, Bank of Baroda, Bank of India, Corporation Bank, Indian Bank and Central bank of India. The years 1913-1917 experienced a period of banking failures. During this period, the number of bank failures increased from 12 in 1913 to 42 in 1914. This trend continued for several years. In 1923, the number of bank failures was 143 and after nine years ended in 1947, bank failures were 547. The period of 1954, witnessed a declining trend in the number of bank failures in the
country. The major reasons for the bank failures in India was mainly due to lack of paid up capital, inefficient management system, high competition, low cash reserves, unsound lending policy, speculative dealings, branch expansion and growth of small banks and absence of regulation and control.

The second stage of Indian banking history began with the establishment of the Reserve bank of India. The RBI is the central bank in our country. It started its operations on April 1, 1935 in accordance with the provisions of RBI Act 1934. The bank was formed on the basis of recommendations of the Hilton-young commission. At the time of formation the head office of the Reserve bank was set up in Calcutta. Later on, it was moved to Mumbai in 1937. The major function of RBI is the issue of currency notes and maintaining reserves for securing monetary stability in our country. This bank also regulates the credit system in our country. Initially the banking regulation act was passed as the “banking companies act” in 1949 and came in to action on 16th march 1949. This was later renamed as “Banking regulation act 1949”. The state bank of India was set up by the nationalization of the imperial bank of India in July 1955. It was formed on the basis of recommendation of All India credit survey committee on 1st July 1955. The purpose was to serve the economy in general and particularly rural areas. In the meanwhile, seven subsidiaries of the State bank of India such as State bank of Patiala, State bank of Mysore, State bank of Bikaner and Jaipur, State bank of Hyderabad, State bank of Travancore, State bank of Saurashtra and State bank of Indore were nationalized by state bank of India (Subsidiary banks) Act 1959.

The nationalization of banks in India was a significant decision taken by the government of India. Prior to the nationalization, majority of the banks in India were
controlled by private parties and corporate families. They collected huge sum of money from the public and provided credit only to big landlords or established business houses. Hence, the purpose of nationalization was to ensure whether the funds are available to needy and required sections of the society such as agriculturist, small and village industries etc. The other prominent reasons for the nationalization of banks in India were the expansion of banking services in the unbanked areas, to reduce regional imbalance, and for creating banking habits among the people. With these reasons fourteen major private banks with deposits of rupees 50 crore and above were nationalized. These banks includes, Allahabad bank, Bank of Baroda, Bank of India, Bank of Maharashtra, Canara bank, Central bank of India, Dena bank, Indian bank, Indian overseas bank, Punjab national bank, Syndicate bank, Union bank of India, United bank of India and United commercial bank (UCO bank). In the year 1980, another six more private banks with deposits of rupees 200 crore were nationalized. These banks consist of Andhra bank, Corporation bank, New bank of India, Punjab and sindh bank, Orientel bank of commerce and Vijaya bank. Later the new bank of India was merged with Punjab national bank. Both the phases of nationalization took place during the prime ministerial period of Indira Gandhi. The purpose of nationalization was to ensure a smooth supply of credit to socially desirable sections and provides funds to the sectors like agriculture and small and village industries for the expansion and economic development.

The third phase of development of banking in India is noticeable by consolidation, diversification and liberalization of banking system in our country. The financial sector reforms played significant role in the overall development of banking industry. The reforms were very essential for raising the banking efficiency and to
generate high income for the banks. It also contributes to the macroeconomic stability. In 1991, India embarked in the era of economic reforms which gave path to liberalization, privatization and globalization of Indian thought into the global platform. The financial sector reforms was assumed to be the most essential part to these reforms. The financial sector reforms were stimulated with the recommendations of several committees like chakravarthy committee (1985), Vaghul committee (1987) and most remarkably by Narasimham committee (1991 & 1998). On the recommendation of Narasimham committee (1991) many changes were occurred in the banking industry such as freedom of entry for new banks especially new private sector and foreign banks, branch licensing policies, reduction in the statutory liquidity ratio (SLR) and cash reserve ratio (CRR). In 1998, the government of India appointed another committee under the chairmanship of Mr. Narasimham. The purpose of this committee was to review the progress of banking reforms and to design a programme which strengthens the entire financial system of the country.

**Banking system in Kerala**

In ancient times, an indigenous banking system was followed by the private money lenders and Hundi merchants. Apart from this, Chitties or kuries also occupied a significant position in the financial system of Kerala. The activities of these indigenous bankers were mainly associated with money related matters. The Nedungadi Bank was the first bank started in Kerala by Sri. Appu Nedungadi in the year 1899, but got registration only in the year 1910. The Travancore Permanent funds were the first registered bank in Kerala. The modern form of banking in Kerala was initiated by Syrian Christians of Thrissur. They were started joint stock companies for undertaking banking activities. The Catholic Syrian bank and South
Indian Bank were the prominent banks established during this period. Later on Hindu-Nair community was initiated in to the service of “The Cochin Nair Bank” and it was subsequently combined with State Bank of Travancore. After wards, many banks had started their operations in different parts of the State. Many of the banks were established in Christian dominated areas like, Kottayam, Thiruvalla, Palai etc.

In the year 1917, companies Regulation Act was passed. Thereafter, many banks were registered and started to render banking services to the customers. The Ambalapuzha Christian bank was the first bank registered as per the provision of companies Regulation Act 1917. This trend was followed by many other banks including Catholic Syrian bank, Travancore Federal bank, South Indian Bank etc.

The period 1932-1933 witnessed an increasing trend in the number of banks in the State. It was increased from 5 in 1917-18 to 274 by 1932-33 which was reported as a record in the Kerala banking history.

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<th>Year</th>
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<td>6</td>
<td>NA</td>
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<tr>
<td>1920-1921</td>
<td>43</td>
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<tr>
<td>1928-1929</td>
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<td>64</td>
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<td>1929-1930</td>
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<td>1932-1933</td>
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<tr>
<td>1936-1937</td>
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<td>155</td>
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<tr>
<td>1954-1955</td>
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Now, Kerala has got a well-established banking system. Kerala became the first state in India to have brick and mortar branches in all grama panchayats and villages. The growth and development of banking system in Kerala was also highlighted by the establishment of literacy centres in all block and covered all households with bank accounts.

This chapter provides a detailed investigation about the evolution of banking system in India. The chapter describes the various phases of growth and development of banking sector in India. The study also furnishes the important information relating to Kerala banking scenario.

In the next chapter researcher has made an attempt to discuss in detail about various aspects of internet banking such as different electronic delivery channels, growth of internet in India, evolution of internet banking, benefits and applications of internet banking, risk in internet banking and finally the recommendations of internet banking working group.