Chapter IV

ORIGIN AND DEVELOPMENT OF BANKING INDUSTRY IN INDIA

4.1 Early Periods

Commercial banking of the western type is a recent development in India. But banking was not unknown to India. From very ancient times indigenous banking and money lending existed in India in the form of family or individual business. The ancient Hindu Scriptures refer to their existence in the Vedic period.

Chanakya's Arthasasthra (about 300 B.C.) has several references to show that there were in existence powerful guilds of merchant bankers who received deposits, advanced loans and carried on other banking functions. During the Moghul period, bankers were fairly prominent in the financing of trade and the use of instruments of trade. They rendered great service to the East India Company in the early days of British occupation. The revenue of the East India Company was collected primarily through the indigenous bankers of various districts. From the early Vedic period right through the Moghul period as well as that of the East India Company's rule the money lenders and the indigenous bankers conducted business similar to that of modern bankers.
All through the period of ancient Indian history, moneylenders who were called either bankers, or seths, or shroffs are recorded to have carried on a roaring business in money lending and banking.¹

The first European Bank in India was started in Calcutta in 1770 by one of the leading agency houses viz., Messers Alexander & Company under the name "The Bank of Hindoostan". The Bank was started mostly to meet the needs of foreign trade during the period. The Bank of Hindoostan failed in the year 1832, with the fall of the agency house of Messers. Alexander & Company.

Banking in the modern sense came to be established in India with the setting up of three Presidency Banks - The Bank of Bengal in 1806, The Bank of Bombay in 1840 and The Bank of Madras in 1843 by the respective Presidency Governments of Bengal, Bombay and Madras. The Presidency Banks were successors to agency houses which invariably combined banking with their commercial and trading activities, and were floated by the East India Company to facilitate the borrowings of the Government and maintenance of credit. These Presidency Banks were really like central banks for their respective areas as they performed central banking functions and each-was the Government’s banker in its area.

4.2 Pre-Independence Period

With the enactment of the Joint Stock Companies Act 1850, Indian joint stock banks began to be floated. The first Indian bank was Oudh Commercial Bank started in 1881. It was followed by the Punjab National Bank in 1894.

The Swadeshi Movement, prompted Indians to start many new banking institutions. The number of joint stock banks in India increased remarkably during the boom of 1906-13. The Peoples Bank of India Ltd., The Bank of India Ltd., The Central Bank of India Ltd., The Indian Bank Ltd., and The Bank of Baroda Ltd., were started during this period. The boom continued till it was overtaken by the crash of 1913-17, a severe crisis faced by the Indian joint stock banks.

The Indian Companies Act was passed in 1913. It contained only very few regulations specially applicable to banks. In 1920, the Imperial Bank of India Act was passed which brought into existence on January 27, 1921 the Imperial Bank of India. The Imperial Bank of India was the result of the fusion of the three Presidency Banks. The Reserve Bank of India was started as a private shareholders bank in April 1935 to act as the central bank of the country.

The Indian Companies Act 1913 was amended in 1936 to bring in control over the mushroom growth and failure of the banks in the country. But it was not sufficiently effective.
The two World Wars proved a boom to the banking industry when many large and small banks were started. A good proportion of them stood the test of time and survived the subsequent crises, but at least an equal number of them failed. Though the Reserve Bank of India was constituted in 1935, much could not be done in respect of bank failures.

4.3 Post-Independence Period

The post-independence period had witnessed a massive growth of the Indian banking system. The first step taken in this direction was nationalisation of the Reserve Bank of India in September, 1948.

To have sound and balanced growth of banking in the country, the Banking Regulation Act 1949 was passed. The Act, the first of its kind to regulate the banks has extensively enlarged the control of the Reserve Bank of India over the banking industry. It came into effect from March 16, 1949. The Banking Regulation Act gave wide powers to the Reserve Bank of India to regulate, supervise and develop the banking system. The fifties witnessed the consolidation of banking structure and the emergence of big commercial banks through amalgamations and mergers.

The All India Rural Credit Survey Committee appointed by the Reserve Bank of India, reviewed the rural credit scene in India in 1954 and made a few major recommendations for improving rural credit. On the basis of its recommendations the Imperial Bank of India was nationalised and renamed as State Bank of India from July 1, 1955, based on the provisions of the State
Bank of India Act 1955. The State Bank of India (Subsidiary Banks) Act was passed in 1959 enabling State Bank of India to take over the then eight state associated banks as its subsidiaries. Of the eight banks, the State Bank of Bikaner and State Bank of Jaipur were merged into one bank: the other state-associated banks which were made subsidiaries consisted of State Bank of Patiala, State Bank of Saurashtra, State Bank of Indore, State Bank of Hyderabad, State Bank of Mysore and State Bank of Travancore.

To maintain the confidence of the public in the banks and to stabilise the banking system, the Deposit insurance Corporation was formed in 1962. Compulsory mergers and amalgamation of the banks of weak financial structure with other healthy banks were undertaken on a massive scale since the sixties.

The Indian banks made rapid progress in the sixties. In a very limited scale, a few of the Indian banks established their branches abroad. In December 1967, the scheme of Social Control over banks was announced in the Parliament. The basic objectives of social control were to ensure an equitable and purposive distribution of credit within the resources available, keeping in view the relative priorities of developmental needs in the country. It was to ensure without actual take over of banks the achievements of those social ends into public ownership, that nationalisation could conceivably secure.

Social Control brought about a change in the outlook. The Boards of Directors of the banks were of bankers, reconstituted giving adequate
representations to various interests like agriculture, small scale industries etc. Banking was professionalised by making the Chief Executive of the banks as a full-time employee.

4.4 Post-Nationalisation Period

The scheme of Social Control initiated in December 1967 was found to be unsatisfactory and inadequate by the Central Government. Banks were to be adequately motivated towards speedy achievements of the social objectives of meeting the legitimate requirements of the weaker sections of society. Accordingly fourteen major Indian commercial banks each with a deposit of Rs 5000 lakhs or more, were nationalised on 19th July, 1969. After eleven years of the first phase of banks nationalisation, on 15th April, 1980, the ownership of six more Indian private sector banks each having deposits of Rs.20000 lakhs or more were taken over by the Government of India.

According to the then Prime Minister Smt. Indira Gandhi, the nationalisation of major banks was an important step for the mobilisation of people's savings, to be channelised towards productive purposes: There is an added assurance about the development of the national resources under Government ownership.²

The statement of objects and reasons appended to the Banking Companies (Acquisition & Transfer of Undertakings) Bill 1969 says:

The banking system touches the lives of millions and has to be inspired by a larger social purpose and has to subserve national priorities and objectives, such as rapid growth in agriculture, small industries and exports, raising of employment level, encouragement of new entrepreneurs and the development of the backward areas. For this purpose, it is necessary for the Government to take direct responsibility for the extension and diversification of banking services and for the working of a substantial part of the banking system.3

The main consideration that led to the nationalisation of the second batch of banks in April 1980 were to speed up the implementation of the 20-point Economic Programme, raising the share of priority sector advances in the total bank credit and secure effective control over the implementation of credit policy by the banking system.

The preamble to the Ordinance for the Acquisition and Transfer of six banking undertakings in 1980 states that these banks have been taken over “having regard to their size, resources, coverage and organization in order further to control the economy, to meet progressively and serve better the needs of the development of the economy and promote the welfare of the people in

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conformity with the policy of the state towards securing the principles laid down in clauses (b) and (c) of Article 39 of the Constitution.”

Dealing with the socio-economic objectives underlying the nationalisation of banks, the Ministry of Finance (Department of Economic Affairs) Government of India has stated:

Banks have, in fact, traversed a long distance in terms of territory, function and segments of society they serve. They have moved from towns to villages, from large and medium industry to small business and to peddlers of sundryware; from qualified professionals to rickshaw-pullers, to barbers and washermen, to convicts still in jail and ex-convicts, to tribals and physically handicapped, from the privileged to under-privileged and on to un-privileged; in short to all those who work for a living or looking for opportunities to work for a living and believe in dignity of labour and self-respect.\(^4\)

The broad objectives of nationalised banks can be summarised as under:

1. To usher in faster economic growth of the country through mobilisation of savings and channelizing them into productive uses.

2. To improve the economic well-being of the society at large and to help the socially and economically downtrodden people in particular.


3. To reduce the imbalance in economic growth among different regions and thereby facilitate a more balanced growth.

4. To manage properly as trustees, the funds mobilised from the public.

5. To maintain efficiency both in terms of

   (a) rendering service to various types of customers and

   (b) operations.

6. To render professionalised management services.

   As a result of the nationalisation of banks in 1969 and 1980, the total number of public sector banks in the country has increased to 28. These include State Bank of India, its seven subsidiaries and the twenty nationalised banks. The public sector banks accounted for 91 percent of the total deposits and credits of all the commercial banks in India in April 1980.\(^6\)

   The focus of banks since nationalisation primarily has been on widening and deepening the banking system and effecting a structural transformation in the deployment of commercial bank credit in pursuance of the plan objectives of increasing the financial savings, alleviation of poverty, modernisation of agriculture, small and cottage industries. Banking has thus emerged as an effective catalytic agent of social and economic change.\(^7\)

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\(^7\) R.N. Malhotra, "Inaugural Address" at *Bank Economists Meet*, (1986).
A series of measures were taken in close succession, enabling the nationalised banks to play an effective role in economic development. Nationalised banks were directed to identify centres for branch expansion by selecting the hitherto unbanked areas. The Lead Bank Scheme was initiated in 1970 assigning the responsibility of developing the banking activities in the district allotted to each of the nationalised banks. The commercial banks in collaboration with the Central and State Governments sponsored Regional Rural Banks in different parts of the country. As on 31-3-1994 there are 196 Regional Rural Banks in different parts of the country with a network of branches numbering 14561 and deposits and advances to the extent of Rs.830000 lakhs and Rs.510700 lakhs respectively.

As a step towards strengthening the banking sector in India, four Private Sector Banks - United Industrial Bank Ltd., Bank of Tamil Nadu Ltd., Bank of Thaniavur Ltd., and the Paravur Central Bank Ltd., were amalgamated during the financial year 1989-90 with Allahabad Bank, Indian Overseas Bank, Indian Bank and Bank of India respectively.

In addition to the traditional commercial banking functions, banks, as part of the process of diversification of their activities have developed specific divisions or promoted subsidiaries and have assisted widely the promotion of leasing, merchant banking, housing finance, factoring, mutual fund, venture capital, portfolio management, consumer finance and so on.
4.5 Financial Sector Reforms and the Banking Sector

In August 1991, the Government of India appointed a high-level committee to look into the structure, organisation and functions of the financial system. The nine-member Committee headed by Mr. M. Narasimham, former governor of the Reserve Bank India, a deputy governor of the Reserve Bank of India (Banking operations), Chairmen of State Bank of India, Industrial Development Bank of India and ICICI, Mr. Manu Shroff, Mr. Y.H. Malegam, Mr. Mrinal Datta Chaudhuri and the additional secretary, Ministry of Finance (Banking). The Committee submitted its report on November 16, 1991 to the Government of India. The Committee (Narasimham Committee) made a detailed review of the structure, organisation, functioning and procedure of the financial system and made recommendations with far reaching effects relating to the Indian banking system.

The recommendations of the Committee formed the basis of the Financial Sector Reforms introduced in the country in 1992-93 and pursued since then to improve the competitiveness and operational efficiency of the financial sector. In pursuance of the recommendations of the Narasimham Committee, the Reserve Bank of India, among other measures of reform, issued new prudential norms relating to income recognition, classification of assets, provisioning for bad debts and capital adequacy level to be attained by banks. The new income recognition norms laid down that overdue interest not actually received by banks cannot be shown as accrued.
Norms were also laid down for categorising non-performing accounts and making provisions for sub-standard, doubtful and loss-making assets at specified rates. The Statutory Liquidity Ratio (SLR) for scheduled commercial banks which was 38.5 percent on April 3, 1992 has been brought down in a phased manner to 34.24 percent of the outstanding net demand and time liabilities as on 31st March 1994. It has been further reduced to 31.50 percent.

Revised formats for balance sheet and profit and loss accounts of banks have been introduced from the year 1991-92 with a view to reflect the true financial health of the banks. To meet the capital requirements of the nationalised banks, the Government has provided for funds in the budgets of 1992-93, 1993-94 and 1994-95 to the extent of Rs.470000 lakhs, Rs. 570000 lakhs, and Rs. 560000 lakhs respectively. They are also permitted to raise share capital from the public by maintaining at least 51 percent of the share capital under government ownership.

As a part of the exercise relating to strengthening and restructuring of the public sector banks, the Government, on 4th September 1993 merged the loss making New Bank of India with Punjab National Bank thereby bringing down the number of nationalised banks to nineteen.

Guidelines for the setting up of private sector banks and Special Recovery Tribunals were introduced, and the commercial banks that started under those guidelines as on 31-3-94 are: UTI Bank Ltd., Indusland Bank Ltd.,
and ICICI Banking Corporation Ltd. The banks namely: HDFC Bank Ltd., Global Trust Bank Ltd., Bank of Gujarat Ltd., IDBI Bank Ltd. Bank of Punjab Ltd., Centurion Bank Ltd., and The Times Bank Ltd have received “in principle” approval and started functioning since then.

In tune with the recommendations of the Narasimham Committee, the Reserve Bank of India granted freedom to banks to rationalise their existing branch network by relocating branches, opening specialised branches, spinning off business at other locations, setting up of controlling offices and establishing extension counters. Banks attaining the prescribed capital adequacy norms and prudential accounting standards were allowed to set up new branches without prior approval of the Reserve Bank of India. Of the various measures introduced as part of the banking sector reforms, the prudential accounting and capital adequacy standards have in particular changed the entire complexion and character of Indian banking. The majority of the nationalised banks as on 31st March 1992 had turned out with good performance. Only three banks showed a net loss as on 31-3-1992. With the implementation of the new norms in 1992-93, out of twenty nationalised banks, thirteen banks reported a net loss: out of nineteen banks, twelve banks reported a net loss in 1993-94. Highly profit making banks have shown reduced profits.
4.6 Profile of the Sample Banks

4.6.1 Profile of the Canara Bank

Ammembal Subba Rao Pai, a philanthropist, established the Canara Hindu Permanent Fund in Mangalore, then a small port town in Karnataka India, on 1 July 1906. The bank changed its name to Canara bank Limited in 1910 when it incorporated. The bank has gone through the various phases of its growth trajectory over hundred years of its existence. Growth of Canara bank was phenomenal, especially after nationalization in the year 1969, attaining the status of a national level player in terms of geographical reach and clientele segments. Eighties was characterized by business diversification for the Bank. In June 2006, the bank completed a century of operation in the Indian banking industry. The eventful journey of the Bank has been characterized by several memorable milestones. Today, Canara Bank occupies a premier position in the comity of Indian banks. With an unbroken record of profits since its inception, Canara Bank has several firsts to its credit. These include:

- Launching of inter-city ATM network
- Obtaining ISO certification for a branch
- Articulation of ‘Good Banking’ – bank’s citizen charter
- Commissioning of exclusive Mahila banking branch
- Launching of exclusive subsidiary for IT consultancy
- Issuing credit card for farmers
• Providing agricultural consultancy services

Keeping customer convenience at the forefront, the bank provides a wide array of alternative delivery channels that include 2858 ATMs, covering 1139 centres. Several IT initiatives have been undertaken in recent years, which include funds transfer through interbank mobile payment services in ATMs, ASBA facility to net banking users, E-filing of tax returns and facility for viewing details of tax deducted at source, Terminal at 223 branches for customers to use net banking, SMS/e-mail alerts for all transactions done through ATM, net banking, POS, mobile banking, online payments irrespective of amounts, online loan applications and tracking facility, generation of automatic pass sheets through e-mail and automatic renewal of term deposits. Under Government business, the Bank has implemented internet based application for UGC Maulana Azad national fellowship scheme, web portal for national scheme for girl child secondary education, electronic accounting systems of e-receipts-customs for collection of customs duty and e-payment of commercial taxes module for UP, Karnataka, Delhi and Tamil Nadu.

Not just in commercial banking, the Bank has also carved a distinctive mark, in various corporate social responsibilities, namely, serving national priorities, promoting rural development, enhancing rural self-employment through several training institutes and spearheading financial inclusion objective. Promoting an inclusive growth strategy, which has been formed as the basic plank of national policy agenda today, is in fact deeply rooted in the
Bank's founding principles. “A good bank is not only the financial heart of the community, but also one with an obligation of helping in every possible manner to improve the economic conditions of the common people”. These insightful words of our founder continue to resonate even today in serving the society with a purpose. The growth story of Canara bank in its first century was due, among others, to the continued patronage of its valued customers, stakeholders, committed staff and uncanny leadership ability demonstrated by its leaders at the helm of affairs. The Canara bank’s vision is to emerge as a ‘Best Practices Bank’ by pursuing global benchmarks in profitability, operational efficiency, asset quality, risk management and expanding the global reach, and the mission is to provide quality banking services with enhanced customer orientation, higher value creation for stakeholders and to continue as a responsive corporate social citizen by effectively blending commercial pursuits with social banking. Canara Bank was ranked at 816 in the Forbes Global 2000 list.

In the state of Tamilnadu, Canara bank is the third largest nationalised bank, with a network of 564 branches, covering all the 32 districts. The bank has actively participated in all the development schemes of the government. The bank has lead district responsibility in seven districts (Dindigul, Coimbatore, Erode, Nilgiris, Tiruppur, Madurai and Theni). In order to give better attention towards the economically disadvantaged in urban centres, the bank has opened exclusive micro finance branches. Presently, the Canara bank
has 19 micro finance branches, of which three of them were in Tamilnadu state (Madurai, Chennai, and Coimbatore).

4.6.2 Profile of the Indian Overseas Bank

Indian Overseas Bank (IOB) was established on 10th of February, 1937, by Shri.M.Ct.M.Chidambaram Chettiar with the twin objectives of specialising in foreign exchange business and overseas banking. IOB had the distinction of simultaneously commencing operations in three branches at Karaikudi, Chennai, and Yangon (Myanmar). Since IOB aimed to encourage overseas banking and foreign exchange operations, it soon opened its branches in Penang and Singapore. In 1940s, IOB opened branches in Malaya, Ceylon and Bangkok. Then in 1963, The Burmese government nationalised IOB’s branch in Rangoon. IOB was the first bank to venture into consumer credit, as it introduced the popular personal loan scheme. IOB was one of the 14 major banks that were nationalised in 1969. After nationalization, the bank gave emphasis to on opening its branches in rural parts of India. In 1977, IOB opened a branch in Seoul. In 1979, IOB opened a foreign currency banking unit in the free trade zone in Colombo. IOB is the first bank to enter precious metals trade. The bank commenced gold wholesale trade on 20th November, 1997 and commenced its retail trade during January 1998. In the year 2000, the Bank had successfully launched its maiden Public Issue of Equity shares at par for Rs.111.20 crores, which brought the government's share in the bank's equity down to 75%. The equity shares of IOB are listed in the Madras Stock
Exchange (Regional), Bombay Stock Exchange, and National Stock Exchange of India Ltd., Mumbai. Since its inception, IOB absorbed five banks, including Kulitali Bank (est. 1933) during 1960s for the purpose of consolidating the banking sector in India by the merger of weak private sector banks with the stronger ones, and afterwards IOB acquired Bank of Tamil Nadu in 1988-89, Mumbai-based Adarsha Janata Sahakari Bank in 2001, and it has absorbed the Bharat Overseas Bank in 2007. Then in 2009 IOB took over Shree Suvarna Sahakari Bank, which was founded in 1969 and had its head office in Pune. Shree Suvarna Sahakari Bank had nine branches in Pune, two in Mumbai and one in Shirpur.

As early as 1964, IOB made a beginning in computerisation in areas of inter branch reconciliation and provident fund accounts. The bank has set up a separate computer policy and planning department (CPPD) to develop software packages on its own and to impart training to staff members in this field. Besides developing software to routine banking operations, the bank has developed a number of customer support products such as any branch banking, home utility bank services and speedy transfer and realisation services. The bank managed whole Y2K compliance in-house at a very nominal cost. The CPPD of the bank has been awarded ISO 9001 certification. All the regional offices of the bank have been connected by VSAT facility.
The bank has sponsored three regional rural banks namely: Pandyan Grama Bank in Tamil Nadu, Puri Gramya bank, and Dhenkanal Gramya bank in Orissa.

Indian Overseas Bank offers investment options like mutual funds and shares. It provides a wide range of consumer and commercial banking services, including savings account, current account, depositary services, VISA cards, credit cards, debit cards, online banking, any branch banking, home loans, NRI account, agricultural loans, payment of bills / taxes, provident fund scheme, forex collection services, retail loans, etc.

4.6.3 Profile of the Indian Bank

Indian Bank is one of the indigenous banks of India that emerged as a result of the Swadeshi Movement during the British Raj. The bank was established on 15th of August, 1907 by Shri.Annamalai and Shri.Ramaswami Chettiar in Madras. One of the prime figures associated with the establishment of the bank was V. Krishnaswamy Iyer, a lawyer from Madras (Now Chennai).

IB began its international expansion in 1932 when it opened a branch in Colombo. A branch in Jaffna followed three years later, but this was not successful and Indian Bank closed it in 1939. Just before World War II reached the region, Indian Bank opened a branch in 1940, in Rangoon (Yangon). The next year it closed the Rangoon branch, but opened branches in Singapore, and in Kuala Lumpur, Ipoh, and Penang. The rapid advance of the Japanese Army forced IB to close all its branches in Malaya and Singapore. Although the
Japanese forces did not reach Ceylon, IB closed the Colombo branch in 1942. After the war, IB reopened its Malayan and Singapore branches. Then in 1948 it reopened its branch in Colombo.

The 1960s saw IB expand domestically as it acquired Mannargudi Bank (est. 1932) and Salem Bank (est. 1925). Then on 19 July 1969 the Government of India nationalised 14 top banks, including Indian Bank.

In 1973 Indian Bank, Indian Overseas Bank, and United Commercial Bank established United Asian Bank Berhad in response to a new banking law in Malaysia that prohibited foreign government banks from operating in the country. International expansion continued in 1978 with IB becoming a technical adviser to PT Bank Rama in Indonesia, the result of the merger of PT Bank Masyarakat and PT Bank Ramayana. Two years later, Indian Bank, Bank of Baroda, and Union Bank of India established IUB International Finance, a licensed deposit taker in Hong Kong. Each of the three banks took an equal share in the joint venture.

In 1987, Indian Bank bought in two more acquisitions when it rescued Bank of Tanjore, based in Tamil Nadu.

Indian Bank offers a wide variety of banking products and services to its customers, including various deposit schemes, loan options, financial services, stock investment services and a number of specialized services such as remittance, collection, 7 day banking branches, cash management and
electronic funds transfer. The bank has core banking solution implemented in all its branches and extension counters.

Apart from its regular banking services, the Indian Bank has also been offering various other services through its 3 subsidiary companies, which are Indbank Merchant Banking Services Ltd., IndBank Housing Ltd. and IndFund Management Ltd.

Indian Bank has been a leader in bringing new initiatives for development of rural banking and extending help to the farmers of India. The bank has received award from Honorable Union Minister of Finance for excellence in agricultural lending. Apart from it, the bank also received the best performer award for Micro-Finance activities in Tamil Nadu and Union Territory of Puducherry from National Bank for Agriculture and Rural Development.

This chapter conferred about the development of banking in India, and the profiles of the banks restricted to this study. The following chapter reports the data analysis results obtained, and their implications in view of customer perception and satisfaction of banking services.