Chapter 2

Banking in India and Its Role in Development

2.1 Introduction

2.2 Development Phase of Banking in India
   2.2.1 Phase I
   2.2.2 Phase II
   2.2.3 Phase III

2.3 Role of Banking in Development
   2.3.1 Concept of 'Development'
   2.3.2 Banks and Economic Development
   2.3.3 Banks and Rural Development
   2.3.4 Banking in India and Development
   2.3.5 Recent Development in Commercial Banks in India
Chapter 2

Banking in India and Its Role in Development

2.1. Introduction

From very ancient times, banks constituted an important part of Indian economy. In India, the ancient Hindu scripture refers to the money lending activities during the Vedic period. During Ramayana and Mahabharata eras, banking had become a full-fledged business activity.

2.2. Development Phase of Banking in India

The history of banking in India had its origin in the 18th century with the establishment of trading centers by East India Company for trading and banking operations. The 'Bank of Hindustan', 1770 and 'The General Bank of India', 1786 were initial banks established in India.

From 1786 till today the journey of Indian banking system can be segregated into three phases. They are mentioned below -

1. Phase I : Early phase from 1786 to 1969.
2.2.1. Phase I:

The history of Indian Banking dates back to establishment of 'Bank of Hindustan', by English Agency house in Calcutta in 1770, which was under the directions of the Europeans. However, this bank could not survive for long because of failure of parent firm in 1832. The Sholapur Bank Ltd. started by trading house also went into liquidation in 1818 due to unwise combination of banking business with trading operations by them.

The Bank of Calcutta began its banking business in the year June 1806. The government of India was not aware of the great need for banks in India till 1809, and in that year, a royal charter redesignated the 'The Bank of Calcutta' as 'The Bank of Bengal'. It was the first joint stock bank of British Indian sponsored by the Govt. of Bengal.

Two more Presidency banks namely 'The Bank of Bombay' and 'The Bank of Madras' were formed in April 1840 and July 1843. These three banks were called presidency banks, because they were partly financed by East India Company. The three presidency banks were governed by a Royal Charter, which was revised periodically. The Paper Currency Act was passed in 1861 and the right of note issue of the Presidency Banks was abolished. None of these three banks had any branches till 1862. Then they concentrated on branch expansion at a rapid pace. By 1876, The Bank of Bengal had 18 branches, Bank of Madras and the Bank of Bombay 15 branches each.

In India, the Joint Stock Companies Act, 1850 was the first legislative enactment in the country, which enabled the corporate
sector to enter into the banking business as per the provision of this Act. After Presidency Bank, 'Allahabad Bank' was one of the oldest banks, established in the year 1865. The Bank of Bombay, 1840, went into liquidation in 1868, but it was revived in the same year with the same name. In 1881, 'Oudh Commercial Bank' came into existence and 'Punjab National Bank' was registered in 1895 with Lahore as its head office. The 'People's Bank' was established in 1901 and 'City Union Bank Ltd.' in 1904.

Swadeshi Movement, which promoted Indian Entrepreneurs to start many new banking institutions. Number of joint stock banks and institutions increased remarkably during the period of 1906-1913. The important banking institutions started during these period (1906-1921) were, Bank of India, Ltd. (1906), The Corporation Bank Ltd. (1906), The Indian Bank Ltd. (1907), The Bank of Baroda Ltd. (1908), The Canara Bank Ltd. (1910), The Central Bank of India Ltd. (1911), The South India Bank Ltd. (1911), The Karur Vysya Bank Ltd. (1916), The Union Bank of India Ltd. (1920), and The Tamilnadu Mercantile Bank Ltd. (1921).

The Bank of Bengal, The Bank of Bombay, The Bank of Madras referred as Presidency Banks got amalgamated into the Imperial Bank of Indian which came into existence on January 27th, 1921, by the Imperial Bank of India Act, 1920. This Act, however, did not give the bank power to issue notes and thus it was left without any control over currency of the country.

The Reserve Bank of India, was established as a body corporate under the Reserve Bank of India Act, which came into effect on April 1st, 1935. With a paid up capital of Rs. 5 crore. The Reserve
Bank of India was nationalized in 1948 soon after the country's independence. Though originally privately owned, after nationalization, the RBI is fully owned by the Government of India. The Reserve Bank of India took over all the functions of the Imperial Bank of India, but the later was given the privilege of acting as agent of the former in placed in which it had no branches.

During 1922-48, number of joint stock banks were established. Andhra Bank Ltd. (1923), Karnataka Bank Ltd. (1924), Syndicate Bank Ltd. (1925), The Federal Bank Ltd (1930), Vijaya Bank Ltd. (1931), Dhana Lakshmi Bank Ltd. (1935), Bank of Maharashtra Ltd. (1936), Indian Overseas Bank Ltd. (1937), Dena Bank Ltd. (1938), Lord Krishna Bank Ltd. (1940), Oriental Bank of Commerce Ltd. (1943), etc were established during this period.

1917, 1932 and 1939 were the years of banking crises in Indian. During 1913-48, about 1100 banks failed. The reasons behind bank failures were mismanagement, lack of experienced professional/managerial personnel, unhealthy competition among banks, irrational lending policies, high interest rate on deposits and absence of central regulation bank etc.

After second world war, there was a rapid growth of banks with inadequate capital. The second world war brought revolutionary changes in the Indian Banking Industry. Due to post war and post partition effects experienced by the economy, there was a continuous decline in the total number of banks in India. "The number of branches of bank decreased from 4886 in 1946 to 4021 in 1953." ² This was mainly due to the mismanagement.
In 1949, after independence, keeping in view the necessity of regulating rapid growth of banking institutions and their problems, a separate Act known as 'The Banking Companies Act' was enacted. In March 1948, a bill was introduced in parliament and was passed in February 1949. It came into force on March 16, 1949. The act was called as, 'Banking Companies Act, 1949', now known as 'Banking Regulations Act 1949.'

After independence, there was a great demand for nationalization of Imperial Bank of India. However, Government was not in favour of nationalization. The 'Rural Banking Enquiry Committee' (1950) also recommended against nationalization. Reserve Bank of India has appointed "All India Rural Credit Survey Committee" (1951), which strongly recommended the nationalization of Imperial Bank.

Thus, the Imperial Bank was brought under public ownership from July 1st, 1955, and was converted into State Bank of India, with the main objective of facilitation the extension of banking in the rural and semi-urban areas. State Bank of India established its seven subsidiaries, according to the provisions of State Bank of India Act 1959, as follows,

1. State Bank of Bikaner and Jaipur
2. State Bank of Hyderabad
3. State Bank of Mysore
4. State Bank of Patiala
5. State Bank of Saurashtra
6. State Bank of Travancore
7. State Bank of Indore
In 1967, the then ruling congress party had adopted 'social control on banks' for the first time, by stating that, "It is necessary to bring the banking institutions under social control in order to ensure the social-economic growth and to fulfill our social purpose more effectively and to make credit available to the producers in all fields where it is needed."³

Thus the objective of social control over banks was "to ensure without active take-over of banks into public ownership the achievements of those social ends that nationalization could conceivably secure. The major aim clearly was a more purposeful distribution of available credit in terms of accepted investment priorities and correspondingly more efficient, mobilization of savings."⁴

In December 1967, the Government initiated the scheme of social control over banks. Following steps were taken for this purpose -

a) Formation of National Credit Council - to assess the demand for bank credit, to determine priorities for disbursal of loans and advances and to co-ordinate lending and investment policies.

b) Enactment of Banking Laws Act, 1969 (Amendment)

c) Appointment of Banking Commission, Feb. 1969, under the chairmanship of Shri. R. G. Saraiya, to conduct the comprehensive enquiry into the structure of banking and its financial needs, policies, practices of our banking system. The social control scheme initiated by the Government in December 1967, was found unsatisfactory and inadequate. There were complaints that the Indian commercial banks
provide their advances to large and medium scale industries and sectors demanding priority such as agriculture and small scale industries were not receiving the attention from the banks.

2.2.2. Phase II

Nationalization of banks began with the passing of the Reserve Bank of India Act, 1948. (Transfer of public ownership) and it was a revolution in Indian banking system.

On July 19th, 1969 fourteen major banks each having deposits of more than Rs. 50 crore were nationalized and taken over by the Govt. On the same date, 14 new banks with all the legal characteristics of a body corporate were established. Each of the new bank has a common seal and perpetual succession.

The broad objectives of nationalization of 14 major banks in 1969 were summed up by the then Prime Minister Mrs. Indira Gandhi in parliament on July 21st, 1969 was as follows -

"While the nation is committed to establish a socialistic pattern of society, the Govt. felt that the public ownership and control of commanding heights of the national economy and of its strategic sectors were essential and an important aspect of the new social order which we are trying to build. As the financial institutions are amongst most important levers of the achievement of its social objectives, the nationalization of bank was felt as a significant step in the process of public ownership over the principle institutions for the mobilization of people's savings and canalizing them towards productive purposes. The government felt that the public ownership of the major banks will help in the most effective mobilization and
development of national resources so that our objective can be realized with a great degree of assurance."

**Table No. 2.1**  
**List of Nationalized Banks** (Rs. in lakh)

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of the Bank (New names)</th>
<th>Amount of Compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Central Bank of India</td>
<td>1750</td>
</tr>
<tr>
<td>2.</td>
<td>Bank of India</td>
<td>1470</td>
</tr>
<tr>
<td>3.</td>
<td>Punjab National Bank</td>
<td>1020</td>
</tr>
<tr>
<td>4.</td>
<td>Bank of Baroda</td>
<td>840</td>
</tr>
<tr>
<td>5.</td>
<td>United Commercial Bank (UCO Bank)</td>
<td>830</td>
</tr>
<tr>
<td>6.</td>
<td>Canara Bank</td>
<td>360</td>
</tr>
<tr>
<td>7.</td>
<td>United Bank of India</td>
<td>420</td>
</tr>
<tr>
<td>8.</td>
<td>Dena Bank</td>
<td>360</td>
</tr>
<tr>
<td>9.</td>
<td>Syndicate Bank</td>
<td>360</td>
</tr>
<tr>
<td>10.</td>
<td>Union Bank of India</td>
<td>310</td>
</tr>
<tr>
<td>11.</td>
<td>Allahabad Bank</td>
<td>310</td>
</tr>
<tr>
<td>12.</td>
<td>Indian Bank</td>
<td>230</td>
</tr>
<tr>
<td>13.</td>
<td>Bank of Maharashtra</td>
<td>230</td>
</tr>
<tr>
<td>14.</td>
<td>Indian Overseas Bank</td>
<td>250</td>
</tr>
</tbody>
</table>

After 11 years of the first phase of bank's nationalization an ordinance was promoted on April 15th, 1980 by the President of India for acquisition and transfer of undertakings of six more private banking companies. The main objective of second nationalization was to enhance the capacity of banking system to meet more effectively the needs of the developing economy and to promote the welfare of the people in conformity with the national policy.
The list of banks nationalized and the amount of compensation paid is given in table 2.2.

### Table No. 2.2

**List of Nationalized Banks, 1980**

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of the Bank (New names)</th>
<th>Amount of Compensation (Rs. In Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Andhra Bank</td>
<td>6.10</td>
</tr>
<tr>
<td>2.</td>
<td>New Bank of India</td>
<td>5.10</td>
</tr>
<tr>
<td>3.</td>
<td>Vijaya Bank</td>
<td>2.40</td>
</tr>
<tr>
<td>4.</td>
<td>Punjab and Sind Bank</td>
<td>2.10</td>
</tr>
<tr>
<td>5.</td>
<td>Corporation Bank</td>
<td>1.80</td>
</tr>
<tr>
<td>6.</td>
<td>Oriental Bank of Commerce</td>
<td>1.00</td>
</tr>
</tbody>
</table>

After the introduction of social control over commercial banks in 1967, there were complaints regarding regional imbalances in economic development. This program was discussed by National Credit Council. The council also studied the needs of various sectors of the economy and to allocate credit to promote economic growth, especially in the backward and rural areas of the country. For this purpose, the council has constituted a study group under the chairmanship of Dr. D. R. Gadgil. The study group has recommended an 'Area Approach' for commercial banks.

As per the recommendations of the study group, the Reserve Bank of India constituted a committee under the chairmanship of Mr. F. K. F. Nariman in August 1969. On the basis of Study Group's recommendation, Reserve Bank of India initiated the Lead Bank Scheme in December 1969.
The scheme came to be known as the Lead Bank Scheme, under which the commercial banks have to play a role of catalytic agent in the process of economic development especially in backward areas of the country. Under the scheme, all the 338 districts (except metropolitan areas of Bombay, Calcutta, Madras and Union territories of Goa, Delhi and Chandigarh) in the country were allotted to State Bank of India and its 7 subsidiaries, 14 nationalized banks and 2 private sector banks. Later one more private sector bank joined the scheme. The allotment was made in such a way that each bank played its lead role in more than one state and each state had more than one lead bank. The districts were allotted on the basis of size of the bank, adequacy of its resources of handling the volume of work, contiguity of districts, the regional orientation of the bank etc.

The decision to establish RRBs in India was taken by the Prime Minister Smt. Indira Gandhi in 1975, with the primary objective of developing the rural economy for meeting the financial needs of the weaker sections of rural community.

Based on the report of M. Narshimhan Committee, the Government of India promulgated the RRB's ordinance dated September 26, 1975. On October 2, 1975 five RRB's were established in four states.

India was the second major country to provide the insurance cover to bank depositors. The Deposit Insurance Corporation was established with effect from January 1, 1962. It took over the undertaking of the Credit Guarantee Corporation of India Ltd., from July 15th, 1978 with the integration of two organizations the corporation was renamed as the Deposit Insurance and Credit Guarantee Corporation.
After nationalization, the banking sector of India expanded at a fast pace and was really successful in achieving mass participation of public. "During the period of 1969-2003, 58000 new bank branches were opened in India and these new branches had mobilized over rupees 9 trillion worth of deposits."\(^5\)

Between 1969 and 1980 the private banking sector also flourished as private bank branches grew very quickly in numbers in comparison to public sector banks. After second nationalization, Government had gained control over 90% of bank branches. Since 1980, no bank nationalization has taken place in India, rather the trends have changed to privatization. But by 1991, the Indian banking and economy was in financial problem and on the verge of Bankruptcy. At this moment the Indian Government had implemented the economic reforms, The P. V. Narsimham Rao Government took certain steps which are referred as banking sector reforms.

2.2.3. Phase III

This phase has introduced many more products and facilities in the banking sector in its reforms measure. In 1911, under the Chairmanship of M. Narshimhan a committee was set up for liberalization of banking practices. The reform phases are -

1. First Phase of Reforms:

(Narshimhan committee I) Reform process started in Indian Banking Sector with the report of Narshimhan Committee (1991). The main objective of the reforms was to improve operational efficiency of banking sector. In Nov. 1991, committee has
submitted its recommendations to government which are as follows:

- CRR should be used as an instrument of monetary policy and not as a controlling means of expansion of credit. CRR should be progressively reduced from the existing level of 15% to 3 to 5%.
- SLR should be reduced from the then 38.5% to 25% over the period of 5 years. Such reduction would leave more funds with banks which could allocate to promote agriculture, industry and trade.
- Structure of interest rates should be broadly determined by market forces and RBI should be the sole authority to simplify the structure of the rates of interest.
- Committee proposed a substantial reduction in the number of public sector banks through mergers and acquisitions. RBI should have liberalized policy towards foreign banks to open branches in India.
- Removal of duality of control (i.e. finance ministry and RBI) banking department. RBI should assume full responsibility of banking system.
- Setting up of ARF (Asset Reconstruction Fund) to help banks and financial institutions regarding bad and doubtful debts.
- Public sector banks should be free and autonomous. RBI should examine the guidelines and instructions issued to banks in the context of autonomy of banks.

The recommendations of the committee were revolutionary and were opposed by bank unions and leftist political parties. The
first phase of reforms has been successful without any serious domestic or international fallout. The technological upgradation is an important step forward of first phase. By 1997, RBI reported that, though reforms results are in favour of banks, still there is a need for further improvement of banks.

2. Second Phase of Reforms:

(Narshimhan Committee II) The committee was constituted on 26 Dec, 1997 to review financial sector reforms (1991) and to suggest remedial measures for strengthening banking system, institutional structure supervisory system, legislative and technological changes. The major recommendations are as -

- Capital Adequacy Ratio (CRAR minimum) should be increased to 10% by 2002, to strengthen the banking system.
- Net NPA should be brought down to below 5% by 2000 and to 3% by 2002. Committee also proposed ARC (Assets Reconstruction COmpany) to tide over banklog of NPA's.
- For improvement in efficiency of banks, committee has recommended that, simplification of documentation, computer audit, regular updation of operational manual, wholetime director for Nationalized Banks, outsourcing of services.
- Conversion of activities between DFI's and banks, they should convert themselves to banks, provided prudential norms are fully satisfied. The committee proposed prudential and regulatory standards besides new capital norms for Urban Co-operative Banks.
• For integration of financial markets, banks and primary dealers alone should be allowed in inter-bank call and notice money market.

• 'Basle Core Principle for Effective Bank Supervision' should be regarded as the minimum to be attained.

• An integrated system of regulation and supervision be put in place to regulate and supervise the activities of banks, financial institutions and non-banking finance companies. Committee also recommend that, to set up an agency 'Board For Financial Regulation and Supervision' (BFRS) to provide an integrated system of supervision over banks, FIs and NBFCs.

• For clarity in law regarding evidentiary value of computer generated documents, a group should be constituted by RBI. Committee also recommends that RBI should totally withdraw from primary market in 91 days Treasury Bills.

3. Raghuram Rajan Committee Report - ("GenNext" reform)

Raghuram Rajan former head of research at IMF and Professor of finance in Chicago, was asked by planning commission to write a report on how to reform India's financial sector. The mandates of the committee has been to "Outline a comprehensive agenda for the evolution of financial sector". The report delineates hundred of small steps to reform India's Financial Sector. "The important part of the report is its articulation of "GenNext" reforms related to Financial Inclusion, stability and growth within macroeconomic framework it thought appropriate in the Indian context." 6
The report is focusing on issues related to financial sector reforms, financial inclusion, a growth friendly regulatory framework, measures to create an efficient and liquid market and establish robust credit infrastructure. According to the report Central Bank, focusing on price stability can be most effective at delivering good monetary and macro outcomes.

Report suggests, a steady liberalization of constraints on external commercial borrowings and withdrawal of hard-to-monitor stipulations about their end use. It also suggests, elimination of elements of financial repression in the interest of fiscal health. It suggests, necessity of financial inclusion. It means financial broadening access to finance which includes savings accounts, insurance and remittances products.

The Raghuram Rajan Committee has articulated "GenNext" reform for fixing the problems of financial sector.

The impact of banking sector reforms on Indian economy had been very effective. Reforms improve overall efficiency and provide stability to banks during last 20 years, the business per employee of PSB's has almost doubted. Non-performing Assets are reduced and borrowers are getting credit at lower interest rates.

Thus, the history of Indian Banking has described in three phases. The Indian banking has has played crucial role in economic development of the country. Hence, it is essential to understand concept of 'development' and the role of banking in the development process.
2.3. Role of Banking in Development

Banking sector in India, has performed an important role in the development of the country. Before independence banks were known as agency houses but after independence RBI had strengthen the banking system by adapting various policies. Till mid-sixties banking in India was oriented to urban area, but specially after nationalization rural sector development was the important priority of Banking sector. Banks accelerates the development of country by the ways like capital formation, credit creation, advances, allocation of funds. Before discussing role of banking in development, it is necessary to discuss the term 'development'.

2.3.1. Concept of 'Development'

Definition -

1. At a symposium on Social Policy and Planning organized by United Nation, 1970, following definition of 'development' was formulated -

"Development can be defined as a process of improving the capability of a country's institutions and value systems to meet increasing and different demands of a social, cultural, political as well as an economic character." 7

The above definition indicates that, development has many facts. Development means, improvement in 'quality of life' of the people. It refers to transformation of backwards, traditional, stagnant state to a progressive, modern and dynamic state.
2. As per Oxford Dictionary, "Development means, advance, betterment, change, enlargement, evolution, expansion, extension, gain, growth, improvement, increase, progress, promotion, regeneration, reinforcement, spread."

Development is a continuous process of qualitative and quantitative changes in the country which improves standard of living of people. The term consisting of various aspects of human life like economic, social, political, cultural, environmental and technical. Thus, for the improvement of 'quality of life' of society, continuous development process is necessary. Various factors are involved in the development process like Govt., Banks, Society, Institution. Development can be measured by using various criteria like standard of living, infrastructural facilities, education facilities, health care facility. Agricultural development can be measured by agricultural produce, intensity of cropping, cropped area, consumption of fertilizers, consumption of power, net irrigated area, pump-sets, tube wells, roads, electricity. Such criteria shows overall performance of agriculture, modernization of agriculture. Socio-economic development can be measured by various criteria like education facilities, health care facility, road, transport. Industrial development play an important role in economic development. Industrial output, industrial workers, no. of industries, no. of workers engaged in factories are various factors used for industrial development.

Banking sector contributing to improving the 'quality of life' of society by providing finance, accepting deposits, advancing loans and providing banking services. Thus, banking sector accelerates various aspects of development concept.
2.3.2. **Banks and Economic Development**:

Economic development is a dynamic and continuous process. In other words, economic development is economic progress of a country. Banks have catalyst role in economic development because banks control a large part of supply of money in circulation. In India, several financial institutions were established to provide funds to different sectors of economy. The role played by banks in economic development, over different periods, can be described in various ways.

1. 'Banks are financial intermediates.

2. The direct correlation between economic growth on one hand and financial growth driven by the dynamism of the financial sector in general and banks in particular on the other.

3. Role of banks in creation of money which creates the demand for goods and services.

4. Role of banks as a financial catalyst of social development.

5. Role of banks in facilitating / promotion of entrepreneurship - an essential condition of economic development.'

After liberalization, the government has approved significant banking reforms while some of these are related to nationalized banks (like encouraging mergers, disinvestment by government, reducing government interference and increasing profitability and competitiveness), other reforms have opened banking and insurance sector for private and foreign concerns. Financial sector reforms were initiated as a part of overall economic reforms in India and covering industry, trade, taxation, external sector, banking and financial markets, since mid 1991. A decade of economic and
financial sector reforms has strengthened the fundamentals of Indian economy and transformed the operating environment for banking and financial institutions. The reforms has helped economy to avoid crises and has actually fuelled growth. The most significant achievement of financial sector reforms has been the marked improvement in financial health of commercial banks in terms of capital adequacy, asset quality and profitability. The reforms have opened new opportunities for banks. At the same time, have brought competition among banks, both domestic and foreign as well as competition from mutual funds, NBFC's. Such increasing competition is squeezing profitability and forcing banks to work efficiently, which results in overall economic progress.

2.3.3. Banks and Rural Development:

Rural development is development of people living in rural area. Development of rural people means raising of standard of their living.

The world Bank defined rural development as "Rural development is a strategy to improve the economic and social life of a specific group of people, the rural poor, including small and marginal farmers, tenants and the landless." 9

Improvement in standard of living of rural poor means social change through economic change. Uma Lele defines "rural development in terms of raising standard of living of rural people." 10 The ultimate aim of rural development is social change.

For rural development 'availability of funds' is essential requirement. Commercial banks have such lendable funds hence, are involved in rural development. Commercial banking was introduced
in 18th century. In India, up to independence rural sector was ignored by commercial banks. After independence, Govt. has taken various important steps to make commercial banking finance available to rural mass. Through the commercial banks, direct and indirect finance (funds) was given to rural area. In direct finance, banks provide funds directly to rural people. In Indirect finance, funds were extended to rural banks for further lending of funds to rural people.

After nationalization, rural development got momentum due to opening of large number of bank branches in rural and semi-urban area. Commercial banks were realized about their responsibility towards rural society. Various programs were implemented by the banks for rural development e.g. Lead Bank Scheme, Village Adoption Scheme, DRI Scheme. Banks were providing loans and advances to rural people and also mobilizing small savings through a large network of bank branches. After, liberalization, the strategies and policies of banking sector were changed, from rural agrarian policy to rural entrepreneurial development policy. Banks are encouraging rural youth for establishment of trade, enterprises or agri-allied activities. Hence, banks has played vital role in rural area progress.

2.3.4. Banking in India and 'Development' :

Banks performs important functions in the 'development' of a country. Banks are converting non-productive financial resources in productive resources. It is difficult to think about development without network of commercial banks. The development process can be sustained with the help of banks. In the following ways banks are accelerating development process in India.
1. **Capital Formation** -

   Under Capital Formation function commercial bank has to accept deposits. People deposit their savings in banks which results in capital formation. It is a function of generation, mobilization and channelizing of savings of society. Bank offers facility of saving and thus encourage the habit of savings amongst society.

   "Commercial banks cannot satisfy the massive need for development capital in economies like India nor are they capable of financing the much needed infrastructure therein, yet they make a most basic and flexible contribution to development process." 

2. **Branch Expansion** -

   Rapid economic development presupposes rapid expansion of commercial banks. Initially, the banks were conservative and limited upto civilized area. After nationalization and introduction of lead bank scheme, branch expansion gained momentum.

   **Table 2.3**

   **Branch Expansion of Commercial Banks**

<table>
<thead>
<tr>
<th>As on June 30</th>
<th>Total No. of Branches</th>
<th>Rural Branches</th>
<th>Rural Branches as a percent of Total</th>
<th>Population per Bank Office</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>8260</td>
<td>1860</td>
<td>22</td>
<td>63800</td>
</tr>
<tr>
<td>1991</td>
<td>60650</td>
<td>32750</td>
<td>54</td>
<td>14150</td>
</tr>
<tr>
<td>2009</td>
<td>82408</td>
<td>31699</td>
<td>38</td>
<td>14000</td>
</tr>
</tbody>
</table>

   **Source:**
   i) Economic Survey, 2006-07, Table S-56
   ii) RBI, Statistical tables relating to banks in India

   Above table shows that, since nationalization, there was 997% increase in branches, but most important progress is in rural branches
i.e. from 1860 to 31699 branches. The population per branch is decreased from 63800 to 14000 per branch.

Expansion of banking facilities in rural, backward area and provision of bank credit to farmers and rural artisans results in socio-economic development.

3. **Deposits Mobilization and Credit Creation**

The basic role of commercial banks is to mobilize financial resources to meet the financial demands of various productive sectors of economy. It depends upon effective mobilization of deposits. The trend in increase in deposits and credit of scheduled commercial banks are as follows -

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Scheduled Commercial Banks</th>
<th>Bank Deposits (Rs. In crore)</th>
<th>Bank Credit (Rs. In Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950-51</td>
<td>430</td>
<td>820</td>
<td>580</td>
</tr>
<tr>
<td>1970-71</td>
<td>73</td>
<td>5,910</td>
<td>4,690</td>
</tr>
<tr>
<td>1990-91</td>
<td>271</td>
<td>1,92,540</td>
<td>1,16,300</td>
</tr>
<tr>
<td>2000-01</td>
<td>297</td>
<td>9,62,620</td>
<td>5,11,430</td>
</tr>
<tr>
<td>2009-10</td>
<td>165</td>
<td>44,92,826</td>
<td>32,44,788</td>
</tr>
</tbody>
</table>

Source: RBI, Report on currency and finance, 2000-01
Quarterly handout March 2010, RBI

Since independence, deposit mobilization and credit were growing at a rapid rate particularly after nationalization.

Growth of deposits in India of all SCB’s was as follows -

- 1951-1971 (20 years) : 700% or 7 times
- 1971-1991 (20 years) : 3260% or 32.6 times
- 1991-2010 (20 years) : 2340% or 23.4 times
It means, most rapid expansion was during 1970-1991 i.e. more than 32 times. It was mainly because of mobilization and Lead Bank Scheme.

It also shows, rapid expansion of credit which results in industrial and agricultural output. Bank credit has expanded from Rs. 580 crores in 1950-51 to Rs. 32,44,788 crores in 2009-10.

4. Priority Sector Lending by Banks -

Prior to nationalization, commercial banks had neglected priority sectors like agriculture. Neglect of priority sector lending was one of the cause of nationalization of top 14 banks in 1969. The actual position of priority sector lending by bank is as follows -

Table 2.5

Advances to Priority Sector by Public Sector Banks

<table>
<thead>
<tr>
<th>Priority Sector</th>
<th>June 1969</th>
<th>June 1971</th>
<th>March 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>160</td>
<td>340</td>
<td>4,14,973</td>
</tr>
<tr>
<td>SSI</td>
<td>260</td>
<td>440</td>
<td>3,69,430</td>
</tr>
<tr>
<td>Other Priority Sector</td>
<td>20</td>
<td>130</td>
<td>2,37,092</td>
</tr>
<tr>
<td>Total</td>
<td>440</td>
<td>910</td>
<td>10,21,495</td>
</tr>
<tr>
<td>Total Bank Credit</td>
<td>3020</td>
<td>4080</td>
<td>24,93,499</td>
</tr>
<tr>
<td>% of priority to total bank credit</td>
<td>15%</td>
<td>25%</td>
<td>40.96%</td>
</tr>
</tbody>
</table>


The total credit extended by public sector banks to agriculture, SSI and other priority sector increased from Rs. 440 crores in June 1969 to Rs. 10,21,495 crores in March 2011. As a result advances to
priority sector as percentage of total credit increased from 15% in June 1969 to 40.96% in March 2011. It means, rate of progress was quite rapid soon after nationalization.

5. **Finance for Agriculture** -

Agriculture is the main occupation of the rural population and the development in agriculture results in style and standard of living of the people. In order to reduce unemployment and to raise income sources of farmers, development of allied activities in agriculture is essential.

Banks, through a network of branches throughout the country provide finance to agriculture and allied activities. After nationalization maximum segment of advances were issued to priority sectors like agriculture by the banks. As per the above table agriculture sector finance was increased from Rs. 160 crores in 1969 to Rs. 1,55,220 crores in March 2006, which is tremendous increase in finance.

6. **Finance to Industrial Development** -

In order to reduce unemployment, poverty and increase standard of living, industrial development plays a dominant role. Such industrial development is encouraged by the finance provided by banking institutions.

Commercial banks plays catalyst role in development of industrialization. It helps in the formation of new venture, financing to sick industries for making them viable, finance to purchase capital goods. Bank also provide finance to purchase consumer durable. It
means banks not only improve standard of living but also help in creation of demand for consumer goods.

The above table shows that, credit to small scale industries was increased from Rs. 260 crores in June 1969 to Rs. 82,430 crores in March 2006.

7. Allocation of Funds -

Banks also help in proper allocation of funds among different regions. Branch expansion makes it possible for banks to develop their business in different regions. It helps in transference of surplus fund from excess region to neglected area. By doing so, commercial banks can create infrastructure which is essential for economic development.

All regions of the country are not equally developed. Certain regions are more developed than other. Banks collect such surplus fund and transfer it to less developed area.

8. Financial Inclusion -

Financial inclusion is delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups. Under financial Inclusion, banks has to provide banking services to financially excluded population. He financial Inclusion is necessary for sustainable and equitable development.

Bank has to establish a system for financing to excluded population. Banks provides an avenue of deposit of savings withdrawal and all banking services. Banks tie-up with the technology solution providers such as Bio-metric cards. In which the customer will enjoy 'virtual banking' at their door-steps.
Financial inclusion is essential for unorganized illiterate and disadvantaged population. The network, infrastructure and human resources of commercial banks would play important role in financial inclusion. Hence, it is necessary to discuss about recent developments of commercial banks in India.

It is clear from the above explanation that Banks plays a very special and dynamic role in the development and economic growth of every economy. Banks are an important constituent of country's money market. The bank lending and investment activities leads to improvement in quality of life. Agriculture activities and Industrial innovations become possible only through finance provided by banks. Thus banks had occupied important place in the life of a nation.

2.3.5. Recent development in commercial banks in India:

The earliest commercial Banks were known as agency houses and were started by East Indian Company. Before independence banks could not develop themselves to desired extent. After independence RBI followed the policy of merger to strengthen the banking system. The bank nationalization is an important development in the history of banking. At present these banks function in accordance with national policies and programs and priorities given to the rural sector.

The growth and development of commercial bank in India during the period from 1969 to 2010 is shown in Table 2.6 and District and population group-wise deposits and credit of commercial bank are shown in Table 2.7
### Table 2.6

**Progress of Commercial Banks in India**

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of commercial banks</th>
<th>No. of scheduled commercial banks</th>
<th>No. of branches</th>
<th>Deposits (Rs. in Crore)</th>
<th>Credit (Rs. in Crore)</th>
<th>Credit Deposit Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 1969</td>
<td>89</td>
<td>73</td>
<td>8262</td>
<td>4646</td>
<td>3599</td>
<td>77.5</td>
</tr>
<tr>
<td>Mar 2002</td>
<td>298</td>
<td>294</td>
<td>66190</td>
<td>1131187</td>
<td>609053</td>
<td>53.8</td>
</tr>
<tr>
<td>Mar 2003</td>
<td>294</td>
<td>289</td>
<td>66535</td>
<td>1311761</td>
<td>746432</td>
<td>56.9</td>
</tr>
<tr>
<td>Mar 2004</td>
<td>291</td>
<td>286</td>
<td>67188</td>
<td>1542284</td>
<td>865594</td>
<td>56.1</td>
</tr>
<tr>
<td>Mar 2005</td>
<td>288</td>
<td>284</td>
<td>68355</td>
<td>1732858</td>
<td>1124300</td>
<td>64.9</td>
</tr>
<tr>
<td>Mar 2006</td>
<td>222</td>
<td>218</td>
<td>69471</td>
<td>2109049</td>
<td>1507077</td>
<td>71.5</td>
</tr>
<tr>
<td>Mar 2007</td>
<td>183</td>
<td>179</td>
<td>71839</td>
<td>2611933</td>
<td>1931189</td>
<td>73.9</td>
</tr>
<tr>
<td>Mar 2008</td>
<td>175</td>
<td>171</td>
<td>76050</td>
<td>3196939</td>
<td>2361914</td>
<td>73.9</td>
</tr>
<tr>
<td>Mar 2009</td>
<td>170</td>
<td>166</td>
<td>80547</td>
<td>3834110</td>
<td>2775549</td>
<td>72.4</td>
</tr>
<tr>
<td>Mar 2010</td>
<td>169</td>
<td>165</td>
<td>85393</td>
<td>4492826</td>
<td>3244788</td>
<td>72.2</td>
</tr>
</tbody>
</table>

Source: Banking Statistics, Quarterly Handout March 2010, RBI, Mumbai

A picture of progress of commercial banks in India in above Table reveals that -

1. over the years from June 1969 to March 2007, the bank branches have grown more than eight times that increased from 8262 in 1969 to 66190 in 2002 and ten times in March 2010 i.e. 85393.

2. In March 2003 number of banks reduced from 289 upto 165 by March 2010. From the period March 2002 to March 2010, the growth of deposits and credit have grown more than four times and five times respectively.

3. But, it is important to note that the growth of deposits and credit over last ten years has been slowed down. The credit
deposit ratio has increased from 53.8 percent to 72.2 percent. It indicates increase in credit.

**Table 2.7**

**District and Population Group-wise Deposits and Credit of Scheduled Commercial Bank (March 2010)**

<table>
<thead>
<tr>
<th>State / District</th>
<th>No. of Offices</th>
<th>Deposites</th>
<th>Credit (in Rs.)</th>
<th>Amount Outstanding</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>No. of Accounts</td>
<td>Amount (in Rs.)</td>
<td>Amount Outstanding</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>8321</td>
<td>7,11,98,158</td>
<td>12,01,99,142</td>
<td>9,96,85,976</td>
</tr>
<tr>
<td>Rural</td>
<td>2167</td>
<td>1,03,28,403</td>
<td>23,29,788</td>
<td>17,00,949</td>
</tr>
<tr>
<td>Semi Urban</td>
<td>1538</td>
<td>1,25,04,774</td>
<td>39,98,116</td>
<td>21,96,051</td>
</tr>
<tr>
<td>Urban</td>
<td>1285</td>
<td>1,02,14,915</td>
<td>59,01,026</td>
<td>28,79,646</td>
</tr>
<tr>
<td>Metropolitan</td>
<td>3331</td>
<td>3,81,50,066</td>
<td>10,79,70,212</td>
<td>9,29,09,330</td>
</tr>
<tr>
<td>Ahmednagar</td>
<td>257</td>
<td>14,20,531</td>
<td>5,23,397</td>
<td>2,94,139</td>
</tr>
<tr>
<td>Rural</td>
<td>121</td>
<td>4,59,688</td>
<td>1,05,183</td>
<td>84,624</td>
</tr>
<tr>
<td>Semi-Urban</td>
<td>89</td>
<td>6,31,134</td>
<td>2,30,326</td>
<td>1,27,625</td>
</tr>
<tr>
<td>Urban</td>
<td>47</td>
<td>3,29,709</td>
<td>1,87,887</td>
<td>81,890</td>
</tr>
</tbody>
</table>


Table shows the district and population group-wise deposits and credit of scheduled commercial bank in Maharashtra and Ahmednagar district. The population groups of bank centers are defined as follows-

i) Rural group includes centre with population less than 10,000

ii) Semi-urban group includes centers with population 10,000 and above but less than 1 lakh.

iii) Urban group includes centers with population 1 lakh and above but less than 10 lakh.
iv) Metropolitan group consists centers with population above 10 lakh.

The data reveals from the table 2.1 (B) that, in rural area of Maharashtra and Ahmednagar district numbers of offices are more than semi-urban and urban area. If rural deposits of Maharashtra is compared with Ahmednagar district, there is wide scope to increase deposits in rural area. Credit amount outstanding in both areas is serious. Bankers have to take necessary steps.
References:

2. Ibid P. 7
3. Agarwal B.P., "Commercial Banking in India", Classical publishing company, New Delhi, 1983 P. 41
11. Hukku V. N., "Role of Commercial Banking in Developing Economy with special reference to India", P. 2