Growth and Development of Indian Commercial Banks

2.1 MAJOR FUNCTIONS OF COMMERCIAL BANKS

Commercial Banks play a very important role in our economy. Economic thinkers and progressive bankers have stressed the importance of commercial banks in the process of economic development from time to time. The importance of commercial banks can best be illustrated by a brief explanation of their major functions.

2.1.1 Creating Money. One of the major functions of commercial banks and a distinguishing feature that separates them from other financial institutions is the ability to create and destroy money. This is accomplished by the lending and investing activities of commercial banks in cooperation with the central bank. In fact, banks are not only purveyors of money but also manufacturers of money\(^1\).
The power of commercial banking system to create money is of great economic significance. It results in the elastic credit system that is necessary for economic progress at a relatively steady rate of growth. If bank credit were not available, the expansion of our production facilities would be in many cases impossible or delayed until funds could be accumulated out of profits or other sources. At the same time, the money supply should not increase at a faster rate than the production of goods to avoid inflation. Thus, if money supply lags it will lead to deflation and if money supply exceeds than it will lead to inflation. Both these situations are undesirable from economic point of view. Commercial banks play an important role in economy by controlling the money supply.

2.1.2 Payment Mechanism. Providing for a payment mechanism or transfer of funds is one of the important functions performed by commercial banks. The increasing efficiency with which funds are managed can be observed from the total money supply and currency with the public. For example, the currency with the public as on March 2008 was Rs.5,67,746 crore while money supply on that date was Rs. 40,28,158 crore. Thus, 14.09 percent of total money supply was with the public while the balance 85.91 percent stands for deposits with the banks. Bank performs this payment mechanism through clearing cheques.

2.1.3 Pooling of Savings. Commercial banks perform a very important service to all sectors of the economy by providing facilities for the pooling of savings and making them available for economically and socially desirable
purposes. The saver is rewarded with the interest on his savings that are safe in deposit form with the bank.

2.1.4 Extension of Credit. The primary function of commercial banks is the extension of credit to worthy borrowers. In making credit available, commercial banks are rendering a great social service; through their actions production is increased, capital investment is expanded and a higher standard of living is realized. Extension of trade is done by financing for domestic trade, foreign trade and industry.

2.1.5 Safe Keeping of Valuables. The safe keeping of valuables is one of the oldest services provided by commercial banks. They have vaults that are safe from burglars. For this service banks charge nominal charge. Such services rendered by banks help them to get more deposits by attracting more customers.

2.1.7 Agency Services. Besides the above functions, banks act as an agent of their customers. As an agent, they collect dividend, rent, and bills and underwrite sale of shares and debentures and work as a trustee. They also sale financial products on behalf of their clients. For these services they charge a service charge.

2.2 COMMERCIAL BANKING IN INDIA

2.2.1 Banking during Pre-nationalization Period. A synoptic presentation in banking in India in the pre-british regime has been made by T.A. Vaswani in his book Indian Banking System. He mentions that, in the Vedic literature, which
historians place around 2000-1400 BC, there are references to credit transactions. The Budhist Jatakas of the fifth and sixth centuries BC mention about moneylenders. Manu Smriti, said to have been written some time in the second or third century AD, contains separate chapters on ‘recovery of debt’ and ‘deposits and pledges’. In Kautilya’s ‘Arthasastra’ there have been references on ‘interest rate’. The Jain Temples at Dilwara, Mt. Abu bear silent testimony to the wealth of Jain Bankers. Another indigenous banking community the Multaniyas of the 14th century are reported to have acted as financiers to the Sultans of Delhi. The memoirs of French traveller Tavernier give valuable insight into the methods of business of indigenous bankers in the 17th century. According to him, there was not a village where an indigenous banker did not practice his business.

Modern Banking has come to India on western lines from the beginning of the 19th century. The earliest institutions which undertook banking business under the British regime were the agency houses which carried on banking business in addition to their trading activities. Most of these institutions closed their doors during the period 1829-32. The first joint stock bank was started at Calcutta by the name of Bank of Hindustan in the year 1770 and was under European Management. Three banks in the name of Bank of Calcutta (1806), the Bank of Bombay (1840), and the Bank of Madras (1843) were started with financial participation by the Government. These banks were known as ‘Presidency Banks’ and were given the right of note issue. The first purely Indian Bank was the Oudh Commercial Bank, which came into existence in the year 1881, followed by Punjab
National Bank in 1894. In 1905, 1913 and 1921 there were serious banking crisis. The three presidential banks were amalgamated to form the Imperial Bank of India, which started functioning on 27th January 1921. In 1955, the Imperial Bank of India was reconstituted as the State Bank of India and converted into a purely commercial bank. In 1959-60, the State Bank of India took over the seven provincial banks as its subsidiaries. Many small banks were also merged with the State Bank of India.

2.2.2 Nationalization of Banks. The nationalization of 14 major commercial banks was the beginning of a revolution in the field of Indian Banking. It was different from nationalization of the Reserve Bank of India (RBI) in 1949 and nationalization of the Imperial Bank in 1955, as these were having very little socio-economic impact compared to the changes brought in 1969. The rationale behind the nationalization of banks by the Government of India was explained by the then Prime Minister Mrs. Indira Gandhi in her speech on the eve of nationalization. She said, "while the nation is committed to establish a socialist pattern of society, the Government felt that the public ownership and control of the commanding height of the national economy and of its strategic sectors were essential and important aspects of the new social order which we are trying to build. As the financial institutions are amongst the most important levers for the achievement of its social objectives, the nationalization of peoples' savings and canalizing them toward productive purposes, the Government felt that the public ownership of the major banks will help in the most effective mobilization and
With the social objective, fourteen leading commercial banks were nationalized on July 19, 1969. After a lapse of more than ten years of the first phase of nationalization of banks, on April 15, 1980, six more banks were nationalized in the second phase of nationalization. The list of these banks is given in the list 2.1. The New Bank of India was later merged with the Punjab National Bank in 1993. The IDBI Bank got the status of a commercial bank in the year 2004 and categorized as Other Public Sector Bank by the RBI. Thus, there are 28 public sector banks, which include State Bank of India and its seven subsidiaries, 19 nationalized banks and IDBI bank under the category of other bank.

<table>
<thead>
<tr>
<th>1st Phase</th>
<th>2nd Phase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Allahabad Bank</td>
<td>1. Andhra Bank</td>
</tr>
<tr>
<td>2. Bank of Baroda</td>
<td>2. Corporation Bank</td>
</tr>
<tr>
<td>3. Bank of India</td>
<td>3. New Bank of India</td>
</tr>
<tr>
<td>5. Canara Bank</td>
<td>5. Punjab and Sind Bank</td>
</tr>
<tr>
<td>7. Dena Bank</td>
<td></td>
</tr>
<tr>
<td>8. Indian Bank</td>
<td></td>
</tr>
<tr>
<td>9. Indian Overseas Bank</td>
<td></td>
</tr>
<tr>
<td>10. Punjab National Bank</td>
<td></td>
</tr>
<tr>
<td>11. Syndicate Bank</td>
<td></td>
</tr>
<tr>
<td>12. Union Bank of India</td>
<td></td>
</tr>
<tr>
<td>13. United Bank of India</td>
<td></td>
</tr>
<tr>
<td>14. United Commercial Bank</td>
<td></td>
</tr>
</tbody>
</table>
2.3 STRUCTURE OF BANKING SYSTEM IN INDIA

2.3.1 Constituents. The constituents of the present banking system in India are of varying origin and sizes. At the apex is the Reserve Bank of India, the central bank of the country which regulates the banking system in India. The Reserve Bank of India is followed by State Bank of India which was created in the year 1955 by nationalizing the Imperial Bank of India, seven subsidiaries of the State Bank of India, 19 major nationalized banks, private sector banks, foreign banks, cooperative banks and Regional Rural Banks. The banks can be grouped as scheduled and non-scheduled banks.

2.3.2 Scheduled Banks. A scheduled bank is one, which is registered, in the second schedule of the Reserve Bank of India. The following conditions must be fulfilled by a commercial bank for inclusion in the schedule.

1. The banker concerned must be in business of banking in India;
2. It is either a company defined in Section 3 of the Indian Companies Act 1956, or corporation or a company incorporated by or under any law in force in any place outside India or an institution notified by the Central Government in this behalf;
3. It must have paid-up capital and reserves of an aggregate real exchangeable value of not less than rupees five lakhs;
4. It must satisfy the Reserve Bank of India that its affairs are not conducted in a manner detrimental to the interests of its depositors.
Schedule banks are under the purview of the various credit control measures of the RBI. They are required to maintain a certain minimum balance in their accounts with RBI and do certain things prescribed by the RBI. They also enjoy certain privileges from the RBI such as refinancing facilities, clearance facilities etc.

2.3.3 Non-Scheduled Banks. Banks that are not included in the second schedule of the RBI are known as non-scheduled banks. They may be classified into four groups:

1. Banks with paid-up capital and reserves in excess of Rs. 5 lakhs.
2. Banks with paid-up capital and reserves ranging between Rs. 50,000 and one lakh rupees.
3. Banks with paid-up capital and reserves ranging between one lakh of rupees and five lakhs.
4. Banks with paid-up capital and reserves below Rs. 50,000.

Non-scheduled banks are not entitled to all the facilities that the scheduled banks avail from the RBI.

2.4 SECTOR-WISE CLASSIFICATION

The Indian commercial banks can be classified into:

(a) Public Sector Banks,
(b) Private Sector Banks and
(c) Foreign Banks.
2.4.1 Public Sector Banks. The public sector banks include State Bank of India, its subsidiaries, nationalized banks and IDBI Bank. Thus, there are 28 public sector banks at present. State Bank of India is the biggest commercial bank in the country. It was originally established in 1806 when the Bank of Calcutta (latter called Bank of Bengal) was established, and then amalgamated as the imperial bank of India after merger with the Bank of Madras and the Bank of Bombay. The share of Imperial Bank was sold to the Reserve Bank of India and thus it came into existence on July 1, 1955 under the State Bank of India Act 1955. The State Bank of India has played an important role in extending credit facilities to cooperative undertakings, self-employed professionals, and small-scale and cottage industries. The central government nationalized other state banks functioning in different states and made them subsidiaries of the State Bank of India. At present State Bank of India have seven subsidiaries. These are (1) State Bank of Bikanir, (2) State Bank of Hyderabad, (3) State Bank of Indore, (4) State Bank of Mysore, (5) State Bank of Saurashtra, (6) State Bank of Patiala and (7) State Bank of Travancore. The SBI and its associate banks have a network of 15,814 branches throughout the country as on March 2008. SBI and its associates account for 20.1 percent of total bank branches.

Nationalized banks refer to the private sector banks that were nationalized in two phases. In the first phase of nationalization, 14 private sector banks were nationalized in the year 1969 and in the second phase 8 more private sector banks
Table 2.2

Number of Branches of Scheduled Commercial Banks

<table>
<thead>
<tr>
<th>Bank Groups</th>
<th>Number of Offices as on the last day of</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Bank of India &amp; Associates</td>
<td>2,462</td>
</tr>
<tr>
<td></td>
<td>(30.6)</td>
</tr>
<tr>
<td>Nationalized Banks</td>
<td>4,553</td>
</tr>
<tr>
<td></td>
<td>(56.6)</td>
</tr>
<tr>
<td>Regional Rural Banks</td>
<td>NA</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Private Sector Banks</td>
<td>900</td>
</tr>
<tr>
<td></td>
<td>(11.2)</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>130</td>
</tr>
<tr>
<td></td>
<td>(1.6)</td>
</tr>
<tr>
<td>Total</td>
<td>8,045</td>
</tr>
<tr>
<td></td>
<td>(100)</td>
</tr>
</tbody>
</table>

Figures in parentheses show the percentage to the total.

(Source: Banking Statistical Returns- various issues and Statistical Tables Relating to Banks: 2008-09, RBI)

were nationalized by the Central Government. Later, Punjab National Bank was merged with the New Bank of India in the year 1993. Thus, there are 19 nationalized banks. The IDBI Bank got the status of a commercial bank in the year 2004 and categorized as Other Public Sector Bank by the RBI. The nationalized banks including IDBI Bank had a network of 39,204 branches (which is about 50 percent of the total) as on 31st March 2008 throughout the country as shown in Table 2.2. All the public sector banks (28) are notified as scheduled commercial banks by the Central government of India. Regional Rural Banks account for 19 percent of the total bank branches with only 4 percent of total assets of scheduled commercial banks.
2.4.2 Private Sector Banks. The private sector banks include both scheduled commercial banks and non-scheduled commercial banks. These banks perform the same functions as performed by other commercial banks and follow the regulations framed by the RBI. Private sector banks are further classified into old private sector banks and new private sector banks that emerged after 1991. There were 17 old private sector banks and 8 new private sector banks as on 31st March 2008. These banks have a network of 8,294 branches that accounts for 10.5 percent of the total.

2.4.3 Foreign Banks. Foreign banks also undertake usual banking business in addition to foreign exchange transactions. Foreign scheduled commercial banks are regarded under the second schedule of RBI but have their registered offices outside India. These banks have played a prominent role in India’s foreign trade until the Second World War. Since then, a number of leading Indian banks also entered into the field of foreign exchange. Similarly, foreign banks have also entered in the field of internal trade and started competing with Indian commercial banks in attracting deposits, discounting bills and making advances to trade and industry. There were 29 foreign banks with 279 branches in India as on March 2008.
A redeeming feature of the banking system in India is that despite the slump in the number of banks, there has been a considerable increase in the number of bank branches. The number of bank branches as shown in Table 2.3 stood at 8,262 as on 30th June 1969 and it went up to 78,666 as on 31st March 2008. Consequently, the average population per bank branch has been reduced from 64,000 to 14,000.

An important fact is that public sector banks account for 89 percent of total commercial banks while SBI and Associates account for about 20 percent and nationalized banks account for about 50 percent of all commercial banks. This shows the importance and role of commercial public sector banks in India.

### Table 2.3

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural</td>
<td>1,833</td>
<td>35,206</td>
<td>32,878</td>
<td>31,105</td>
</tr>
<tr>
<td></td>
<td>(22.2)</td>
<td>(58.5)</td>
<td>(51.2)</td>
<td>(39.5)</td>
</tr>
<tr>
<td>Semi-urban</td>
<td>3,342</td>
<td>11,344</td>
<td>13,980</td>
<td>17,897</td>
</tr>
<tr>
<td></td>
<td>(40.4)</td>
<td>(18.8)</td>
<td>(21.8)</td>
<td>(22.8)</td>
</tr>
<tr>
<td>Urban</td>
<td>1,584</td>
<td>8,046</td>
<td>9,597</td>
<td>15,530</td>
</tr>
<tr>
<td></td>
<td>(19.2)</td>
<td>(13.4)</td>
<td>(14.9)</td>
<td>(19.7)</td>
</tr>
<tr>
<td>Metropolitan</td>
<td>1,503</td>
<td>5,624</td>
<td>7,763</td>
<td>14,134</td>
</tr>
<tr>
<td></td>
<td>(18.2)</td>
<td>(9.3)</td>
<td>(12.1)</td>
<td>(18.0)</td>
</tr>
<tr>
<td>Total</td>
<td>8,262</td>
<td>60,220</td>
<td>64,218</td>
<td>78,666</td>
</tr>
<tr>
<td></td>
<td>(100)</td>
<td>(100)</td>
<td>(100)</td>
<td>(100)</td>
</tr>
<tr>
<td>Population per branch (in thousands)</td>
<td>64</td>
<td>14</td>
<td>15</td>
<td>14</td>
</tr>
</tbody>
</table>

Note: Figures in parentheses show percentage of total distribution.
The thrust of banking expansion after nationalization has mostly been into unbanked centres, keeping in view the need for rural development and removal of regional imbalances. From Table 2.3, it can be seen that as on June 30, 1969, rural areas had 22.2 percent, semi-urban had 40.4 percent, urban had 19.2 percent and metropolitan had 18.2 percent of distribution of bank branches and the same stood at 39.5 percent, 22.8 percent, 19.7 percent and 18 percent for rural, semi-urban, urban and metropolitan respectively as on 31st March 2008. This indicates the concentration of bank branches in rural areas.

2.6 GROWTH OF BANK DEPOSITS AND CREDITS

Expansion of deposits has been an important feature in the past. Planned economic development, deficit financing and increased currency issue have led to increase in bank deposits. At the same time banks have contributed a lot in mobilizing savings through publicity and service. The deposits and credits of the scheduled commercial banks in India during 1969 to 2008 are shown in the Table 2.4, which show the direction of growth of Indian banking in terms of deposits and credits. Deposits of the scheduled commercial banks of India have a tremendous growth over these periods. Deposits have gone up to Rs.31,96,939 crores in the year 2008 from Rs. 4,646 crores in the year 1969 registering an annual growth rate of 18.24 percent. Per-capita deposits have also increased during this period as shown in the Table 2.4. Similarly, credits and per-capita credits have also increased during the period. Credits have registered an annual growth of 18.10 percent. These
indicate role played by commercial banks in mobilizing the deposits and channeling those into productive sectors. The credit deposit ratios have been also increasing since 1998 and stood at 73.9 percent in the year 2008.

Table 2.4

Deposits and Credits of Scheduled Commercial Banks in India

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposits (Rs. in Crores)</td>
<td>4,646</td>
<td>2,01,199</td>
<td>5,98,485</td>
<td>31,96,939</td>
</tr>
<tr>
<td>Per-capita Deposits (Rs.)</td>
<td>88</td>
<td>2,368</td>
<td>6,170</td>
<td>28,327</td>
</tr>
<tr>
<td>Credits (Rs. in Crores)</td>
<td>3,599</td>
<td>1,21,865</td>
<td>3,24,079</td>
<td>23,61,914</td>
</tr>
<tr>
<td>Per-capita Credits (Rs.)</td>
<td>68</td>
<td>1,434</td>
<td>3,356</td>
<td>20,928</td>
</tr>
<tr>
<td>Advances to Priority Sector (Rs. in Crores)</td>
<td>504</td>
<td>44,572</td>
<td>1,08,905</td>
<td>8,24,773</td>
</tr>
<tr>
<td>Credit-Deposit Ratio</td>
<td>77.5</td>
<td>60.6</td>
<td>54.2</td>
<td>73.9</td>
</tr>
</tbody>
</table>

(Source: RBI: Basic Statistical Returns of the Scheduled Commercial Banks in India 1997, 2000 and 2008 issues)

2.7 BANKING SECTOR REFORMS

2.7.1 Background. After independence in 1947, the Government felt that loans extended by colonial banks were biased toward working capital for trade and large firms (Joshi and Little, 1996). It was also perceived that bank should play greater role in the implementation of the planned development strategy by mobilizing financial resources for strategically important sectors. With this view, all large private sector banks were nationalized as discussed earlier. The
nationalized banks, State Bank and its associates together known as public sector banks, were found to dominating in the field of banking in terms of asset holding, business and branch network. Although non-nationalized private sector banks and foreign banks were allowed to coexist at that time, their activities were highly restricted through entry restrictions and strict branch licensing policy. Thus, their activities remained negligible.

During the period 1969-91, banking sector registered remarkable growth in the branch expansion, mobilization of deposits and extension of credits. However, many banks remained unprofitable, inefficient and unsound owing to their poor lending strategies and lack of internal risk management under government ownership (Shirai et al., 2002). Major factors that contributed to the deteriorating bank performance were found to be: (1) stringent reserve and liquidity requirements; (2) low yield on government bonds as compared to the commercial advances; (3) directed and concessional lending; (4) regulated interest rates; and (5) lack of competition.

Against this background, the financial liberalization took place in the second half of the 1980s and the Government of India set up the Committee on Financial System under the chairmanship of M. Narasimham in the year 1991 to examine all aspects relating to structure, organization and functioning of the Indian financial system. The second phase of bank reform came with the recommendations made by M. Narasimham in the Report of the Committee on Banking Sector Reforms.
2.7.2 Banking Sector Reforms: First Phase. In August 1991, the Government of India appointed a committee to review the financial system under the Chairmanship of Sri M Narasimham, former Governor of the Reserve Bank of India to examine all aspects relating to the structure, organization and functioning of the financial system. The Committee’s report was tabled in Parliament on December 17, 1991. The committee had approached the task of financial sector reform by placing emphasis on the steps needed to improve the financial health of banks and development financial institutions to make them viable and efficient in order to serve the emerging needs and enhance the competitive efficiency of the real sector. The committee suggested several policy and structural changes designed to enhance competitive efficiency, productivity and profitability of the financial system and enhance flexibility and autonomy in the functioning of banks and Development Financial Institutions (DFIs). The major recommendations of the committee were the following:

i. Phased reduction of Statutory Liquidity Ratio (SLR) to 25 per cent over a period of five years.

ii. Progressive reduction in Cash Reserve Ratio (CRR).

iii. Phasing out of directed credit programmes and redefinition of the priority sector.

iv. Deregulation of interest rates so as to reflect emerging market conditions.
v. Stipulation of minimum capital adequacy ratio of 4 per cent to risk weighted assets by March 1993, 8 per cent by March 1996, and 8 per cent by those banks having international operations by March 1994.

vi. Adoption of uniform accounting practices in regard to income recognition, asset classification and provisioning against bad and doubtful debts.

vii. Imparting transparency to bank balance sheets and making full disclosures.

viii. Setting up of special tribunals to speed up the process of recovery of loans.

ix. Setting up of Asset Reconstruction Fund (ARF) to take over from banks a portion of their bad and doubtful advances at a discount.

x. Restructuring of the Banking System so as to have three or four large banks which could become international in character, 8 to 10 national banks and local banks confined to specific regions and rural banks including Regional Rural Banks (RRBs) confined to rural areas.

xi. Setting up one or more rural banking subsidiaries by public sector banks.

xii. Permitting RRBs to engage in all types of banking business.

xiii. Abolition of branch licensing.

xiv. Liberalising the policy with regard to allowing foreign banks to open offices in India.

xv. Rationalisation of foreign operations of Indian Banks.
xvi. Giving freedom to individual banks to recruit officers.

xvii. Inspection by supervisory authorities based essentially on the internal audit and inspection reports.

xviii. Ending duality of control over banking system by Banking division and RBI.

xix. A separate authority for supervision of banks and financial institutions which would be a semi-autonomous body under RBI.

xx. A revised procedure for selection of Chief Executives and Directors on Boards of Public Sector Banks.

xxi. Segregation of direct lending functions of IDBI to a separate institution.

xxii. Obtaining resources from the market on competitive terms by DFIS.

xxiii. Speedy liberalisation of capital market by removing restrictions on premium dispensing with prior government approval, etc.

xxiv. Supervision of merchant banks, mutual funds, leasing companies, etc., by separate agency to be set up by RBI and enactment of separate legislation providing appropriate framework for mutual funds and laying down prudential norms for such institutions.

The possible impact of these diverse recommendations can be analyzed as follow.

a. The lowering of reserve rates will enable banks to enlarge their credit portfolio thus improving their profits.
b. Relaxation of regulations with respect to licensing will enable banks to open branches in potential centres freely and as an incentive for better performance.

c. Deregulation of interest rates will enable a competitive environment to grow and provide for efficiency of the Banking System.

d. Effective supervision of the Banking System through off-site surveillance and on-site supervision through the new wing of the Reserve Bank of India under Department of Supervision.

e. Prudential Norms to enable a better and transparent accounting system for the banks.

f. Setting up of recovery tribunals will help to reduce the non-performing assets in the banking system.

g. Capital Adequacy Measures will strengthen the banking system.

In short, the recommendations are aimed at strengthening the banking system so as to enable it to take on its foreign counterparts ably in the wake of increasing globalisation and integration with the world economy. Many of the recommendations of the report have been accepted and implemented. Some have not been accepted and some implemented with modifications. Among these are the reductions in SLR/CRR, adoption of prudential norms for asset classification and provisions, introduction of capital adequacy norms and deregulation of most of the interest rates.
2.7.3 Banking Sector Reforms: Second Phase (Narasimham Committee - II). The “Committee on Banking Sector Reforms” was appointed by Central Government and was headed by Shri M. Narasimham. This Committee submitted its report on 23rd April 1998. The committee made the following recommendations.

1. **Three Tier Banking**: There should be three types of banks: (i) Two or three large Indian Banks with international character; (ii) Eight or Ten large National Banks to take care of the needs of large/medium corporate sector, and (iii) Large or Local Area/Regional Banks to serve local trade, small industry and agriculture.

2. **Universal Banking**: The distinction between Development Finance Institutions and commercial banks should disappear paving the way for universal banking. DFIs should also give working capital finance while commercial banks term loans.

3. **Narrow Banking**: Weak banks whose accumulated losses and net non-performing assets exceed their capital funds can be rehabilitated by branding them as “Narrow Banks” (banks which restrict their operation to only certain activities).

4. **Mergers**: Merger among the banks to be encouraged especially among the strong banks to obtain “Force Multiplier Effect”.

5. **Govt. Holding in Banks**: Govt. holding in banks should be reduced to 33%. The government should not disinvest its capital. The capital should
be increased by market subscription to bring down the government holding to 33%.

6. **Capital Adequacy Requirement**: The Capital Adequacy ratio should be increased from existing 8% to 9% by 2000 AD. And to 10% by 2002. The start up capital for new private banks is increased.

7. **Asset Classification**: An account should be classified as Non Performing Asset (NPA) if interest or installment is not serviced for a period of 90 days.

8. **Provision Requirement**: Banks should make general provision of 1% on their standard assets.

9. **Directed Credit**: The directed credit should also encompass other areas of credit like food processing, fisheries, dairy, etc.

10. **Autonomy to Banks**: Functional autonomy should be given to the banks. The appointment of M.D./Chairman should be left to the Board of the banks.

11. **Recruitment Policy**: The recruitment procedure and remuneration policies should be changed to attract specialized officers.

12. **Other Recommendation**:

   a. To revamp existing banking laws, particularly RBI Act, Banking Regulation Act, Sick Industries and Companies Act, etc;
   
   b. Setting up of Asset Reconstruction Fund (ARF) for bank NPAs;
   
   c. Segregating regulatory & supervisory function of RBI;
d. RBI should become a regulator and maintain arms length from banks. There should be no RBI nominee in Boards of Banks;
e. Autonomy Status for Board for Financial Supervision;
f. Professionalisation of Bank Boards; and
g. Thrust on technology up-gradation.

2.8 SUMMARY

Commercial banks play a very important role in the economy of a country as they create money by pooling savings in form of deposits and lending for better uses; facilitates payment mechanism; and provide a variety of services. Commercial banks in India, in its modern form, exist since 1770 but got momentum after the nationalization of banks that took place in the year 1969. Thereafter, banking sector had gone through many reform measures. However, it was found that the financial performance of most of the banks deteriorated. To strengthen the banking sector as a whole, reform measures were recommended by M.Narasimham in 1991 and 1998 in phased manner.
REFERENCES


