CHAPTER II

Emergence of Banking System.

1. Historical development of banking Industry.

2. Banking an individual urge or and a state responsibility.

3. Banking a traditional out come of Economic development.


5. Unification and polarization of banking potential.
1. HISTORICAL DEVELOPMENT OF BANKING INDUSTRY.

Banking in India is of an ancient origin. It has gone through various stages of evolution and development since the Vedic times (2000 to 1400 B.C.) When the money lending business was quite prosperous. Pledging, commenced around the Buddhist era (500 B.C.) and deposit banking, in the second and third centuries A.D. There is a mention of the Indigenous banking that has been mentioned in the laws of Manu. Since the time of the Vedas the banker has been an indispensable pillar of Indian society. Banking has known and practiced in India as a time when the rest of the world had yet to evolve a medium of exchange in the form of money. This fact is a fair evidence to show that Indians were quite familiar with the business of banking much before it came into use in the west. The banker, first in the form of money lenders, followed by indigenous bankers, and later on as commercial banks have been playing a decisive role in the economic life of our country. So significant has been their contribution in the service of mankind, that their impact has been felt in almost every conceivable activity of man. Their contribution in financing schemes of the Government during war and peace, for culture, and for trade, commerce and industries.
According to Crowther "The Bankers, had two other ancestors, one was the money-lender and another was the gold-smith". A money-lender is one, who advances credit to his customers, day-in and day-out, while a banker implies any individual or private firm which in addition to providing loans, either receives deposits, or deals in Hundi, or both, grants loans for trade and Industry. The money lender finances mainly for consumption. According to the Central Banking Inquiry Committee reports, "opinions regarding these bankers are divided, some consider them as wholly abominable, and unscrupulous usurers, a land grabber, the fametor of factions called him the cultivator's friend, the traditional guardian of his property, an ever present help in time of trouble."

Indigenous bankers who were popularly known as Seths, adequately financed the requirement of production, trade and commerce. They have been the main source of finance for industry and agriculture. Indian banking was, in no respect inferior to merchant banking in other parts of the world. The indigenous banker was the trusted custodian of the deposits of the people's royalty. They financed not only for the trade of the country but also filled the requirements of the royal
treasury. (These were the main source of finance for industries and agriculture in India.)

At present, the system of indigenous banking is an institution in itself with its excellent past regarding the respectability, resourcefulness and integrity of its members, their hereditary relations and ultimate present contacts with their customers and simple economical and popular ways of work.

But with the fall of the Mughal Empire, continuous wars and uncertain condition of life prevalent in those days marred their business. The advent of East India Company, which patronized the Agency Houses and Presidency banks had shown much of the glory of the indigenous bankers. To adjust themselves to the new circumstances must, therefore, be as described not to their narrowness or conservatims but to the circumstances of the time. During the later part of the Eighteenth century, when the East India Company, was in power without responsibility most of the foreign trade passed out of the hands of the people. The inland trade also was monopolized by the servants of the company for a considerable time.

As a result of this the indigenous bankers
naturally lost their old predominance. It is a recognised fact that the indigenous bankers tried their best to adjust themselves to the new environment, but the difficulty before them was that at no cost East India Company wanted their survival, and the rigid attitude led to their ultimate decline.

The establishment of the Indian National Congress in 1885 had its impact on the growth of modern Indian banking. At the turn of the century, India had 20 banks, 3 presidency, 9 Indian and 8 foreign banks. The Swadeshi Movement gave fill-up to Indian business enterprises and this is in turn helped the growth of Indian banking. Quite a few banks that were launched in this period, are the leaders of our banking industry today. For nearly two centuries, the era was marked by all-in-all support of the requirements of a colonial economy. India owned commercial banks, specialized in financing agricultural produces, while the foreign banks confined their business to the financing of exports of primary goods to the United Kingdom and other industrialized nations. But the commercial banks could not get success to replace money lenders into banking. The money lender who was an oasis in the desert of finance in the rural sector, financed mostly through
money lending and dis-counting of hundies. Thus the usurious practices of the indigenous agencies and associated therewith continued to corrode the static economy, with the banks un-willingly contributing to their preservation.

During the Second World War Indian banking registered a note-worthy progress from 1938 to 1945. The number of commercial banks increased from 180 to over 700, after independence.

The war time growth came to an end in 1949 and the ship of India's economic advancement had to pass through several strains and stresses and face many road-blocks and pit-falls during this decade (1950-60).

During 1950 to 1960 the planned development, deficit financing of a very high magnitude was resorted and a tremendous investment both in the public and private sectors were made. Currency, in circulation accelerated to a great extent and the bulk of credit also greatly stepped up.

By 1951 the number of banks were reduced by over one hundred and deposits diminished to Rs.908 crores. The former development was largely due to the fact that
127 companies were declared as non-banking companies since March 1949, when the Banking Companies Act (now Banking Regulation Act) came into operation.

The process of strengthening the banking system through transfers of assets and liabilities voluntary amalgamation and compulsory mergers were done which helped to nationalize the branch structure of the banks and thereby led to a considerable economy in operation.

In the modern commercial age, money is the pivot around which the whole economy revolves, and the "money economy" could not do without the institution of banking for any considerable time. Banking methods might have been changed but throughout Indian history bankers as a class, have enjoyed great honour and their influence on social life has been phenomenal.
2. BANKING AN INDIVIDUAL URGE OR STATE RESPONSIBILITY.

Development of banking has been an ancient feature of India. The process of this development has been rather slow because of the people's urge and confidence in banking takes time. The pace of development cannot be matched with the pace for the need of advancement. It means that the State alone is responsible for the slow rate of the development. People's inner desire is very important for banking advancement. The individual urge is the first stage of the development through which human desire prefers the use of banking machinery for their economic development. Individual urge means an inner drive or impulse or intention to do certain acts in a specific manner to achieve the desired goal. In this sense the function of self motivation is called individual urge. Self motivation is that which inspires oneself to fill any desire. Therefore, it is said that individual urge is related with desire for security in terms of economic, social and spiritual one and desire for response in terms of companionship, social mindedness, confidence and desire for new experience and terms of adventures, new interest and new ways of doing the existing practices. Therefore, it is worth-while to
analyze that felt and unfelt need of an individual which accelerate the self-motivation process, through satisfaction of such needs. While introducing a new concept or a new technology in the form of Banking, is the most important consideration. It is the satisfaction of felt needs of banking of an individual. Each individual is placed at one of the hierarchy levels and for motivating him/her, one has to identify the specific need satisfaction for favourable acceptance of the new technology to be introduced. Banking as an important innovation in the economic region has the characteristic to satisfy individual desire for security, for response and for new experience. Therefore, it is the self-motivation which induces, one to use the banking. As an individual finds many facilities through banks like deposits, cheques, travelling cheques and other many more facilities, one likes to get involved in banking functions. At that time when there were no banking facilities, people faced many difficulties to keep money secure. Therefore, it was, the inner feeling of an individual to participate in the banking function.

Banking, on the other hand, is the instrument which deals with public money and is run only on those conditions where people desire it and take benefit
through it. Bank is that factor, which fascinates people to participate in various function, besides it is a tool of the country’s development, as all the economic activities revolve around the banks. Therefore, the Government also shares the responsibility for more production and development (our country is predominantly an agricultural country). Therefore, most of the people live in rural areas. Banks and state both are responsible to make them involve in banking functions, share or participate in the banking system. The work of the economic growth will be half-done if the rural people do not take part in banking functions. The state and banking policy provide inspiration to them to participate in banks. The history of developed nations is a guide-line which evokes state responsibility to accelerate the pace of banking development in a developing country. It not only gives greater confidence to the masses but also incites people’s urges in much greater dimensions. If the individual urge is combined with the state responsibility it becomes a perfect technique for advancement. This is the combination of man and material at command, this can be used as the advanced technology for banking. It is important to note that either of them cannot flourish without the help of
each other. India's mixed economy also helps to undertake, to combine the individual and the state in the joint venture, so as to attain inter-dependence of economic and a social system for the acceleration and the pace of the development of our economy in conformity with the techniques available outside the country.

Confidence of the masses is an important factor in participating banking function. It is the grass root that can be quite emerged of policy making and the result oriented. As such we can state, that the individual urge and the state responsibility both function as the wheels of the carriage to catch the speed of economic development. People of the nation can be expected to create the will and determination in larger interest of the society. This has to be supplemented by the state authority in the shape of the state responsibility so as to give a much greater dimension in developing economy. Banking Industry in India is one of the most influential enterprise which combines urban and rural masses together and undertake collective responsibility of rural and urban industry. The power potential is both in the possession of the state and the individual which forms the actual force of the economy of the country. The greater the
participation between them, the greater is the pact of the development of the banking industry. It can be only through the individual in the collective way which can mobilize state responsibility for the development of the banking industry. This is a very important part of the banking management so as to combine individual urge with state responsibility in the emergence of the banking industry. This is a sort of direct or indirect methodology in the working and an enterprise like banking industry, even the import and export of working technology requires complete harmony and understanding between the state and the people for the greater participation by each other. Such a methodology gives maximum success and avoids risks in a competitive economy.
3. BANKING A TRADITIONAL OUT-COME OF ECONOMIC DEVELOPMENT.

Banking activity which is known as an industry does not act as a manufacturing industry. Business of Banking, is in truth, only a public service. It produces funds for trade and Industry and plays a vital role in the economic and financial condition of the country. In India banking service has been rendered by several agencies. There have always been indigenous bankers, like, individuals, families or firms who from the very early times have been rendering such services to the agriculturists and merchants. The money lenders have been following their vocation for centuries, with close and informal relations between the lenders and the borrowers. The financial demand of rural people was completely met by those money lenders. It has been a very effective financial agency in the rural region in our country. Though the money lender has his dark side, yet he has fulfilled a definite purpose in our rural economy.

Indigenous banking was another feature which existed in olden days. These comprise with heterogeneous class of working people. They have generally been
combined, banking with trading on commission business. The contribution of indigenous bank as a whole to the supply of finance was substantially large. The business of finance was about 75 to 90% of the total internal trade of the country. This was a credit agency. Indigenous bankers occupy a position of considerable importance in the country's economy and economic development.

This past history clearly indicated that banking system in our economy always remained in existence. These banks were known as effective tools of economy. People were generally self-reliant till they require money from them but for the productive and un-productive purposes. As close financial agencies money lenders came into the way for the help of people and indigenous banks worked efficiently for urban areas. The internal trade in our country was very wide and it fulfilled the consumer requirements. Some commodities were very famous abroad, on their demand these commodities were exported to their countries.

The success behind this development was much related to financial agencies. Though money lenders have always been black-listed due to their mischievous
activities but they have functioned successfully as a financial agency for the development of economy. Indigenous banks were much related to urban business. It provided money to the merchants.

In more recent times organised banking has taken up the same role to a large extent. Commercial banks are the chief characters to play the role as financial agent for the economic development of our country-men. It is common knowledge that commercial banking are providing facilities and credit to urban as well as to rural people. These banks have assumed developmental role for the social welfare and economic benefits. Moreover the banking Industry does not obtain spectacular and high profits as in certain manufacturing concerns ṣṣṣ. Industries ṣṣṣ in olden days money-lenders and indigenous banks used to get.

Commercial banks now play a more crucial role in accelerating the tempo of growth in a developing economy. At present commercial banks play a vital role compared to olden days. (The spreading business at international level is also governed through banking). In fact banks, now, are the mark of the nation, the nerve centre of economics and finance of a nation and
the barometer of its economic prosperity. The commercial banks mobilize the people's saving and divert them into productive channels. It is through these functions that they serve as the index of commercial, Industrial and financial stability and growth of a nation.

As soon as the society got changed from ancient to modern, the commercial banks influenced the economy in a greater amount. Entrance of the East India Company made a revolution in our economic world. Agency houses operated the functions of commercial banking. The banks in Madras, Bombay and Calcutta were opened. These were not the result of any forced phenomena, but as soon as economic requirements arose then the demand for financial help also increased. The industrial development and, diversion of people from rural to urban, cottage Industry to large Industry, prevailed to depend upon banking more pronounced. After Independence these banks are functioning successfully with their objective of welfare and economic development.

The nationalization of banks in 1969 was a turning point in the history of banking. The Socialistic pattern of society was the slogan given by the Indian government. The nationalization of banks could fulfill
the object of socio control. Nationalization of banks could maintain the balance in socio-economic structure which was going to decline.

Now the commercial banks have been organised in a sophisticated manner. The requirements of the society and industries are closely related as they both are in need of finance, and which is provided by banking institutions. Now the glamour for growth is increasing in the world. In our country, where we are only in the developing stage, we have to adopt the process of development of banking and according to our demand.

With the result of increasing economic development the banks must have a commercial outlook to keep pace with commercial development. For their own existence and solid foundation they require an increase in their own profit, income and objectives. As the industries depend upon the banks and vice-versa. Every unit of bank tries to win over the other for their business, tries to get the maximum profit to achieve their objectives for their profit as well to help in economy. Thus the Industry and banks are inter-linked. Each unit of bank tries to win over the other, with the result of this, economic development of the country depends very much on the
activities of banks, and banks have to look at the commercial out-look to keep pace with commercial development.
4. MASS PARTICIPATION OF PEOPLE IN BANKING INDUSTRY.

For Economic growth there should be adequate banking facilities. The surplus saving of the people may be utilized for promoting national development. The changing role of the banks in promoting saving, has been playing in developing economy. Mobilizing resources, and improving the quality of range of banking service in rural areas (the significant factor) through the credit flow. The banks in making millions of people thrift, is a concession of credit. It becomes necessary to plan the bank working in such a way that it may act as a pivotal instrument of planning and to involve people in the banking Industry. The banks should prepare the plan in this regard for the aim so as the urban and rural people both start taking interest in various functions of banks, which are provided to them. The extension of adequate and well managed banking facilities should command the confidence of the people. It is an essential factor for mobilizing people for the use of banks. Consequently it is said that saving and investment capital, are the significant functions which attract the people for their participation in banks.

In olden times the masses of the people used to go
for the finances to either money-lender or to indigenous bankers, therefore, the utilization of banks, is not a new one. The dark age comes in between and in the British period, banks came into existence which provided facilities of finances to people. After Independence several measures were taken to attract people for their participation in banks. Mass participation is meant for the large number of people, involved in banking functions. The expansion of the banking facilities requires immediate attention in view of the fact that the country has embarked upon economic planning to raise the living of the masses.

Organization extension of the banking system is a necessity for economic development and for the mass participation of people in banks. It is mostly realized when the flow of money is directed to banks. In order to popularize the banking functions, it provides many incentives to its consumers. The gift system, traveller cheques, cash certificates, high rate of interest, small saving scheme, draft and cheque encashment etc., in some way or other, people are related to these functions. In urban areas people cannot imagine living without banking, but in rural areas people still do not take benefit out of it. In rural areas banks are utilized
only for credit purpose. And as, the economic liberty, it is a pre-requisite for growth and no progress of the rural people is possible till the money-lender is out to a reasonable size. Crowther has stated regarding the rural credit, "The services, he performs are undoubtedly useful and necessary, even though the reward he extracts in return may usually be rapacious." Seeing all these situations, banks have been proving a successful competitive alternative of them. The bank's agencies, and a state aided agency, could do hard work on this matter.

In our country the organised banking sector covers only 30% to 50% people, the unorganized sector constitutes a powerful force and threat to the monetary balance. The impact of cash money will not promote the economic growth. Therefore, a strong step is needed to attract the people for bank facilities. Door to door services will promote the participation of people, the incentives like high rate of interest, income-tax exemption, immediate payment of credit, cheques, draft should be clear in lesser time and other schemes for the benefit of the consumer will raise the number of people participating in banks for one or for more purposes. However, the urban people are more
conscious about the banks they utilize, for various purposes but rural people still are not much awakened.

The larger number of people who may take more benefits through banks live in rural areas. The banks render their door services through mobile banks for rural people and deposit money. They may be expressed well all about the incentive which are given by banks. The advertisement will also promote the number of rural people for the use of banks. Co-operative banks are also working in this field.

In order to facilitate the people in large numbers regional banks should be opened. Such local or unit banks by utilizing the services of the larger national may increase the number of people. and medium regional banks. The first thing to be done is to list the total number of places requiring banking and in those places banks should be opened. facilities. Banks can do a lot of work regarding the assistance of government.

Full employment is a phenomena which is essential to obtain all round prosperity. The concept of full employment states the situation, where no individual in a country is un-employed. Government takes several steps to achieve it, through banks. The economic planning, Economic Committees, advisors and other learned persons
are rendering their services to make all the schemes and plans successful. Their working of-course cannot succeed without the help of banking, as banking is a major tool to implement the plan and get success through it. The monetary and financial policies of government are implemented through banks, such as 20-point Programme. The financial assistance are provided to poor persons under this programme through Banks.

Apart from physical factors some psychological factors are also required for increasing the number of people in banks. The good-will and confidence, are the base for gross creation of proper atmosphere. "Climate" is required to generating confidence, and goodwill. It is the pre_requisite for establishing a healthy banking system. Many factors are responsible to contribute the larger number of people to involve in banks. The standard of performance of business, technical knowledge, understanding and experience, the safety of banks etc. The most important factor is, the public notion towards banking business. This is one of the most unpredictable factor which is susceptible to all kinds of rumours and hear-saying. This uncertainty is greatly responsible for re-trading the growth and development of banking system. The doubt will loose the confidence of
public which is no vital for its success. The insurance of bank deposit is intended to give a measure of protection to depositors, in particular to small depositors.

It is argued that sick banks should be rehabilitated. The weak banks should be put on a sound footing. There is still, a change required for the working method.
The growing need of banking is an indication of economic development of our nation for the financial requirement. Its utility, objective and purpose are different in our country. Different people involve themselves in different vocations. Among them some require greater financial help while some require lesser. Some people need for a short period and some wish to take finance for a long term. These varieties of occupations may be classified in various categories. In our country the living of the people may be divided into two categories, one from regional point of view, which is rural based, another is urban based. Though heterogeneity of vocation is greater in urban areas but financial sector is stronger. The rural people are engaged either in agriculture or in small and cottage industry, partially or wholly. The media of financial agencies is also different in rural and urban areas. The existence of indigenous bankers are mainly in rural areas and banks are in urban regions. The working method and system of both are very different. The functions of money-lender are for their own interest, and for the same, they do not feel guilty to exploit the creditors.
The business of the indigenous bankers is generally a family concern and mainly they operate it with their own funds. They do not, as a rule attract deposits from their friends and relations. They grant loans against all kinds of securities such as gold, jewellery, land, promissory note, hundies, etc. They lend against the personal credit of the borrower to a much greater extent, than is done by the joint-stock banks. The indigenous bankers accept securities which would not be acceptable to the scheduled banks. They also buy and sell remittance bills and discount hundies. They finance the movement of crops from the villages to the mandi-centers and ports. They also purchase rural produce and act as the purchasing or distributing agents for the mandi firms.

The indigenous bankers still follow the traditional methods with regard to their banking business. They keep accounts according to the Mahajani system, and their principal instrument is the hundi or the internal bill of exchange drawn up in a flowery language carrying a high rate of interest ranging from 9 to 10%.

As the indigenous bankers rely principally on
their own funds, there is very little contact of indigenous bankers with the organised sector of the money market. When these bankers are hard pressed for money during the busy season they re-discount hundies with the commercial banks. In this way some funds flow from the organised sector to un-organised part of the money market. As they take a risk against the natural calamities, they charge a very high rate of interest and grant loans for short periods only.

The problem of reforming the indigenous financial system has been discussed for a long time by thinkers. A number of suggestions have been made from time to time. Yet no satisfactory solution has been arrived at. There are three main views on the future of indigenous banking. One school of thought believed, that it should be eliminated altogether as it is not in tune with the emerging economic structure of the country. The second school advocates, the establishment of direct lines with Reserve Bank of India so that indigenous banking can be given not merely a formal recognition but can be made to play a distinct role in the country's economic development. The third school would like this un-organised sector to be linked with commercial banking.
More and more experts have been advocating the third view.

It is argued that indigenous banking organised on traditional lines can hardly become an instrument of economic change. The process of emergence modern Industry, trade, organised banking in our country is a big challenge for these to adapt itself to the changing environment. With an ever-widening geographical and functional coverage of commercial and co-operative banks. The sphere of activity of indigenous banking has been shrinking continously. In view of high rate of interest, lack of ability and the absence of a proper image in public eyes, it is believed, they have to fight strongly for their survival.

The view that indigenous bankers have no alternative but to face and compete elimination, is exaggerated. There are certain factors which lead to think that despite the, rapid growth of co-operative credit institutions and commercial banks, the unorganised sector will have its place in the economy. With the increasing tempo of economic development the demand for credit from small borrowers has increased manifold or will increase further in future years. The
existing organised institutions will not be able to meet all the credit requirements of the small men. The type of banking services provided by in-digenous bankers is perhaps more suitable to meet the needs of small men. However, if indigenous banking is integrated with commercial banking it would help in weaning the former away from financing socially undesirable activities.

The Indian Central Banking Enquiry Committee had stressed the need for integrating the indigenous bankers who constitute the core of the un-organised money market with the organised money market and had recommended linking the in-digenous bankers with the Reserve Bank of India. The Reserve Bank of India has repeatedly tried to bring indigenous bankers within its fold but without much success. In persuance to the recommendations of the Indian Central Banking Enquiry Committee, the Reserve Bank of India prepared a scheme to include indigenous bankers doing banking business. In the second schedule to the Reserve Bank of India Act, 1934, the Reserve Bank suggested three conditions for their direct integration." (1) Shedding of non-banking business. (2) Maintenance of proper books of accounts and (3) Acceptance of the Reserve Bank Inspection and regulation of their banking business." On fulfillment of these
conditions, indigenous bankers were to receive the Reserve Bank privilege of re-discount, re-financing and remittance facilities as also the right to secure the advance against securities. These conditions were not acceptable to shroffs. Considering the fact that these banks played their part in the financial system of the country, the area of operation of them in an organised manner should be extended. The Reserve Bank of India should exercise indirect influence over the business of indigenous bankers through the agency of commercial banks, so that the function of organised sector may have impact upon the un-organised one.

The unification of organised and un-organisation banking sector influences our economic development. The growth of our economy remains inadequate if rural areas have not come into the influence of developing functions as the majority of the people still live in the rural areas. The demand and objective of rural people is different from urban. However, the banking potential is very much dependent on their demand and requirement. Apart from diversities the financial agencies can work effectively for the rural and urban people uniformly.

The organised sector of banking provides service
to rural and urban people. The rural banks do better in the rural areas. The consolidated work of banking, polarizes the banking potential. The system, ability of work, the nature of workers, and their tolerance can increase the banking potential. The urban people are aware of their requirements and economic use of finance. The banks are duty-bound for their efficient service. The rural people who are mostly illiterate cannot follow, the complexities of bank working. It is the legislation and the working method of banks which can attract rural people to use the banks for their economic purposes.

In the decades and at present, many programmes of branch expansion have been made to unify the rural and the urban sector and to polarize the banking potential, and a new dimension is to generate for the economic growth of our country.
FOOT NOTES


4. The bulletin of Reserve Bank of India, 1934.