2. HISTORY AND DEVELOPMENT OF BANKING SECTOR IN INDIA THROUGH THE YEARS

2.1 MEANING OF A BANK

There is no unanimity among scholars about the derivation of the word ‘Bank’. Some say it owes its origin to the French word, ‘banque’ which means bench. Others say that the Italian word, ‘banca’ (money changer’s counter) is the origin of word,’ ‘Bank’. There is still another group of people who believe that word bank has been derived from the Greek word ‘BANQUE’ which means a bench. In the olden days, Jews entered into money transactions sitting on benches in a marked place. When a banker was not in a position to meet obligations, the bench on which he was carrying on the money business was broken into pieces and he was taken as bankrupt. Thus both the words Bank and bankrupt are said to have origin from the word ‘Banque’. However, ‘banque’ seems to be the most plausible source of the modern word bank because in medieval Europe money changers used to display their coins on a bench. In the case of a failure of any medieval banker, the ‘banco’ or ‘banque’ was customarily broken and the person doing the business of money lending or money exchanging was declared ‘bankrupt’ literally broken bench.

According to section 5(b) of the Banking Regulation Act, 1949, which was the first state act enacted to control and regulate the activities of the banking companies, banking means, “Accepting for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise”. Other definitions used in Indian statutes are:

(a) A banker includes any person acting as a banker. (The Negotiable Instrument Act 1981, Sec.3)

(b) Any company or corporation carrying on the business of banker can be regarded as a banker or a bank. (Section 2(2) of the Banker’s Book Evidence Act.)

2)
According to Oxford English Dictionary, “A bank is an establishment for custody of money received from or on behalf of its customers. Its essential duty is the payment of the orders given on it by the customers; its profit is mainly from the investment of money left unused by them.”

According to Charles Woelfel’s Encyclopedia of Banking and Finance, “Bank is an organization engaged in any or all of the various functions of banking, i.e. receiving, collecting, transferring, paying, lending, investing, dealing, exchanging and servicing (safe deposit, custodianship, agency, trusteeship) money and have claims to money both domestically and internationally.”³

The term banking has been defined by Prof. Crowther as,” It is an institution which collects money from those who have it to spare who are saving it out of their income and lends this money out to those who require it”.

Different economists, banking professionals and authorities explained their viewpoint regarding bank. It has been rightly said by A.K. Basu that a general definition of a bank or banking is by no means easy, as the concepts of banking differ from age to age, and country to country. Further, it is not possible to make an exhaustive catalogue of its functions and services, as they deserve, varied, ever expanding and have wide ramifications. With the progress of civilization banking is assuming wide functions and greater responsibilities. It is said that a bank borrows money with one hand and lends with other. In analysis of this dual role of banking lies its true nature.⁴

2.1.1 Modern Banking

India is a vast country. Before 1947, undivided India was equal to Europe excluding Russia in its area. It is situated in south of Asia. Inspite of a part of Asia, it is separated from it. It is separated by Himalayas in North India. India has vast oceans in South, East and West. Due to its vastness a it is also called subcontinent. This vast country has been given different names in different times. In Vedic period, it was called ‘Arya-Varat’. In ancient period, it was called ‘Bharatvarash’. Perhaps due to fame of king Bharat, it was called Bharatvarash. Greek called it Indus on the name of
river Sindh. In the medieval period, it was called “Hindustan’ and Hind. European called it India. After Independence, it is called as Bharat Ganrajya or Republic of India.

Banking in the modern sense, was established in India with the setting up of three Presidency banks - the Bank of Bengal in 1806, the Bank of Bombay in 1840 and the Bank of Madras in 1843. These were successor to agency houses, which invariably combined banking with their commercial and trading activities and were floated by East India Company to facilitate the borrowings of the government and maintenance of credit. These presidency banks were amalgamated in January 1921 into the Imperial Bank of India. The motive behind it was to create a central bank in the country with the monopoly of note issue and which can serve as banker’s bank. By this time, a number of joint stock company banks had come to be established after the acceptance of limited liability in 1860. This year is, therefore, considered to be a landmark in the banking history of India, as it was only afterwards that some well known banks were established. ‘The Bank of Upper India’ in 1863, the ‘Allahabad Bank’ in 1865, the ‘Bangalore Bank’ in 1868, the ‘Alliance Bank of Simla’ in 1874 etc. Indian – managed joint stock banks also began to be floated, the first being the ‘Oudh Commercial Bank’ in 1881, followed by the ‘Panjab National Bank’ in 1894. Then the Swadeshi movement of 1906 gave rise to the ‘Bank of India’, the ‘Indian Bank’ at Madras, the ‘Central Bank of India’, the ‘Bank of Baroda’ and their likes.

The two world wars proved to be a boom to the banking industry when many large and small banks were established. A good proportion of them stood test of time and survived the subsequent crisis, especially the Great Economic Crash (1929-33). Though the RBI was established in 1935, much could not be done in respect of bank failures till the Banking Companies Act, 1949 was put on the statutes’ book in March 1949. The independence of the country, in August 1947 changed the whole approach towards commercial banking and the government came to recognize it as a positive instrument for faster economic development.\(^5\)

The post independence period had witnessed a great change of the Indian banking system. The first step taken in this direction was nationalization of Reserve Bank of
India in September 1948. The RBI is working as a Central Bank of the country. In order to have a sound and balanced growth in the banking business in the country, the Banking Regulation Act 1949 was passed. In 1955, Imperial bank of India was nationalized and renamed as State Bank of India. By 1959, eight Banks in the erstwhile princely states were also brought under the control and full or near full ownership of SBI. The SBI together with its subsidiaries is the largest commercial bank in India in terms of branch network, resources and manpower. Except SBI and SBI group, all other banks were working as private sector banks. There had been persistent complaints, particularly in the year 1960, that the banking system had not been discharging its function in consonance with the aims of our democratic socialism. It was also noticed that most of the commercial banks were concentrated in urban areas where the branches prove to be economically viable. Main stream banking in India was controlled by few industrialists and was catering to the need of a certain class of customers.

The scheme of social control was initiated by the government in December 1967 for more equitable and purposeful distribution of bank credit. On 19th July 1969, major Indian scheduled commercial banks, with a deposit of Rs. 50 crore or more, were nationalized. After 11 years of the first phase of banks nationalization, on 15th April 1980, six more banks were nationalized. This path breaking measures were taken to achieve the desire goal and economic objectives. The banking has emerged as an effective catalytic agent of socio-economic change.

2.1.2 Functions of a bank

A company is engaged in banking business if its primary job is receiving of deposits and lending or investing the same. Absence of any of these will not constitute the business of banking. Business of a bank, basically, is an exchange of rights against rights and of rights against money. Banking is essentially two way traffic. An institution which receives deposits but does not loan or which loans only but does not accept deposits may be anything but not a bank. A bank is a dealer in debts and this dealership is crucial and dominant part of banking business. Thus the essential function of a bank is two folds:
i. Acceptance of deposits

ii. Investments of funds

Section 8 of the Banking Regulation Act, 1949 prohibits a banking company from engaging in trading activities. Section 6 of the same act states that in addition to the business of banking as defined in Sec. 5(b), a banking company may engage in any one or more of the mentioned forms of business. Section 6 puts a maximum limit to various services that can be undertaken by a bank. Any act outside these permitted forms of business will be ultra virus.

Usual business: In terms of Sec. (6) a bank may deal in deposits and loan business, deal in negotiable instruments, deal in foreign currency, deal in shares securities and debentures, deal in safe custody and safe deposit business and deal in collection and remittance business. All these jobs are incidental to the banking fabric and are subject to directions and guidelines issued by the RBI from time to time. Banks are also called custodians of public money. Basically, the money is accepted as deposit for safekeeping. But since the banks use this money to earn interest from people who need money, banks share a part of this interest with the depositors. Lending money is one of the two major activities of any bank. In a way, bank acts as an intermediary between the people who have the money to lend and those who have the need for money to carry out business transactions.

Remittance Business: Apart from accepting deposits and lending money, banks also carry out, on behalf of their customers the act of transfer of money- both domestic and foreign- from one place to the other. This activity is known as ‘Remittance Business’. Banks issue Demand Drafts, Banker’s Cheques, and Pay Orders etc. for transferring the money. Banks also have the facility of quick transfer of money also known as Telegraphic Transfer or Tele cash orders.

Agency Business: Banks may also carry agency business on behalf of customers, government/semi government, authorities and institutions except acting as attorney on behalf of customers. Banks also act as trustees for various purposes.
Loans and Guarantees: It can also contract, negotiate and issue public as well as private loans. It may also carry on and transact every type of guarantee and indemnity business.

Property Business: It may manage, sale and realize any property obtained by it in settlement of its claims. It can also acquire, hold and deal with any property or any right, title or interest in any property placed with it as security for any loan or advance. It may also undertake the administration of estates as an executor.

Government Business: Earlier Government business used to be exclusively carried out by Government treasuries where all type of transactions took place. However, banks act on behalf of the government to accept its tax and non-tax receipts. Most of the government disbursements like pension payments and tax refunds also take place through banks. The banks carry out this business for a fee to be paid by the government and providing this service requires a lot of effort and organization.

Other Business: It can perform all such other things which are incidental to the promotion or advancement of the business of banking company. The central government has also reserved with it, the exclusive right to specify by notification in the official gazette, any other form of business, which is lawful for a company to carry on. The list of permitted business is very wide, comprehensive and covers both the accepted norms and practice of banking as is known to the modern world.

2.1.3 What a bank can not do?

Every bank in India is prohibited to do any business other than those defined in Sec.6 of the Banking Regulation Act, 1949. Banking is a very sensitive industry and no country can afford to allow banks to get engaged in trading and speculative activities. The Act also prohibits trading and speculative activities. Though banks trade in deposits and loans yet banks are not traders exchanging form of wealth or thriving on wages. They can neither engage in trading activities nor can undertake trading risks. Section 8 of the Act puts a particular prohibition on trading. It states that a banking company can not directly deal in buying or selling or selling or bartering of goods
except in connection with the realization of security given to it or held by it for a loan or engage in any trade or buy, sell or barter goods for otherwise than in connection with the bills of exchange received for collection or negotiation or with the undertaking of the administration of estates as executor, trustee or otherwise. A bank is not permitted to hold any immovable property, however, acquired, if it is not used by it for its own purposes, for a period of more than 12 years including the period of 5 years permitted by the RBI. However, an immovable property for its own use can be acquired and held on permanent basis as permitted under Section 6(I). There is a growing demand to permit banks to enter leasing business.6

2.2 ORIGIN OF BANKING IN INDIA

The origin of banking in India is very ancient. Historians say that banking activities were in prevalence during the Vedic period between 2000 and 1400 B.C. It is believed that the transition from money lending to banking must have occurred even before Manu, the great Hindu jurist, who has devoted a section of his work to deposits and advances and laid down rules relating to rates of interest. Banking functions like accepting deposits, granting loans against pledges and acting as the treasurer or banker to the king were being carried out during the second or third B.C. During the Mahabharata and Ramayana eras money lending flourished. The indigenous money lenders, who were known as Jagat Seths or Shahs were engaged in remittances of funds of commercial communities and in discounting Hundies. Between 1197 and 1247 AD, the Jain bankers from Ahmedabad are said to have financed the construction of ‘Dilwara temples’ near Mount Abu in Rajasthan by accepting Hundies. The famous French traveler J.B.Travernier, who came here during 17th century AD, has paid growing tributes to the Shroffs, who existed in every village acting as money changers and issuing Hundies. During the Mogul period, the indigenous bankers played a very important role in lending money and financing foreign trade and commerce. The Moguls gave encouragement to indigenous bankers and conferred titles of ‘Seths’ or ‘Jagat Seths’ on them. The Moguls had a distinguished coinage system and gold and silver coins were in circulation. Jagat Seths used to act as collection agents for state finances in times of need. It was only in time of Emperor Aurangzeb, who was a staunch Muslim that the indigenous banking received a setback because charging of interest by bankers was declared immoral.7
During the days of the East India Company, it was the turn of the agency houses to carry on the banking business. The General Bank of India was the first Joint Stock Bank to be established in 1786. The others which followed were the Bank of Hindustan and the Bengal Bank. The Bank of Hindustan is reported to have continued till 1906 while the other two failed in the meantime.

In the modern age, banking constitutes the fundamental basis of economic growth. The term bank is being used since long time but there is no clear conception regarding its beginning. According to one viewpoint, in good old days, Italian moneylenders were known as Banche or Banacheri, because they kept a special type of table to transact their business, called Banchi. Origin of the word bank belongs to the word Banchi or to the Greek word Banque. Both these words refer to some kind of banking. According to another viewpoint, bank originated from the German word Bank meaning Joint fund. Casa de San Giorgio was the first bank to be established in 1148. In simple words bank refers to an institution that deals in money. It accepts deposits from the people, gives loans to those who are in need, creates credit, and undertakes agency work.

To quote Bhabha, “Banking is the kingpin of the chariot of economic progress. As such its role in expanding economy of a country like India can neither be underestimated nor overlooked. The success of our plans, among other things, depends on the smooth and satisfactory performance of the role by banking industry of our country.” A healthy banking system is essential for any economy striving to achieve good health and yet remain stable in an increasingly global business environment. The Indian banking system, with one of the largest banking networks in the world, has witnessed a series of reforms over the past few years like the deregulation of interest rates, dilution of the government stake in public sectors banks, and the increased participation of private banks. Indian banks have not only been keen to tap the domestic market but also to compete in the global market place. In India though the money market is still characterized the existence of both the organized and unorganized segments, institutions in the organized money market have grown
significantly and are playing an important role amongst the institutions in the organized sector of the money market, commercial banks and commercial cooperative banks have been in existence for the past several decades. The Regional Rural Banks came into existence in the middle of seventies. Thus with the phenomenal geographical expansion of the commercial banks and the setting up of RRBs during the recent past, the organized sector of money market has penetrated into the rural areas as well. The banking system occupies an important place in a nation’s economy. It plays an important role in the economic development of a country and forms the core of money market in a developing country. Earlier the indigenous banks dominated the financial system. They financed to trade, industry and commerce. They offered financial services such as fund transfer, collected revenue on behalf of the government and as money changers.

The history of Indian Banking can be identified by three distinct phases as follows:

First phase: Early phase from 1786 to 1969 of Indian banks.
Second Phase: Nationalization of Indian Banks in 1969 to 1991 prior to Indian banking sector reforms.

2.2.1 First phase: Early phase from 1786 to 1969 of Indian banks

Banking in India originated in the first decade of 18th century with the establishment of The General Bank of India in 1786. After this Bank of Hindustan and Bengal bank were established. The General Bank of India and Bank of Hindustan are now defunct. The oldest bank in existence in India is the State Bank of India which was established as The Bank of Calcutta in Calcutta in June 1806. At that time, the banking activity took roots and prospered in Calcutta being the most active trading port due to the trade of British Empire. In the midst of 19th century, The East India Company set up three banks namely The Bank of Bengal in 1809, The Bank of Bombay in 1840 and Bank of Madras in 1843. The modern era of banking commenced with the establishment of these three banks. These banks were independent units and were
called as Presidency banks. These three were amalgamated in 1920 and a new bank, Imperial Bank of India was established. All these banks started as private shareholders banks and the shareholders were mostly Europeans. The first fully Indian owned bank was the Allahabad Bank set up in 1865. During this period, the banking sector had not been quite encouraging because of failure of banks, stagnant economic conditions, introduction of Currency Act 1861 and a decline in prices. The banking system progressed tremendously in the first half of this century. The deposits increased exponentially. The world wars contributed to raising the level of economic activity. The three presidency banks which were amalgamated to establish the Imperial Bank of India functioned as a quasi – central bank. The next bank to be set up was the Panjab National Bank Ltd., which was established with its headquarters at Lahore in 1894 for the first time exclusively by Indians. Most of the Indian commercial banks, however, owe their origin to the 20th century. Bank of India, Central Bank of India, Bank of Baroda, Canara bank, Indian Bank, and the Bank of Mysore were established between 1906 and 1913. The last major commercial bank to be set up in this phase was the United Commercial Bank in 1943. On the recommendations of Hilton Young Commission Reserve Bank of India was established in 1935 and Indian banking sector was formally regulated by it. The Imperial Bank was appointed as an agent to the RBI and it continued to act as such for other banks also. The establishment of this bank as the central bank of the country was an important step in the development of commercial banking in India. During the first phase the growth of banking in India was slow and banks also faced periodic failures between 1913 and 1948. At the time when the country became independent in 1947, the banking sector in India was relatively small and extremely weak and the public has lesser confidence in the banks. The banks were largely confined to urban areas, extending loans primarily to trading sector dealing with agriculture produce and banking services were not made available to agriculture sector, small industries, and self employed entrepreneurs and small traders. Deposit mobilization was slow. Banking services were not available at semi and semi- urban areas. The Government of India concerned by the frequent bank failures in the country which caused miseries to innumerable small investors and to streamline the functioning and activities of commercial banks, came up with the Banking Companies Act, 1949 which was later changed to Banking Regulation Act 1949 as per amended Act 1965 (Act No.23 of
The reserve Bank of India as the central banking authority was given extensive powers for controlling and supervising the banking activities. The following conclusions emerged with reference to the banking system in India during this first phase:

1. There was a high degree of concentration in the banking business.
2. The degree of concentration declined after 1935.
3. The smaller banks have emerged for providing banking facilities in the country.
4. The big banks have failed to tap the deposits.

The banking sector was unorganized during this phase. Comparable data on the liabilities and assets of various banks were not available. Various banks invested in different financial assets and there was no similarity in the portfolio of banks. Therefore the credit ratio was not balanced properly in the banking sector.

2.2.2. Second Phase: Nationalization of Indian Banks in 1969 to 1991 prior to Indian banking sector reforms

The financial system is a weapon to counter the poverty. It is a tool to build a good and strong economy. The financial system converts dreams into realities. The wealth of a country can only be constructed through a better financial system. It helps to increase the savings by offering better returns to the savers. It enhances the efficiency of a business concern which is reflected in the economic development. The financial system is complex and is closely connected with various aspects i.e. financial instruments, financial markets and financial services. At present the Indian economy has a highly diversified structure of financial institutions. Similarly a large number of new financial institutions have to be introduced to fulfill the needs of the dynamic corporate sector. Financial institutions are the active players in the capital market. These organizations provide long term loans on easy instalments to the corporate sector. They help in promoting new business enterprises expansion and diversification of existing companies. There was a strong need for the establishment of the financial institutions because a large number of organizations exist in the market.
Since independence, Indian banking has made a significant progress. Banking has occupied a significant status in the context of economic growth of our country. Before 1969, however, ownership and organizational structure of the banking was dominated by big industrialists for profit motive. As a result, there was little flow of credit to the rural and sub-urban areas. Priority sectors of the economy, viz. agriculture, small industries, export industries, and weaker sections of society like small artisans, traders, transporters etc., did not get sufficient credit. Commercial banks as they were privately owned, on regional basis resulted in the development of banking on ethnic and provincial basis with parochial outlook. These organizations did not play their due role in the planned development of the country. Deposit mobilization was slow. Even the available resources and deficient savings mobilized by commercial banks were not properly utilized for the development of the country.

The second phase was known as revolutionary phase, during which the banking sector made significant changes due to various reasons particularly the rapid changes in political scenario which has shown its impact on the functioning of the banking system. The problem of concentration of economic power in fewer hands was exposed. Several official reports investigated these problems by the following committees:

a) Mahalanobi Committee 1964.
c) R.K.Hazari Committee 1966.
d) Patel Committee 1966
f) Dutt Committee 1969.

These committees formed the basis of significant changes in Indian banking sector. There was a strong need to spread the credit flow equally among the various classes of borrowers. There was a strong feeling that the entire credit facilities from the banking sector were enjoyed by the large industrial houses. These feelings provided a broad setting for the revolutionary changes in the structure, operations, policies and practices of banks during this phase.
Keeping in mind these shortcomings and with a view to making banking system more useful to economic growth, the main features of this phase was influenced by the following factors:

1. Social Control of Banks, and
2. Nationalization of Banks

1. Social control of Banks
Social control means a system in which the banking system is controlled and regulated by the government though its ownership continues to be with the private sector. The government and the Reserve Bank of India regulate banking system in regard to branch expansion, credit creation etc. Though the Reserve Bank made rules and regulations in the first phase of the banking sector, yet the banking system suffered in terms of coverage and credit gaps. The network of branches covered only the populated cities and excluded the rural and smaller towns. Therefore, the government had concentrated to provide the credit flow to agriculture, exports, small scale industries, artisans, retail traders and so on. The control of banking sector was in the hands of leading industrial houses. Therefore the government introduced the scheme of social control at the end of 1967 and thus the banks came under social control with the following objectives:

i. Maximum utilization of the banking resources for rapid economic development of the country.
ii. Check on the growth of monopolies in money market
iii. Check on misuse of financial resources.
iv. Achieve social objectives like equal distribution of income.
v. Change in management and credit policy of the banks

The government made its efforts to remove the control of the business houses over banks without removing the private ownership of banks. The social control was strongly influenced by the following factors.
a) Credit flow to all segments of society - The scheme of social control required the reorganization of the board of directors of the banks. The board was revamped and appointed the persons who had specialized knowledge in agriculture, rural economy, small scale industries, cooperation and banking. The chairmen of the banks, who were industrialists, were replaced by professional managers. They were highly skilled, knowledgeable, talented and expert in their fields and were related to banking, finance, economics and business administration.

b) National Credit Council. The National Credit Council was set up in February 1968 with the objective of assessing credit priorities on all India basis. The primary functions of the council were to predict the future demand to the bank credit from all sectors of the economy, proper utilization of available resources towards granting of loans to priority sectors and to coordinate the lending and investment activities of the banking sector. In October 1968 two committees were appointed for examining the problems regarding equitable allocation of bank credit to all the sectors.

The first committee was headed by Prof. D.R.Gadgil to enquire into the question of credit gaps. The committee recommended that the government revamp its activities and follow the urban orientation of the banking system. The banking system also drew its attention to the problems of small farmers. The group reported that the bank credit should be made available to priority sectors without fail. The committee also found that the bank credit was unevenly distributed among different states. The banking sector prepared its new agricultural strategy in order to reduce the disparities in various sectors. To fulfill the needs of the agriculture sector creation of an Agriculture Finance Corporation was suggested as an agriculture strategy and accordingly a corporation was set up as a joint sector entity. The corporation helped the banks to participate actively in developing the agriculture sector. The committee also suggested that the banks should follow the area approach of branch expansion. The individual banks may devote for intensive development of special geographical areas under the network process. The network process expands their efforts at deposit mobilization and finance to agriculture and small scale industries. Every bank was appointed as a lead bank which undertook the responsibility for intensively
developing chosen areas with regard to their network in that area. The study group also suggested the formulation of better coordinating facilities. Strong need of better coordination between the banks was also felt for cooperative organizations, financial institutions and the government organs. The committee also felt the integration of the credit and banking business with their activities. The lead banks were also involved in financing the agriculture and small scale industries to improve their efficiency. The lead banks played a distinct role in providing finance to priority sectors.

The second committee was appointed under the chairmanship of Shri V.T. Dahejia to examine the matters related to concentration of economic power into fewer hands and to look into the factors related to whether the flow exceeds its limits to the industry sector. It submitted its report in September 1969. The committee observed that the industry enjoyed the bank credit and ignored the remaining portfolios of the economy. The committee recommended the need for minimizing the inventory holdings by industry in order to reduce the demand for bank finance and the credit flow to the priority sector.

2. Nationalization of Banks
A radical change emerged during the second phase of banking sector history and a significant milestone in Indian Banking happened in late 1960s when The Government of India nationalized fourteen major commercial banks on July 19,1969 which had deposits of more than Rs. 50 crore, followed by nationalization of 6 more commercial banks on April 1980. Each of these had deposits of more than 200 crores. Rs. 87 crores was paid as compensation to the shareholders of 14 banks. When the country became independent Indian banking was exclusively in private sector. In addition to the Imperial bank, there were five big banks namely the Central Bank of India Ltd., the Panjab National Bank Ltd., the Bank of India Ltd., the Bank of Baroda Ltd., and the United Commercial Bank Ltd. each holding public deposits aggregating Rs. 100 crores and more. Rest of the banks were exclusively regional in character holding deposits of less than Rs. 50 crores. Government first implemented the exercise of nationalization of a significant part of the Indian banking system in the year 1955, when Imperial bank of India was nationalized in that year for the stated objective of, “extension of banking facilities on a large scale, more particularly in the
rural and semi-urban areas,” to form the State Bank of India. SBI was to act as the principal agent of the RBI and handle banking transactions of the Union and state governments throughout India. State Bank of India was obliged to open an accepted number of branches within five years in unbanked centres. Government subsidized the bank for opening unremunerative branches in non urban areas. The seven banks now forming subsidiaries of SBI were nationalized in 1960. This brought one-third of the banking sector under the direct control of the Government of India. One more phase of nationalization was carried out in the year 1980, when six more banks were nationalized. This brought eighty percent of the banking sector in India under Government ownership. The country entered the second phase i.e. the phase of nationalized banking emphasis on social banking in 1969-70. The aim of the nationalization was to control the heights of the economy in conformity with national policy and objectives. Public confidence in banking system was the principal motive behind nationalization of banking. It also aimed at increasing national savings. Mrs. Gandhi had then stated that, “Nationalisation of major banks is a first step towards mobilization of public savings and brings the institutes making their productive use, within the orbit of state ownership.” Expansion of banking facilities in rural and suburban areas, decentralization of economic power, giving more credit to priority sectors and to ensure enough development funds for the planned growth of the country were other aims of the nationalization. These are deemed as Public sector banks. After nationalization, the government acquired full ownership of these banks. Employees of these banks continue to function as before and are treated as government employees. These banks are now being managed and controlled by the government. Nationalization has given a new orientation to the banking system. Banking in the sunshine of government ownership gave the public implicit faith and immense confidence about the sustainability of banking institutions.
After the amalgamation of New Bank of India with Panjab National bank currently there are 19 nationalized banks in India.

- Allahabad Bank
- Andhra Bank
- Bank of Baroda
- Bank of India
- Bank of Maharashtra
- Canara Bank
- Central Bank of India
- Corporation Bank
- Dena Bank
- Indian Bank
- Indian Overseas Bank
- Oriental Bank of Commerce
- Punjab & Sind Bank
- Punjab National Bank
- Syndicate Bank
- Union Bank of India
- United Bank of India
- UCO bank
- Vijaya Bank

The following steps have been taken by the Government of India to regulate banking institutions in the country:

- Enactment of Banking Regulation Act 1949.
- Nationalization of State Bank of India 1955.
- Nationalization of SBI subsidiaries 1959.
- Nationalization of 14 major banks 1969.
- Creation of Credit Guarantee Corporation 1971.
- Establishment of Regional Rural Banks 1975.
- Nationalization of seven more banks 1980
The second phase period was marked by the consolidation of the banking sector. From 566 banks in 1951, the number came down to 86 in 1971, as weaker banks were merged with the healthier ones. The department of banking was set up under the ministry of finance. In 1974, priority sector norms were introduced and commercial banks were given five years to meet the norm of 33 percent of credit. The lead bank scheme was introduced for making banks responsible for the credit need to specific districts. The twin structure of rural branches of commercial banks and cooperative banks however were not sufficient to meet the needs of rural economy and hence Regional Rural Banks were promoted in 1975. The nationalization of banks led to vast changes in the Indian banking system. The measure bore fruit with rural branches increasing to more than forty five percent of the total branch network in 1979 from 22.2 percent in 1969. The priority sector lending increased from 15 percent to 30.6 percent during the same period. The number of bank offices, particularly in rural areas increased sharply. Deposits and advances rose significantly and more and more people gained access to banks. As savings habit grew, the share of financial assets in gross national product also increased. The hanging destination of credit flows brought neglected sectors like agriculture and small scale industries into the banking fold.

No one can deny the fact that the rapid increase in bank branches took place in the post-1969 period when India nationalized its banking sector. There were several objectives behind the bank nationalization strategy including the transformation of class banking into mass banking and to reach out to neglected sectors such as agriculture and small scale industries. At the time of nationalization, there were only 89 scheduled commercial banks with 8262 branches throughout the country. But in March 2004 the number of scheduled commercial banks increased to 290 and the branch network increased to 69071. With such a rapid increase in bank branches, the population covered per branch, which was 64000 in 1969, also decreased to 16000 in 2004. Even the proponents of the banking sector admit that such a rapid expansion of bank branches, with more than half of the branches opened in rural areas, after nationalization was unparallel in the recent economic history of any other developing country. Nationalization forced commercial banks increasingly to meet the credit requirements of the weaker sections of the nation and to eliminate monopolization by vested interests of large industry, trade and agriculture. No doubt, the banking system under the nationalization regime was not perfect as it failed to meet the banking needs
of remote rural areas and small borrowers but at least a serious effort was made to spread banking services both geographically and functionally.

2.2.3 Third phase: New Phase of Indian Banking with the advent of financial and banking sector reforms after 1991.

The post nationalization period yielded significant changes in the operational policies and practices of the banks. The following developments took place and various committees were appointed to study and frame the guidelines to be followed for bank credit and for its functioning.

A) Tandon Committee:
This committee was appointed in 1974 to frame the guidelines for follow up of bank credit. It was a revolutionary step in the banking sector. The committee studied about the scientific evolution of bank credit. The committee suggested about the strong need of bank credit that should be in safe limits to avoid inflationary pressure on the economy. Bank credit portion has been rationed to the industrial sector and increased the contribution to the priority sector.

B) Chare Committee:
The chare committee was appointed to study the implementation of the Tandon’s committee framework. The committee also reviewed about the notable development in the sphere of working capital. It also enquired about the functioning of the cash credit system.

C) Marathe Committee:
This committee was appointed to study about the credit functioning of the banking sector. The committee recommended the credit monitoring arrangement. According to this scheme the bank grant loans to the industrial houses without the approval of the Reserve Bank of India. The RBI stipulates the post sanction monitoring activities.
D) Daheji Committee:
The Daheji committee recommended the introduction of New bill market scheme. The committee found that the bank credit to industry provided more than its output and the finance was diversified by the industry to acquire the fixed assets. But actually the provision of bank credit was meant for the purpose of short term needs. This method of acquisition of fixed assets was not a healthy trend for the industry. The findings and recommendations led to the introduction of new methods like new bill market scheme. The Narsimham group was appointed by the Reserve Bank of India to study the use of bill exchange as an instrument for providing credit and the creation of new bill market in India.

The banking system in India expanded rapidly after nationalization. The number of bank branches, for instance, increased from about seven thousand in 1969 to more than sixty thousand in 1994, two third of which were in rural areas. The deposit base rose from Rs. 50 billion in 1969 to around Rs. 3.5 trillion in 1994. In 1992 the nationalized banks held 93 percent of all deposits.

The Table No. 1 below shows the progress made from June 1969 to March 2004 by the Indian Banks:-
<table>
<thead>
<tr>
<th>Particulars</th>
<th>June 1969</th>
<th>March 2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Banks</td>
<td>89</td>
<td>290</td>
</tr>
<tr>
<td>Scheduled Commercial Banks (Excluding 196 RRBs)</td>
<td>73</td>
<td>90</td>
</tr>
<tr>
<td>Branches</td>
<td>8262</td>
<td>69071</td>
</tr>
<tr>
<td>Rural Branches</td>
<td>1833</td>
<td>32227</td>
</tr>
<tr>
<td>Metro Branches</td>
<td>1503</td>
<td>9750</td>
</tr>
<tr>
<td>Population per Branch</td>
<td>64000</td>
<td>16000</td>
</tr>
<tr>
<td>Deposits (Rs. Crore)</td>
<td>4646</td>
<td>1542284</td>
</tr>
<tr>
<td>Credit (Rs. Crore)</td>
<td>3599</td>
<td>865594</td>
</tr>
<tr>
<td>Investments (Rs. Crore)</td>
<td>1361</td>
<td>675868</td>
</tr>
<tr>
<td>Per Capita (Rs.)</td>
<td>88</td>
<td>14313</td>
</tr>
<tr>
<td>Per Capita Credit</td>
<td>68</td>
<td>8404</td>
</tr>
</tbody>
</table>

Source: Business Standard, October 2004

Thus the table indicates that in June 1969 the number of commercial banks were 89 which rose to 290 in March 2004. The total number of branches was 8262 in June 1969 which increased to 69071 in March 2004. The per capita deposits were Rs. 88 in 1969 and Rs. 14313 in 2004 and per capita credit also increased from 68 in June 1969 to 8404 in March 2004. The growth has been phenomenal in rural India where the number of branches zoomed from 1833 to 32227. In contrast, the number of branches in the metropolitan cities grew at a slower rate, from 1503 to 9750.