Chapter - 2

Banking in India
BANKING IN INDIA

(HISTORICAL PERSPECTIVE UPTO 1969)

Evidences regarding the existence of money lending operations in India are found in the literature of the vedic times i.e. 2000 to 1400 B.C. From this time onwards, India possessed a system of banking, which fulfilled her needs and proved very beneficial to her, although its methods were different from those of modern banking. The literature of the Budhist period supplies ample evidence of the existence of Sresthis, or bankers in all the important trade centers and of their wide-spread influence in the life of the community. Their chief activity was to lend money to traders, to merchant adventures who went to foreign countries and discovered valuable materials, and to kings who were in financial difficulties due to war or other reasons, against the pledge of movable or immovable property or personal surety.

Lending money on interest was practiced but it was against the law. From the laws of Manu, it appears that money lending and allied problems had assumed
considerable importance and that deposit banking in some form had come into existence by the second or third century of Christian era.

Hundis or indigenous bills of exchange came into use from the 12th century, and it appears from the writings of a few Muslim Historians, European travelers, state records and the Ain-i-Akbari that both under the early Muslim and Moghul rulers in India indigenous bankers played a prominent part in lending money with cash or bills and giving financial assistance to rulers during period of stress.

During the Moghul rule the issue of various kinds of metallic money in different parts of the country gave the indigenous bankers great opportunity for developing the very profitable business of money changing. The indigenous bankers, however, could not develop to any extent the system of obtaining deposits regularly from the public and paying interest on them, and those who made savings either hoarded them, or lent them to friends and neighbors. The reason seems to be that many of them combined trade with banking business and such type of combination cause reduction in banking business and have
got negative impact on the development of banking in India. The entry of English traders in Indian market during 17th century doesn’t make much effect on the indigenous banking because of lack of the knowledge of financial terminology used by the local traders. Although East Indian Company make much effect towards such scenario and tried to established connection with the local bankers. English agency- houses in Calcutta and Bombay began to conduct banking business besides their commercial business. From this time the business and power of indigenous banks start decreasing, although East India Co. successfully promoted the establishment of banking in India on western line, on the ground that the agency- houses and the indigenous bankers were more suitable for the banking requirement of India. Gradual expansion of power of English trade in India led the East India Company to abandon its opposition to establishment of banks on western lines in India. The result of such favorable condition to the English Empire gave them way for the establishment of govt. treasuries and bankers, which lead the decline of indigenous bankers. This condition lead Indian indigenous bankers, towards reduced
resources and limited facility, made them handicapped on their competitive area with commercial banks and gradually they began loosing their ground just like in England, where family bankers had to give place to the larger joint stock banks.

**Emergence of Imperial Bank of India**

After the establishment of English houses, with the policy of providing finance facility to the traders, these houses started serving as bankers to the East India Co., the member of the services and the European merchants in India, at Calcutta and Bombay. They financed the movement of crops issued paper money and make a roadway for the establishment of joint-stock banks. First among them was Hindustan Bank in Calcutta establish in 1770 by one of the agency houses. Later on Bengal Bank and the Central Bank of India were established during 1785 and later voluntarily liquidated in 1791 due to some political instability.

The Bank of Bengal, was established in 1806 and got its charter as Bank of Bengal in 1809. So as to establish its own borrowing facility, the charter imposed
certain restrictions on its working. The greatest development made in this bank was permission to issue notes in 1823, and 1839, and also allowed to open branches and to deal in land exchange. During 1840-43, Bombay and Madras banks came into being with the capital of Rs. 50 and 30 lacs.

Emergence of joint stock banks

An Act was passed in 1860 and according to this Act, it permitted the starting of joint stock banks on the basis of limited liability, as it was essential to enable large business companies to secure the large amounts of capital that they needed, but soon afterwards the banks were checked to the right of note issues. During American civil war American cotton supply being terminated, due to which there was a boom in Indian cotton trade with England, which led to blind speculation. These Banks with other companies jumped into this speculation, but all of them got failed within a short span of time and suffered heavy loss and also loose public confidence. Followed by this incident, currency confusion arises during 1873-93, cause trade uncertainty and created an unfavourable
atmosphere to the establishment of new banks. Due to these unfavourable circumstances, from 1865 till the end of the century, the progress in the creation of joint stock banks was very slow. Because of this prevailing condition it resulted into gradual fall of successful banking in India and there were only 9 banks with capital and reserve of over 5 lacs and their total paid up capital and reserve being Rs. 1½ crores and then total deposits Rs. 8 crores. The Allahabad Bank and the Alliance Bank of Simla were established in 1865 and 1875 under European management. In 1881, the first ever bank came into existence with limited liability and controlled by Indians was Oudh Commercial Bank, followed by Punjab National Bank in 1894 by Lala Harkishan Lal. All of them made good progress but failed in 1913, because of its maximum investment in industrial development. It had locked its maximum investment in industries, which caused panic among the depositors and it found its liquid resources inadequate, and the other banks declined to come to its assistance.
In 1906, with the Swadeshi movement wave, which brought about much excitement in banking business during 1913, the member of smaller banks were established which were controlled by Indian with capital and reserve of over 5 lacs to 9 and 18 lacs, with a total paid up capital was 4 crores and total deposits of Rs. 22 crores. The some of the present, prosperous Indian banks of the present times were the Bank of India, the Indian Bank of Madras, the Central Bank of India, the Bank of Baroda and the Bank of Mysore which were established during this period. Some of them, which were established during this period got failed were Bengal National Bank, the Credit Bank of India, the Bombay Merchants Banks and the Standard Bank of Bombay and Bank of Upper India.

This boom not only brought lots of banks into established condition, but it also followed with the failure of around 87 banks with total paid-up capital of over 1.75 crores, which was slightly more than half of the total paid-up capital of all the joint stock banks that survived in 1917. Due to failure of such a huge no. of banks public confidence started depleting on Indian joint stock banks
and checked the growth of banking habits in India. It was a great setback to the banking development in India. Due to such conditions banks suffer heavy loss and comes under the financial pressure. Due to such heavy financial pressure banks almost wholly dependent upon public deposits for conducting their business. But due to high competition among the banks, led them to offer lucrative and very high interest rates that really could not be afforded by the banks. To control the outflow and inflow of money banks starts conducting risky ventures, in the expectation of high gain and balance of their business. The large sums were locked-up in speculative dealings like - silver, pearls and other commodities. This was not enough, banks in the expectations of high gains, did long term finance without efficient investigations. This resulted into the heavy losses, and large proportions of the total available funds were frequently sunk in a single business.

**Bank Management**

On the other hand these banks were handled by the incapable men, who did not have little knowledge either of the principles of the practice of banking. Even the
shareholders were too ignorant to exercise their rights and duties and to control either the directors or managers. Thus, banks generally issued letter without doing many formalities, which further led to the fraud and criminal mismanagement. Even directors and managers of the concerned banks ran away with the assets of the banks by showing in the book debt to the banks that didn’t exist. To hide their activities they left books in an incomplete state. This description of the causes of the banking crises and failure didn’t apply to all the Indian joint stock banks many of them function successfully especially, larger and the older ones conducted their work on sound lines and although not as strong as presidency bank, but strong enough to withstand the crisis without untoward consequences. By the failure of joint stock banks in India, no conclusions were drawn, because it was witnessed at the same time in western countries, that, there was a similar type of crisis with the joint stock banks there. This crisis with the joint stock banks came into existence because of the non-cooperation attitude between them and the Presidency and exchange bank. Even the bank of
Bengal refused to lend the money to the banks, those were in difficulty in Lahore, against the Govt. securities.

The development of Indian joint stock banks from 1913 to 1949 can be seen from the following table 1.

<table>
<thead>
<tr>
<th>Year</th>
<th>Deposit Trend (Rs. In Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1916</td>
<td>0</td>
</tr>
<tr>
<td>1920</td>
<td>297</td>
</tr>
<tr>
<td>1924</td>
<td>76.86 ✓</td>
</tr>
<tr>
<td>1929</td>
<td>77.44 ✓</td>
</tr>
<tr>
<td>1934</td>
<td>118.79</td>
</tr>
<tr>
<td>1939</td>
<td>153.79</td>
</tr>
<tr>
<td>1944</td>
<td>360</td>
</tr>
<tr>
<td>1949</td>
<td>134.5</td>
</tr>
</tbody>
</table>

The following table clearly indicated the public confidence enjoyed by the banks. It clearly shows crisis period till 1917 and gradual increase in deposit is shown between 1918-21 but again joint stock banks came under the crisis between 1922 and 1928 and further recovered after 1928. After 1928, Indian joint stock banks does not
see back. Thus the figures shown in the table shows that how the weakness of J.S.B. came out when the economic conditions become unfavourable. But it can't be ignored that in between 1917-1947, when the deposits of Indian joint stock banks were tripped those of the imperial banks and the exchange banks increased only by 33 and 20 percent. Their deposits increased substantially at the time of second world war, but this doesn't exist for long. After the partition the deposits again fell down, which further increased only after 1953.

**Deposit Trends of Indian Banks**

Deposit Trends in Indian Banks during 1910-1949
The Development of Banking Industry During Second World War:

After doing much research it is found that the progress of banking in India was slow during Second World War (1939-41). But just after war in 1942-46, this progress increased with much faster rate, branches were opened and deposits were rapid. Even the number of scheduled banks including the Imperial bank and the exchange banks, increased from 51 to 93 in June 1946 and the total no. of their offices including head office from 1,328 to 3,106. Their deposit rose from 238 crores at the beginning of the war, raised to 1,097 crores at the end of 1946. This rise was very little during the war, it was only 20 crores in that three years (1939-41). But the growth of banking business rose so fast after the world war.

But this was not the end of the agony. In 1947, the devil of partition again over powered the whole country and along with other system banking system was also effected very much and it faced strenous condition. But
Fortunately except failure of some banks it did not get much affected. But after the partition India passed through a serious economic condition. During 1942-48, its progress was mainly quantitative while from 1949, the quality of its working improved appreciably. Post world war period was very friendly for the growth of banking business, because after world war enormous fund available. At this time investment in industries was very less, due to non-availability of raw material, import of machinery, therefore funds were unused and there was no hindrance in the development of banks. Therefore, lots of new banks established during this period. Some of them were the United Commercial Bank, Calcutta and Bharat Bank, Delhi, sponsored by the houses of Birla and Dalhia respectively. Around 1,778 new banking offices were established, during this period and only 47 belonged to the imperial Bank, one third to the Big Nine and a little less than two thirds to the sandler Indian scheduled Banks, which had only one third of the deposits of the Indianbanks. The result of this inspite of the enormous increase in total bank deposits the value of resources of the smaller scheduled banks did not exceed Rs. 5 lakhs.
per branch, while in case of bigger banks this amount raises to about 20 to 35 lakhs per branch. During the period of 1939-46 it was observed that the non-scheduled banks having paid-up capital and reserves of Rs. 5 lakhs and over, and between Rs. 1 and 5 lakhs and between 5 lakhs and 7 lakhs.

It can’t be ignored that the war condition brought about a change in the structure of the assets of the banks, but during greater part of the war, the value of bills and advances of schedule banks was somewhat larger than the pre-war value, their growth was much smaller than that of the other assets of the banks. It was seen that the percentage of bills and advances of scheduled Banks to their total assets fell from 62% to 25% and in case of Imperial Bank this percentage of bills and advances, fell from 55 to 20% and in case of big five banks it decreases from 53 to 30%.

To overcome fall in the percentage of bills and advances banks tend to increase their holdings in government and other securities and on the other hand the government was also wanted banks to subscribe as
much as possible to its enormous war loans. But it was witnessed that the period of 1939-44 was still better, because in this period the percentage of the holding to total assets increased from 54 to 61% in case of Imperial bank and 43 to 51% in case of their scheduled bank respectively.

**Impact of Partition of India on Banking Business**

Partition period was tough time for the banking in India, before partition banking was conducted mostly by Hindus even in the Muslim populated areas. But after the partition, they change their places for the purpose of safety. The banking was hugely effected and caused heavy losses to the banking system. But when serious disturbances occured in the area of west punjab where most of the bank offices close down on account of the lack of security and the evacuation of their Hindu staff. Only the exchange bank could function in that area, with considerable difficulty owing to the shortage of staff. But govt. of India helped considerably to such types of banks and section 17 of the Reserve Bank Act which had considerably restricted the power of the Reserve Bank to
make advance to schedule banks, was modified so as to empower the Reserve Bank to provide support and security, which is proper to such banks. Other steps were taken by the govt. was to make an order for the banks who have their head offices in east Punjab or Delhi, given legal authorization to postpone their payment and if they pay, they have to clear payments to depositors not exchanging 10% of their current deposits in India or Rs. 250, whichever was less. Further govt. arranged Rs. 1 crore for rehabilitation programmes for affected banks, these measures became necessary because, while some of the banks that had taken the precaution of removing the bulk of their assets from West Punjab, before the occurrence of the disturbances, others had not done so and found that, although their assets had remained in West Punjab, their clients had transferred themselves from West to East Punjab and demanded their deposits bank in the later area.

The trend of expansion and development of banking in India that was started in 1942 continued upto 1948 and end at 1949. But this trend gets contracted in 1953
after the fall in deposits and profits of banks. In this circumstances the number of scheduled banks get declined from 96 to $89\frac{1}{4}$ in numbers at the end of the 1948 to 1953. When we study the period between 1957 and 61. We can find that the number of non-scheduled banks and their offices fell further by 39-318 and other no of banks cases to function in 1958-61, these were 29 in 1958, 33 in 1959, 27 in 1960 and around 53 in 1961. This was again a major set back on banking section in this period.

**Growth in Deposit during 1951 to 1964:**

It was observed that during the first five-year plan the growth in deposit rises upto 3 percent, which was increased around Rs. 129 crores, this was further observed that after the second five year plan, during 1955 to1960, the bank deposits increased upto 602 crores, by an annual average of 12 percent. In general observation the study shows a drastic increase in deposits during 1961 to 1964. This charge was around 2,049 to 2,820 crores and average of 9% growth in deposits. This drastic growth observed in deposits, just because of the same reasons that are mentioned in above discussion, rise in branch
circulation of note and spread of banking habit. This time the situation was reversed in this period, the percentage of demand deposits to total deposits increased from 39.9% to 46.7% while time deposit fell from 60.1% to 53.3%. This reverse trend was observed due to the emergency created by the Chinese aggression. In this period public desire to keep more liquid assets owing to emergency rather than locked their money in fixed deposits or other long term ventures. It was seen that the ownership of deposits, personal deposits increased from Rs. 309 to 1,166 crores i.e. from 47.8% to 49.02% of the total, during this period. The business deposits increased from Rs. 564 to 675 crores but their % of the total declined from 33.5 to 28.5% while the percentage of Government and Quasi Government deposits increased by 0.7%. The current operating earning of Indian scheduled banks increased from 3.7 crores in 1954 to Rs. 16 crores in 1964.
Borrowings from Reserve Bank Advances and Investments:

Due to rise in industry and trade, the scheduled banks have increased their borrowing from Reserve Bank. But this borrowing was not a steady as it gets changed from season to season, depending upon the change in market scenario or business. This demand was further encouraged by Reserve Bank for the industrial development policy passed in five-year plan. This borrowing from Reserve Bank enabled scheduled banks to lend on large scale to big, medium, or small scale industries. This provides fuel into the government of the industries in India.

This credit increases from 1951 to 69, tremendously. It expanded with a growth of 11 percent per annum. This was possible only because of planned economic policy. It is observed that bank credit in 1951 upto 596 only in the next is, in 1952. While in 1954 it gets down trend from 596 crores to 562 crores, but this further rises to 894 crores in 1957. Now it further rises yearly and reach 2051 crores in 1965. The increasing percentage of bank credit to industries at the expense of
commerce shows the rapid development of industries in the country

**Investment Policy During 1951 to 1964:**

Upto 1953 the Investment policies of the banks were steady. But it was noticed that there was gradual fall in the investment of the banks, percentage of govt. debt fall from 12% in 1956 to 11% in 1963. The investment policy for other securities increased in 1955. It may also be mentioned that the holdings of banks in treasury bills increased from 0.7% in 1951 to 11% in 1962 on the percentage of securities with maturity of 5 rupees or less held by banks has increased from 26% in 1951 to 37% in 1962 to 69. The percentage of securities with maturity between 5 to 10 years held by then decreased from 47 to 39% during the same period.

It was observed that there was a decline in the percentage of cash on hand and reserves with the Reserve Bank to depositors of scheduled banks fall from 11% in 1957 to 7% in 1962 on account of the growing demand for banks credit, larger scope for borrowing from the Reserve Bank, a rapid increase in the number of branches
of the state bank through remittance facilities enable banks to have cash readily at points of need and a larger increase of time deposits slow of demand deposits, which needed a smaller statutory reserve.

**Banks Earning and Expenses upto 1964** :

When we study the trends of earning and expenses of banks during 1954 to 1964. We can find that the current operating earning of Indian scheduled banks increased from Rs. 3.7 crores in 1954 to 16 crores in 1964. While in the case of foreign banks it was witnessed that it got doubled from 12 crores to 28 crores. At this time, the main earning sources were interests from advances and discounting of bills were the main component of the earnings. This earning get enhanced by 10% in case of scheduled bank during this period. While foreign banks could not raise their income through the same source in same circumstances.

**Rural Finance**:

Standard of living in rural Indian is one of the major problems because of poverty and extremely low standard
of living. It was always a problem to provide them proper finance facility. According to the Central Banking Committee the average annual income of an agriculturist in British India was then at Rs. 42 or little. It was estimated by the Central Banking Committee, that the rural indebtedness was around 900 crores in this period and it was further increased by 1200 crores upto 1940. It was inherited by the past generation to the present generation.

**Licensing of Rural Subsidiary Banks:**

Central Banking Committee have recommended that the new rural subsidiary bank should obtain a license from the Reserve Bank. Committee has suggested that a simple procedure might be evolved for dealing with applications for licensing and that as far as possible a license may not be refused except on substantial grounds. Since the rural subsidiaries would be promoted by commercial banks which might be licensed and which would provide the necessary expertise and guidance for the effective functioning of rural subsidiaries, it has been recommended that the licensing process might be simplified and licence issued on
the fulfilment of certain objective Committee also recommended that the Reserve Banks should take over the charges of licensing the rural banks instead of Registrar of Companies. But there was no such recommendation which made this licensing simple while the recommendation of Reserve Bank might have proved strict for licensing the rural subsidiary bank so unlicensed subsidiary rural bank might be discouraged to develop. There would be no point in registering a rural subsidiary bank, if, for any reason, the Reserve Bank is not likely to grant a licence to it. What is required is the prior approval by the reserve bank before registering a subsidiary.

**Progress of Banking in India till 1969:**

In the two decades following the enactment of the Banking Companies Act, 1949, the Indian banking system underwent substantial changes structurally, geographically and functionally. This was a period which witnessed economic development of the country in accordance with a series of Five-Year Plans. The banking system and the Reserve Bank of India endeavored to adapt themselves to the changing economic scene under planning, but in
retrospect it would appear this was comparatively a slow pace till recently. This period also saw the Reserve Bank’s efforts towards the institutionalisation of savings in order to orient the credit system to the needs of a developing economy and the consolidation and strengthening of banking structure and organisation with a view to improving the quality of its service and the widening of the geographical and functional spread of its activity.

The Indian commercial banking system has been regulated and controlled mainly under the provisions of the Banking Regulation Act, 1949. Till recent years, the primary objective of the measure was the protection of the interests of depositors, but the need to strengthen and expand the banking system to meet the needs of a developing economy was also recognised and some steps were taken in this direction. The Act was suitably amended, from time to time. Thus, the Reserve Bank was empowered to secure compulsory mergers of banks. The failure of a couple of banks in the early 1960’s made it necessary to amend the Act further to empower the Reserve Bank to apply to the Central Government for
grant of moratorium of banks and sanction schemes for the reconstruction or amalgamation with another banking company. Even before this amendment, the Reserve Bank was encouraging the merger of small banks with big banks to make them viable units. After the amendment of the Act in 1960, the process of amalgamation gained momentum.

As a result of the coming into force of the Banking Companies Act and the efforts to bring about mergers, there was a decline in the number of non-scheduled commercial banks and their offices. At the same time, there was a remarkable increase in the number of branches of scheduled banks. Compared with over 500 non-scheduled banks in 1951, there were less than 20 such banks in 1969. The number of offices of non-scheduled commercial banks declined from about 1,500 in 1951 to a little over 200 in 1969. In the case of scheduled commercial banks, expansion of offices was fairly rapid. Thus, from 2,689 banking offices at the end of March 1952, the number rose to 4,166 at the end of March 1961 and further to 7,731 at the end of March
1969. Besides opening of branches, another measure was taken to develop the banking habit, namely, the introduction in January 1962 of a system of deposit insurance, India being the second country to do this. The system is being administered by the Deposit Insurance Corporation, whose capital of Rs. 1 crore is owned entirely by the Reserve Bank. The insurance cover was originally a modest sum of Rs. 1,500, in respect of each depositor in each bank. The cover was raised to Rs. 5,000 in 1968 and further to Rs. 10,000 in 1970. By an amendment to the Act, State Central and urban co-operative banks with a paid-up capital and reserves of Rs. 1 lakh or more have been brought under the scope of the Act. The scheme has been extended to co-operative banks in some states, viz., Maharashtra, Madhya Pradesh, Andhra Pradesh and the Union Territory of Goa, Daman and Diu, which have passed the necessary enabling legislation.

**Formation of the state bank of India:**

A major banking development in the 1950’s was the nationalization of the Imperial Bank of India and its
transformation into the State Bank of India, effective July 1, 1955. This was the outcome of the recommendations of the Committee of Direction of the All-India Rural Credit Survey appointed by the Reserve Bank of India in 1951. The Committee recommended the setting up of a State Bank as "one strong state-partnered commercial banking institution with an effective machinery of branches spread throughout the country to stimulate banking development by providing vastly extended remittance facilities for the co-operative and other banks and by following a policy consistent with national policies adopted by the Government without departing from the canons of sound business". Subsequently, in 1960 seven banks, which had special connections with the erstwhile princely states such as Hyderabad, Mysore and Travancore, became subsidiaries of the State Bank of India. This arrangement was preferred to their merger with the SBI.

The State Bank of India has made good progress in the matter of expansion of branches, particularly in areas not served by banks and in meeting the credit needs of
small-scale industries and rural finance, in particular marketing of agricultural products. Between the time of its establishment in July 1955 and July 1969 when 14 commercial banks were nationalized, the State Bank of India’s branches rose by over 200 per cent, to 1569; on the latter date, the subsidiaries of the SBI had 863 offices. Nearly one-third of the bank offices at the end of June 1969 were situated in rural areas, that is at centers with population below 10,000. During the subsequent a little over three-year period ended September 1972 the number of offices of the SBI group in rural areas more than doubled and their share in the total number of offices increased from 33 per cent in 1969.

Table - 2
Centre-wise classification of bank offices of SBI group Upto 1969

<table>
<thead>
<tr>
<th>Centers</th>
<th>As on June 30, 1969</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Offices</td>
<td>Percentage share</td>
</tr>
<tr>
<td>Rural</td>
<td>818</td>
<td>33.2</td>
</tr>
<tr>
<td>Semi-Urban</td>
<td>1,172</td>
<td>47.6</td>
</tr>
<tr>
<td>Urban</td>
<td>247</td>
<td>10.1</td>
</tr>
<tr>
<td>Metropolitan</td>
<td>225</td>
<td>9.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,462</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

Source: Trend and progress of banking in India, Reserve Bank Bulletin,
Indexes of banking growth till 1969

An idea of the substantial growth of banking in the country can be had from the five-fold increase in deposits from Rs. 835 crores in March 1951 to Rs. 4,338 crores in March 1969. The share of the commercial bank deposits owned by the household sector in the total savings in financial assets (gross) rose from 1.94 per cent in 1950-51 to 27.14 per cent in 1965-66. The ratio of deposits to national income, however, was steady around 14 per cent of branch expansion programmes. The other notable features in deposit growth of the period were the higher rate of growth in time deposits relative to savings deposits, the rise in the number of personal accounts relative to business accounts, a substantial share of the deposit expansion in the State Bank of India Group due to branch expansion in semi-urban and rural areas and an uneven growth of deposits as between different States.

Another index of growth of banking is the sharp expansion of bank credit, at a compound rate of 11 per cent per annum during 1951-69. As a result, the credit-deposit ratio increased from 62 per cent in 1951 to 78
per cent in March 1969. The major part of commercial bank credit has traditionally gone particularly to large and medium-scale industries, whole-sale trade and other bigger borrowers. At the end of 1968, the share of commercial bank credit to industry was 68 per cent as against 34 per cent in 1951, while that of commerce was 19 per cent as against 36 per cent for the same period.

**Table-3**

**Distribution of Bank credit to various sectors**

<table>
<thead>
<tr>
<th>Sector</th>
<th>March 1951</th>
<th>March 1968</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Percentage to total</td>
</tr>
<tr>
<td>Industry</td>
<td>199</td>
<td>34.0</td>
</tr>
<tr>
<td>Commerce</td>
<td>211</td>
<td>36.0</td>
</tr>
<tr>
<td>Financial</td>
<td>74</td>
<td>12.7</td>
</tr>
<tr>
<td>Personal</td>
<td>40</td>
<td>6.8</td>
</tr>
<tr>
<td>Agriculture</td>
<td>12</td>
<td>2.1</td>
</tr>
<tr>
<td>Others</td>
<td>49</td>
<td>8.4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>585</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

*Source:* trend and progress of banking in india, Reserve bank bulletin 1969-70.
Small-scale industries, agriculture and allied activities, retail trade, self-employed and small borrowers for long remained, by and large outside the purview of commercial banks. Commercial bank lending to agriculture, excluding plantations was negligible. The major proportion of institutional finance for the agricultural sector came from the co-operative agencies.

A significant feature of banking in India since the early fifties is the emergence of term lending by commercial banks, particularly after the establishment of the Refinance Corporation for Industry in 1958, which was later merged with the IDBI in 1964. In addition, commercial banks have been subscribing to the capital stock and debentures of the specialized financial institutions.

**Reserve Bank of India**

In any credit system, the central bank has a very important role to play. This is especially so in developing countries, where the role of a central bank is not merely that of regulation of credit, but also one of establishment of an adequate institutional machinery for the provision of
credit to the various sectors of the economy. The Reserve Bank of India, established in 1935 initially as shareholders’ bank and nationalized with effect from January 1949, has been fulfilling its dual role of regulation and promotion fairly well. Till about the early 1950s, the Bank did not have much of scope for credit regulation, since credit expansion by the banking system was of modest dimensions and there was little need for the banking system to borrow from the Reserve Bank. So, the Bank concentrated its efforts on three areas of policy, namely, the strengthening of the commercial banking system, the reorganization and streamlining of the cooperative credit structure, to purvey in particular the needs of agriculture and the promotion of institutions for the provision of medium and long-term finance for the manufacturing sector on a modest scale. In all these areas, it must be said that the record of the Reserve Bank has been on the whole good.

In respect of weeding out the weak elements in the banking system and in ensuring growth of banking on sound lines, the main statutory instrument was the
Banking Companies Act that came into force in March 1949. It should be emphasized that till a few years ago, the fundamental objective of the authorities in the sphere of banking was to keep the interest of the depositors. Other objectives such as enlargement of the role of banks in economic development were subordinate to that of protecting moneys of the depositor. In the early years of the working of the Banking Companies Act, the emphasis of policy by the Reserve Bank and Government was more in the direction of containing what was feared would be over expansion of branches rather than any aggressive keenness for opening of branches. In any event, except in regard to the State Bank of India, no financial or other inducement was given to the non-nationalised banks to embark on expansion of branches in a big way.

Credit regulation assumed importance with the fairly rapid growth of the economy as part of a series of five-year Plans. Although the First five-year Plan began some time in 1952, inflationary pressures gathered momentum only from the time of the Second Plan onwards in 1956. Apart from the expanded credit demand from the private
sector, the primary source of inflation in the Indian economy has been budgetary deficits of the Central Government. Credit policy in the ordinary way cannot be of much avail in a context where the biggest monetary expansion is occurring through deficits of the Government sector. However, even in such a situation, the central bank of a country has a role to perform, namely, preventing any marked secondary inflationary pressures as a result of rising liquidity of the banking system. In this spirit, the Reserve Bank has endeavored to control credit expansion for the private sector. The Reserve Bank now possesses all the usual instruments of central bank regulation, namely, bank rate, open market operations, variable reserve ratio and selective credit controls. In a developing economy, as already mentioned, the central bank's promotional role is very important. Extension of the magnetized sector and of the banking habit, narrowing of seasonal and regional gaps between the supply of and the demand for funds, the availability of adequate credit at reasonable cost to neglected and priority sectors, such as agriculture, small-scale industries and exports, and the development of adequate institutional machinery for
meeting the requirements of industry and agriculture for medium and long-term funds are important aspects of the central bank's promotional growth. In all these respects, the Reserve Bank's performance should be said to have been good. The Reserve Bank has also played an active role in the establishment of institutions for credit to agriculture and manufacturing. Besides helping in the establishment of apex institutions in the co-operative field, the bank established as a part subsidiary, in 1963, the Agriculture Refinance Corporation. In the field of credit for industry, the bank played an important role in the establishment of the Industrial Finance Corporation of India in 1948, the State Financial Corporations from 1952 onwards, the Refinance Corporation for Industry in 1958 and the Industrial Development Bank of India, a wholly owned subsidiary, in 1964. In all these institutions, the Bank's contribution has been in terms of share capital, loans and management. The establishment of the Deposit Insurance Corporation in 1962 to provide insurance cover to depositors has already been referred to.
An important development in the field of expanding the flow of credit to small-scale industry was the institution of a credit guarantee scheme in July 1960, in respect of loans made by banks and other credit institutions to small-scale industrial units. While the risk was borne by the Central Government, the formulation of the scheme and its administration has been the responsibility of the Reserve Bank.

**Scheme of social control over commercial banks:**

Government in December 1967 initiated the scheme of social control over banks. The Boards of Directors of commercial banks were reconstituted, providing for a majority of members having specialized knowledge or practical experience in the fields of economics, law, cooperation, agriculture and rural economy, banking, finance, small-scale industry, etc., and any other knowledge or experience useful to a bank. In addition, the chairmen of the banks, who were to be appointed as whole-time executives, had to be professional bankers and not industrialists or businessmen. The banks were also prohibited from making loans to their Directors of
concerns in which their Directors were interested. The Reserve Bank was given further powers over bank management. A high level body called the National Credit Council was set up in February 1968, with the Finance Minister as Chairman and the Governor of the Reserve Bank as Vice-Chairman, and consisting of representatives of industry, trade, agriculture, commercial banking, cooperative sector and professionals including economists, to assess periodically the demand for bank credit and to provide guidelines for credit priorities on an all-India basis, for ensuring a purposeful and equitable distribution of bank credit.

The legislative measure for social control of banks was the Banking Laws (Amendment) Act, 1968, which came into force on February 1, 1969. In terms of the Act, not less than 51 per cent of the total number of members of the Board of Directors of a bank had to consist of persons who have special knowledge or practical experience in one or more of matters such as accountancy, agriculture and rural economy, banking, cooperation, economics, finance, law and small-scale
industry. In addition, every bank was to have a whole-time chairman who is not an industrialist but is a professional banker and has special knowledge and practical experience of banking (including financial institutions) or financial, economic or business administration; his term was not to exceed five years at a time. The Reserve Bank was vested with the powers of appointment, removal or termination of the services of not only the chairman, but also any director, the chief executive officer (by whatever name called) or any other officer or employee of a bank, whenever the circumstances so required. In exercising these functions, the Bank was required to have, as its criteria, not only the interests of the bank or its depositors, but the interest of banking policy or public interest.

Another notable development to enlarge the commercial bank's involvement in agricultural finance was the establishment in 1968 of the Agricultural Finance Corporation Limited, as a joint venture by the leading commercial banks for financing priority agricultural
projects and to help commercial banks participate actively in developing the agricultural sector.

In accordance with the guidelines indicated by the National Credit Council, the Reserve Bank also introduced changes in its branch expansion policy with a view to extending the banking facilities to wider areas and also mobilizing their deposit resources. It was when the social control experiment was in progress that the Banking Commission was set up in the early part of 1969.

As regards the functional aspects of banking, the major change in policy was one of directing credit to the priority sectors, in particular agriculture, small-scale industry and exports and of translating credit priorities into individual banking credit decisions.

**Nationalization of 14 commercial banks**

A far-reaching measure affecting the banking system was the nationalization of the 14 major Indian commercial banks with effect from July 19, 1969, on account of what was regarded as inadequacies of the social control device. True, the necessary organizational changes to give effect
to social control were put through by the banks fairly and promptly. They also reduced their loans to directors and the concerns in which they were interested and increased their lending to agriculture and small-scale industries. Nevertheless, it was felt that the social control experiment was basically inadequate to achieve the social goals. Although the Boards were reconstituted, the industrialists and businessmen remained on the Boards and could still exercise their personal influence. The powers of the Reserve Bank to reconstitute the Boards were also not sufficient. The directors of the banks could be removed by the Reserve Bank only in specified circumstances and under prescribed procedures. Further, the Bank's powers to issue directives could be exercised only in exceptional or unusual cases. In these circumstances, it was felt that only through public ownership of banks could the desired objectives be achieved. Consequently, the nationalization of 14 major Indian banks was announced on July 19, 1969. This meant that nearly 85 per cent of banks' deposits (including those of the State Bank of India and its subsidiaries) came under the direct control of the Government.
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