Chapter - II

Public Sector Banks - A Retrospect
2.1 BANKING IN INDIA – A HISTORICAL PERSPECTIVE

Moneylenders and indigenous bankers have played an important role in the Indian economy as purveyors of money and credit from time immemorial. The moneylenders provided loans to people in times of need mainly for consumption purposes, while the indigenous bankers extended credit for financing trade and industry. The indigenous bankers were for long the trusted custodians of the deposits of people and royalty alike. Besides meeting the requirements of the royal treasuries, they were the main source of finance for agriculture, industry and trade. The importance of moneylenders and indigenous bankers was, however, somewhat reduced following the establishment of agency houses and presidency banks patronized by the East India Company towards the close of the seventeenth century. It was then that 'modern banking' system took its birth.

2.1.1 The Presidency Banks

During the early part of the 19th century, the volume of foreign trade was relatively small and the indigenous bankers looked after the financial needs of internal trade. Later on as the trade expanded, the need for banks of the European type was felt and the Government of East India Company took interest in having its own bank. The Government of Bengal took the initiative and the first Presidency Bank, the Bank of Calcutta was established in 1806. One fifth of its total initial capital of Rs. 50 lakhs was subscribed by the State Government, which also appointed three out of the total nine
directors. In 1840 the Bank of Bombay and in 1843 the Bank of Madras were also setup, their capital being Rs. 52 lakhs and Rs. 30 lakhs respectively. The East India Company Government contributed Rs. 3 lakhs in respect of each bank.  

All the three state-partnered banks were also banks of issue. The right of issue was withdrawn by the Government in 1862 and by way of compensation it agreed to keep its balances with them. The Presidency Banks had their branches in important trading centres but mostly lacked uniformity in their operational policies. In 1867, the Bank of Bengal submitted a proposal for a big bank with an authorised capital of Rs. 10 Crores. But the Government did not like it since it felt that a single All-India strong banking institution may be difficult to manage due to paucity of suitable personnel. In 1899 the Government proposed to amalgamate these three banks into one so that it could also function as a Central bank, but the presidency banks did not favour the idea. However, the conditions obtaining during First World War period (1914-18) emphasized the need for a unified banking institution, as a result of which the Imperial Bank of India was set up in 1921.

2.1.2 The Imperial Bank of India

The Imperial Bank of India was established on 27th January, 1921 pursuant to the Imperial Bank of India Act of 1920. It took over three Presidency Banks as ‘growing concerns’ with all their assets, liabilities and

1 Reserve Bank of India, History of the Reserve Bank of India, Bombay, 1960, P.13 and 14.
2 Ibid., P.16.
3 Ibid., P.4.
management. Thus, a sound and unified quasi-central banking institution came into existence. The bank could safely expect a good response and confidence of the public in the banking system, provide stability and extend banking service to the far-flung interior areas of the country. The Imperial Bank being the biggest commercial bank with enormous resources was expected to extend its branches throughout the country and conduct banking business by inspiring public confidence.

The Imperial Bank upto 1935 i.e., the establishment of the Reserve Bank of India, functioned as an Interim Central Bank of the country. It combined the functions of both a commercial bank and a central bank. The Imperial Bank was neither completely on the model of the Central Bank of England nor of the continent, nor of the South African type. The Imperial Bank of India Act, 1920, specifically requires the Bank to undertake Government business and act as a banker to the Government perhaps a function admittedly appropriate to a Central Bank. The Imperial Bank Act does not prevent the bank from pursuing an independent monetary and economic policy which may enable the bank to act as banker’s bank, which is another function of a Central Bank. The bank was to be the custodian of national balances and the manager of public debt. The Act of 1920, of course, permits the Imperial Bank conducting normal banking business. As a Central Bank, it granted loans to other banks, discounted hundies and bills of exchange, granted remittance facilities to other banks. However, it did not possess the power of note issue. It was vested with the Government of India. It had the resemblance of a Central Bank but it did not have the degree of control over the money market which a Central Bank is supposed to possess.
It was expected that the Imperial Bank would rise to the full dignity and stature of a Central Bank. To make it the Central Bank of the land, it would be to divide the Central banking functions from widespread net work of its commercial functions. It would be detrimental to the cause of banking development as well as of providing cheap credit facilities to traders and borrowers. The Hilton Young Commission pointed out that conversion of Imperial Bank into a true Central Bank would involve a radical amendment of the character and would preclude it “from undertaking great many tasks which it now successfully performs as a commercial bank”. Hence, the Imperial Bank on the banking scene occupied prominent place among the other Indian joint stock banks and this has been a bitter source of complaint for the joint banks. The general public in fact stands to gain out of such competition. If the Imperial bank was considered for a Central Bank, it would hamper the banking habit and investment and jeopardise the banking development of the country. This consideration alone negativates the idea of disturbing the present functions of the Imperial Bank. Dr. Trip opined that, industrial finance and absolutely necessary to keep the Imperial Bank as a commercial bank.

5 Ibid.
7 Ibid., P. 457.
The year 1921 marks an era of the new venture of amalgamation of presidency banks into the Imperial Bank and the bank began to gain momentum both in the accumulation of public deposits and private deposits from the year 1923. The Imperial Bank enjoyed a special advantage during the period 1921-1930 in the mobilization of deposits as it also functioned as an agent of the Government doing cash work. The central banking functions of the bank gave the bank an undue advantage in the money market and hence an increased trend in the accumulation of deposits. The position of Imperial Bank of India during 1921-54 has been shown in Table 2.1. The table indicates that the increase in reserves of the Bank was steady throughout the period 1921-31. The proportion of paid-up capital and reserves to total deposits increased to 14.56 per cent in 1931 from 1.8 per cent in 1921. But after 1935 it was continuously declined to 14.11 per cent in 1936, 11.06 per cent in 1941, 4.45 per cent in 1946 and 5.0 per cent in 1951 and has slightly increased to 5.4 per cent in 1954. The table also reveals that the deposits and advances were increasing though the trend was not steady. The total deposits of the Bank which account Rs. 82.71 crores in 1921 reached a record level of Rs. 91.83 crores in 1926; but after 1926 there was a fall in the total deposits of the Imperial Bank. The deposits declined to Rs. 78.54 crores in 1931 and Rs. 78.72 crores in 1936 from Rs. 91.83 crores in 1926. This is mainly due to enactment of the Reserve Bank of India Act in 1934 the Government deposits have been transferred to the Reserve Bank, And fall in public deposits and also Government cash work, economic
depression of 1929 and the consequent economic ills had their influence on the falling trend of deposits. But after 1936, the deposits increased enormously to Rs. 263.65 crores in 1946 from Rs. 78.72 crores in 1936. This was not only the case with the Imperial Bank but with the other banks too. Again there was a fall in the deposits from 263.65 crores to 239.12 crores in 1951 and to Rs. 219.17 crores in 1954.

Table-2.1
POSITION OF IMPERIAL BANK DURING 1921-54

(Rupees in Crores)

<table>
<thead>
<tr>
<th>Years</th>
<th>Paid-up capital and Reserves</th>
<th>Total Deposits</th>
<th>Total Advances</th>
<th>Of which</th>
<th>Proportion of paid-up capital and Reserves to Total Deposits (%)</th>
<th>Proportion of loans and advances to Total Deposits (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1921</td>
<td>8.94</td>
<td>82.71</td>
<td>52.46</td>
<td>18.17</td>
<td>21.92</td>
<td>10.07</td>
</tr>
<tr>
<td>1926</td>
<td>10.50</td>
<td>91.83</td>
<td>47.15</td>
<td>14.52</td>
<td>27.12</td>
<td>5.51</td>
</tr>
<tr>
<td>1931</td>
<td>11.04</td>
<td>78.54</td>
<td>44.01</td>
<td>12.20</td>
<td>27.23</td>
<td>4.58</td>
</tr>
<tr>
<td>1936</td>
<td>11.11</td>
<td>78.72</td>
<td>22.96</td>
<td>3.70</td>
<td>16.37</td>
<td>2.90</td>
</tr>
<tr>
<td>1941</td>
<td>11.25</td>
<td>101.82</td>
<td>34.76</td>
<td>7.44</td>
<td>22.86</td>
<td>4.46</td>
</tr>
<tr>
<td>1946</td>
<td>11.72</td>
<td>263.65</td>
<td>73.27</td>
<td>27.11</td>
<td>36.23</td>
<td>9.93</td>
</tr>
<tr>
<td>1951</td>
<td>11.96</td>
<td>239.12</td>
<td>132.74</td>
<td>123.76</td>
<td>8.97</td>
<td>5.0</td>
</tr>
<tr>
<td>1954</td>
<td>11.37</td>
<td>219.17</td>
<td>133.37</td>
<td>89.09</td>
<td>27.49</td>
<td>16.79</td>
</tr>
</tbody>
</table>


There was no continuous increase in advances of the Imperial Bank as they depended on such factors as the prevailing economic situation, the type of security, the policy of the bank in respect of making loans and finally the
response of the money market. The response of the market is also influenced by the movements in interest rates. Since the Imperial Bank was primarily a private share holder's bank engaged in the business with the objective of making profit, generally many of the loans are in the nature of mortgages. Hence, there has been a fall in the level of loans and advances which figured at Rs. 50.46 crores in 1921 declined to Rs. 47.16 crores in 1926, Rs. 44.01 crores in 1931 and Rs. 22.96 crores in 1936 but increased to Rs. 34.76 crores in 1941, Rs. 73.27 crores in 1946, Rs. 132.74 crores in 1951 and Rs. 133.37 crores in 1954.

But in regard to financing the development of local areas, the Bombay Provincial Banking Enquiry Committee⁸ reported that many complaints received by them showed the neglect by the Imperial Bank of India of the local channels of investment, and the concentration of resource at the Local Head Office⁹. The Bihar and Orissa Provincial Banking Enquiry Committee also referred to the conditions in those states. According to the Committee¹⁰, the Imperial Bank and the joint stock banks did not play much part in financing the industries of the province. The former was precluded by its Act from lending money against plant and fixed equipment but it could certainly provide funds against the security of stocks of goods under its own lock and key as it did in the case of cotton mills at Indore.

¹⁰ Ibld.
Regarding its relation with other banks, the Imperial Bank several times helped other banks by providing ample funds. For example, when the Alliance Bank of Simla failed, it averted a panic in the country by supplying at once funds to pay off one half of the demands of creditors of the Alliance Bank by orders of the Government. When there was rundown on the Tata Industrial Bank, the Bengal National Bank and the Central Bank of India at different times, Imperial bank promptly came to their assistance without any orders from the Government. It also built up close relations with the provincial co-operative banks of different provinces and allowed them overdrafts. The competition of the Imperial Bank with other banks was often exaggerated. The lowering of interest rates rather benefited the business community by reducing the semi-monopolistic position of joint stock banks.

On the other hand, the policy of the Imperial Bank was to exploit seasonal variations in the rates of interest to its advantage. The bank could substantially reduce the difference between the highest and the lowest rates and help money markets on account of its special position amongst commercial banks. From the data of the rates of interest in Calcutta and Bombay as well as of the Imperial Bank of India hundi rate from 1921 to 1935, three points are very clear, viz., (i) a big difference ranging from 3

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to 4 per cent in the highest and the lowest rate for hundies within same years busy and slack season; (ii) the difference between the rates prevailing in Calcutta and Bombay money markets in the same year, which could be reduced by quick movements of funds from one place to another, and (iii), the great difference between the highest and the lowest rates in Calcutta market and in Bombay market separately within the same year. These variations were relatively larger between 1921 and 1930 than in subsequent years. The Imperial Bank of India could reduce seasonal variations by suitable adjustments in its policy of credit creation.

There had been certain allegations against the Imperial Bank regarding the behaviour of its officials and the preferential treatment, in the course of dealings accorded by it to Europeans and their concerns. Bengal Provincial Banking Enquiry committee also observed in this connection¹³, “Another complaint made against the Imperial Bank from its clientele other than banks is the alleged preference to European Customers. The Committee wanted to investigate matters fully but was unsuccessful. On the other hand witnesses made only vague accusations. The Imperial Bank did not produce any figures but merely stated that in making advances it was guided purely by the standing and credit of the firm or person(s), each proposal being dealt with on its business merits”. The complaint about the preferential treatment to European Customers was justified on account of two factors, viz., absence of making a proper enquiry in this respect, and holding of its majority shares by

non-Indians. Mr. Manu Subedar in a separate note had remarked on this point in these words\textsuperscript{14}, "This is a matter of enquiry. But who is to make the enquiry?...whatever the method and work of Imperial Bank is, it must continue undisturbed since there is no provision in law to secure an effective Indian majority, in its control... The fact of existence of Indians in the Central and Provincial Boards does not appear to have made serious impression on the adverse feelings in Indian circle".

Therefore, the All India Rural Credit survey\textsuperscript{15} suggested among other measures the creation of one strong integrated state partnered commercial banking institution with an effective machinery of branches spread over the whole country for stimulating banking development by providing extended remittance facilities for co-operatives and other banks and following a policy which would be in effective consonance with national policies adopted by the Government without departing from the cannons of sound business. Following the recommendations of the Rural Credit Survey Report on 20\textsuperscript{th} December 1954, the Finance Minister announced in the Lok Sabha\textsuperscript{16} the decision of the Government of India to assume effective control over the Imperial Bank as a first step towards setting up of the State Bank.

\textsuperscript{14} Government of India, Mr. Manu Subedar's, Minority Report, Indian Central Banking Enquiry Committee Report, New Delhi 1929-30, p. 253 & 264.
\textsuperscript{15} Reserve Bank of India, "All India Rural Credit Survey Report", Bombay, 1954, p.135.
2.1.3 The Need for a State Bank

In February 1951, the Reserve Bank of India organised an informal conference of certain co-operators, economists and Registrars of co-operatives in order to formulate the future policy, procedure and other steps to be taken by it in relation to agricultural credit. The conference found the formulation of such policies difficult due to shortage of actual information on the credit needs and borrowing practices in rural areas and therefore, it suggested for an All India Rural Credit Survey. In August, 1954, accordingly, a Committee of Directors with Sri A.D. Gorwala as Chairman was appointed to\(^\text{17}\) (i) direct the planning, organisation and supervision of survey, (ii) interpret its results, and (iii) make recommendations. The Committee recommended, inter alia, amalgamation of the Imperial Bank of India and ten other banks into a newly established bank, called the State Bank of India. The Government of India accepted the recommendations of the Committee and the decision to establish a State Bank of India was announced in the Lok Sabha by C.D. Deshmukh, the then Finance Minister. The Chief reasons for the nationalisation of the Imperial Bank were given as follows\(^\text{16}\):

1. The quantum of agricultural credit necessary for the success of agrarian reforms introduced by several states was to be ensured as well as co-ordinated.
2. Financial assistance to the co-operative movement especially to marketing and warehousing was to be ensured.
3. The surplus available in rural areas might be mopped up for the benefit of the national economic development.


The Minister for Revenue Expenditure, A.C. Guha, while introducing the bill for nationalising the Imperial Bank, observed:\(^1\) "It embodies the aspiration and desires of the members of this House and of the public also... the State Bank will cater not only for the agricultural credit requirements but also serve the interests of rural industries and cottage industries ... The purpose of this bill is not merely to take over the Imperial Bank of India, but its purpose is to create our rural life to vitalize and strengthen our peasantry and to rejuvenate the rural areas".

The Government introduced the State Bank of India Bill in the Lok Sabha on 16th April, 1955 and it was passed by Parliament and got the President's assent on 8th May 1955. The Act came into force on 1st July 1955 and from this date the whole of the undertaking of the Imperial Bank within the country was transferred to the State Bank. The overseas branches were also to be transferred in accordance with the provisions of law of those countries in the course of time. Therefore, the Imperial Bank was continued beyond 1st July, 1955, to make it possible to transfer its assets and liabilities. The State Bank of India Act was amended by an Ordinance on 23rd June 1955, (Later Act on 21st September, 1955) to enable the Imperial Bank exist to transfer its assets in London, Burma, Ceylon and Pakistan. The Pakistan Government\(^2\) allowed only branches at port towns, i.e., at Karachi, Chittagong and Narainganj and others were to be closed.


The position of State Bank of India as on July 1955 has been shown in Table 2.2. The percentage share of State Bank of India in total branches, deposits and advances are considerable. Having 15.5 percentage of total branches, State Bank of India shared 17.5 percentage of deposits and 14.2 percentage of advances in India.

Table-2.2
THE POSITION OF STATE BANK OF INDIA IN 1955

<table>
<thead>
<tr>
<th>Item</th>
<th>State Bank of India</th>
<th>All Scheduled Commercial Banks</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Total Branches (No. in lakhs)</td>
<td>484 (15.5)</td>
<td>2,623 (84.5)</td>
<td>3,107 (100.0)</td>
</tr>
<tr>
<td>2. Total Deposits (Rs. in Crores)</td>
<td>219,17 (17.5)</td>
<td>1,03,278 (82.5)</td>
<td>1,25,195 (100.0)</td>
</tr>
<tr>
<td>3. Total Advances (Rs. in Crores)</td>
<td>133,37 (14.2)</td>
<td>80,712 (85.8)</td>
<td>94,049 (100.0)</td>
</tr>
</tbody>
</table>

**Note**: Figures in parentheses indicate percentage to the total

**Source**: Reserve Bank of India, *Statistical Tables Relating to Banks in India*, Bombay, 1956.

2.1.4 State Bank of India

The preamble to the State Bank of India Act, 1955, merely states “the extension of banking facilities on a large scale more particularly in the rural and semi-urban areas and the diverse other public purposes and transfer of the undertakings of Imperial Bank of India” as the main objective of establishing the State Bank of India. However, the All India Rural Credit Survey Committee has outlined the main objective and the role meant for the
State bank of India. According to it, this State-partnered, country-wide banking institution is to be charged with and carry out the positive duty of endeavouring to do its best to help the development of rural and co-operative banking. It is expected to discharge this duty by several means open to it including principally, the effecting of arrangements for the readier and cheaper remittance of money, especially in relation to the relatively undeveloped areas which have been neglected by commercial banks and in which, without such facilities, no development is possible of rural or co-operative banking. It is required (i) to expand itself not only upto the district head quarter places, but beyond it, i.e., sub divisional level (ii) to convert non-banking treasuries into banking treasuries (iii) to significantly increase the facilities of cheap and ready remittance of money especially in undeveloped areas, and (iv) to provide responsive support to the co-operative structure connected with credit and economic activity, especially marketing and processing. There should be effective co-ordination at the sub divisional centres between the State Bank of India and the co-operative banking system of each state.

Its role is also to act as an instrument of development, although principally, the State Governments are directly responsible for the implementation of the programme of co-operative development. The

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committee has also suggested\textsuperscript{25} that the Government should not interfere in the day-to-day working of the bank and the bank on its part not to lower the standards of sound banking\textasciitilde{}.

The Committee\textsuperscript{26} has also stressed upon the training of State Bank personnel in the aims and methods of co-operation and co-operative banking; and wherever suitable, such personnel is to be positively associated with the Boards of Co-operative Credit Institutions so that 'the technical quality of co-operative banking can be assimilated into the higher standards which obtain in commercial banking'.

2.1.5 Subsidiary Banks

The All-India Rural Credit Survey Committee in its report has suggested that the Imperial Bank of India and other State-associated banks should be nationalized and amalgamated into one single unit, viz., the State Bank of India. In 1955, the State Bank of India was formed by transfer of assets and liabilities of the Imperial Bank of India to it, but the other State-associated banks were left out. The State-associated banks did not like to amalgamate themselves with the State Bank nor the State Bank of India agree to absorb them on account of various difficulties, such as, differences in the standard of working, scales of pay of staff, etc. However, after some time, the State Bank submitted a proposal to the State-associated banks for making them as subsidiary banks. Most of these banks agreed to it.

\textsuperscript{25} Ibid, p. 380.
\textsuperscript{26} Ibid, p. 418.
Therefore, the State Bank of India (Subsidiary Banks) Act, 1959, was passed and it received the assent of the President on 10th September 1959. According to provisions of the Act, the following eight State-associated banks were taken over by the State Bank of India as its subsidiaries.

<table>
<thead>
<tr>
<th>Name of the Bank</th>
<th>Subsidiary with effect from</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. State Bank of Hyderabad</td>
<td>1st October 1959</td>
</tr>
<tr>
<td>2. State Bank of Bikaner</td>
<td>1st January 1960</td>
</tr>
<tr>
<td>4. State Bank of Saurashtra</td>
<td>1st May 1960</td>
</tr>
<tr>
<td>5. State Bank of Patiala</td>
<td>1st April 1960</td>
</tr>
<tr>
<td>7. State Bank of Indore and</td>
<td>1st January 1960</td>
</tr>
<tr>
<td>8. State Bank of Travencore</td>
<td>1st January 1960</td>
</tr>
</tbody>
</table>

The separate entity of these banks was retained in the form of subsidiaries to enable them to serve the local needs in their respective areas.

2.1.6 Capital of the Subsidiary Banks and Payment of Compensation

The Authorised capital of the State Bank of Mysore and the State Bank of Travencore was kept at rupees two crores and of other banks at rupees one crore each. All were divided into shares of Rs. 100 each. The State Bank was required to hold at all times not less than 55 per cent of the Issued Capital of that bank. The rest of the capital was to be retained in private hands. As regards compensation to shareholders of existing banks, the

The amount payable was to be determined according to the principles mentioned in the First Schedule of the State Bank of India (Subsidiary Banks) Act, 1959. The Share-holders\textsuperscript{28} were also given option of taking shares in their new respective banks upto the maximum of 45 per cent of the Issued capital. Total compensation payable was Rs. 8.05 crores\textsuperscript{29}.

With effect from 1\textsuperscript{st} January 1963, the State Banks of Bikaner and of Jaipur were amalgamated under the new name of State Bank of Bikaner and Jaipur, with head office located at Jaipur. Thus, after this date there are only seven subsidiary banks of the State Bank of India.

The position of subsidiary bank since 1960 has been shown in Table 2.3. The table shows that 10.0 per cent of deposits and 7.3 per cent of advances in total scheduled commercial banks are shared by State Bank of India group. Thus, in the history of Indian Banking, 1\textsuperscript{st} July, 1955, was an important landmark\textsuperscript{30}, from that day the Government of India transferred the then Imperial Bank of India to the State Bank of India; a long awaited need was thus fulfilled at last.

\textsuperscript{28} State Bank of India, Sections 6 and 7 of the State Bank of India, (Subsidiary Banks) Act, 1959.


Table 2.3

POSITION OF SUBSIDIARY BANKS OF STATE BANK OF INDIA IN 1960

(Rupees in crores)

<table>
<thead>
<tr>
<th>Sl.No.</th>
<th>Name of the Bank</th>
<th>Deposits</th>
<th>Advances</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>State Bank of Hyderabad</td>
<td>19.40</td>
<td>10.71</td>
</tr>
<tr>
<td>2</td>
<td>State Bank of Indore</td>
<td>8.84</td>
<td>6.84</td>
</tr>
<tr>
<td>3</td>
<td>State Bank of Travencore</td>
<td>8.27</td>
<td>4.10</td>
</tr>
<tr>
<td>4</td>
<td>State Bank of Bikaner &amp; Jaipur*</td>
<td>22.97</td>
<td>13.30</td>
</tr>
<tr>
<td>5</td>
<td>State Bank of Mysore</td>
<td>19.94</td>
<td>12.43</td>
</tr>
<tr>
<td>6</td>
<td>State Bank of Patiala</td>
<td>10.70</td>
<td>3.55</td>
</tr>
<tr>
<td>7</td>
<td>State Bank of Saurashtra</td>
<td>13.39</td>
<td>7.93</td>
</tr>
<tr>
<td>8</td>
<td>Total (1 to 7)</td>
<td>103.51</td>
<td>58.86</td>
</tr>
<tr>
<td>9</td>
<td>All Scheduled Commercial banks</td>
<td>1,032.78</td>
<td>807.12</td>
</tr>
<tr>
<td>10</td>
<td>Share of subsidiaries to all Scheduled Commercial banks (8 to 9)</td>
<td>10.0</td>
<td>7.3</td>
</tr>
</tbody>
</table>

Source: Annual Reports of the Banks, 1960.

*From 1963 the State Bank of Bikaner and Jaipur are amalgamated.

2.1.7 Banking Development during 1956-1967 A period of consolidation

The Government kept a watchful eye on the banking system to see that the gains of the nationalization of Reserve Bank of India and State Bank of India should not be frittered away by the misconduct of other banks. Banking legislation passed between the State Bank of India Act, 1955 and the Social Control Act, 1968 sub served the above purpose. In fact, the weeding out process which is called the process of consolidation and strengthening of the banking system was initiated in 1961, soon after the
failure of the Palai Central Bank and Laxmi Bank in 1960. In fact, during the period between 1956 and 1967, a number of amendments came through to improve the working of the banking system or to provide better facilities to the public.

In this connection, the Banking Companies (Amendment) Act, 1961 stipulated a provision to further expedite liquidation proceedings; small depositors were assured of the safety of their funds by making them preferential creditors; and provision was also made for deflection of moratorium on the initiative of the Reserve Bank of India to facilitate the process of compulsory reconstruction or for compulsory amalgamation of banks with other banks. The Reserve Bank of India was further empowered to prepare the scheme of reconstruction or amalgamation of banking companies. As a result of these new schemes, as many as 188 banks were eliminated from banking system by voluntary amalgamation or by compulsory mergers between 1960 and 1965. In 1966, nearly seven weak units were absorbed by bigger banks.

The position of State Bank of India and its subsidiaries from 1955 to 1968 has been shown in Table 2.4. The table indicates that on average having 26.6 per cent of branches and 27.4 per cent of deposits, the State Bank of India and its subsidiaries are rendering 22.4 per cent of advances in total scheduled commercial banks in India. The growth pattern of them in the cases of branches, deposits and advances is to some extent increasing and later it shows a declining trend. The percentage share of branches has
continuously increased to 33.0 per cent in 1962 but later it declined continuously to 30.8 per cent in 1968 whereas the percentage share of them in total deposits also increased (except in 1960) to 32.0 per cent in 1961 from 21.2 per cent in 1955 but later it also declined continuously to 27.0 per cent in 1968. Correspondingly, the percentage share of them in total advances also increased continuously to 29.4 per cent in 1968 except in 1962 and 1963.

Table-2.4
YEAR-WISE POSITION OF STATE BANK OF INDIA AND ITS SUBSIDIARIES FROM 1955 TO 1968

<table>
<thead>
<tr>
<th>Year</th>
<th>State Bank of India and its subsidiaries</th>
<th>All Scheduled Commercial Banks</th>
<th>Share of SBI branches to Total Branches</th>
<th>Share of SBI deposits to Total Deposits</th>
<th>Share of SBI advances to Total Advances</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Branches (In lakhs)</td>
<td>Deposits (Rs. in Crores)</td>
<td>Advances (Rs. in Crores)</td>
<td>Branches (In lakhs)</td>
<td>Deposits (Rs. in Crores)</td>
</tr>
<tr>
<td>1955</td>
<td>484</td>
<td>218.17</td>
<td>133.37</td>
<td>2623</td>
<td>103278</td>
</tr>
<tr>
<td>1956</td>
<td>538</td>
<td>235.66</td>
<td>165.60</td>
<td>2873</td>
<td>132274</td>
</tr>
<tr>
<td>1957</td>
<td>622</td>
<td>366.63</td>
<td>173.48</td>
<td>3273</td>
<td>142794</td>
</tr>
<tr>
<td>1958</td>
<td>712</td>
<td>478.63</td>
<td>172.06</td>
<td>3629</td>
<td>165395</td>
</tr>
<tr>
<td>1959</td>
<td>823</td>
<td>582.11</td>
<td>156.88</td>
<td>3926</td>
<td>193034</td>
</tr>
<tr>
<td>1960</td>
<td>901</td>
<td>577.35</td>
<td>232.24</td>
<td>4150</td>
<td>195339</td>
</tr>
<tr>
<td>1961*</td>
<td>1436</td>
<td>657.37</td>
<td>323.31</td>
<td>4393</td>
<td>204891</td>
</tr>
<tr>
<td>1962</td>
<td>1521</td>
<td>675.13</td>
<td>341.26</td>
<td>4668</td>
<td>225111</td>
</tr>
<tr>
<td>1963</td>
<td>1633</td>
<td>712.20</td>
<td>264.69</td>
<td>5004</td>
<td>247744</td>
</tr>
<tr>
<td>1964</td>
<td>1751</td>
<td>800.27</td>
<td>488.80</td>
<td>5499</td>
<td>282414</td>
</tr>
<tr>
<td>1965</td>
<td>1779</td>
<td>881.47</td>
<td>593.60</td>
<td>5964</td>
<td>315905</td>
</tr>
<tr>
<td>1966</td>
<td>1955</td>
<td>1,02499</td>
<td>657.54</td>
<td>6360</td>
<td>371787</td>
</tr>
<tr>
<td>1967</td>
<td>2107</td>
<td>1,12204</td>
<td>757.24</td>
<td>6779</td>
<td>408484</td>
</tr>
<tr>
<td>1968</td>
<td>2294</td>
<td>1,23606</td>
<td>925.68</td>
<td>7441</td>
<td>461032</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India, Statistical Tables Relating to Banks in India from 1955 to 1968, Bombay.

*Subsidiaries are included.
2.1.8 Social Control: A Transitory Phase

Official recognition of the need to have a close look at the working of the commercial banks came in the wake of a crucial debate in the Rajya Sabha in May 1967\(^{31}\) on a non-official resolution calling for nationalization of banks. The Government accepted, at the conclusion of the debate, an amended resolution committing itself\(^{32}\) to “such steps including nationalization as may be necessary to extend effective social control over these institutions...” Significantly, the Government did not oppose nationalization in contrast to the stand it had taken earlier on similar resolutions. It offered to keep an open mind and undertook to examine all aspects of the question. In accordance with the commitment given by the Government, an intensive examination of the policies and practices, was undertaken leading to the formulation of the policy of social control. The policy\(^{33}\) was announced in Parliament in December 1967.

The basic objective of the social control policy was\(^{34}\) “to ensure, in the immediate future, an equitable and purposeful distribution of credit, within the resources available, keeping in view the relative priorities of developmental needs”. The major instrument conceived of for this purpose

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was the National Credit Council at the All-India level for “assessment of the demand for bank credit from various sectors of the economy” and “determining priorities for grant of loans and advances for investment, having regard to the availability of resources and requirements of the priority sectors in particular agriculture, small-scale industry and exports”. The policy statement took particular care to elaborate that the object of the package was to put through the “short-term measure” to achieve re-orientation of the outlook for the banking system. The crux of the problems was underlined as one of slow deposit growth, due to the inadequate level of savings; and with a large volume of saving accruing to the banking system, the allocational problem would recede to the background.

While accepting the importance of the equitable distribution of resources particularly in the short run, the refrain through the social control policy statement and the National credit council resolution was the explicit concern for only three sectors: agriculture, small-scale industry and exports. In fact, it was in a way the inevitable a corollary of the official diagnosis. The package of social control measures was intended to meet, as the policy statement sought to highlight, the persistent complaints” that several priority sectors such as agriculture, small-scale industries and exports have not been receiving their due share of bank credit”.

The council was composed of representatives from various sectors. The council was to be a forum where “relative claims of credit of different sectors could be discussed and priorities determined”. Association of interest groups would, it was explicitly mentioned, “help the council in taking
appropriate decisions on budgeting and planning of overall credit". The process of competing pulls would, it was thought, result in a rational allocation of credit and the question of the representation on the council of the diverse interest groups received primary attention.

Another important part of the package was a group of legislative measures to ensure that the decisions of the Reserve Bank made in the light of the deliberations of the council were implemented by the commercial banks. Doubts were expressed whether the banking system, because of their "close traditional links" with industrial and business houses, could be relied upon to discharge the responsibility of bringing about a change in the pattern of lending and investment. If particular clients or groups of clients were not to be favoured in the matter of distribution of credit, their influence would have to be neutralized in the constitution of the Boards of Directors and in the actual credit decision made at different level of the bank managements. The bank managements\textsuperscript{35} would have to be given appropriate guidelines and their implementation ensured by "Orienting their decision making process".

2.1.9 Implementation of Social Control Policy

While the social control policy was announced in December 1967, and the legislation amending the Banking Regulation Act came into force on 1\textsuperscript{st} February 1969, the commercial banks had, in anticipation of the proposed statutory changes, completed the reconstitution of the Board and appointed

ion-industrialist professional bankers as chief executives. The reconstitution was entirely a matter for the banks and the Reserve Bank had no legal authority to intervene so long as the arithmetical requirements had been duly complied with. A comparison of the Boards of the fourteen major banks in the private sector as on 1st January 1967, and as on 18th July 1969 after they had been duly reconstituted, indicates that out of 146 directors as many as 39 were continuing on the Boards of the reconstituted Boards; in four banks, 32 out of 39 directors continued to serve on the new Boards. Simultaneously with the change in the composition of the Boards, the banks initiated necessary steps in arranging to transfer to other banks borrowal accounts in which their directors were interested. The amending legislation gave them a period of one year from the commencement of the new Act within which to eliminate such loans already on their books. However, before the Act formally came into force, 16 major banks (including the State Bank of India) had, between December 1967 and December 1968 reduced the loans to directors and their concerns from 10.1 per cent of the total advances to 3.1 per cent.

In the first meeting of the council in March 1968, there was general agreement that the main issues were to deposit mobilization and credit allocation to particular sectors though, in their conception of the range of priority sectors, the council made a specific mention of agricultural credit.

36 Morarji Desai, A Note on working of social control over the Commercial Banking System presented In the 1969 session of the AICC at Faridabad, P.S. reprinted In "Banking Policy in India : An Evaluation" by Ghosh, D.N., Allied Publishers Private Limited, 1979, p. 219
However, as the problems of credit planning were complex if appointed a standing committee, with the Governor of the Reserve Bank as its chairman, to formulate concrete proposals for the consideration of the council. The second meeting of the council in July 1968 endorsed the recommendations of the Standing Committee that commercial banks should take up the financing of agriculture and small-scale industries to a larger extent as a matter of urgency. The second meeting of the council setup five study groups for specific issues.

(a) deposit mobilization by commercial and co-operative banks;
(b) inflation of the credit needs by Industry and trade;
(c) organisational framework for the implementation of objectives of social control;
(d) area / project approach for agricultural credit, and
(e) bank finance for road transport operators.

The third meeting of the council, held on 21 March 1969, the last occasion it met, suggested a positive target for the expansion of branches, namely, every town with a population of more than 10,000 should be covered by banking facilities by the end of 1970. This was an endorsement of the report of the Study Group on deposit mobilization. The report of the Study Group on bank finance to road transport operators, which had also become available in the meantime, was considered by the council and it suggested that credit to them should be treated on lines similar to those of

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While the council had indicated specific guidelines in respect of agriculture and small-scale industries, it indicated generally that the aim of commercial banks should be to fill credit gap in respect of small borrowers and particularly the weaker section of the community. As an illustration, retail trade was indicated as an area where the banks could increase their involvement.

2.1.10 Nationalisation: Objectives and Performance

Objectives of Nationalisation

In her broadcast address on 19 July 1969, the day on which the fourteen major banks were nationalized, the then Prime Minister Indira Gandhi explained that nationalization was intended to "accelerate the achievement" of the objectives of social control, which were elaborated as:

1. removal of control by a few,
2. provision of adequate credit for agriculture and small-scale industry and exports,
3. giving of a professional bent to management,
4. encouragement of new classes of entrepreneurs, and
5. the provision of adequate training as well as terms of service for bank staff.

One could conceivably argue that nationalization was being looked upon not as a radical departure from the social control phase, but as an acceleration of the process initiated through the package of social control measures. The explanatory statement on bank nationalization made in Parliament two days later on 21 July 1969 was also in the same refrain.

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except for the emphasis it sought to place on the role of the nationalized banks as a catalytic agent for growth. The statement emphasized, that it would be\textsuperscript{39} "one of the positive objectives of the nationalized banks to actively foster the growth of the new and progressive entrepreneurs and to create fresh opportunities for hitherto neglected and backward areas in different parts of the country".

And the banking system\textsuperscript{40} touches the lives of millions and has to be inspired by larger social purpose and has to subserve national priorities and objectives, such as rapid growth in agriculture, small industries and exports; raising of employment levels, encouragement of new entrepreneurs and the development of the backward areas. For this purpose, it is necessary for Government to take direct responsibility for the extension and diversification of banking services and for the working of a substantial part of the banking system. Ownership by the Government was considered vitally important for extension and diversification of banking services. It would appear from the contemporary official pronouncements that several objectives were given equal prominence and the nationalized sector of banking was expected to give simultaneous attention to all these objectives. As these lacked specificity in operational terms, what were set forth as main aims for the public sector banks comprised the fulfillment of two main objectives, namely, mobilization of deposits through a massive programme of branch expansion especially in

\textsuperscript{39} Ibid.

the unbanked rural areas, and diversification of bank credit to ensure a flow of financial assistance to the neglected sectors of the economy in an increasing measure.

Following the introduction of the scheme of social control, the tempo of branch expansion no doubt accelerated substantially. The number of bank offices went up by 665 during the first year (1968) of social control and no fewer than 785 new offices were opened during the first six months of 1969. But there was no significant re-orientation of the lending activities of banks so as to ensure that the legitimate credit requirements of priority sectors and weaker sections were adequately met. In many banks, people who had been controlling their policies in the past continued to exercise their influence over them in one way or another, some times by the continued presence of the board chairman or vice-chairman on the boards of the banks. Even the directions issued by the Government were not followed by many of the banks. Advances to priority sectors as of June 1969 amounted to just Rs. 500 crore, constituting not more than 14 per cent of gross bank credit. Agriculture accounted for Rs. 190 crore, small industries for Rs. 280 crore and all other priority sectors put together for Rs. 30 crore. It was felt that social control was not sufficient to make the commercial banking system a meaningful instrument of socio-economic policy. Expansion of public sector banking was considered inevitable. Hence, on 19 July 1969, Government of India promulgated an ordinance, called the Banking companies (Acquisition and Transfer of Undertakings) ordinance, 1969, in terms of which the Central Government acquired the undertaking of the 14 biggest commercial banks.
incorporated in India which had deposits of not less than Rs. 50 crore each. The names of the fourteen major commercial banks are Allahabad Bank, Bank of Baroda, Bank of India, Bank of Maharastra, Canara Bank, Central Bank of India, Dena Bank, Indian Bank, Indian Overseas Bank, Punjab National Bank, Syndicate Bank, Union Bank of India, United Bank of India and United Commercial Bank. The position of total public sector banks at the time of Nationalisation has been shown in Table 2.5. The table reveals that at the time of nationalization, the 83.3 per cent of branches, 93.0 per cent of deposits and 93.7 per cent of advances are shared by the public sector banks.

Table-2.5

POSITION OF SCHEDULED COMMERCIAL BANKS IN INDIA IN 1969

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Name of the Bank</th>
<th>Total Branches (No. in lakhs)</th>
<th>Total Deposits (Rs. in Crores)</th>
<th>Total Advances (Rs. in Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>State Bank of India</td>
<td>1,569 (19.8)</td>
<td>1,114.11 (23.2)</td>
<td>841.36 (24.8)</td>
</tr>
<tr>
<td>2.</td>
<td>Subsidiaries of State Bank of India</td>
<td>893 (11.3)</td>
<td>324.96 (6.8)</td>
<td>279.54 (8.2)</td>
</tr>
<tr>
<td>3.</td>
<td>14 Nationalised Banks</td>
<td>4,134 (52.2)</td>
<td>3,034.61 (63.0)</td>
<td>2,061.68 (60.7)</td>
</tr>
<tr>
<td>4.</td>
<td>Other Scheduled Banks</td>
<td>1,319 (16.7)</td>
<td>334.24 (7.0)</td>
<td>213.40 (6.3)</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>7,915 (100.0)</td>
<td>4,807.92 (100.0)</td>
<td>3,395.98 (100.0)</td>
</tr>
</tbody>
</table>

Note: Figures in parentheses indicate the percentage to the total.

Source: Reserve Bank of India, Statistical Tables Relating to Banks in India, 1970, Bombay.
2.1.11 Nationalisation of Six more Banks

On 15th April 1980, the President of India promulgated an ordinance "to provide for the acquisition and transfer of the undertakings of certain banking companies, having regard to their size, resources, coverage and organisation, in order, further, to control the heights of the economy, to meet progressively and serve better, the needs of the development of the economy and to policy of the state towards recurring the principles laid down in clauses (b) and (c) of article 39 of the constitution and for matters connected therewith or incidental there to". With this ordinance, the following six banks passed into the ownership of Government:

1. The Andhra Bank Limited
2. The Punjab and Sind Bank Limited
3. The New Bank of India Limited
4. Vijaya Bank Limited
5. Corporation Bank Limited and
6. The Oriental Bank of Commerce Limited

Unlike in the case of the banks nationalized in 1969, the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1980, stipulated the mode of compensation following nationalization. The amount of compensation to the banks was shown in Table 2.6.
Table-2.6

COMPENSATION GIVEN TO THE SIX NATIONALIZED BANKS IN 1980

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Name of the bank</th>
<th>Amount of compensation (Rs. in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>The Andhra Bank Limited</td>
<td>610</td>
</tr>
<tr>
<td>2.</td>
<td>The New Bank of India Limited</td>
<td>510</td>
</tr>
<tr>
<td>3.</td>
<td>Vijaya Bank Limited</td>
<td>240</td>
</tr>
<tr>
<td>4.</td>
<td>The Punjab and Sind Bank Limited</td>
<td>210</td>
</tr>
<tr>
<td>5.</td>
<td>Corporation Bank Limited</td>
<td>180</td>
</tr>
<tr>
<td>6.</td>
<td>The Oriental Bank of Commerce Limited</td>
<td>100</td>
</tr>
</tbody>
</table>

The amount was to be given to the banks at their option in the following form:

(a) In cash (to be paid by cheque drawn on the Reserve Bank) in three equal annual installments the amount of each installment carrying interest at the rate of five and a half per cent per annum from the commencement of the ordinance, or

(b) In saleable or otherwise transferable promissory notes or stock certificates of the Central Government issued and repayable at par, and maturity at the end of:

i. Ten years from the commencement of the ordinance and carrying interest from such commencement at the rate of six per cent per annum, or

ii. Thirty years from the commencement at the rate of seven per cent per annum, or

(c) Partly in cash (to be paid by cheque drawn on the Reserve Bank) and partly in such number of securities specified in sub clause (i) or sub-clause (ii) or both, of clause (b) as may be required by the existing bank, or
(d) Partly in such number of securities specified in sub-clause (i) of clause (b) and partly in such number of securities specified in sub-clause (ii) of that clause as may be required by the existing bank.

Therefore, at the end of the year 1980 the total public sector banks are 28. The position of all groups of the banks has been shown in Table 2.7 and Chart II.I. The table shows that at the time of the nationalization of six more commercial banks in 1980, the percentage share of branches, deposits and advances of public sector banks account 89.7 per cent, 94.7 per cent and 95.4 per cent. The structure of the commercial banks at present in India has been shown in Chart II.I.

Table-2.7

POSITION OF SCHEDULED COMMERCIAL BANKS AT THE END OF 1980

<table>
<thead>
<tr>
<th>S. No</th>
<th>Name of the Bank</th>
<th>Total Branches (No. in lakhs)</th>
<th>Total Deposits (Rupees in Crores)</th>
<th>Total Advances (Rupees in Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>State Bank of India</td>
<td>5,169(25.8)</td>
<td>9,295,02(22.3)</td>
<td>7,212,50 (27.4)</td>
</tr>
<tr>
<td>2.</td>
<td>State Bank Associates</td>
<td>2,563(12.8)</td>
<td>2,410,35(5.8)</td>
<td>1,490,29 (5.6)</td>
</tr>
<tr>
<td>3.</td>
<td>14 Nationalised Banks</td>
<td>3,119(15.5)</td>
<td>24,697,45(59.3)</td>
<td>14,609,40 (55.4)</td>
</tr>
<tr>
<td>4.</td>
<td>6 Banks Nationalised Banks on 15th April, 1980</td>
<td>2,674(13.3)</td>
<td>2,781,39(6.8)</td>
<td>1,575,43 (6.0)</td>
</tr>
<tr>
<td>5.</td>
<td>Regional Rural Banks</td>
<td>2,675(13.3)</td>
<td>213,61(0.5)</td>
<td>253,46 (1.0)</td>
</tr>
<tr>
<td>6.</td>
<td>Other Scheduled Commercial Banks</td>
<td>3,864(19.3)</td>
<td>2,240,78(5.3)</td>
<td>1,217,38 (4.6)</td>
</tr>
<tr>
<td>Total</td>
<td>20,064(100.0)</td>
<td>41,638,60 (100.0)</td>
<td>26,358,46 (100.0)</td>
<td></td>
</tr>
</tbody>
</table>

Note: Figures in parentheses indicate the percentage to the total.

Source: Reserve Bank of India, Statistical Tables Relating to Banks in India, Bombay, 1981.
CHART - II.1

SHARE OF PUBLIC SECTOR BANKS IN TOTAL COMMERCIAL BANK BRANCHES, DEPOSITS AND ADVANCES

Note:
PSB = Public Sector Banks
O = Other Commercial Banks
CHART - II.II

THE INDIAN BANKING SYSTEM

Reserve Bank of India

Commercial Banks | Regional Rural Banks

Public Sectors Banks | Private Sectors Banks

State Bank Group | Other Nationalised Banks

Indian | Foreign

State Bank of India | Associate Banks

Co-operative Banks

State Co-operative Banks

Central Co-operative Banks

Primary Credit Societies