CHAPTER II

SOME FEATURES OF BANKING

The Indian banking industry has been evolved itself as a powerful instrument for economic growth. The banking habit has to be spread through the establishment of new branches in urban, semi-urban and rural areas. This will enable the banking industry to mobilise savings at an accelerated rate, provide better customer services, deploy credit for productive use, effectively implement the monetary policy of the Reserve Bank of India, and spread the banking habit among people. Thus, a sound banking calls for a sound banking policy and effective organisation to widen and deepen banking services on integrated approach.

In this chapter, an attempt is made to examine some of the aspects of banking, particularly the manner in which branch banking has assisted the growth of banking and also the economic and other implications of extending banking facilities to the rural and semi-urban areas.

A BRIEF HISTORY OF BANKING:

Joint-stock banking was first introduced in India by the agency houses. The General Bank of India
was one of the earliest joint-stock banks established in India. The three banks namely the Bank of Bengal (1809), the Bank of Bombay (1840), and the Bank of Madras (1843) were known as Presidency Banks and were amalgamated in 1921 to form the Imperial Bank of India. In 1935, Reserve Bank of India came into existence and is the Central Bank of the country. It keeps the financial structure upon an even keel. The Banking Regulations Act, 1949 came into force on March 16, 1949 to promote and develop banking industry on right and sound lines. In 1955, the State Bank of India Act was passed to transform the Imperial Bank into a State-owned bank. The State Bank of India (subsidiary banks) Act was passed in September 1959, enabling the State Bank of India to take over eight State-owned or State associated banks as its subsidiaries. The motivation was to expand the banking into rural and semi-urban areas. The Government of India nationalised 14 major banks on July 19, 1969 and six more on April 15, 1980. From the above discussion it can be said that onwards of Independence, steps have been taken to regulate and promote banking sector on sound and proper lines; and to make available banking services to an ordinary man.
OBJECTIVES OF BANK:

Improving the socio-economic status of the people is the main objective of banking industry. This main objective is being achieved through:

1. Means and mechanism for effective use of resources;
2. Mobilising savings and deploying them in accordance with national priorities;
3. Engulfing credit gap;
4. Associating in national programmes for higher production; and
5. Subserving the social aims.

FUNCTIONS OF BANK:

Achieving the objectives as said above depends on the functions which are undertaken by an institution. The history of banking disclosed that it was essentially trade-oriented. During planning era a host of service functions had witnessed. However, the basic functions of a bank are continued on two activities namely, (1) receiving deposits and honouring the depositor's demand, and (2) lending funds. Besides deposit mobilisation and their deployment which are the core of banking activities, the commercial banks perform agency and
general utility functions to render a variety of services to their customers.

RURAL ORIENTATION:

India's population is more than 84 crores and more than 75 per cent of her population live in rural areas. Country's rural population is mainly engaged in agriculture and allied activities. Poverty and unemployment are still rampant in rural society. Thus, rural development in general and agricultural development in particular command top priority in any economic development programme. In other words, development without rural development is a distant hope.

BRANCH POLICY:

Having significant thought on this issue, a change felt towards production-oriented in the theory and policy of banking sector meriting optimum production by diverting credit as much as possible from speculation to productive. Banks have an important task in developing saving habit among rural population through their branches expansion programme. Thus, effective branch expansion policy is of utmost important to envisage thrust of nationalisation. Till 1956, the Reserve Bank of India followed a cautious policy on branch expansion
in view of the unhealthy nature of war time expansion and post-war, post-partition strains in the economy. A liberal branch licencing policy was adopted after 1956, and all licenced banks were ordinarily permitted to open branches on liberal basis. But, the banks selected only the developed urban areas for opening branches. The branch licencing policy was further liberalised in March 1968. Under this expansion programme, the main emphasis was on the opening of offices in semi-urban and rural centres. In May 1968, commercial banks were asked to aim at opening at least one-third more branches than they had opened under the earlier expansion programme. At least 50 per cent of the total branches were to be in rural and semi-urban areas.

Keeping in view the need for rectifying the deficiencies in branch expansion that continued to persist in urban areas, particularly in the context of emphasis on rural development and in the light of recommendations of James Raju and Dantwala Committees, a comprehensive branch licencing policy for the years from 1979-1981 was formulated by the Reserve Bank of India in August, 1978. The new policy inter alia, provided for the opening of 6,500 additional bank offices in rural and semi-urban areas of the deficit districts of the
country. Another branch licencing policy for the three year period from April 1982 to March 1985 laid continuous emphasis on increasing banking facilities in rural and semi-urban areas; and on reducing inter-regional disparities in the spread of banking facilities. A Five Year branch licencing policy coterminus with the Seventh Five Year Plan (1985-1990), was formulated by the Reserve Bank of India. The main objective of this policy was to achieve a coverage of 17,000 population (1981 census) per bank office in rural and semi-urban areas of each block.

Thus, it is clear that the main thrust of the successive branch licencing policies continues to be on improving banking facilities in rural areas, with greater emphasis on a proper spatial distribution of branches to provide comprehensive coverage for all the rural areas. As a result of the deliberate policy pursued vigorously after nationalisation to take banking to rural and less developed areas, there is now a much dispersal of banking facilities. However, the spreading of bank branches to rural and semi-urban areas has never been an easy job.

Opening of a branch in unbanked rural area is far more arduous and exacting than opening yet another branch in a well-developed centre. One of the difficulties
which banks have had to face in opening new branches in rural areas is that of finding suitable premises for the new offices.

Banks are faced with certain difficulties in respect of meeting the staff requirements of these branches. Although, these difficulties do limit to some extent the ability of banks to undertake a programme of branch expansion in rural areas on a large scale. However, they are not quite formidable. This is not all. There are certain difficulties on the operational side. As a result of which, the working of a rural branch cannot be achieved as easily and smoothly as in the case of its urban counterpart. One of the most important difficulties relates to management of cash resources at these branches. While none of these difficulties pose a very serious problem to banks, the fact remains that, as a result, the operating expenses as well as the financial burden on these branches tends to be higher.

The real problem faced by banks in their branch expansion programmes are in the fields of organisation and costs. Rural branches take about five years to reach the break-even point. Even after that period, their profitability remains comparatively low. It is
a well-known fact that most of the offices opened in rural and semi-urban areas in the past twenty-two years have shown huge losses, and it is not certain when they would reach break-even point.

However, in spite of the above factors, the banks will have to systematically expand their offices in rural and semi-urban areas, preference being given to those regions which have more than the national average of population per office. The opening of such branches will have to be viewed not only from profitable angle but as agencies for bringing about a socio-economic change in their area of operations. Hence, from the long-term development strategy point of view, the present policy of expanding bank offices in rural and semi-urban areas will have to be continued to assist in the rapid development of the Indian economy and in ensuring the success of the integrated rural development programme. India's prosperity entirely depends on rural prosperity.

CREDIT POLICY:

A major requirement of successful credit administration is an accurate estimate of credit needs in various sectors of the economy. The quantum, the
character and composition, direction and distribution of credit are of paramount importance in the context of economic development. In brief, credit policy is concerned with the enunciation of a broad policy guidelines for the sectoral flow of funds in accordance with the declared socio-economic objectives and the availability of resources. The main objectives of the credit policy are:

1. To ensure safety of advances.
2. To provide sound assets and to safeguard depositors' funds.
3. To match the planned loan outlay with resource outlay.
4. To ensure overall profitability, etc.

Credit policy differs from bank to bank and depends upon traditions, strengths and weaknesses. In formulating a credit policy, the policy makers should have adequate knowledge of banking industry, finance, customers' needs, history of depositors and borrowers, political, economic and social environment of the country, current guidelines of the Government and the Reserve Bank of India, future trends of deposits and advances; and staff skills available in the banks.
The primary emphasis of credit policy prior to nationalisation was on ensuring uninterrupted flow of credit to industrial concerns, wholesale trade and commerce. While the credit to industry has increased from 34 per cent in 1951 to 67 per cent in 1969, the agricultural sector credit almost remained the same proportion (i.e., 2.10 per cent in 1951 and 2.20 per cent in 1969). The reasons for the high concentration on industrial credit were facilitated as a result of (i) very low capital base of banks managed by a few persons and (ii) inter-locking directorship and corporate finance. Often the political forums stirred to curb this class banking. "To play their proper role in the expanding economy of India, it is very necessary for our commercial banks follow a progressive credit policy as contrasted with the traditional conservative policy".

Following nationalisation, a new credit policy envisaging extension of banking facilities to priority

and neglected sectors on preferential terms and conditions was framed. Virtually, there was ten-fold increase in bank lending to the weaker and depressed sections of the society in less than ten years after nationalisation. The target fixed for the priority sector advances has been considerably raised in the recent years from 33.30 per cent at the end of March, 1979 to 40 per cent by the end of Sixth Plan. The new credit policy is two pronged:

1. Liberal credit policy to priority and neglected sectors; and
2. liberal credit policy pertaining to projects in backward rural areas and to help correct regional imbalances in the economy.

CHANGED CONCEPT:

The Indian banking industry has undergone a radical transformation in the scale and scope of its operations in response to the changes that have taken place in the social, political and economic environment. It is completely different from what it was 22 years ago.

in the quality, style and range of services offered by commercial banks in India. The revolutionary change and the dramatic transformation that have taken place in the profile of Indian banking since nationalisation, speak of the banking system's dynamic response to the challenging tasks set before it. Thus, the banking sector has shown remarkable responsiveness to the needs of planned economy. As a consequence, the branch network has increased from 8,262 in June 1969 to 59,645 in March 1991. Deposits have increased from Rs. 4,665 crores in June 1969 to Rs. 2,00,036 crores as at the end of March 1991, and bank credit stood at Rs. 1,32,510 crores. What is more, the banks have been adding over Rs. 26,000 to Rs. 28,000 crores to their deposits every year. It is indicative of the fact that their deposits growth has gathered momentum in the recent years. At this rate the banks are likely to add additional deposits of over Rs. 5 to 6 lakh crores during the next ten years. The colossal growth of the banking system during this decade will not only be impressive but also indicative or rapid development. This phenomenal growth also calls for professional management, innovative instruments, quick services and entrepreneurial skills. Apart from unprecedented growth and functional diversification, the
post-nationalisation period has witnessed a complete reorientation of banking from 'class' banking to 'mass', from 'asset base' lending to 'production oriented' lending, and from 'elite' banking to 'social' banking. There has, in fact, been a change in the very concept, precept and outlook of banking industry, and it has no parallel in the annals of banking anywhere in the world. What indeed is creditable is the fact that the banking industry in India had no precedent to follow upon its own ingenuity and innovativeness to gear itself to execute the challenges of 21st century.