CHAPTER II

EVOLUTION OF BANKING INSTITUTION

In this chapter, the researcher studied in detail the origin of commercial banking, early history of commercial banking, growth and development of banking in India.

The word "Bank" is derived from the word "bancus" or "banque" which means a bench. The early bankers, (the Jews in Lombardy) transacted their business on benches. When a banker failed his "banco" was broken up by the people, from which the word "bankrupt" came into existence. There are others, who are of the opinion that the word "bank" is originally derived from the German word "banck" meaning a joint stock fund, which was italianised into "banco", which appears to be more possible. Professor Ramachandra Rao observed that the history of banking dates back, from the middle ages in Europe.

EARLY HISTORY OF BANKING

As early as 2000 BC, there is evidence to show that the temples of Greece were used as banks. But the spread of irreligion soon destroyed the public sense of security in depositing money and valuables in temples, and the priests were no longer acting as financial agents.

The followers of Aristotle's dictum was that the charging of interest was unnatural and immoral. The Hebrews had maintained moneylenders business and made no sin of interest, but only of usury. However, upon the revival of civilisation, banks were established in the middle of the 12th century at Venice and Genoa, though in fact they did not become banks as we understand them today.

In the 14th Century money dealers in Florence, received money on deposits and were lenders of money, and at one time these bankers' were said to have had eighty banks, though it could boast of no public bank.

In Rome, the banking institutions which were called "Tabernae Argentariae" or "Menasae Numulariae", conducted their business independently, using cheques and drafts. They called the draft "attributio" and

payment of money by drafts as "prescribere" and "rescribere", and a kind of loan banks at Rome, lent money free of interest to the poor citizens.

However in many countries, with the advancement of civilization, public or national banks were established to facilitate commerce or to serve the Government.

The Bank of Venice is supposed to be the oldest bank established as early as 1171 AD. Later a public bank was established by the magistrates of Barcelona in 1401.

The Bank of Genoa came into existence in 1407. In 1609, the Bank of Amsterdam was founded. Most of the banks now in existence are established on the model of the Bank of Amsterdam.

Merchants of England started depositing their daily cash with the goldsmiths along with other valuables. Goldsmiths acknowledged the same by issuing receipts known as "Goldsmiths’ Notes", wherein there is an undertaking by the goldsmiths to repay the amount on demand to the depositor or to the bearer of the receipt. Realising that the entire cash was not withdrawn by the depositor they started keeping only a part of cash with them

and lend out the remaining portion in the form of bank notes subject to a condition of repayment within a fixed time.

In due course, goldsmiths started giving interest on deposits and also maintained "pass books". (which were earlier known as "passage books"). Later the goldsmiths confined themselves only to banking business as it was profitable and gave up their goldsmith business. This resulted in the emergence of independent banking concerns and thus goldsmiths laid the foundation for the modern banking business. They performed all functions such as accepting deposits, issue of banking notes, giving loans and maintaining passbooks which are associated today with the customer services of modern commercial banks.

In 1672 Goldsmiths banking business was revived when Charles II failed to repay the heavy borrowings. To win the confidence of other depositors, some goldsmith offered the facility of withdrawing money without notice akin to the present current account. But the distrust the public had of goldsmiths proved to be a turning point and at this stage private banking based on jointstock principles emerged in England. The Bank of England was established in 1694 and from 1858 onwards many jointstock banks with limited liability were established in England5.

BANKING SYSTEM IN INDIA

In India there were evidences in "Arthasastra" (3000 B.C.) and "Manu Smriti" about the existence of "banking" business.

Aurangazeb in his regime conferred the title of "seth" as the most eminent banker of his time known as Maneekchand. Seth Maneekchand and his five other brothers were equally great bankers. But it is equally true that the Indian banking, received a certain amount of setback during the long reign of Aurangazeb, an orthodox muslim who objected to the idea of taking interest on money as unnatural and immoral.\(^6\)

The first banking institution in India is said to be the "Bank of Hindustan" started in 1770 by Alexander and Co., an english agency house in Calcutta, which failed in 1782 due to the failure of its agency house. The Bank of Bengal in 1806, the Bank of Bombay in 1840, and the Bank of Madras in 1843 were the successors to the agency houses. By this time a number of joint stock company banks with limited liability were established in 1860. The Bank of Upper India (1863), the Allahabad Bank (1865), the Bangalore Bank (1868), the Alliance Bank of Simla (1874), etc. came into being.

Indian-managed joint stock banks such as Oudh Commercial Bank in 1881, Punjab National Bank in 1894, the Bank of India, the Indian Bank of Madras, the Central Bank of India and the Bank of Baroda and the like were also established\(^7\). Banking in the modern sense came into being with the establishment of three Presidency banks.

These banks were floated by the East India Company to facilitate borrowings of the government and maintenance of credit. These Presidency banks were amalgamated in January 1921 into Imperial Bank of India. The intention was to create a Central Bank in the country with the monopoly of note issue and serve as banker's bank and a government bank. To begin with, it was shareholders bank until its transformation into the State Bank of India in July 1955.

The evolution of bank marketing in post-independence India can be broadly classified into three phases, namely pre-nationalisation period (preceding 1969), the post nationalisation period (after 1969 and upto the mid eighties) and the modern period (after the mid eighties). Reflecting the marketing stance of Indian banks during these three phases, they have been named the "Traditional banking period", the "Development banking period" and the "Bank marketing period" respectively. These names are reflective of

only the major trends and there could be even overlapping. (for example, even in the bank marketing period, development banking continues to be relevant and vice-versa)\(^8\)

**TRADITIONAL BANKING PERIOD**

Meticulous maintenance of accounts books and an inward-looking approach in transacting business with the customers, strict adherence of rules and regulations both in mobilisation of deposits and deployment of funds were followed. Top priority for security was given only while sanctioning loans.

Thus security oriented approach to lending, as against the need-based approach was followed. As a result only rich people and industrialist who were able to offer security enjoyed the banking services. That is why this period was termed as the "Class Banking" era of Indian banking as against the era of "Mass Banking" after nationalisation of the commercial banks in 1969.

**DEVELOPMENT BANKING PERIOD**
(Post-nationalisation period from 1969 to mid 1980's).

After nationalisation there were 22 public sector banks including SBI and its subsidiaries and many private sector banks were urging each other in mobilising deposits and lending loans. Spurred by the well-known socio

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economic objectives of nationalisation, the public sector banks went in for phenomenal branch expansion during the seventies to cover practically every nook and corner of the country. Financial assistance on a very large scale was made available to economically weaker sections of the society, agriculturists, small scale industrialists, small traders and others. Practically, it may be said that purpose oriented lending instead of security oriented lending was adopted. On the deposit side, to mobilise more deposits banks tailored many new and novel deposits schemes.

To a large majority of the masses, this era offered their first-ever opportunity to enter the portals of a bank branch and they gratefully tapped up all that they got there. In any case the banker was doing them a great favour by reaching out to them on their doorsteps - an experience which had no precedent.

At the very best, the banker adopted a "selling" stance. But it must be remembered that during this period the banker pushed his range of banking products amongst the customers in order to achieve the predetermined levels of deposits and advances fixed by his superiors.

The banks came out with its market segmentation scheme and innovative loan products like IRDP (Integrated Rural Development Programme), DRI (Differential Rate of Interest) Scheme, Crop loan, etc. were
extensively marketed. Rural branch expansion was given so much importance and the banks were compelled to open rural branches in order to open branches in the urban and metropolitan areas.

**BANK MARKETING PERIOD**  
*(The Modern period - after mid 1980s)*

There was competition among the public and private sector banks in rendering services to the rural masses. Inadequate communication and transport network in the countryside, resulted in customer dissatisfaction with banking services.

The RBI urged commercial banks to take stock of the state of affairs, consolidate their gains and go slow on branch expansion, thus ushering in the period of consolidation. The management and to some extent the banks could visualise the risks inherent in continuing to do business as before and decided to introduce the principle of marketing in banking also.

Bank marketing means identifying the prospective customers, and their needs, and retaining them. Bank marketing can be

- selling of bank schemes
- persuading the prospective customer to bank with them.
- finding out customer needs
- deposit mobilisation
- talking politely to the customer
- aiming at customer satisfaction.

FINANCIAL DISINTERMEDIATION

The process of financial disintermediation has posed a serious threat to the very survival and growth of basic banking activities. In this scenario, the banks were looking for alternatives to survive and thrive. At this stage the 'discipline' of bank marketing were exercised, with its emphasis on the customer to the entire banking operations, which gave way to a number of new banking services and rising customer needs and expectations.

Wide spread television viewing, rising standard of living, higher propensity for consumption among the middle class, job mobility, entry of foreign and private sector banks, government intervention, formulation of consumer protection act have all contributed towards the rising customer needs and satisfaction. In addition to the above factors, liberalisation and globalisation policy adopted by the Indian Government also contributed towards the increasing need of the Customer Service.

To satisfy the needs and expectations of the customer, bankers started introducing the Concept of Customer Services in commercial banks.