

AN OVERVIEW OF BANKING SYSTEM IN INDIA

* Mohd. Abdul Taufeeq, Research Scholar, Dr. Babasaheb Ambedkar Marathwada University, Aurangabad.

Introduction

A bank is a financial institution that provides banking and other financial services to their customers. A bank is generally understood as an institution which provides fundamental banking services such as accepting deposits and providing loans. There are also non-banking institutions that provide certain banking services without meeting the legal definition of a bank. Banks are a subset of the financial services industry.

A banking system also referred as a system provided by the bank which offers cash management services for customers, reporting the transactions of their accounts and portfolios, through out the day. The banking system in India, should not only be hassle free but it should be able to meet the new challenges posed by the technology and any other external and internal factors. For the past three decades, India's banking system has several outstanding achievements to its credit. The Banks are the main participants of the financial system in India. The Banking sector offers several facilities and opportunities to their customers. All the banks safeguard the money and valuables and provide loans, credit, and payment services, such as checking accounts, money orders, and cashier's cheques. The banks also offer investment and insurance products. As a variety of models for cooperation and integration among finance industries have emerged, some of the traditional distinctions between banks, insurance companies, and securities firms have diminished. In spite of these changes, banks continue to maintain and perform their primary role—accepting deposits and lending funds from these deposits.

Need of the Banks

Before the establishment of banks, the financial activities were handled by money lenders and individuals. At that time the interest rates were very high. Again there were no security of public savings and no uniformity regarding loans. So as to overcome such problems the organized banking sector was established, which was fully regulated by the government. The organized banking sector works within the financial system to provide loans, accept deposits and provide other services to their customers. The following functions of the bank explain the need of the bank and its importance:

- To provide the security to the savings of customers.
- To control the supply of money and credit
- To encourage public confidence in the working of the financial system, increase savings speedily and efficiently.
- To avoid focus of financial powers in the hands of a few individuals and institutions.
- To set equal norms and conditions (i.e. rate of interest, period of lending etc) to all types of customers

History of Indian Banking System

The first bank in India, called The General Bank of India was established in the year 1786. The East India Company established The Bank of Bengal/Calcutta (1809), Bank of Bombay (1840) and Bank of Madras (1843). The next bank was Bank of Hindustan which was established in 1870. These three individual units (Bank of Calcutta, Bank of Bombay, and Bank of Madras) were called as Presidency Banks. Allahabad Bank which was established in 1865 was for the

first time completely run by Indians. Punjab National Bank Ltd. was set up in 1894 with head quarters at Lahore. Between 1906 and 1913, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. In 1921, all presidency banks were amalgamated to form the Imperial Bank of India which was run by European Shareholders. After that the Reserve Bank of India was established in April 1935.

At the time of first phase the growth of banking sector was very slow. Between 1913 and 1948 there were approximately 1100 small banks in India. To streamline the functioning and activities of commercial banks, the Government of India came up with the Banking Companies Act, 1949 which was later changed to Banking Regulation Act 1949 as per amending Act of 1965 (Act No.23 of 1965). Reserve Bank of India was vested with extensive powers for the supervision of banking in India as a Central Banking Authority.

After independence, Government has taken most important steps in regard of Indian Banking Sector reforms. In 1955, the Imperial Bank of India was nationalized and was given the name "State Bank of India", to act as the principal agent of RBI and to handle banking transactions all over the country. It was established under State Bank of India Act, 1955. Seven banks forming subsidiary of State Bank of India was nationalized in 1960. On 19th July, 1969, major process of nationalization was carried out. At the same time 14 major Indian commercial banks of the country were nationalized. In 1980, another six banks were nationalized, and thus raising the number of nationalized banks to 20. Seven more banks were nationalized with deposits over 200 Crores. Till the year 1980 approximately 80% of the banking segment in India was under government's ownership. On the suggestions of Narsimhan Committee, the Banking Regulation Act was amended in 1993 and thus the gates for the new private sector banks were opened.

The following are the major steps taken by the Government of India to Regulate Banking institutions in the country:-

- ✓ 1949: Enactment of Banking Regulation Act.
- ✓ 1955: Nationalization of State Bank of India.
- ✓ 1959: Nationalization of SBI subsidiaries.
- ✓ 1961: Insurance cover extended to deposits.
- ✓ 1969: Nationalization of 14 major Banks.
- ✓ 1971: Creation of credit guarantee corporation.
- ✓ 1975: Creation of regional rural banks.
- ✓ 1980: Nationalization of seven banks with deposits over 200 Crores.

Nationalization

By the 1960s, the Indian banking industry has become an important tool to facilitate the development of the Indian economy. At the same time, it has emerged as a large employer, and a debate has ensued about the possibility to nationalize the banking industry. Indira Gandhi, the then Prime Minister of India expressed the intention of the Government of India (GOI) in the annual conference of the All India Congress Meeting in a paper entitled "***Stray thoughts on Bank Nationalization***". The paper was received with positive enthusiasm. Thereafter, her move was swift and sudden, and the GOI issued an ordinance and nationalized the 14 largest commercial banks with effect from the midnight of July 19, 1969. Jayaprakash Narayan, a

national leader of India, described the step as a "*Masterstroke of political sagacity*" Within two weeks of the issue of the ordinance, the Parliament passed the Banking Companies (Acquisition and Transfer of Undertaking) Bill and it received the presidential approval on 9 August, 1969. A second step of nationalization of 6 more commercial banks followed in 1980. The stated reason for the nationalization was to give the government more control of credit delivery. With the second step of nationalization, the GOI controlled around 91% of the banking business in India. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank. It was the only merger between nationalized banks and resulted in the reduction of the number of nationalized banks from 20 to 19. After this, until the 1990s, the nationalized banks grew at a pace of around 4%, closer to the average growth rate of the Indian economy. The nationalized banks were credited by some; including Home minister P. Chidambaram, to have helped the Indian economy withstand the global financial crisis of 2007-2009.

Government policy on banking industry (Source:-The Federal Reserve Act 1913 and The Banking Act 1933):

Banks operating in most of the countries must contend with heavy regulations, rules enforced by Federal and State agencies to govern their operations, service offerings, and the manner in which they grow and expand their facilities to better serve the public. A banker works within the financial system to provide loans, accept deposits, and provide other services to their customers. They must do so within a climate of extensive regulation, designed primarily to protect the public interests.

The main reasons why the banks are heavily regulated are as follows:

- To protect the safety of the public's savings.
- To control the supply of money and credit in order to achieve a nation's broad economic goal.
- To ensure equal opportunity and fairness in the public's access to credit and other vital financial services.
- To promote public confidence in the financial system, so that savings are made speedily and efficiently.
- To avoid concentrations of financial power in the hands of a few individuals and institutions.
- Provide the Government with credit, tax revenues and other services.
- To help sectors of the economy that they have special credit needs for eg. Housing, small business and agricultural loans etc

Classification of Banking Industry in India

Indian banking industry has been divided into two parts, organized and unorganized sectors. The organized sector consists of Reserve Bank of India, Commercial Banks and Co-operative Banks and Specialized Financial Institutions (IDBI, ICICI, IFC etc). The unorganized sector, which is not homogeneous, is largely made up of money lenders and indigenous bankers.

An outline of the Indian Banking structure may be presented as follows:-

1. Reserve banks of India.
2. Indian Scheduled Commercial Banks.
 - a) State Bank of India and its associate banks.
 - b) Twenty nationalized banks.
 - c) Regional rural banks.
 - d) Other scheduled commercial banks.

3. Foreign Banks
4. Non-scheduled banks.
5. Co-operative banks.

Reserve bank of India

The reserve bank of India is a central bank and was established in April 1, 1935 in accordance with the provisions of reserve bank of India act 1934. The central office of RBI is located at Mumbai since inception. Though originally the reserve bank of India was privately owned, since nationalization in 1949, RBI is fully owned by the Government of India. It was inaugurated with share capital of Rs. 5 Crores divided into shares of Rs. 100 each fully paid up.

RBI is governed by a central board (headed by a governor) appointed by the central government of India. RBI has 22 regional offices across India. The reserve bank of India was nationalized in the year 1949. The general superintendence and direction of the bank is entrusted to central board of directors of 20 members, the Governor and four deputy Governors, one Governmental official from the ministry of Finance, ten nominated directors by the government to give representation to important elements in the economic life of the country, and the four nominated director by the Central Government to represent the four local boards with the headquarters at Mumbai, Kolkata, Chennai and New Delhi. Local Board consists of five members each central government appointed for a term of four years to represent territorial and economic interests and the interests of cooperative and indigenous banks.

The RBI Act 1934 was commenced on April 1, 1935. The Act, 1934 provides the statutory basis of the functioning of the bank. The bank was constituted for the need of following:

- To regulate the issues of banknotes.
- To maintain reserves with a view to securing monetary stability
- To operate the credit and currency system of the country to its advantage.

Functions of RBI as a central bank of India are explained briefly as follows:

Bank of Issue: The RBI formulates, implements, and monitors the monetary policy. Its main objective is maintaining price stability and ensuring adequate flow of credit to productive sector.

Regulator-Supervisor of the financial system: RBI prescribes broad parameters of banking operations within which the country's banking and financial system functions. Their main objective is to maintain public confidence in the system, protect depositors interest and provide cost effective banking services to the public.

Manager of exchange control: The manager of exchange control department manages the foreign exchange, according to the foreign exchange management act, 1999. The manager's main objective is to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

Issuer of currency: A person who works as an issuer, issues and exchanges or destroys the currency and coins that are not fit for circulation. His main objective is to give the public adequate quantity of supplies of currency notes and coins and in good quality.

Developmental role: The RBI performs the wide range of promotional functions to support national objectives such as contests, coupons maintaining good public relations and many more.

Related functions: There are also some of the related functions to the above mentioned main functions. They are such as; banker to the government, banker to banks etc....

- Banker to government performs merchant banking function for the central and the state governments; also acts as their banker.
- Banker to banks maintains banking accounts to all scheduled banks.

Controller of Credit: RBI performs the following tasks:

- It holds the cash reserves of all the scheduled banks.
- It controls the credit operations of banks through quantitative and qualitative controls.
- It controls the banking system through the system of licensing, inspection and calling for information.
- It acts as the lender of the last resort by providing rediscount facilities to scheduled banks.

Supervisory Functions: In addition to its traditional central banking functions, the Reserve Bank performs certain non-monetary functions of the nature of supervision of banks and promotion of sound banking in India. The Reserve Bank Act 1934 and the banking regulation act 1949 have given the RBI wide powers of supervision and control over commercial and co-operative banks, relating to licensing and establishments, branch expansion, liquidity of their assets, management and methods of working, amalgamation, reconstruction and liquidation. The RBI is authorized to carry out periodical inspections of the banks and to call for returns and necessary information from them. The nationalization of 14 major Indian scheduled banks in July 1969 has imposed new responsibilities on the RBI for directing the growth of banking and credit policies towards more rapid development of the economy and realization of certain desired social objectives. The supervisory functions of the RBI have helped a great deal in improving the standard of banking in India to develop on sound lines and to improve the methods of their operation.

Promotional Functions: With economic growth assuming a new urgency since independence, the range of the Reserve Bank's functions has steadily widened. The bank now performs a variety of developmental and promotional functions, which, at one time, were regarded as outside the normal scope of central banking. The Reserve bank was asked to promote banking habit, extend banking facilities to rural and semi-urban areas, and establish and promote new specialized financing agencies.

References

1. Delhi. Hajela T.N. (2009) "Banking Reforms" Anne Books Pvt. Ltd., New Delhi
2. Hemant. S. Ahluwalia (2008) "Banking and Financial Services" Adhyayan Publishers, New Delhi
3. Manoranjan Sharma (2008) "Dynamics of Indian Banking – Views and Vistas" Atlantic Publishers, New Delhi
4. Nanda. R. (2010) "Banking in India" Surendra Publications, New Delhi
5. Pani. R.N. (2009), "Banking Crisis in Historical Perspective", ALP Books, New Delhi
6. Swami. B.K. (2008) "Commercial Banking in the Changing Scenario", Excel Books, New Delhi
7. Uppal. R.K., Rimpikaur (2007) "Banking in India – Challengers and Opportunities", New Century Publications, New Delhi.