

# **'INDIAN BANKING SYSTEM – AN OVERVIEW'**

*A Research Project Submitted  
to*

**DEPARTMENT OF ECONOMICS,  
VIVEKANAND COLLEGE, KOLHAPUR (Autonomous)**



*For*

**Faculty of Social Science**

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**DEPARTMENT OF ECONOMICS,  
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**Project Completion Certificate**

This is to certify that **Kalyani Lad and PratikshaJadhav, B. A. III**, of Vivekanand College, Kolhapur (Autonomous) has successfully completed research project entitled "**Indian Banking System – an overview**" for the academic year 2021-22.

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Head, Department of Economics

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Research Guide .

## DECLARATION

We hereby declare that the research project entitled “**Indian Banking System-an overview**” being submitted herewith under the Faculty of Social Sciences of Department of Economics, Vivekanand College, Kolhapur (Autonomous) completed and written by me/we has not formed earlier the basis for the award of any degree or similar title of this or any other university or examining body.

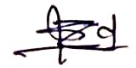
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- **INTRODUCTION**

The banking sector is the lifeline of any modern economy. It is one of the important financial pillars of the financial sector, which plays a vital role in the functioning of an economy. It is very important for economic development of a country that its financing requirements of trade, industry and agriculture are met with higher degree of commitment and responsibility. Thus, the development of a country is integrally linked with the development of banking.

In a modern economy, banks are to be considered not as dealers in money but as the leaders of development. They play an important role in the mobilization of deposits and disbursement of credit to various sectors of the economy. The banking system reflects the economic health of the country. The strength of an economy depends on the strength and efficiency of the financial system, which in turn depends on a sound and solvent banking system. A sound banking system efficiently mobilized savings in productive sectors and a solvent banking system ensures that the bank is capable of meeting its obligation to the depositors.

- **OBJECTIVES**

1. To know the history and structure of Indian banks
2. To study the structure of banking system
3. To evaluate the impact of Nationalisation on banking system
4. To evaluate the banks critically



- **HISTORY OF INDIAN BANKS**

- **Pre Independence Period (1786-1947)**

The first bank of India was the "Bank of Hindustan", established in 1770 and located in the then Indian capital, Calcutta. However, this bank failed to work and ceased operations in 1832.

During the Pre Independence period over 600 banks had been registered in the country, but only a few managed to survive.

Following the path of Bank of Hindustan, various other banks were established in India. They were:

The General Bank of India (1786-1791)

Oudh Commercial Bank (1881-1958)

Bank of Bengal (1809)

Bank of Bombay (1840)

Bank of Madras (1843)

During the British rule in India, The East India Company had established three banks: Bank of Bengal, Bank of Bombay and Bank of Madras and called them the Presidential Banks. These three banks were later merged into one single bank in 1921, which was called the "Imperial Bank of India."

- The Imperial Bank of India was later nationalised in 1955 and was named The State Bank of India, which is currently the largest Public sector Bank.
- Given below is a list of other banks which were established during the Pre-Independence period

- **Structure of the Indian Banking System**

Reserve Bank of India is the central bank of the country and regulates the banking system of India. The structure of the banking system of India can be broadly divided into scheduled banks, non-scheduled banks and development banks.

Banks that are included in the second schedule of the Reserve Bank of India Act, 1934 are considered to be scheduled banks.

All scheduled banks enjoy the following facilities:

Such a bank becomes eligible for debts/loans on bank rate from the RBI  
Such a bank automatically acquires the membership of a clearing house.  
All banks which are not included in the second section of the Reserve Bank of India Act, 1934 are Non-scheduled Banks. They are not eligible to borrow from the RBI for normal banking purposes except for emergencies.

Scheduled banks are further divided into commercial and cooperative banks.

Scheduled, Non-Scheduled Banks and Development Banks

- **Commercial Banks**

The institutions that accept deposits from the general public and advance loans with the purpose of earning profits are known as Commercial Banks. Commercial banks can be broadly divided into public sector, private sector, foreign banks and RRBs.

- In Public Sector Banks the majority stake is held by the government. After the recent amalgamation of smaller banks with larger banks, there are 12 public sector banks in India as of now. An example of Public Sector Bank is State Bank of India.
- Private Sector Banks are banks where the major stakes in the equity are owned by private stakeholders or business houses. A few major private sector banks in India are HDFC Bank, Kotak Mahindra Bank, ICICI Bank etc.

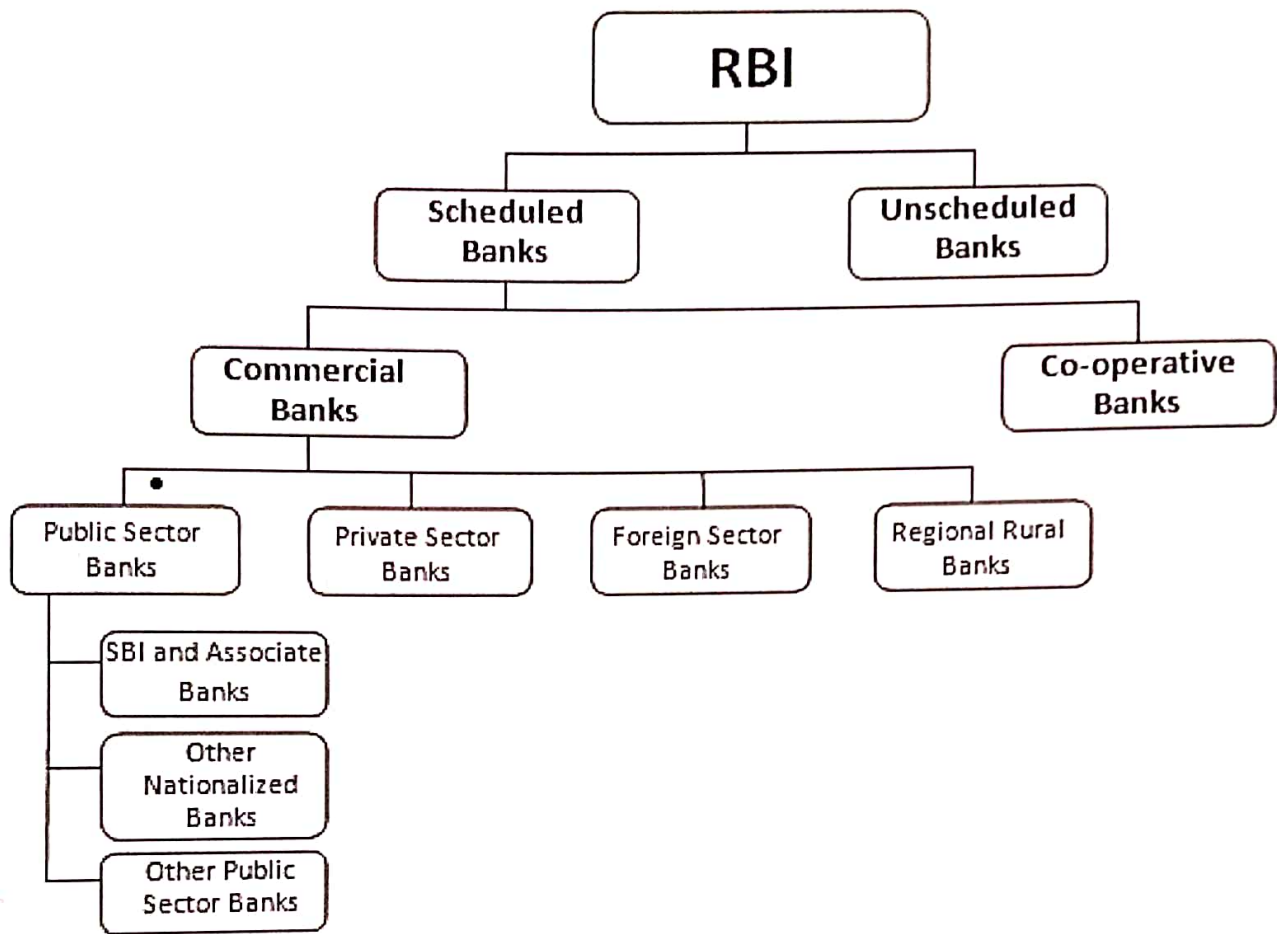


- A Foreign Bank is a bank that has its headquarters outside the country but runs its offices as a private entity at any other location outside the country. Such banks are under an obligation to operate under the regulations provided by the central bank of the country as well as the rule prescribed by the parent organization located outside India. An example of Foreign Bank in India is Citi Bank.
- Regional Rural Banks were established under the Regional Rural Banks Ordinance, 1975 with the aim of ensuring sufficient institutional credit for agriculture and other rural sectors. The area of operation of RRBs is limited to the area notified by the Government. RRBs are owned jointly by the Government of India, the State Government and Sponsor Banks. An example of RRB in India is Arunachal Pradesh Rural Bank.
- Cooperative Banks

A Cooperative Bank is a financial entity that belongs to its members, who are also the owners as well as the customers of their bank. They provide their members with numerous banking and financial services. Cooperative banks are the primary supporters of agricultural activities, some small-scale industries and self-employed workers. An example of a Cooperative Bank in India is Mehsana Urban Co-operative Bank.

- Development Banks

Financial institutions that provide long-term credit in order to support capital-intensive investments spread over a long period and yielding low rates of return with considerable social benefits are known as Development Banks. The major development banks in India are; Industrial Finance Corporation of India (IFCI Ltd), 1948, Industrial Development Bank of India' (IDBI) 1964, Export-Import Banks of India (EXIM) 1982, Small Industries Development Bank Of India (SIDBI) 1989, National Bank for Agriculture and Rural Development (NABARD) 1982



## IMPORTANCE OF BANKS

### 1. Bring Economic Stability

Banking sector plays a crucial role in attaining the economic stability. They are the one who assists in controlling the depression and inflation phases. During depression, banks adopt cheap money policy and increase the flow of money in economy. Whereas at the time of inflation, it follows strict money policy to decrease the flow of money. It increases the interest rate on borrowings to control the people's spending during inflation.

### 2. Creates Money

Banks generates money in an economy by advancing loans to all those who are in need of funds. It is one which grants credit out of the money collected by it from public. These institutions aim at maintaining sufficient flow of funds.

### 3. Facilitates Trade

It helps in doing both internal and external trade. Banks enable merchants in conducting trade by provide them proper payment facility, issuing letter of credit, discounting bill of exchange and providing them other guarantee documents.

### 4. Money Transfer

It enables people to transfer their funds rapidly even to far distant places. It has facilitated the payment system by providing various instruments such as draft, cheque and bill of exchange. Payment done via these instruments is more safe and convenient instead of paying in cash.

# Banking



Personal  
Loan



Vehicle  
Loan



Home  
Loan



Business  
Loan



Gold  
Loan



Savings /  
Current  
Account



Fixed  
Deposit



Internet /  
Mobile Banking



Customer  
Care



Credit /  
Debit Cards

# Banking



Personal  
Loan



Vehicle  
Loan



Home  
Loan



Business  
Loan



Gold  
Loan



Savings /  
Current  
Account



Fixed  
Deposit



Internet /  
Mobile Banking



Customer  
Care



Credit /  
Debit Cards



## NATIONALISATION OF BANKS

years ago, the Indian financial sector underwent a tectonic shift, when Indira Gandhi government nationalized the 14 biggest commercial banks in 1969. According to many economists nationalization of banks was the single-most-important economic policy decision taken by any government after 1947. The impact of this decision is considered by some to be, even more than the economic reforms of 1991.

During that time many Asian countries were switching to more market-oriented policies, India on the other hand, supported the socialist policies.

However, with the looming banking crisis in current times, debates have emerged about the privatisation of banks. This raises the question of whether nationalisation of the bank in the first place was the right move or not.

In 1955, India nationalized Imperial Bank of India with extensive banking facilities on a large scale, especially in rural and semi-urban areas.

It formed State Bank of India to act as the principal agent of RBI and to handle banking transactions of the Union and State governments all over the country



On 19th July 1969, a major process of nationalization was carried out and 14 major commercial banks in India were nationalized.

The second phase of nationalization Indian Banking Sector Reform was carried out in 1980 with six more banks.

This step brought 80% of the banking segment in India under Government ownership.

## What factors led to the nationalization of banks?

After independence, the Government of India (GOI) adopted planned economic development for the country. Nationalisation was in accordance with the national policy of adopting the socialistic pattern of society.

Nationalization came at the end of a troubled decade. India has suffered many economic as well as political shocks.

There were two wars (with China in 1962 and Pakistan in 1965) that put immense pressure on public finances.

Two successive years of drought had not only led to food shortages but also compromised national security because of the dependence on American food shipments (PL 480 program).

Subsequently, a three-year plan holiday affected aggregate demand as public



investment was reduced.

The decade of 1960-70s was the lost decade for India as the economic growth barely outpaced population growth and average incomes stagnated.

Industry's share in credit disbursed by commercial banks almost doubled between 1951 and 1968, from 34% to 68% whereas agriculture received less than 2% of total credit.



Agriculture needed a capital infusion, with the initiation of the Green Revolution in India that aimed to make the country self-sufficient in food security.

Other reasons responsible for the nationalization of banks were-

1. Social welfare
2. Controlling private monopolies
3. Expansion of banking to rural areas
4. Reducing regional imbalance to curb the urban-rural divide
5. Priority Sector Lending: In India, the agriculture sector and its allied activities were the largest contributors to the national income.
6. Mobilization of savings: Nationalisation aimed at mobilizing the savings of the people to the largest possible extent and to utilize them for productive purposes

## What were the benefits of nationalization?

After the nationalization of banks, the branches of the public sector bank India rose to approximately 800% in deposits and advances took a huge jump by 11,000%.

Banking under government ownership gave the public implicit faith and immense confidence about the sustainability of the banks.

Banks were no longer confined to only metropolitan or cosmopolitan in India. In fact, the Indian banking system has reached even to the remote corners of the country.

This is one of the main reasons for India's growth process, particularly in the Green revolution.

Purpose of nationalization is to promote rapid growth in agriculture, small industries and export, to encourage new entrepreneurs and to develop all backward areas.

Public deposits in the bank have increased so much that leaving it completely to the private sector might pose a challenge.

Banks, by advancing loans to the speculators and non-priority sector, have created havoc in the economy.

Balance of payment crisis 1991 started an era of liberalization, privatization and globalisation. However, the political control of bank lending continued even after the 1991 reforms which today had culminated into the bad loan or Non Performing Assets crisis that has slowed down India's growth trajectory.



## ISSUES WITH INDIAN BANKS

Key observations and recommendations of the standing Committee include:

1. **NPAs of public sector banks:** The Committee noted that the problem of high loan write-offs and NPAs, combined with low asset growth, is more severe for public sector banks (PSBs) than private banks. However, it stated that once most of the larger NPAs get resolved as per the Insolvency and Bankruptcy Code or other mechanisms, the situation will become better for PSBs. In this regard, the Committee observed that the present crisis is transient and should not warrant privatisation of public sector banks. The Committee expressed concern about limited improvements in the short-term earnings of PSBs as a result of NPAs. To help in pre-empting frauds by structured sharing of credit information and follow-up action among banks, it recommended the formulation of a law to set up a Public Credit Registry.

2. **Lowering of Capital to Risk-weighted Assets Ratio (CRAR) requirement:**

The Committee noted that RBI's requirement of a minimum CRAR of 9%, to prevent banks from becoming highly leveraged, is 1% higher than the Basel III norms for internationally active banks. This is applicable to all PSBs, even though nine of them do not operate internationally. The Committee observed that such a high CRAR requirement is impractical for these banks, and a relaxation would (i) release capital of approximately Rs 5.34 lakh crore, (ii) grow loans and generate an additional Rs 50,000 crore of income annually, and (iii) avoid the need for capital infusion in these banks.

3. **Banks under Prompt Corrective Action (PCA):**

The Committee observed that 11 PSBs have been placed under the PCA framework by the RBI based on factors such as capital inadequacy and high NPAs. These banks have restricted lending and deposit-taking capabilities as a result. Despite the imposition of PCA, recoveries in these banks have either been stagnant, or grown marginally. The Committee recommended that the RBI should provide a roadmap to these banks to enable them to come out of PCA and resume normal operations.

## Conclusion

As discussed earlier that the liberalization in the policies have led to more private banks coming to effect, the public banks and their dominance have shifted. Earlier their share was up to 8% which now has come down to 66%. But with the emergence of Nationalization, the monopoly has come to an end. There has also been a reduction in the regional imbalance by setting up banks in the rural areas or so. The surplus profit can also be utilized been protection of public interest. The working conditions have also improved and hence, the overall experience of the Nationalization has been quite beneficial for India and its economy.

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