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Banking Operations and Development in India

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Abstract – India is not only the world's largest independent democracy, but also an emerging economic giant. Without a sound and effective banking system, no country can have a healthyeconomy. Banks play a vital role in the economic development of a country. Theyaccumulate the idle savings of the people and make them available for investment. The Department of Banking Operations & Development is entrusted with theresponsibility of regulation of commercial banks under the regulatory provisions contained in the B.R. Act, 1949 and RBI Act, 1934 besides enunciation of banking policies. Its functions broadly relate to prescription of regulations for compliance with various provisions of Banking Regulation Act on establishment of banks such as licensing, branch expansion, maintenance of statutory liquidity, management and operations, amalgamation, reconstruction and liquidation of banking companies and issue of guidelines on Prudential Norms relating to CapitalAdequacy, investments and loans. In order to achieve its objective, it has to maintain aflexible organizational set-up with activities in tune with the time. This paper delineates aspects of banking operations and development in india. The study also deals with the need for a regulatory body to regulate, develop and guide the numerous bank and financial institution who work in the field of banking. The paper discusses the factors and theoretical position associated with banking operation.

Keywords: Banking Operation, Development, B.R. Act 1949, RBI Act 1934

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INTRODUCTION

The Vedas (2000–1400 BCE) are the earliest Indian texts to mention the concept of usury, with the word *kusidin* translated as "usurer". The Sutras (700–100 BCE) and the Jatakas (600–400 BCE) also mention usury. Texts of this period also condemned usury: Vasishtha forbade Brahmin and Kshatriya varnas from participating in usury. By the 2nd century CE, usury became more acceptable. The Manusmriti considered usury an acceptable means of acquiring wealth or leading a livelihood. It also considered money lending above a certain rate and different ceiling rates for different castes a grave sin. The Jatakas, Dharmashastras and Kautilya also mention the existence of loan deeds, called *rnapatra*, *rnapanna*, or *rnalekhaya.* Later during the Mauryan period (321–185 BCE), an instrument called *adesha* was in use, which was an order on a banker directing him to pay the sum on the note to a third person, which corresponds to the definition of a modern bill of exchange. The considerable use of these instruments has been recorded. In large towns, merchants also gave letters of credit to one another. The use of loan deeds continued into the Mughal era and were called *dastawez*. Two types of loans deeds have been recorded. The *dastawez-e-indultalab* was payable on demand and *dastawez-e-miadi* was payable after a stipulated time. The use of payment orders by royal treasuries, called *barattes*, have been also recorded. There are also records of Indian bankers using issuing bills of exchange on foreign countries. The evolution of *hundis*, a type of credit instrument, also occurred during this period and remain in use.

The development of Banking system in India can be categorised in Four phases.

1. Pre-Independence Phase (1786-1947)
2. Pre-nationalisation Period (1947 to 1969)
3. Nationalisation Period (1969 to 1991)
4. Liberalisation Period (1991 to till date)

1. Pre- Independence Phase (1786-1947):

The origin of the Banking system in India can be traced with the foundation of Bank of Calcutta in 1786. The Banking in India originates in the last decade in the 18th century with the foundation of the English Agency houses in Bombay and Calcutta (now Kolkata).

- Three presidency banks Bank of Bengal, Bank of Bombay and Bank of Madras established in the 19th Century under the charter of the British East India Company.

- In 1935, the presidency banks merge together and formed a new bank named Imperial Bank of India.
- The Imperial Bank of India subsequently named the State Bank of India.
- The first Indian-owned Allahabad Bank was set up in 1865 in Allahabad.
- In 1895, the Punjab National Bank was established in 1895.
- The Bank of India founded in 1906 in Mumbai.
- Many more commercial banks such as Canara Bank, Indian Bank, Central Bank of India, Bank of Baroda and Bank of Mysore were established between 1906 and 1913 under Indian ownership.
- The central Bank of India, RBI establish in 1935 on the recommendation of Hilton-Young Commission.

At that time, the Banking system was only covered the urban population and need of rural and agriculture sector was totally neglected

2. Pre-nationalisation Period (1947 to 1969):

At the time independence, the entire Banking sector was under private ownership. The rural population of the country had to dependent on small money lenders for their requirements. To solve these issues and better development of the economy the Government t of India nationalised the Reserve Bank of India in 1949.

- **In 1955** the **Imperial Bank of India** was nationalised and named the **State Bank of India.**
- The Banking Regulation Act enacted in 1949.

3. Nationalisation Period (1969 to 1991):

In 1955, government nationalised the Imperial Bank of India and started offering extensive banking facilities, especially in rural and semi-urban areas. The government constituted the State Bank of India to act the principal agent of the RBI and to handle banking transaction of the Union Government and State Government all over the country.7 banks owned by the Princely state were nationalised in 1959 and they become subsidiaries of the 1959 and they became subsidiaries of the State Bank of India. In 1969, 14 commercial bank in the country were nationalised. In the phase of banking sector reforms, 7 more banks were nationalised in 1980. With this, 80% of the banking sector in India came under the government ownership. The Indian Banking system immensely developed after nationalisation but the rural and weaker section of the society was still not covered under the system. To solve these issues, the **Narasimham Committee** in 1974 recommended the establishment of **Regional Rural Banks (RRB)**. On **2nd October 1975, RRBs were established** with an objective to extend the amount of credit to the rural section of the society. **Six more banks** further nationalised in the year 1980. With the second wave of nationalisation, the target of priority sector lending was also raised to 40%.

1. Andhra Bank
2. Corporation Bank
3. New Bank of India
4. Oriental Bank of Commerce
5. Punjab & Sindh Bank
6. Vijaya Bank

4. Liberalisation Period (1991 to till date)

to improve financial stability and profitability of Public Sector Banks, the Government of India set up a committee under the chairmanship of **Shri. M. Narasimham**. The committee recommended several measures to reform banking system in the country.

- The major thrust of the recommendations was to make banks competitive and strong and conducive to the stability of the financial system.
- The committee suggested for no more nationalisation of banks.
- Foreign banks would be allowed to open offices in India either as branches or as subsidiaries.
- In order to make banks more competitive, the committee suggested that public sector banks and private sector banks should be treated equally by the Government and RBI.
- It was emphasised that banks should be encouraged to abandon the conservative and traditional system of banking and adopt progressive function such as merchant banking and underwriting, retail banking, etc.

- Now, foreign banks and Indian banks permitted to set up joint ventures in these and other newer forms of financial services.

- 10 Privates players got a license from the RBI to entry in the Banking sector. These were Global Trust Bank, ICICI Bank, HDFC Bank, Axis Bank, Bank of Punjab, IndusInd Bank, Centurion Bank, IDBI Bank, Times Bank and Development Credit Bank.

The Government of India accepted all the major recommendation of the committee.

Recent Development in Indian Banking Sector:

- Kotak Mahindra Bank and Yes Bank got a license from RBI to entry in the system in the year 2003 and 2004.

- In 2014, RBI grants in-principle approval to IDFC and Bandhan Financial Services to set up banks.

Today, Indian Banking industry is one of the most growing flourishing industries. Banking systems of any country need to be effective, efficient as it plays the active in the economic development of the country.

1. The Banking Regulation Act1949:

The Banking Regulation act 1949 is a legislation in India, that states all banking firms will be regulated under this act. There is a total of55 Sections under the banking regulating act. Initially the law was only applicable to banks, but after 1965, it was amended to make itapplicable to co-operative banks and also to introduce other changes. The act provides a framework that regulates and supervisescommercial banks in India. This act gives power to the RBI to exercise control and regulate banks under supervision.

OBJECTIVE:

The act came into force on March 16th 1949. The Banking Regulations Act was enacted in February 1949 with the following objectives:

- The provision of the Indian Companies Act 1913 was found inadequate to regulate banks in India. Therefore, a need was felt to introduce a specific legislation having comprehensive coverage on issues relating to the banking business in India.

- Due to inadequacy of capital, many banks failed and therefore prescribing a minimum capital requirement was felt necessary. The banking regulation act brought in certain minimum capital requirements for banks.

- The key objectives of this act was to cut competition among banks. The act has regulated the opening of branches and also changing thelocation of existing branches.

- To prevent random opening of new branches and ensure balanced development of banks through the system of licensing.

- Assigning power to RBI to appoint, reappoint and remove the chairman, director and officers of the banks. This could ensure the smoothand efficient functioning of banks in India.

- To protect the interest of depositors and public at large by incorporating certain provisions like prescribing cash reserve ratio and liquidityreserve ratios.

- Provide compulsory amalgamation of weaker banks with senior banks, and thereby strengthen the banking system in India. Introduce provisions to restrict foreign banks investing funds of Indian depositors outside India.

- Provide quick and easy liquidation of banks, when they are unable to continue operations or amalgamate with other banks.

Features:

The main features of the banking regulation act are as follows:

♦ **Prohibition of trading (Section 8):** According to Section 8 of the Banking Regulation Act, a bank cannot directly or indirectly deal with buying or selling or bartering of goods. However it may barter the transactions relating to bills of exchange received for collection or negotiation.

♦ **Non-banking asset (Section 9):** A bank cannot hold any immovable property, howsoever acquired, except for its own use, for any period exceeding seven years from the date of acquisition thereof. The company is permitted, within a period of seven years, to deal or trade in any such property for facilitating its disposal.

♦ **Management (Section 10):** This rule states that every bank shall have one of its directors as Chairman on its Board of Directors. It also states that not less than 51% of the total number of members of the Board of Directors of a bank shall consist of persons who have special knowledge or practical experience in accountancy, agriculture, banking, economics, finance, law and co-operatives.

- **Minimum capital (Section 11):** Section 11 (2) of the Banking Regulation Act, 1949, states that no bank shall commence or carry on business in India, unless it has minimum paid-up capital and cash reserve prescribed by the RBI.

- **Payment of commission (Section 13):** According to Section 13, a bank is not permitted to pay directly or indirectly by way of commission, brokerage, discount or remuneration on issues of its shares in excess of 2.5% of the paid-up value of such shares.

- **Payment of dividend (Section 15):** According to Section 15, no bank shall pay any dividend on its shares until all its capital expenses (including preliminary expenses, organisation expenses, share selling commission, brokerage, amount of losses incurred and other items of expenditure not represented by tangible assets) have been completely written-off.

Importance:

- Banking Regulation Act gives the power to RBI to license banks and also the regulation of the shareholding.

- It grants power to RBI to conduct appointment of the boards and management members of banks.

- It also lays down directions for audits to be managed by RBI, and control merging and liquidation.

- RBI issues directives on banking policy in the interests of public good and can impose penalties if required.

- Co-operative Banks were incorporated under this act in the amendment of 1965.

- The Section 6 of the banking regulation act comprises of the permitted business of banks. The act consists of the following points:

√ Banking for borrowing, raising or taking up of money, selling, collecting and dealing in the bills of exchange, promissory notes, railway receipts.

√ Acting as agents on behalf of the Government.

√ Contracting for public and private loans and issuing the same.

√ Managing the selling and realizing any property which may come into the possession of the company.

√ Undertaking and executing trusts.

√ Dealing with acquisition, construction and maintenance of the building.

2. Reserve Bank of India:

Establishment

The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the **Reserve Bank of India Act, 1934**.

The Central Office of the Reserve Bank was initially established in Calcutta but was permanentlymoved to Mumbai in 1937. The Central Office is where the Governor sits and where policies are formulated.Though originally privately owned, since nationalisation in 1949, the Reserve Bank is fully owned by the Government of India.

Preamble

The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as:

"to regulate the issue of Bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage; to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability while keeping in mind the objective of growth."

Central Board

The Reserve Bank's affairs are governed by a central board of directors. The board is appointed by the Government of India in keeping with the Reserve Bank of India Act.

- Appointed/nominated for a period of four years

- Constitution:

Official Directors

- Full-time: Governor and not more than four Deputy Governors

Non-Official Directors

- Nominated by Government: ten Directors from various fields and two government Official
- Others: four Directors - one each from four local boards

Legal Framework

I. Acts administered by Reserve Bank of India

- Reserve Bank of India Act, 1934
- Public Debt Act, 1944/Government Securities Act, 2006
- Government Securities Regulations, 2007
- Banking Regulation Act, 1949
- Foreign Exchange Management Act, 1999
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (Chapter II)
- Credit Information Companies (Regulation) Act, 2005
- Payment and Settlement Systems Act, 2007
  - Payment and Settlement Systems Regulations, 2008 and Amended up to 2011 and BPSS Regulations, 2008
  - The Payment and Settlement Systems (Amendment) Act, 2015 - No. 18 of 2015
- Factoring Regulation Act, 2011

II. Other relevant Acts

- Negotiable Instruments Act, 1881
- Bankers' Books Evidence Act, 1891
- State Bank of India Act, 1955
- Companies Act, 1956/ Companies Act, 2013
- Securities Contract (Regulation) Act, 1956
- State Bank of India Subsidiary Banks) Act, 1959
- Deposit Insurance and Credit Guarantee Corporation Act, 1961
- Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970
- Regional Rural Banks Act, 1976
- Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980
- National Bank for Agriculture and Rural Development Act, 1981
- National Housing Bank Act, 1987
- Recovery of Debts Due to Banks and Financial Institutions Act, 1993
- Competition Act, 2002
- Indian Coinage Act, 2011: Governs currency and coins
- Banking Secrecy Act
- The Industrial Development Bank (Transfer of Undertaking and Repeal) Act, 2003
- The Industrial Finance Corporation (Transfer of Undertaking and Repeal) Act, 1993

MAIN FUNCTIONS

Monetary Authority:

- Formulates, implements and monitors the monetary policy.
- Objective: maintaining price stability while keeping in mind the objective of growth.

Regulator and supervisor of the financial system:

- Prescribes broad parameters of banking operations within which the country's banking and financial system functions.
- Objective: maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public.

Manager of Foreign Exchange

- Manages the Foreign Exchange Management Act, 1999.
- Objective: to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

Issuer of currency:

- Issues and exchanges or destroys currency and coins not fit for circulation.
- Objective: to give the public adequate quantity of supplies of currency notes and coins and in good quality.

Developmental role

- Performs a wide range of promotional functions to support national objectives.

Regulator and Supervisor of Payment and Settlement Systems:

- Introduces and upgrades safe and efficient modes of payment systems in the country to meet the requirements of the public at large.
- Objective: maintain public confidence in payment and settlement system

Related Functions

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

CONCLUSION:

From the findings of the study, it can be concluded that there are unique operationalmanagement practices in banking system.Operation procedure manuals to back operation policies, existence of specific guidelinesto support faith-based banking, and frequency of carrying out regular audit to ensurespecific faith-based compliance in operations and procedures.The primary growth drivers that will help transform the Indian banking sector include financial inclusion, enhanced payment systems, internet and mobile systems which will lead thebanking sector to achieve its aim of expansion and growth. With one of the reform measures i.e. passing of the Banking Laws (Amendment) Bill, 2011, there will be way for more banks and foreign investments to enter the banking industry. Establishment of new banks will create competition enabling banks to improve their operational efficiency and technology. Given the under penetration of banking services in India, new bank licenses to be issued will alsocontribute towards financial inclusion and development.

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