Pre- Independence History of Commercial Banks in India

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Abstract: ***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 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 9th August, 1969.

A second dose 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 dose of nationalization, the GOI controlled around 91% of the banking business of India.

Key Words; Employer, Nationalization, Commercial Banks

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INTRODUCTION

In 1806 the bank of Calcutta was established as a joint stock bank with limited liability, which was brought under the royal charter in 1806 and renamed as Bank of Bengal. Subsequently, the bank of Bombay of Bombay and bank of madras were established by East India Company in 1840 and 1843 respectively. The business of the presidency bank was initially confined to discounting of bills or other negotiable private securities, keeping cash accounts, receiving deposits and issuing and circulating cash notes. The major innovations in banking method and organization came with establishment of bank of Bank of Bengal, which included o Use of joint stock system for raising capital o Conferring of limited liability on shareholders by means of a charter o Provision for the note issue which could be accepted for public revenue payments o General provision for acceptance of deposits from general public o Imposition of explicit limit on credit and the kind of securities it could accept o Provision for regulatory changes in the board of directors In 1951, when the first Five Years Plan was launched, the development of rural India accorded the highest priority. The all India Rural Credit survey Committee recommended the creation of a State-partnered and state sponsored bank by taking over the Imperial bank of India and integrating with it ,the former state owned or state associated banks. Accordingly an Act was passed in the parliament in May 1955. Later, the state Bank of India (subsidiary banks) Act was passed in 1959 enabling the State bank of India to take over eight former state associated banks as its subsidiaries. 12A banking crisis that occurred during 1913 revealed weakness of the banking system such as the maintenance of an unduly low proportion of the cash and other liquid assets, the grant of large unsecured advances to the directors of banks and to the companies in which the directors were interested. The issue of failures of banks was investigated in detail by the Indian Central banking Enquiry Committee (1929-31). The terms of reference of which included ―the regulation of banking with a view to protecting the interest of the public‖. The report of the Indian Central Banking Enquiry Committee emphasized the need for enacting a special Bank act, covering the organization, management, audit, and liquidation of banks. The authoritative recommendations of the Committee have been an important landmark in the history of banking reforms in India.

REVIEW OF LITERATURE

When Reserve Bank of India Act, 1934 came into effect, an important function of the reserve bank was to hold the custody of the cash reserves of banks, granting them accommodation in a discretionary way and regulating their operations on accordance with the needs of the economy through instruments of credit control. With regard to the banking system of the country, the primary role of Reserve Bank was conceived as that of the lender-of-the-last-resort for the purpose of ensuring the liquidity of the short term assets of banks.

INDIAN COMPANIES (AMENDMENT) ACT, 1936

The first attempt at banking legislation in India was the passing of the Indian companies (Amendment) Act 1936, incorporating a separate chapter on provisions relating to banking companies. There were two important features of the new legislation, which embodied some of the recommendations of the Indian Central Banking Enquiry Committee. For the first time a determined effort was made to evolve a working definition of ‗banking' and to segregate banking from other commercial operations. The special status of Scheduled banks was recognized through certain provisions of the amended Act, such as building up of the reserves, were made applicable only to non scheduled banks could be left to the general supervision and control of the Reserve Bank. These provisions, however, touched only the firing of the problem of banking regulation.

BANK FAILURES AND REMEDIAL MEASURES:

The banking regulation and supervision function is governed by the provisions of the act, which comprehensively deals with several aspects of banks ranging from setting up of a bank to amalgamations besides several operational issues. The department of Banking Operations, which was entrusted with the administration of the act, was originally organized in August 1945 to provide the requisite administrative machinery to discharge the several duties and responsibilities, which were expected to devolve upon the Reserve Bank after the passing of the Banking companies Bill.

MATERIAL AND METHOD

Prior to independence, there were a number of bank failures and the banking sector had not then developed to meet their requirements of the economy. The supervisory power conferred initially in 1940 vested the reserve Bank with the right to inspect banking companies on a restricted scale in the consultation with the government of India. The purpose of this inspection was limited to satisfy Reserve Bank regarding the eligibility for license, opening the branches, amalgamation and compliance with directives issued by it. With the prior consent of banking companies concerned the Reserve Bank undertook to inspect their books and accounts with a view to determining the real or exchangeable value of their paid up capital and reserves for the purpose of considering their eligibility for inclusion in the Second Schedule to the reserve Bank of India Act. Specific powers to inspect banking Companies Ordinance, 1946. The Ordinance made the prior consent of a banking company unnecessary for its inspection and also widened the objective of the inspection. The partition of India in 1947 adversely impacted the economies of Punjab and West Bengal, paralyzing banking activities for months. India's independence marked the end of a regime of the Laissez-faire for the Indian banking. The Government of India initiated measures to play an active role in the economic life of the nation, and the Industrial Policy Resolution adopted by the government in 1948 envisaged a mixed economy. This resulted into greater involvement of the state in different segments of the economy including banking and finance. The major steps to regulate banking included: In 1948, the Reserve Bank of India, India's central banking authority, was nationalized, and it became an institution owned by the Government of India. In 1949, the Banking Regulation Act was enacted which empowered the Reserve Bank of India (RBI) "to regulate, control, and inspect the banks in India." The Banking Regulation Act also provided that no new bank or branch of an existing bank may be opened without a license from the RBI, and no two banks could have common directors.

However, despite these provisions, control and regulations, banks in India except the State Bank of India, continued to be owned and operated by private persons. This changed with the nationalization of major banks in India on 19th July, 1969.

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 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 9th August, 1969. A second dose 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 dose of nationalization, the GOI controlled around 91% of the banking business of India 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.

LIBERALIZATION

In the early 1990s the then Narsimha Rao government embarked on a policy of liberalization and gave licenses to a small number of private banks, which came to be known as New Generation tech-savvy banks, which included banks such as Global Trust Bank (the first of such new generation banks to be set up) which later amalgamated with Oriental Bank of Commerce, UTI Bank (now re-named as Axis Bank), ICICI Bank and HDFC Bank. This move, along with the rapid growth in the economy of India, kick started the banking sector in India, which has seen rapid growth with strong contribution from all the three sectors of banks, namely, government banks, private banks and foreign banks.

The next stage for the Indian banking has been setup with the proposed relaxation in the norms for Foreign Direct Investment, where all Foreign Investors in banks may be given voting rights which could exceed the present cap of 10%,at present it has gone up to 49% with some restrictions.

The new policy shook the Banking sector in India completely. Bankers, till this time, were used to the 4-6-4 method (Borrow at 4%; Lend at 6%; Go home at 4) of functioning. The new wave ushered in a modern outlook and tech-savvy methods of working for traditional banks. All this led to the retail boom in India. People not just demanded more from there The following are the steps taken by the government of India to Regulate Banking Institutions in 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 crore.

1.2D Banking Reform Period:

CONCLUSION

Following the 1991 report of the Narasimham Committee, more comprehensive reforms took place that same year. The reforms consisted of (a) a shift of banking sector supervision from intrusive micro-level intervention over credit decisions toward prudential regulations and supervision; (b) a reduction of the CRR and SLR; (c) interest rate and entry deregulation; and (d) adoption of prudential norms.3 Further, in 1992, the Reserve Bank of India issued guidelines for income recognition, asset classification and provisioning, and also adopted the Basle Accord capital adequacy standards. The government also established the Board of Financial Supervision in the Reserve Bank of India and recapitalized public-sector banks in order to give banks sufficient financial strength and to enable them to gain access to capital markets.

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