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HISTORY OFBANKING IN INDIA AND EMERGENCE OF NEW GENERATION BANKS

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ABSTRACT

The existing banking structure in India is elaborate and has been serving the credit and banking services' needs of the economy. It has now become a core sector of Indian economy. However, it came through a number of evolutionary stages. Banking sector has undergone huge changes to period to period in the world as well as in India. Today people cannot imagine about running of our daily life without banks. How they become the integral part of our life? It is an interesting query that leads us to the origin of the banking. And it is also the tracing of human history and trade to an extent. Evolution of banking habit among people is long backed story. This paper explores the evolution and growth of this flourishing industry from its ancient period to the new generation banks.

Key words: Economic reforms, Nationalization, New generation Banks

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1.1. INTRODUCTION

The history of banking begins with the first prototype banks of merchants of the ancient world, which made grain loans to farmers and traders who carried goods between cities. This began around 2000 BC in Assyria and Babylonia. There are different views existing about the origin of the word banking. According to some economists the word bank has been derived from the German word 'BANC', which means a joint stock firm. But there was another opinion that the bank word has come from the Italian word 'BANCO' which means a heap or mound. Some others say that the word bank has originated from the Greek word 'BANQUE' which means a bench. In olden days the Jews are entered in to market for money business was sitting on bench and when they are not in a position to meet the obligation, the bench on which they carrying the business was broken in to pieces and they were taken as bankrupt. Thus, there is a view that both words bank and bankrupt are originated from the word BANQUE. However, the origin of the word bank has come from the word banc' or 'Banco 'which seems to be more convincing that it was used to the establishment of the most ancient bank that is 'Bank of Venice'.

The banking business traced back its history from early 2000 B.C. Babylonians had developed a system of banks. They used their temple for keeping valuables mainly gold and silver for safe custody and also started lending against those valuables at a higher rate of interest. In the same time Greek temple were used as depositories for people's surplus funds. The priests of their temple were acted as financial agents for long period till they lost their public interest. In the middle age period banking activities were mainly confined with Jews and Lombardys. The Christians were forbidden from banking business mainly in lending activities against interest as their religion considered it as a sinful activity. But the scenario was changed during 13th century by the development of trade and commerce as well as the church lost the hold on Christians. In the initial stage of banking, mainly dealt with money lending activities, also they were concentrated their transactions among the selected number of families or group.

The ancient bank, 'Bank of Venice' was founded in Italy in 1157. And it was the first public sector banking institution. The bank of 'Barulona' in Spain was established in 1401 followed by 'Banks of Geniva' in 1407 and 'Bank of Amsterdam' (1609), where the banks

which accepted deposits with a provision of which could be drawn on demand and transferred from one account to another. These are the land marks of banking history in the world.

Indian banking system was originally developed from Britain. Our present banking institutions are mainly modeled on British type. In England, money exchange was the important function of bank during the period of Edward III. Royal exchanger exchanged the various foreign coins tended to him by travelers, and merchants entering in the kingdom, in to British money and also supplied foreign money to those who are going out. It is considered was the first banking activity in Britain. In the Elizabethan age, growth of foreign trade was at high rate in Britain backed by influx of gold from America. This resulted in the development of modern banking system in Britain. Public banking system was originally started by Seizure, Charles I in 1640. Merchants in England were started to keep their valuables with gold smiths who in those days have strong rooms and watchman. This was because of they lost their huge amount of deposit by keeping it with royal mint for safe custody. Then they entrusted with their cashiers for the same but later they also started to misappropriate their holdings.

Large amount of money was left with gold smith for safe custody against their signed receipt known as goldsmith's notes containing an underwriting to return the money to the depositor or to bearer on demand. This resulted in to two major changes which were foundation of issue and deposit banking. Gradual development was happened when they recognized that a large sum of money left with them for a long time and also, they found that it is profitable to lend out the part of their holdings with a fixed maturity. As a result of which they began to lend out money for an interest and also offered a considerable rate of interest to money deposited with them instead of charging a fee for custody. The idea was from Dutch banking system. The Bank of England was started in 1694 with Tonnage Act. In 1708 another Act was also passed which allowed banks to be started with unlimited liability with the right to issue notes and this led to starting of joint stock banks in London.

1.2. HISTORY OF BANKING SYSTEM IN INDIA

India has a long back story in banking industry in the book 'Civilization in ancient India' by R.C Dutt (revised edition, vol I. p.39) says that "Loans and usuries were all understood in those days,

and Rishis occasionally lament their state of indebt with simplicity of primitive times." In Vedic period itself giving and taking credit in one form or another which was the main form of banking was existed. But the transition from money lending to banking must have occurred before Manu (Beginning of 1750 B.C). It is evidenced in the books of Buhler named "The laws of Manu"-(published by sacred books of East Vol-XXV p.286-1866). The author quotes the word of Manu as "Sensible person should deposit his money with a person of good family of good conduct, well acquainted with Law, veracious, having many relatives, wealthy and honorable". He also gave us the rule which governed the policy of loans and rate of interest. Dr. Pramath Nath Banergee in his book 'Public Administration in Ancient India' had quoted from GouthamaBrihaspathy and Badhayana regarding to regulation of interest. In ancient India, during Maurya dynasty (321 to 185 BC), an instrument called Adesha was in use which was used as a request to pay the money to third party, which is considered as the old form of bills of exchange in India. There was evidence for the use of such instrument during Budhist period also. There were many professional money lenders and bankers existed in many parts of India during that period and they were called as Sethi (Seth). In Koutilya's'Artasastra' also had some references about banking system.

Banking in those days meant largely on money lending, financing kings and their wars. In 1715 century Indian bankers highly esteemed and regarded as worthy and treated as they were only reliable agency of deposits, jewelers, cash and holdings. Public confidence of Indian banking can be well evidenced from the fact that 'Hundies' of banks was date back to Mahabharata. They were quite vogue during that period. Even in the modern period bills of exchanges are used for collection of debts, and this was now changed as bills. Hindus in India especially Vaishya community was mainly confined with banking business. The growth of indigenous banking in India was by this rural money lending. And they were the principal bankers, to them banking business was concerned with the issue and discount of bills of exchange, money lending and money exchange. They used their private funds for lending. And the bases of all such activities were the banker's knowledge about the customers and their financial position. Alone this basis they lend their money against personnel, goods, immovable properties etc. The fact is that, high rate of interest was charged for lending money in that period. Generally lending was made at 40-60 percent interest P.A. while standing crops were mortgaged

against repayment. This phase had changed by the introduction of better means of communication, uniform currency, unification of country under one central government etc. The unified currency was the land mark change during that period. The coin rupee was standardized by Shershah in 1542. The word rupee is found in Sanskrit, which means shaped, stamped, impressed, coin. The English traders came to India in 17th century. But they could not make to utilize the services of Indian indigenous bankers, because of their inexperience about the European trade and language barriers. Hence, their agency houses in Bombay and Calcutta started banking business in India. These agency houses began to serve as bankers to trade, financed movements of crops, issued paper money and established joint stock banks. Gradually banking businesses have taken from the hands of money lenders to joint stock banks, eventhough it occupies an important role among Indian credit organizations.

1.3. EMERGENCE OF JOINT STOCK BANKS IN INDIA

The evolution stage of banking in India got its remarked change when it started the joint stock banks in India. The banking sector has got its well-defined structure by the introduction of these joint stock banks. The main reason for the introduction of such banks in India was the Swadeshi Movement. As a result of the movement there started a number of institutions in Indian origin. In Calcutta, agency houses undertook the banking activities for their constituents. Messers Alexander& Co. and MessersForgisson& Co. were the prominent among them and they were the early joint stock banks in India. Whereas the Bank of Hindustan was the earliest bank started under European direction in India, which was established by agency house of Calcutta in 1770. The banking sector was neededgreat importance during that period due to the commercial disaster of 1829-32 backed by the collapsing of agency houses mainly because of their over concentration towards profitability instead of safety. By this situation, Indian legislature decided to separate banking business from any other kind of commercial undertaking. It was mentioned in Indian companies Act 1913 under section 27 G (1). So originally banking business in India was developed in 18th century. The first bank was General Bank of India in 1786 and Bank of Hindustan in 1790.

In 1839 presidency bank of Bengal was given power to open branches and deal inland exchanges. Then two other presidency banks were also commenced which were Bank of

Bombay (1840), Bank of Madras (1843) respectively. In 1860 the principle of limited liability was first introduced in joint stock banks. In between1865-70 period only one bank was established which was Allahabad bank(1865). And is still functioning today as the oldest joint stock bank. Then Punjab National Bank is formed in1895 with its head office at Lahore. Foreign banks were also startedduring that period especially in Calcutta as it was the important trading zone in that era. The remarkable changes were happened in the Indian economy by Swadeshi movement. It prompted Indians to start many institutions, number of joint stock banks in the period of 1906-13. People Bank of India Ltd, The Bank of India Ltd, the Central Bank of India Ltd and the Bank of Baroda, Canara bank, Indian bank, Bank of Mysore etc. are started during that period.The movement also led to start a number of private banks also in India.

It was important to note the amalgamation happened in India, by three presidency banks to imperial bank of India Which was came in to existence in 27.1.1921 by the imperial bank of India Act of 1920. Imperial bank of India has the role to play as central bank and it was allowed to hold government balances and manage the public debts and clearing houses till the establishment of RBI in 1935.Even though it had no power to issue notes. Later this imperial bank was transformed State Bank of India in 1955. The severe trade depression started in 1929 and disobedience movement1931 were necessitated growth of banking institution to some extent. The Royal commission in Indian currency and finance suggested that a central bank should be there for proper control of Indian banking industry especially regards to currency and credit organizations. But the commission has no opinion to change the imperial bank as central bank. To start a new central bank a bill was introduced in legislative assembly and which was dropped first. A fresh bill by George Schuster in September 1933 was presented and enacted on 6th march 1934. On 1st April 1935 RBI started its functioning as country's central bank.

1.4. BANKING REGULATION ACT 1949

AfterIndia become a sovereign republic, the government of India initiated certain measures to play an active role in Indian banking system as well as economy. The major step regarding to this was nationalization of RBI in 1949. Enactment of banking regulation Act was another important turning point in the banking history in the same year. The growth was very slow and banks were also experienced periodic failures in between 1913 and 1948.Deposit mobilization

was slow, moreover, the savings bank facility provided by the Postal department was comparatively safer to public. The reason traced that provisions of Indian company Act was too in adequate to regulate banking companies. These all brought a need for a comprehensive law regarding the business of banking. And this was the reason for introduction of banking companies Act in 16.03.1949. Section 2 of the Act clearly defined the business of banking. Periodically it had made a number of amendments and which is now known as Banking Regulation Act 1949.Next phase of evolution of Indian banking scenario starts with nationalization of banks,

1.5. NATIONALIZATION OF BANKS

By 1960 the Indian banking industry had become an important tool to facilitate the development of Indian economy. The scheme of social control initiated by Government of India in 1967 was not fruitful. It was unsatisfactory and inadequate. With the objective of ensuring motivation towards speedy economic development and meeting the needs of weaker sections of the society, Indian government has started to focus on nationalization of commercial banks. Indira Gandhi, theprime minister of India during that period expressed her intention of bank nationalization in annual conference of the all India congress meeting in a paper entitled “stray thoughts on bank nationalization”. Then the government of India issued an ordinance and nationalized 14 major commercial banks with effect from the midnight of 19.07.1969.Within two weeks of the ordinance issue, the parliament passed the banking companies bill and received presidential approval on 9th August 1969. Six more commercial banks were also nationalized in 1980 by the second phase of nationalization and government of India taken around 91% of banking business in India. Later in 1993 Bank of India merged with Punjab National Bank and the number of nationalized banks were reduced to 19.

Nationalization was brought by the government mainly for some important purposes which were, to remove the control from the hands by few, to make provision of adequate credit facility to agriculture, small scale industries and exports, for introducing professionalism in bank management, and for the encouragement of new entrepreneurs etc. Though these were the motives behind nationalization, the main focus was implementing the government control on banks and priority sector lending. It was resulted in increased deposit mobilization because of

increased public confidence on banks.Even though it is considered as the first banking revolution, the nationalization of banks did not get an expected result at all. It made the banks as loss making institutions. Lack of accountability, lack of profit motive, political interference on bank etc. were the main causes for this failure.

Indian economy had faced a deep crisis in 1990s. Foreign currency had plumed to almost $ 1 billion, high rate of inflation, fiscal deficit etc. resulted in lossof interest of NRI and foreign investors in India economy.Immediate actions needed to overcome the situations originally directed to wave and welcoming the liberalization, privatization and globalization policies to India.Indian economy was experienced major policy changes in early 1991. The new economic reforms popularly known as LPG model aimed at making Indian economy as vibrant and globally competitive. A series of reforms were made as a part of this especially in trading sector, financial sector, industrial sector etc.

1.6. ECONOMIC REFORMS IN INDIA

India followed a mixed economy system after the republic. Although it had so many advantages of market economy and planned economy system, Indian economy faced the problem of declining foreign exchange, growing imports etc. In 1980s India was facing the economic crisis due to various reasons, Balance of Payment, etc, these are mainly due to the gulf war. India's oil import bill increased and exports slumped. As a result of this India was in serious crisis at the end of 1990s. Government measures against crisis was led to national sentiments, which was taking loan from IMF, Bank of England, Union Bank of Switzerland etc, by pledging India's gold reserve. Chandrasekhar was the Prime Minister of India during that period. And his government had collapsed in 1991.Narasimha Rao took over as Prime Minister, Dr. Manmohan Singh as finance minister, in this period and they formed several reforms to strengthen Indian economy which is collectively known as economic reforms.

Financial sector reforms have great role in the changing scenario of Indian economy. It made drastic changes in the financial sector. As result of this, interest rates were reduced, burden of priority sector requirement eased. Capital market are de-regulated, restriction on capital inflow also liberalized, and the most important change was the granting permission to entry to private

sector in banking and insurance sector. The reforms were made through three phases. First phase was state intervention for institutional development. The second phase of was deregulation, rationalization, and simplification of policies. Last phase of financial reform was total liberalization or economic liberalization.Main purpose of economic liberalization was to encourage competition and thereby increase the productivity of financial sector. Highly regulated Interest rates, credit control policies were discouraging saving and investments during that period.

Financial sector reforms in India were grounded in the belief that competitive efficiency in the real sectors of the economy to its full potential cannot be realized unless financial sector was re-formed. Thus, the basic objective of financial sector reform was to improve the allocation of resources for accelerated growth and removing structural deficiencies.Economic liberalization and deregulation were highly influenced in the banking sector. Indian banking sector had very week capital base and reserve funds, thus there has been steady decline in the corporate borrowings from banks and it affected the performance of banking system as well as financial system adversely. Banking sector reforms were introduced in this background as a part of economic reforms and which was according to the recommendations of a committee headed by Narasmham. As a part of economic reforms India government took initiatives to improve the banking sector.

1.7. NARASIMHAM COMMITTEE RECOMMENDATIONS

To study the problems in Indian financial system and to suggest the measures and guidelines for improvement in the efficiency and productivity of financial system, Narasimham committee was set up in 1991. The committee found the following problems of banks.

- The system of maintaining high liquid assets (cash, gold, securities etc) which was due to the fact that Statutory Liquidity Ratio was 38.5%, Cash Reserve Ratio was 15%, in short 53.5% of their idle funds were needed to be kept with RBI.
- Huge lending to priority sector.
- Highly regulated interest rate structure.

In order to remove the inconsistencies with banking sector, the committee suggested some recommendations. On the basis of such recommendations as banking sector reforms were introduced by the government. Some of the important reforms were

- Reduction in SLR and CRR: Both the CRR and SLR gradually reduced during the economic reform period. In India CRR remains now in 3-15% against the earlier 15 plus level, SLR reduced to 25% level. Etc.
- Deregulation of interest rates: Interest rates were reduced from 20 Lakh to 2 Lakh. Interest rates on bank loans above 2 lakhs are full decontrolled.
- Prudential Norms: New prudential norms were introduced for the identification of income sources, assets classifications, provisions etc.
- Operational autonomy: banks are allowed to open new branches, up grading extension activities if they satisfy Capital Adequacy Ratio.
- Diversification: The banks were allowed to diversify their products and services.
- New generation banks: License were given to start new private sector banking institutions and they are permitted to adopt new and innovative technologies for their service delivery and designing of products.

To compete with the global presence and prepare the economy to face the challenges in the banking sector, banks needed to have a strategy backed by management and organization supported system. Banks needed to update their technology in payment and delivery system, work culture, service orientation, skills to meet customer preferences etc. Along with this,banks needed to adopt new system and procedure for meeting emerging changes, and to restrict their role in emphasizing the specialization etc. Most of all banks needed to introduce innovative products and services to meet the everchanging needs of customers in best way. This was the original reason to start the new generation banks in that period by adopting information and communication technology with banking. They are collectively termed as new generation tech savvy banks.

1.8. DEVELOPMENT OF NEW GENERATION BANKS

New generationbanks are the banks which use the information and communication technology for performing their banking business. Which were started their working in India during the time

of reforms. As a result of privatization of banking sector and introduction of banking sector reforms in the period of 1990s several new banks were stared in new forms with technological advancement. These banks were collectively called new generation banks. The important reasons behind the introduction of these types of banks were to improve the efficiency in functions, to make a new image of super power apart from mere bankers, to enhance the banking habit among common people with new technology etc. Besides which the economic reform backed by globalization, privatization and liberalization had made enormous changes in the economy. It had witnessed a sea change in the way of banking is done and that was the route to start up new generation banks in India. Technology has made tremendous impact in banking. “ANYWHERE BANKING” and “ANYTIME BANKING” have become a reality. Growing integration of economies and the markets around the world have made global banking a reality.Technological advancement and global transfer of these technologies originally paved the way of emergence of innovative banking based on Information and Communication Technology and itadoption in India.

RBI in 1993 issued the guidelines to set up new banks in the period of 1993. When RBI issued the guidelines, they got over all 113 applicants for starting new banks. They werelargely from industrial corporations. But it finally picked up 10 applicants and gave permission to start up. In 1994 new generation banks are started but four did not survive. Three were merged with HDFC bank Times bank Centurion bank which had taken over by Punjab National Bank and another one GTB was forced to merge with public sector oriental bank of commerce etc. Now India have so many Indian origin new generation banks as well as foreign banks. Important new generation banks are:ICICI bank, Kotak Mahindra bank, ING VYSYA bank, AXIS bank, YES bank, INDUS IND bank, Federal bank, HDFC bank, UTI bank, Bank of Punjab, Development And Credit Bank, UCO bank, Union bank of India, United bank of India, Bank of Baroda, Syndicate bank, Indian overseas bank, Oriental bank of commerce etc.

New generation banks changed the entire concept of banking as branchless any where any time banking. But it does not mean branch will not exist, branches are there and they may become the retail outlets of banks, as it were offering a wide range of financial services and financial products.

1.9. CONCLUSION

Banks have come a long way from the temples of the ancient world, but their basic business practices have not changed. History of banking reveals the changing faces of the banking from ancient world to today’s fingertip banking. May the future changes take banks completely off from the street corner to internet. Since 1991, the Indian economy has undergone significant transformation in terms of its size and composition. The economic structure has diversified substantially and the economy has been opened up to integrate with the global economy. If the real economy is dynamic, the banking system needs to be flexible and competitive, the evolutions and changes in banking structure was made in this context. It is viewed from this perspective that the scope for further growth in the size and strength of the existing banking structure is essential to cope with the multiple objectives and everchanging customer demands. The paper attempted to shed lights on the long way of emergence of new generation banks.

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