

Evolution and Growth of Commercial Banking in India: A Study of the Post-Independence Era

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Abstract:

The beginning of banking system in India was marked by the opening of English agency houses which did business in the 18th and 19th centuries. Then, commercial banks were established with unlimited liability. The Bank of Hindustan was established in 1770 by Agency House of Alexander and Company. Bengal Bank was set up in 1785. It shut shop in 1791 after it suffered severely from the temporary reverses imposed by Tipu Sultan upon the Company. The need for an organized banking system in the beginning of the 19th century gave birth to Bank of Calcutta in 1806. The East India Company issued Charter in 1809 converting this bank into the State Aided Presidency Bank and renamed it as Bank of Bengal. Banks were founded under similar Charter in Bombay as Bank of Bombay, 1840 and in Madras as Bank of Madras, 1843. These presidency banks carried on the functions of commercial bank along with the fulfilment of the requirements of the British Government at that time. They were established under the full control of foreign shareholders having full support of the government and it may be said that they were more responsive to the interest of the government and the foreign shareholders and had little concern with the requirement of national economy.

KEY WORDS: shareholders, commercial, Consequently.

INTRODUCTION

The major developmental event in the history of commercial banking in India was the establishment of Allahabad Bank of India in the year 1865. This bank also was the outcome of the efforts of the foreign shareholders and was later brought under control of the Chartered Bank of Australia and China. It may rightly be said that Allahabad Bank, too, functioned keeping in view the wider interest of its shareholders, neglecting the wider interests of India. But still there was no banking legislation in the country. First of all in 1876, the banking legislation was introduced as the Presidency Bank Act, 1876 and the concept of limited liability was incorporated in it.

But, the establishment of these banks created awakening among Indian businessmen, industrialists for establishing commercial banks with the Indian shareholders and their control on them. Consequently, the first major bank, the Punjab National Bank, was established in 1895. It is, thus, evident that the Indian business community realized that they should come forward to bring into existence of commercial banks with their own efforts which could look after the banking requirements of the Indian community and also to have control over the income and profits of these banks, so that they could not be transferred to foreign country.

With the onset of 20th century, the *Swadeshi* Movement got momentum and the Indian businessmen realized that they should come forward to contribute their mite to develop indigenous structure for the fulfilment of their business requirements. As a result, a number of commercial banks were established with Indian efforts after 1906. The important banks, which were established during this period, were the Central Bank of India, Bank of India and Bank of Baroda. It is, thus, evident that with the beginning of 20th century, the commercial banking in India, pre-dominantly under Indian control, took a firm root because all these banks enjoy the strong position even today.

But, the growing consciousness on the part of the Indian businessmen to come forward to enter in the field of commercial banking business created dismal picture during the First World War, and many of them failed. The failure of banks shook the confidence of the people in the banks and then the British government realized the need to exercise effective control over banking business in the country. The British Government appointed some committees to study the situation and suggest measures to have control over the unhealthy expansion of banking business, particularly keeping in view the widespread inflationary trend all over the world. On the recommendations of committees, the British Government realized the need to establish a central bank in the country and thus, the three presidency banks were amalgamated and the Imperial Bank of India was established in the year 1921. The Imperial Bank of India was not a full fledged central bank, it was only a semi-central bank because it was not only deprived of its commercial banking functions but, it was not assigned some powers to exercise control over the commercial banks and also handle the government funds.

The demand for a full-fledged central bank went on increasing and the British Government appointed Hilton Young Commission in 1925, a high powered commission, to look into the matter and suggest measures for establishment of central bank for the country. The commission recommended the establishment of the Reserve Bank of India as shareholders' bank. But, Indian opinion was against the establishment of this bank in the ownership and under the control of private shareholders. Some people favoured the conversion of the Imperial Bank into the central bank of the country. But, the shareholders of the Imperial Bank of India were not in favour of leaving commercial banking functions, a basic necessity to assume the role of a central bank. This controversy prevented the establishment of the Reserve Bank of India just after the submission of the report of Hilton Young Commission. However, with the growing demand of the establishment of central bank in the country, the British government could not postpone the matter for long time. But, the government was in favour of establishing the Reserve Bank of India as state owned bank. The British government, the major power at that time, was protagonist of laissez-faire policy in management of economic and business affairs and as such, it could not be expected that the Reserve Bank of India would be established as a state owned bank. So, this bank was established as a shareholders' full-fledged central bank in 1935. But as stated earlier, Indian opinion was against to this policy of the British government.

The National Planning Committee under the chairmanship of Pt. Jawaharlal Nehru categorically stated in 1937 that the central bank of country would not be left in the hands of private shareholders, mostly the foreign shareholders, and it should be state owned bank. The Reserve Bank of India started functioning after 1935 and the banking system of the country was brought on a proper track, even though the Reserve Bank of India was a shareholders' bank. With the beginning of the second world war in 1939, the growth and consolidation measure in the field of commercial banking got some set back and once again a large number of commercial banks with inadequate financial support and experience came into being and most of them came to their natural death with cessation of the Second World War. The Reserve Bank of India could not do much as central bank for bringing about desired improvement in the banking system of the country, specially due to the political situation in the country and also in the absence of a banking legislation providing the legal parameters for functioning of the bank. The foregoing analysis leads to the conclusion that before Independence the banking system of the country, in spite of its weaknesses and ups and downs had developed into a viable financial establishment creating expectation for its being developed into a strong financial mechanism in consonance with the growing economy of the country. But, it must be stated that banking system under the shareholders' control had its built-in-weaknesses. Again, these banks were purely profit earning organization having no relation with the developmental requirements of the country.

With the achievement of political freedom of the country, the immediate steps taken by the government were the nationalization of the Reserve Bank of India in 1948 and promulgation of Banking Regulation Act, 1949. With these two steps, the Reserve Bank of India was more responsive to the requirements of national economic policy and more powerful to exercise control over banking system. In the absence of a comprehensive banking legislation, the banking operations in the country were rudderless and therefore, a new legislation created an atmosphere in the country for giving a better orientation to control and consolidation of the system.

COMMERCIAL BANKING DURING POST-INDEPENDENCE PERIOD

As stated earlier, immediately after the establishment of a national government of free India two major steps viz., nationalization of the Reserve Bank of India and promulgation of Banking Regulation Act 1949, were taken to tighten the regulatory control over expansion and working of commercial banks in the country. In this regard, the following important steps were initiated:

- (i) Gradual elimination of non-scheduled and weaker banks through the process of absorption, amalgamation and reconstruction;
- (ii) Mobilization of deposits and expansion of banking services in semi-urban and rural areas and thereby strengthening the Indian money market; and
- (iii) Providing assistance to the weaker sections of society with a view to create employment opportunities on the wider scale.

When new constitution of Independent India was introduced in 1950, the socio-economic policy of the government was given a new orientation. Without going into the details of constitutional provisions and related matter, it must be pointed out that our Constitution is based on a democratic system of society and governance, social justice and equality egalitarianism and balanced growth of the economy, etc. To achieve these objectives, the comprehensive planning process was initiated in the country and the first five year plan was launched in the year 1951. Ideologically, the Government of India, under the congress government, Pt. Jawaharlal Nehru as the then Prime Minister, was committed to socialistic pattern of society and thereby nationalization of commercial banks. But, in view of other pressing matters relating to political and administrative reforms in the country, the government perhaps, could not decide in favour of the whole nationalization of commercial banking in India. However, the decision was taken to nationalize the Imperial Bank of India by creating a new bank named as the State Bank of India in 1955. The basic character of the State Bank of India as a commercial bank remained intact but as a public sector bank. It was assigned the task of expanding banking business in rural area. The State Bank of India was strengthened by linking seven subsidiary banks with it. These seven subsidiary banks were- State Bank of Mysore, State Bank of Hyderabad, State Bank of Patiala, State Bank of Saurashtra, State Bank of Travancore, State Bank of Indore and State Bank of Bikaner and Jaipur. In this way, a strong base in realm of commercial bank in India was created with the emergence of the State Bank of India and its subsidiaries.

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