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EVOLUTION OF BANKING IN INDIA

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Abstract -

The evolution of banking in India represents a dynamic journey intertwined with the nation's economic, social, and political history. This research article provides a comprehensive exploration of this evolution, spanning from the pre-independence era to the contemporary digital age. Delving into the early development of banking in India, it examines the influences of colonial rule, indigenous banking practices, and regulatory frameworks. The post-independence period witnessed significant reforms, including nationalization and the establishment of the Reserve Bank of India (RBI), shaping the banking sector's structure and function. Subsequent liberalization and privatization initiatives in the 1990s ushered in a new era, marked by the entry of private and foreign banks, fostering competition and innovation. The advent of technology further revolutionized banking, with digitalization transforming service delivery and customer experiences. This article evaluates the current trends and future outlook, considering emerging challenges and opportunities such as fintech innovation and financial inclusion efforts. Through a historical lens, it illuminates the transformative forces that have shaped banking in India, offering insights for policymakers, practitioners, and researchers alike.

Introduction –

The evolution of banking in India stands as a testament to the nation's economic resilience, adaptability, and growth. From its inception amidst colonial rule to its modern-day manifestation as a powerhouse of financial innovation, the journey of Indian banking reflects a tapestry interwoven with historical, socio-economic, and regulatory threads.

Rooted in ancient trade practices and indigenous financial systems, the early foundations of banking in India were shaped by the intersection of local customs and foreign influences. The colonial era saw the establishment of the first European banks on Indian soil, setting the stage for a gradual transformation of the financial landscape. Yet, it was not until India's struggle for

independence and subsequent nation-building efforts that the true contours of its banking system began to take shape.

Post-independence, the newly-formed nation embarked on a path of economic reconstruction and self-reliance, guided by socialist principles and central planning. In this context, the Reserve Bank of India (RBI) emerged as a cornerstone institution, tasked with regulating monetary policy and supervising the burgeoning banking sector. The era of nationalization in the 1960s and 1980s further underscored the government's interventionist approach, aiming to democratize access to financial services and steer credit towards priority sectors.¹

However, the winds of change blew through India's economy in the 1990s, as the nation embraced liberalization, privatization, and globalization. This watershed moment heralded a new era of dynamism and competition in the banking sector, as barriers to entry were dismantled, and private and foreign players entered the fray. The subsequent decades witnessed a surge in innovation, efficiency, and customer-centricity, as banks vied for market share in an increasingly globalized world.

Yet, perhaps the most transformative force in the evolution of Indian banking has been the advent of technology. From the advent of ATMs to the rise of internet banking and mobile payments, technological advancements have reshaped the very fabric of the banking experience. Today, India stands at the forefront of digital innovation, with initiatives such as the Unified Payments Interface (UPI) and Aadhaar-enabled payments revolutionizing financial inclusion and empowering millions with access to formal banking services.

The banking sector in India plays a vital role in this country's economic development. Over the centuries, numerous changes have occurred within this industry, from technological advancement to the diversification of financial services and products.

Currently, the Indian banking system includes commercial banks, small finance banks, and cooperative banks.

Banks operating within the boundaries of India abide by the Banking Regulation Act 1949.²

¹ <https://unacademy.com/content/bank-exam/study-material/general-awareness/a-brief-note-on-indian-banking-system/>

² <https://groww.in/blog/the-evolution-of-banking-in-india>

What is Bank? –

As per the Banking Companies Act of 1949, a bank is a financial institution that dispenses banking and other financial operations to their customers. A bank is generally considered as an institution which provides fundamental banking services such as providing loans and accepting deposits.

Indian Banking Sector

Banks and banking in India have been classified into various groups. In its activities, each group has its own set of advantages and disadvantages. They have their own distinct target audience. Some work exclusively in the rural sector, while others work in both rural and urban settings. The majority of them only serve cities and major towns.

The banking industry is one of the most essential financial pillars of the financial sector, and it is critical to the economy's functioning. It is critical for a country's economic development that its trade, industrial, and farm funding needs are handled with greater commitment and responsibility. As a result, a country's progress is inextricably related to the development of banking. In today's economy, banks should be viewed as development leaders rather than money merchants. They play a crucial role in deposit mobilization and credit disbursement to many sectors of the economy.

The Reserve Bank of India (RBI), commercial banks, cooperative banks, and development banks comprise India's banking system (development finance institutions). The core of India's financial system is these institutions, which serve as a meeting point for savers and investors. Banks play a vital role in the development of poor countries by mobilizing resources and efficiently allocating them.³

Types of Banks in India

1. Central Bank

The Reserve Bank of India is the central bank of our country. Each country has a central bank that regulates all the other banks in that particular country.

The main function of the central bank is to act as the Government's Bank and guide and regulate the other banking institutions in the country. Given below are the functions of the central bank of

³ <https://jupiter.money/blog/evolution-of-banking-in-india/>

a country:

- Guiding other banks
- Issuing currency
- Implementing the monetary policies
- Supervisor of the financial system

In other words, the central bank of the country may also be known as the banker's bank as it provides assistance to the other banks of the country and manages the financial system of the country, under the supervision of the Government.⁴

2. Cooperative Banks

These banks are organised under the state government's act. They give short term loans to the agriculture sector and other allied activities.

The main goal of Cooperative Banks is to promote social welfare by providing concessional loans. They are organised in the 3 tier structure

Tier 1 (State Level) – State Cooperative Banks (regulated by RBI, State Govt, NABARD)

- Funded by RBI, government, NABARD. Money is then distributed to the public
- Concessional CRR, SLR applies to these banks. (CRR- 3%, SLR- 25%)
- Owned by the state government and top management is elected by members

Tier 2 (District Level) – Central/District Cooperative Banks

Tier 3 (Village Level) – Primary Agriculture Cooperative Banks⁵

3. Commercial Banks

- Organised under the Banking Companies Act, 1956
- They operate on a commercial basis and its main objective is profit.
- They have a unified structure and are owned by the government, state, or any private entity.
- They tend to all sectors ranging from rural to urban
- These banks do not charge concessional interest rates unless instructed by the RBI
- Public deposits are the main source of funds for these banks⁶

⁴ <https://testbook.com/banking-awareness/history-of-banking-in-india>

⁵ <https://testbook.com/banking-awareness/history-of-banking-in-india>

⁶ <https://byjus.com/bank-exam/history-banking-india/>

The commercial banks can be further divided into three categories:

- 1) **Public sector Banks** – A bank where the majority stakes are owned by the Government or the central bank of the country.
- 2) **Private sector Banks** – A bank where the majority stakes are owned by a private organization or an individual or a group of people
- 3) **Foreign Banks** – The banks with their headquarters in foreign countries and branches in our country, fall under this type of bank

Public Sector Banks	Private Sector Banks	Foreign Banks
State Bank of India	Catholic Syrian Bank	Australia and New Zealand
Allahabad Bank	City Union Bank	Banking Group Ltd.
Andhra Bank	Dhanlaxmi Bank	National Australia Bank
Bank of Baroda	Federal Bank	Westpac Banking Corporation
Bank of India	Jammu and Kashmir Bank	Bank of Bahrain & Kuwait BSC
Bank of Maharashtra	Karnataka Bank	AB Bank Ltd.
Canara Bank	Karur Vysya Bank	HSBC
Central Bank of India	Lakshmi Vilas Bank	CITI Bank
Corporation Bank	Nainital Bank	Deutsche Bank
Dena Bank	Ratnakar Bank	DBS Bank Ltd.
Indian Bank	South Indian Bank	United Overseas Bank Ltd
Indian Overseas Bank	Tamilnad Mercantile Bank	J.P. Morgan Chase Bank
Oriental Bank of Commerce	Axis Bank	Standard Chartered Bank

Punjab National Bank	Development Credit Bank (DCB Bank Ltd)	There are over 40 Foreign Banks in India
Punjab & Sind Bank	HDFC Bank	
Syndicate Bank	ICICI Bank	
Union Bank of India	IndusInd Bank	
United Bank of India	Kotak Mahindra Bank	
UCO Bank	Yes Bank	
Vijaya Bank	IDFC	
IDBI Bank Ltd.	Bandhan Bank of Bandhan Financial Services.	

4. Regional Rural Banks (RRB)

- These are special types of commercial Banks that provide concessional credit to agriculture and rural sector.
- RRBs were established in 1975 and are registered under a Regional Rural Bank Act, 1976.
- RRBs are joint ventures between the Central government (50%), State government (15%), and a Commercial Bank (35%).
- 196 RRBs have been established from 1987 to 2005.
- From 2005 onwards government started merger of RRBs thus reducing the number of RRBs to 82
- One RRB cannot open its branches in more than 3 geographically connected districts.

5. Local Area Banks (LAB)

- Introduced in India in the year 1996
- These are organized by the private sector
- Earning profit is the main objective of Local Area Banks

- Local Area Banks are registered under Companies Act, 1956
- At present, there are only 4 Local Area Banks all which are located in South India

6. Specialized Banks

Certain banks are introduced for specific purposes only. Such banks are called specialized banks.

These include:

- Small Industries Development Bank of India (SIDBI) – Loan for a small-scale industry or business can be taken from SIDBI. Financing small industries with modern technology and equipment's is done with the help of this bank
- EXIM Bank – EXIM Bank stands for Export and Import Bank. To get loans or other financial assistance with exporting or importing goods by foreign countries can be done through this type of bank
- National Bank for Agricultural & Rural Development (NABARD) – To get any kind of financial assistance for rural, handicraft, village, and agricultural development, people can turn to NABARD.⁷

7. Payments Banks

A newly introduced form of banking, the payments bank has been conceptualized by the Reserve Bank of India. People with an account in the payments bank can only deposit an amount of up to Rs.1,00,000/- and cannot apply for loans or credit cards under this account.

Options for online banking, mobile banking, the issue of ATM, and debit card can be done through payments banks. Given below is a list of the few payments bank in our country:

- Airtel Payments Bank
- India Post Payments Bank
- Fino Payments Bank
- Jio Payments Bank
- Paytm Payments Bank
- NSDL Payments Bank⁸

⁷ <https://groww.in/blog/the-evolution-of-banking-in-india>

⁸ <https://jupiter.money/blog/evolution-of-banking-in-india/>

Feature of Banking –

1) Deals with Money

A bank's main characteristic is that it handles all financial transactions. You can put your money in a bank account, for example, to store it safely, and you will be interested in the money you save in the account.

2) Provides Loans

Banks gain additional money by providing loans for a variety of products. The bank earns the additional funds by lending money to the qualifying person at predetermined rates.

Banks now provide loans for a variety of purposes, including study loans, vehicle loans, housing loans, personal loans, and so on.

3) Withdrawal and payment facilities

Customers can use a bank's numerous payment and withdrawal services to receive their money quickly and easily. Customers can use cheques and draughts to withdraw money, as well as ATMs established by banks at various sites throughout the city.

4) Internet services

Modern banks now provide internet services, which is another element of a bank. The growth of the internet and its integration into the banking industry has made it even easier for customers to do numerous transactions. Through their apps, banks are providing online services. You can pay your bills, buy groceries, and shop without having cash on you.

5) Business

Banking's sole purpose is not to supply consumers with banking services. To make additional money, all banks are involved in subsidiary enterprises. Their only responsibility is to deliver optimum customer satisfaction and maximum interest rates in order to attract more clients to bank with them. To make a profit, money is moved from one hand to the next.⁹

Evolution of Banking in India ¹⁰

The banking sector in India has seen a great deal of evolution. Banks have been with us for a long period of time, even before the country got its independence, the banks existed. Given below is a clear picture of the banking history and its evolution: Banking history in India can be broadly

⁹ <https://testbook.com/banking-awareness/history-of-banking-in-india>

¹⁰ <https://groww.in/blog/the-evolution-of-banking-in-india>

divided into the following stages:

- 1) Pre - Independence (Before 1947)
- 2) Post - Independence Phase - (Between 1947 to 1991)
- 3) Liberalisation (1991 - Until Now)

- **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:

1. The General Bank of India (1786-1791)
2. Oudh Commercial Bank (1881-1958)
3. Bank of Bengal (1809)
4. Bank of Bombay (1840)
5. 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.

Reasons why major banks failed to survive during the pre-independence period –

- Indian account holders had become fraud-prone
- Lack of machines and technology
- Human errors & time-consuming
- Fewer facilities

- Lack of proper management skills.¹¹

- **Post Independence Period (1947-1991)**

At the time when India got independence, all the major banks of the country were led privately which was a cause of concern as the people belonging to rural areas were still dependent on money lenders for financial assistance.

With an aim to solve this problem, the then Government decided to nationalise the Banks. These banks were nationalised under the Banking Regulation Act, 1949. Whereas, the Reserve Bank of India was nationalised in 1949.

Candidates can check the list of Banking sector reforms and Acts at the linked article.

Following it was the formation of State Bank of India in 1955 and the other 14 banks were nationalised between the time duration of 1969 to 1991. These were the banks whose national deposits were more than 50 crores.¹²

Given below is the list of these 14 Banks nationalised in 1969:

- Allahabad Bank
- Bank of India
- Bank of Baroda
- Bank of Maharashtra
- Central Bank of India
- Canara Bank
- Dena Bank
- Indian Overseas Bank
- Indian Bank
- Punjab National Bank
- Syndicate Bank
- Union Bank of India
- United Bank

¹¹ <https://unacademy.com/content/bank-exam/study-material/general-awareness/a-brief-note-on-indian-banking-system/>

¹² <https://byjus.com/free-ias-prep/types-banks-india/>

- UCO Bank

In the year 1980, another 6 banks were nationalised, taking the number to 20 banks. These banks included:

- Andhra Bank
- Corporation Bank
- New Bank of India
- Oriental Bank of Comm.
- Punjab & Sind Bank
- Vijaya Bank

Apart from the above mentioned 20 banks, there were seven subsidiaries of SBI which were nationalised in 1959:

- State Bank of Patiala
- State Bank of Hyderabad
- State Bank of Bikaner & Jaipur
- State Bank of Mysore
- State Bank of Travancore
- State Bank of Saurashtra
- State Bank of Indore

All these banks were later merged with the State Bank of India in 2017, except for the State Bank of Saurashtra, which merged in 2008 and State Bank of Indore, which merged in 2010.

Once the banks were established in the country, regular monitoring and regulations need to be followed to continue the profits provided by the banking sector. The last phase or the ongoing phase of the banking sector development plays a hugely significant role.

Liberalisation Period (1991-Till Date)¹³

To provide stability and profitability to the Nationalised Public sector Banks, the Government decided to set up a committee under the leadership of Shri. M Narasimham to manage the various reforms in the Indian banking industry.

¹³ <https://pwwskills.com/blog/history-of-banking-in-india-bfsi/>

The biggest development was the introduction of Private sector banks in India. RBI gave license to 10 Private sector banks to establish themselves in the country. These banks included:

Global Trust Bank

- ICICI Bank
- HDFC Bank
- Axis Bank
- Bank of Punjab
- IndusInd Bank
- Centurion Bank
- IDBI Bank
- Times Bank

The other measures taken include:

- Setting up of branches of the various Foreign Banks in India
- No more nationalisation of Banks could be done
- The committee announced that RBI and Government would treat both public and private sector banks equally
- Any Foreign Bank could start joint ventures with Indian Banks
- Payments banks were introduced with the development in the field of banking and technology
- Small Finance Banks were allowed to set their branches across India
- A major part of Indian banking moved online with internet banking and apps available for fund transfer

Thus, the history of banking in India shows that with time and the needs of people, major developments have been brought about in the banking sector with an aim to prosper it.

Reasons Why Banks Were Nationalised in India¹⁴

To get a clearer picture of the impact of nationalisation on the banking industry and the general population, let's understand why the government decided to nationalise banks:

¹⁴ <https://jupiter.money/blog/evolution-of-banking-in-india/>

- **To Energise Priority Sectors:** Banks were collapsing at a fast rate – 361 banks failed between 1947 and 1955, which converts to about 40 banks a year! Customers lost their deposits with no chance of recovering them.
- **A Neglected Agricultural Sector:** Banks favoured large industries and businesses and neglected the rural sector. Nationalisation came with a pledge to support the agricultural sector.
- **Expansion of Branches:** Nationalisation facilitated the opening of new branches to ensure maximum coverage of banks throughout the country.
- **Mobilisation of Savings:** Nationalising the banks would allow people more access to banks and encourage them to save, injecting additional revenue into a cash-strapped economy.
- **Economic and Political Factors:** The two wars in 1962 and 1965 put a tremendous burden on the economy. The nationalisation of Indian banks would give the economy a boost through increased deposits.

The Positive Effects of Nationalisation

The nationalisation of Indian banks was one of the most significant events in the evolution of banks in India. Today, India has 19 nationalised banks.

Here are a few ways that nationalisation benefited the economy:

- 1) **Increased Savings:** There was a sharp increase in savings with the opening of new branches. As national income rose in the 1970s, gross domestic savings almost doubled.
- 2) **Improved Efficiency:** The efficiency of banks improved with additional accountability. It also increased public confidence.
- 3) **Empowering SSIs:** Small-scale industries (SSIs) received a boost resulting in a proportionate improvement in the economy.
- 4) **Financial Inclusion:** The overall statistics of the banking sector and the Indian economy showed a marked improvement. It reflected on parameters like the share of bank deposits to GDP, the gross savings rate, the share of advances to DGP, and the gross investment rate from 1969 to 1991.
- 5) **Better Outreach:** Banks were now no longer only restricted to metropolitan areas. Branches were opened in the remotest corners of the country.
- 6) **A Surge in Public Deposits:** The increased reach of banks helped small industries, agriculture, and the export sector grow. This growth was accompanied by a proportionate increase in public deposits.

- 7) **Elevating the Green Revolution:** The Green Revolution, one of the biggest priority items on the government's agenda, received a boost thanks to the support that the newly-nationalised banks provided to the agricultural sector.¹⁵

Drawbacks of Nationalisation

To provide an unbiased view on the subject, here are a few downsides of nationalisation:

- 1) **Socio-Economic Challenges:** The banks couldn't provide sufficient support to eradicate poverty or provide adequate financing to the grassroots levels of society. This was particularly obvious in rural India.
- 2) **Competition From Private Banks:** Despite government support and increased impetus through a rise in deposits, public sector banks were never able to surpass private banks in performance.
- 3) **Failure to Achieve Financial Inclusion:** Although financial inclusion was the major objective of nationalising banks, it was not adequately enabled. It was only achieved to a limited extent after the launch of a type of savings account called Jan Dhan Yojana.¹⁶

Conclusion –

In conclusion, the Indian banking sector faces both opportunities and challenges. Fintech innovation promises to reshape traditional banking models, offering new avenues for service delivery and customer engagement. However, this rapid evolution also brings regulatory and cybersecurity concerns that must be addressed proactively.

The evolution of banking in India mirrors the nation's journey towards economic prosperity and social empowerment. By leveraging technology, fostering innovation, and embracing inclusivity, Indian banks can continue to play a pivotal role in driving sustainable development and realizing the aspirations of millions across the country. This research illuminates the transformative forces that have shaped Indian banking and offers valuable insights for policymakers, practitioners, and researchers navigating the future of finance.

¹⁵ <https://testbook.com/banking-awareness/history-of-banking-in-india>

¹⁶ <https://unacademy.com/content/bank-exam/study-material/general-awareness/a-brief-note-on-indian-banking-system/>