CHAPTER – II
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HISTORY OF BANKING

Introduction

Since this work relates to development of banking and other financial institutions, it is quite relevant to go into the history of banking in the world and how it spread in our country. Hence, in this chapter we shall be dealing with the history of banking since the olden days with detailed analysis of its development in India.

In the olden days when life was simple, man had only the barest minimum of daily needs like food, clothes and shelter from the harsh forces of nature. These were enough for his well being. Cooke states that in the most remote ages of the world, man recognised no other wants than those of being clothed and fed. The standards of value in all countries were cattle skins of animals and the produce of the soil.¹

As population increased and civilization advanced, human wants multiplied at a rapid pace. With the increase in human requisites man was no longer self-sufficient and hence different trades came into being. Thereafter, man began to specialize in one particular trade or work, and exchanged the produce of his work with the produce arising out of other kinds of work. The farmer for instance, would receive milk from the dairy owner in exchange for his crops and so on. This is known as the Barter System. But this system was too crude
and unwieldy. Goods could not be easily exchanged for other goods.

Men hit upon the idea of a common standard of value for all goods. Money came into existence. The term ‘money’ is derived from the Latin word ‘Moneta’. The first forms of money that were used were different commodities chosen as the standard commodity. Cowries, glass, oil, rice, tobacco, dates, goats, and other materials were used as standards by different tribes in the past. In course of time metals like gold, silver, iron, copper and bronze have been used as money. There had been agreement on the use of one or more of three metals for purposes of exchange, these being silver, copper and gold.

For many years silver was pre-eminent. After the division of the Roman Empire, gold had a prior place. This is because gold has been the most precious and beautiful metal. Moreover, the merchants in those days would require that the precious metal they received should be of a certain degree of fineness. But metal could not serve as a perfect medium of exchange and therefore steps were taken to establish a coinage of uniform and proper value.

Early Coinage

The Greeks played a dominant role in the early financial market and the first coins were struck in Lydia, a Greek province about 700 B.C. The early coins were of different shapes like oval, rectangular, square, knife-like and shirt-
like. It seems possible, based on references in the Hindu epics, that coins including a decimal division, were in fact in use in India some hundreds of years earlier. After the Lydians, coinage developed rapidly in the Greek cities and in their colonies in Sicily and Italy.

In course of time, the rulers and even the private entrepreneurs could manage to reduce the amount of metal in their coins. Thus a smaller amount of silver or gold would buy as much as before. As early as 540 B.C., Polycrates of Samos is said to have cheated the Spartans with coins of simulated gold. In the ancient and medieval world, the coins of different dominations conveyed at the major trading centres. Most probably bad coins were used, whereas good coins were retained. It is from this incident that Thomas Gresham derived his famous law stating that bad money always drives good money out of circulation.

The Paper money that came into existence in the 17th century was known as 'token money'. Metallic money was found by merchants to be unsafe to transport. Moreover, there was a scarcity of metals and therefore, state authorities found it more economical to use paper money. Besides paper money, other form of money was developed which was known as credit money or bank money e.g., cheques, bills of exchange and promissory notes.

As the quantity of money increased and goods were no longer exchanged for goods, people began to look for a safe
place to deposit their surplus amount of money. The surplus money also began to be lent with interest to those who needed it. The Athenian money lenders were among those who charged a very high rate of interest. Money lending and borrowing facilitated the greater circulation of wealth, which led finally to the creation of Banks.

**Origin of Banking**

Cooke pointed out that the science of Banking originated in Italy from where we derive our knowledge of Book Keeping by double entry. The Bankers and Merchants used to write their Bills of exchange upon benches in the market place and other public places. When a Banker or a Merchant lost his credit and was unable to meet his debts, his bench was broken. It is from this practice that we get the word "bankrupt" in English language, which is derived from two Italian words ‘Branco’ and ‘rotto’ meaning ‘broken bench’. From the first of these two words, the terms ‘Bank’ and ‘Banker’ are derived.⁴

The Banking system had a substantial existence in Roman times. So far as any business can be given ethnic association, Banking belongs to the Italians. The Banking-houses or Banks in Rome were called Argentinae, Tabernae, or Mensa Numularia and the Bankers were called Argentarii, Mensarii, Numularii or Colybista.⁵ The Bankers were also money-changers. They lent money on interest and charged a lower rate of interest on deposits accepted by them. The mode
of transaction was somewhat similar to that which is used in modern Banks. The Banking-houses of Venice and Genoa were the recognised forerunner of modern Commercial Banks.

Coinage in India

The first form of money that was used in India was metallic money. Vedic literature mentions the 'satamas' (coins), 'niskas' (weights) and 'hiranya pindas' (ornaments). Before the 5th Century B.C., some smaller states like Surasena, Uttara Panchala, Kalinga and Andhra had issued coins. These coins were used even during the Mauryan period i.e., from the 4th to the 2nd century B.C. The data on Indian coinage can be found in Kautilyas Arthashastra. During the reign of Chandragupta Maurya, literature talks about coins of 'silver' (rupya-rupa), gold (swarnarupa), copper (tamrarupa) and lead (sisarupa). Coins as a medium of exchange were used from the Mauryan age. After the Mauryans, the Indo-Bactrians (250BC-50AD), the Indo-Parthians (250BC-80AD), the Kushanas (40AD-241AD) and the Guptas (320AD-540AD) refined the coins and gave them different shapes. The Indo-Greek and Kushana coins had symbols of the Greek and Indian gods and their kings. The Gupta coins depicted the royal interest on riding, hunting and music.6

The Rupee (in silver) was introduced from the Mughal period and was recognised as a standard currency. It was Sher Shah who had minted this type of currency. He also issued gold mohurs and copper paise. The Portuguese were the first to open a mint in Goa in the year 1510, and in 1775 they used
the word ‘Rupia’ for their coins. The English opened a mint in Bombay in 1717 and the French in Arcot in the year 1736 with the objective to issue Mughal rupees and other coins. Besides the mint in Bombay, the English set up other mints in Madras, Bombay, Banaras, Calcutta, Dacca, Patna, Murshidabad and Farukhabah.\(^7\)

After the downfall of the Mughal Empire, many small states started to issue their own coins. During this period, the English East India company gained administrative powers and divided its holdings into three Presidencies - Bombay, Calcutta and Madras. Each Presidency was allowed to issue its own coins and only these coins were allowed to circulate in the respective Presidencies. It was in 1835 that the British parliament passed an Act by which a uniform coinage was introduced in India and in which the portrait of king William-IV replaced that of the Mughal Emperor. In 1860, the Government had to issue paper money as the silver rupees were not able to meet the needs of a growing trade transactions.\(^8\)

**The First Bankers in India**

The banking in India was in practice since time immemorial. The Vedas and Manusmritis had records of banking transactions in ancient India. Temples were considered safe places to deposit gold, ornaments and other valuables. The gods of these temples were known as the first bankers and the priests and priestesses acted as their tellers.\(^9\) These agents accepted deposits on behalf of their gods and
lent the same on interest to those who needed it. From time immemorial, the bankers had always been an improtant member of the society. Even during the Ramayana and Mahabharata ages, banking had become a full-fledged business activity. The Vaishyas were the principal bankers during the Vedic period. The Bankers were divided into three main classes: the city shroffs, the Zillah Bankers and the village Mahajans.\textsuperscript{10} The literature of the Buddhist period also provides information regarding the existence of "shreths", "seths", "shahukars" and bankers in all the important trade centres in India which had a great impact on the welfare of the society. The Hindu Dharmashastra laid down principles that different rates of interest should be charged on different believers belonging to different castes and that only the Vaishyas should take up the profession of money-lending. According to Preston, it may be accepted that the system of banking eminently suited India's then requirements and was enforced in this country many centuries before the science of Banking became an accomplished fact in India.\textsuperscript{11}

The deposit banking, however, came into being quite later i.e., by the 2nd and 3rd century of the Christian era.\textsuperscript{12} Like the Vaishyas of the Vedic period, gradually Indian bankers also emerged later like the Jainas, Marwaries, Khatris, Aroras, Chettis, Multanis, Rehtis and Mohammedans and Banias in U.P., Gujarat, Rajasthan and West Bengal. According to the famous French traveller J.B. Fraverner, every Indian village had money changers called "shroffs" who
undertook all the remittance of money and issued letters of exchange.\textsuperscript{13}

The indigenous banking in India is a family business inherited by the son from his father, the son automatically acquiring training within the family itself. He did not have to incur any expenses to learn the art of indigenous banking. The indigenous bankers became very popular and their\textit{ hundis} were and are still negotiated in all parts of the country and even outside the country. The Chettis provided credit for financing India's foreign trade with South-East Asian countries. The indigenous bankers employed\textit{ gumastes} or expert agents who supplied all the necessary information from different parts of the country.

The indigenous banking could not flourish well during the Muslim period as the Muslim ruler believed in the Quran teaching that accepting money by way of charging interest is a sin. It was only in the time of Jahangir and Shah Jahan that banking in India showed signs of prosperity. Money banking houses were set up and it was during this period that Muslim writers wrote about the existence of\textit{ hundis} or indigenous bills during the Mughal period.\textit{ Hundis} played an important role in providing financial assistance and in financing internal and external trade\textsuperscript{14} and this raised indigenous bank to occupy a higher position in the economy of the country. During the reign of Aurangzeb, banking system in the economy suffered a setback. People found it more convenient to borrow from friends and neighbours than from the banks. Though

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indigenous banks had been playing an important role, the institution had been characterised by serious problems. Such problems are the mixture of banking business with trade which had adversely affected the banking system in the country. In certain cases indigenous bankers had to incur losses because of non-recovery of loans and the prevalence of different types of gold and silver coins circulated in different parts of the country. They did not publish the balance sheets and proper accounts. Their records were always kept in secret and they never developed the hundis.

The indigenous bankers operated in their respective centres and thereby had an intimate relationship with their clients and customers. This helped them to carry on their work smoothly and efficiently. Indigenous bankers and money-lenders were the main source of credit in the Indian economy up to the year 1850 or 1860 i.e., before the establishment of the Presidency Banks and the Joint-stock Banks. Even during the first half of the 20th century, the indigenous bankers and money lenders supplied the major chunk of credit, especially in the remote areas of the country.\textsuperscript{15}

This distinction between indigenous bankers and money-lenders should be emphasised. The money-lenders operated with their own capital fund arising out of their savings, while indigenous bankers operated with the deposits accepted from public. The latter discounted hundis whereas the former did not do so. The indigenous bankers and their methods of operation were far better than the money-lenders. There is one
thing common between them in that they both were ancient institutions and did not belong to the organised sector.

When the British ruled in India, many changes took place in India-socially, economically and politically. The Indian banking system began to decline as the Shahukars could not make changes in the methods of their operations to suit the changed economic conditions of India. Besides, the Industrial Revolution had a great impact on Indian economy. People obtained work in the different factories and industries and did not have to depend anymore on the 'shahukars' and 'seths'. In this way the indigenous banking system headed towards a complete breakdown. This led to the necessity of a modern banking system.

**Origin of Central Banks**

The government banks were founded with an aim to promote trade and commerce and to meet the requirements of a state. Thus central banking has passed through many phases of evolution. The design and structure of the central banks, their significance and policies, their relations with the government and with the public, their contributions toward economic development, all form part of this evolutionary process.

The central bank is the organ of government that undertakes the major financial operations and by other means, influences the behaviour of financial institutions so as to support the economic policy of the government. In the past, it
so happened that out of many banks in a country, one bank would acquire a higher position of a central bank enjoying the sole right of note issue and acting as the government’s bank and agent. Such banks were not called central banks but were known as ‘bank of issue’ or as ‘national banks’. In course of time, such a national bank besides issuing notes had to perform other functions too, which were similar to the functions of a modern central bank. This led to the adoption of the term ‘Central Bank’ in place of ‘National Bank’. But central banks are different from commercial banks in certain vital respects. First, they are governed by agencies of government. Secondly, their motive behind is not achieving individual profit but social profit.

Central Banking is a recent phenomenon and is related to the 19th and 20th centuries, even though there were institutions which transacted certain central banking functions in earlier times. The growth of central banks has been very slow. Amongst the existing central banks, the Risk Bank of Sweden which was originally set up as private bank in 1656, was recognised as state bank in the year 1968 and later developed into a Central Bank. Since its inception, the Bank enjoyed the right to issue notes and this right was confirmed by an Act passed in 1809. Unfortunately, the Bank lost the liberty of issuing notes when ‘enskilda’ banks established from 1830 onwards took away the right to issue notes. It was not until 1897 that the monopoly of note issue was given back to the Risk bank.  

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The Bank of England, founded in 1694, assumed the position of the central bank and developed the fundamentals of the art of central banking. It started functioning as a full-fledged central bank only after the passing of the Bank of Charter Act, 1822. Other major central banks established in the 19th century were the Bank of France (1800), the Bank of Netherlands (1814), the National Bank of Austria (1817), the Bank of Norway (1817), the National Bank of Belgium (1850), the Banks of Spain (1856), the Bank of Russia (1860), the Bank of Germany (1875) and the Bank of Japan (1882).

The Bank of France was established with the State's assistance but mainly with private capital. Since its inception, it functioned side by side with the State. The Bank of France had the exclusive right of note issue in Paris and acted as the government's banker. The shareholders were represented by a board of fifteen Regents, who were elected by the two hundred largest shareholders. In course of time, the Bank of France set up many other branches and acquired the monopoly of note issue in the entire country.

The Bank of the Netherlands was founded in 1814 with private capital. The President and the Secretary were appointed by the state while the other members of the Managing Board and the Board of Directors were elected from among the shareholders. The Bank was established to replace the old Bank of Amsterdam as the latter had become discredited.
The National Bank of Austria was set up in 1817 in order to bring about a sound monetary system in the country. The Bank enjoyed the right to issue currency notes till the year 1847. Owing to the wars and revolts which broke out in Austria between 1847 and 1866, the right to issue notes was given to the Government. The Bank was recognised as the Bank of Austria-Hungary in 1878.21

The Bank of Norway which was instituted in 1817 started functioning with private capital. The Governor and Vice-Governor were appointed by the King and the directors were elected by Legislature. The Bank enjoyed the privilege of note issue and acted as Government's banker.22

The National Bank of Belgium was set up in 1850 and it had the sole right of issuing notes. Prior to the establishment of the Bank, there were four banks issuing notes but the notes of none of these banks had a national circulation. The Bank was a private bank but the Governor was appointed by the Government.23

The Bank of Spain instituted in the year 1856 had to share the right to issue notes with other provincial banks, and was not granted a monopoly of note issue till the year 1873. The Bank operated with private funds but the appointment of the Governor was the task of the Government.24

The Bank of Russia was established in 1860 to issue notes. Besides this, the other objectives were to bring about
stabilisation in the currency and to promote the development of commerce, industry and agriculture. The Governor and Deputy Governor were appointed by the Government, while a Council was formed to look after the transactions of the Bank.\textsuperscript{25}

The Reichbank of Germany was instituted in 1875. It was owned partly by the Government and partly by shareholders. When the German empire was founded, there were several banks which issued notes. The most popular among these was the Bank of Prussia. In course of time, the Bank of Prussia was acknowledged as the apex bank and was renamed as the Reichbank.\textsuperscript{26}

The Bank of Japan was founded in the year 1882 with an aim to stop the excessive issuing of notes by the several national banks. These banks were asked to withdraw the notes and so the Bank of Japan had the sole right of note issue. The Bank was a joint-stock company but the Government appointed the Governor, Deputy Governor and four Directors.\textsuperscript{27}

**Banking in the USA**

The growth of central banking began in the 20th century. This gained momentum when the International Financial Conference which met at Brussels in 1920, suggested that all countries which have not yet established a Central Bank should proceed to do so. Accordingly, central banks have been established not only in the existing independent countries but
also in many new independent states. The movement of central banking gained further force after the setting up of the International Monetary Fund in 1947.28

The central bank of the United States of America is a system of twelve connected banks called the Federal Reserve Banks.29 Hence, the Federal Reserve System is made up of the twelve Reserve Banks.30 The capital of each Reserve Bank was subscribed by the 'member banks' in its region. The member banks enjoy certain rights in controlling over the functioning of the system such as electing some of the Directors on the local boards - the Boards of the individual Reserve Banks. But more power is exercised by Board of Governors of the Federal Reserve System over the Reserve Banks. The Board of Governors is in Washington and it consists of seven Governors appointed by the President of the United States. From among these seven, the Chairman and the Vice-Chairman, are appointed by the President for a term of four years. Thus, the American Central bank may be described as directed by men appointed for fairly long terms. In the 1950's, the Open Market Committee has come out to be an effective decision-making body in the system. The Committee consisted of the seven Governors along with the heads of five of the twelve Reserve Banks. It met once every three weeks and has attended by sixty or seventy people.31

Modern Central Bank

At present, all countries have a central bank of their own as they have felt the need of having centralised monetary
reserves as well as vesting the control of currency and credit in one bank with the State's intervention. They have also realised the significance of a central bank as a means of cooperation and relation with banks of different countries. Most of the central banks in different countries have been set up as state-owned institutions.

A modern central bank has been defined as the supreme monetary institution which is at the apex of the monetary and banking structure of a country. The powers and range of functions of a modern central bank vary from country to country. But there are certain common functions performed by all central banks. According to De Koch a Central bank is a:

(1) Bank of issue;
(2) Banker, agent and financial adviser;
(3) Custodian of member banks' cash reserves;
(4) Custodian of nation's foreign exchange reserves;
(5) Lender of the last resort;
(6) Bank of central settlement and transfer, acting as a clearing house.
(7) Controller of credit.32

Central Bank in India

In India, the idea of establishing a Central Bank is an old one. In 1836, a group of merchants proposed a scheme for a Central Bank to ensure monetary stability. But the idea of establishing a Central Bank came to an end with the setting up of three Presidency Banks at Calcutta, Madras and Bombay.
The idea was revived in 1867 by amalgamating the three Presidency banks which the Government deferred implementation until the Imperial Bank of India came into being in 1921. The Imperial Bank undertook all the general banking business of the Government and acted as the Government's bank.

The Hilton Young Currency Commission (1926) suggested the creation of a separate bank called the Reserve Bank of India. The Commission suggested the importance of such a bank in bringing about monetary stability. The Commission also recommended that the bank should be a shareholder institution and to avoid political pressure on the Bank, no members of the central and state legislatures should be allowed to serve as Directors of the bank. Bills were passed in 1927 and in 1929 to support the recommendations of the Hilton Young Commission. Unfortunately, nothing positive came out to establish a Central Bank. Besides the Hilton Young Commission, the Simon Commission (1930), the First Round Table Conference (1931), the Central Banking Enquiry Committee (1930), and the White Paper on Indian Reforms (1933) were all in favour of a Central Bank for India.  

The Reserve Bank Bill was introduced in the Legislative Assembly in 1933 to institute the Reserve Bank as the central bank of the country. The Bill became an Act on 6th March, 1934 and termed the Reserve Bank of India Act, 1934. Mainly the Act has the provisions pertaining to the establishment,
management and functioning of the Reserve Bank. The Act also contains certain provisions concerning the commercial banks. The Reserve Bank of India Act, 1934 also made a classification between scheduled and non-scheduled banks. The Scheduled banks are those banks which are included in the second schedule of the Act and have a paid-up capital and reserves of not less than Rs. 5 lakhs. The operations of these banks are controlled by the Reserve Bank (RBI) and they are eligible for its rediscounting facilities. The Non-scheduled banks are those banks which are not included in the second schedule of the R.B.I. Act, 1934.\footnote{34}

The Reserve Banks of India with a share capital of Rs 5 crores was inaugurated in April 1935 and functioned as a private shareholders bank. The affairs and functions of the Reserve Bank were taken care of by the Central Board of directors consisting of 16 members. The Issue Department and Banking Department are kept separate. The Reserve Bank of India had to be nationalised on January 1, 1949 after the passing of a Bill by the Indian Legislature in September 1948\footnote{35} because it failed to act in the interest of domestic stability and people’s welfare and had failed to identify itself with the national aspirations. After nationalisation, the Central Board of Directors consisted of Governor, two Deputy Governors, ten Directors and one government official was instituted. Before 1949, the Reserve Bank of India had been performing two functions i.e. regulation and provision of credit to various sectors. It had concentrated on three things first-on the strengthening of the commercial banking system;
secondly, on the strengthening of co-operative banking system and thirdly on the promotion of other financial institutions. At present, the Reserve Bank of India, performs all the functions of a Central Bank.

Evolution of Commercial Banks

The Commercial Banks are the most important source of institutional credit in the modern age. It is difficult to give an exact definition of the term ‘Commercial Bank’. According to the Oxford Dictionary, a Bank is “an establishment for the custody of money, while it pays out on a customer’s order”. This definition was not accepted as it did not mention the supreme function of a Commercial Bank, i.e. credit creation. Sayers states that a Bank is an institution whose Bank deposits are widely accepted in settlement of other people’s debts to each other.\(^{36}\)

The Commercial Banking has been practised since time immemorial. The development of traditional commercial banking was related to one factor i.e. money changing. In those days kings, rulers and governments required financial facilities and therefore granted banking rights in exchange for loans.

Around 2000 B.C., the famous temples of Ephesus, Delphi and Olympia in Greece were used as depositories for people’s surplus amount of money. The accumulated fund in turn was lent to those who needed it. Hence, these temples became centres of money lending activities in ancient times.
The temples of Delphi and other safe places acted as storehouses for the precious metals before the days of coinage and later they lent out money for public and private purposes at interest, though they paid none themselves. Private money changers began with the task of reducing many metallic currencies, more or less exactly to a common unit of value, and went on to accept money on deposit at interest and to lend it out at higher interest putting meanwhile drafts to be drawn on them. The banker in the Smriti period performed most of the functions of a modern Commercial Bank such as accepting deposits and lending the same against security and without security.\textsuperscript{37}

In ancient Rome, the pattern of banking was similar to that in ancient Greece. After the fall of the Roman empire, i.e. after the death of Emperor Justinian in 565 AD, banking suffered a setback and it was only in the middle ages that banking was revived and took a new shape. During the middle ages, money lending transactions were mainly carried by the Jews and the financial agents of Lombardy. The Christians did not indulge in any act of money-lending as it was considered to be sinful for them to lend money to others on interest. In course of time, Christians too entered into the business of money-lending and thereby tried to compete with the Jews.\textsuperscript{38}

The development of Commercial banking in England can be traced back to the activities of the London goldsmiths during the reign of Queen Elizabeth-I. The goldsmiths were popular during the middle of seventeen century. This is
mainly because in the year 1640, King Charles-I seized all the large hoards of gold that were kept in the Tower of London by the London merchants. The London merchants were so frightened by this event that although their seized deposits were returned by the monarch they decided to look for a safer place for their gold and in the process of the search they deposited their bullion with the goldsmiths. The goldsmiths in turn lent the money on interest and even issued notes certifying the receipts of valuables and money. These notes took the form of the present day Bank note. Later, the goldsmith's business suffered a setback due to the ill-treatment they received at the hands of Charles-II. After the collapse of the goldsmiths' activities, the need was felt for a developed English banking. As a consequence, private banking came into existence and finally the Bank of England was set up in the year 1694.\(^9\)

With regard to English Commercial banking, Geoffrey Crowther has remarked:

The present-day banker has three ancestors of particular note. One we have already met, the merchants whose high and widespread reputation or credit enables him to issue documents that will be taken all over the known world as titles to money. To this the title of 'merchant banker' is reserved by usage to the older cosmopolitan and more exclusive private banking firms, nearly everyone of which can trace its ancestry to a trader in commodities, more tangible (though hardly more profitable) than money.

The banker's two other ancestors are the moneylenders and the goldsmiths. Lending and
borrowing are almost as old as money itself and the village money-lender is found even in quite primitive communities. He is not usually regarded as a very lovely object. usurer is one of the oldest terms of abuse. But the services he performs are undoubtedly useful and necessary even though the reward he exacts in return may usually be rapacious. The money-lender works, of course, with his own capital. But if there are any other members of the community with money to spare, it will be quite natural for them to entrust it to the money-lender for investment, in view of his skill and experience in the technique of exaction. As soon as the money-lender reaches this stage, he is an embryonic banker. He has become a money borrower as well as a money-lender. At first he may merely lend out his clients' money on commission, just as a present day solicitor does. But it is obviously both more convenient for his clients and more profitable for him to borrow their money outright, paying interest on it and mingling it with his own capital and then to lend out the whole lot, making his profit from the difference between the moderate rate of interest he pays to his lending clients and the high rate he charges to his borrowing clients.

...The goldsmith ancestry of the modern Bank is purely an English affair. Indeed, the Bank as a provider of circulating money is almost entirely an English invention. 40

The commercial banking transactions in the under-developed Afro-Asian countries have been practised by expatriate banks and national banks. But the national banks were not entirely owned by the government such as the Bank of the North Africa Ltd., and the Bagos Ltd. both in Nigeria. The branches of the expatriate banks were set up in the colonised countries of the world. For example, the London Banks which at first established their branches in India also
opened their offices in many other colonies in the East. Even in the West Indies like the Bahamas, Bermudas, British Guyana and other British territories only expatriate banks existed.41

The former colonies also set up their own banks which had no branches outside their territories. Examples of the earlier local banks are the National Bank of Malta, the Bank of Cyprus and the Mauritius Commercial Bank.42

In the U.S.A., the banks are directly or indirectly linked with the New York money market. The development of nationwide branch banks has been prevented by law, and also by the traditional feelings. It was only after 1930, and particularly since 1945, that branch banking has grown quite rapidly. California is the State where branch banking has gone the farthest. In the year 1965, there were 49 banks with 695 branches in New York city. At the other extreme, Chicago city had 84 unit banks which were not allowed to have branches at all.43

The large-scale bank organisation plays a vital role in the American economy. 'Groups' or 'Chains' of banks, under substantially common ownership have developed. About 427 banks are believed to be under the control of forty-six holding companies. The Transamerica group, with ten banks spread over six states was the biggest in term of deposits. The scale of bank organisation has also been greatly modified in recent years due to amalgamation. This has a great impact on some
of the giant and big banks in Pittsburgh, Boston, Dallas, Kansas city, Baltimore, Washington DC and elsewhere. The degree of concentration of banking in many of the large cities is now very high and we cannot describe the United States, even outside California, as a country of small banks. What is still lacking outside California, is the wide network of branches. The United States remains predominantly a country of local banks.

In the present day world, economic activities in all countries, are in one way or another, relate to the aggregate money supply comprising of currency demand and time liabilities with the banks. In the modern day, credit or bank money constitutes the major chunk of the aggregate money supply. Here lies the significance of the commercial banks. Today the commercial banks not only issue and transfer deposits but they also offer different types of account, act as underwriter to new issues, deal in foreign exchange, provide locker facilities, and other services. No doubt commercial banks are performing many functions but one should not confuse the functions of a central bank with those of a commercial bank. The former aim at stabilising the monetary policies in the economy whereas the latter aim at maximisation of profits thereby accelerate economic development.

Commercial Banking in India

The East India Company sowed the seeds of modern commercial banking in India. The English Agency Houses
in Calcutta and Bombay began to serve as bankers to the East India Company. Calcutta was the principal port through which external trade was considered by the East India Company with Europe, the Far East and China. The British merchants in Calcutta instituted the great Mercantile Houses. The entire American and European business was run by them. They not only accepted deposits and granted loans but also issued paper money. They provided financial facilities for shipping and for production and transportation of crops.

The first joint-stock Bank established in India in 1770 by Messrs Alexander and Company was the Bank of Hindustan. This Bank issued notes valued at Rs. 20 lakhs. Two other joint-stock commercial banks were the Bengal Bank and the Central Bank of India which came into existence in the year 1785. The Central Bank issued notes valued at Rs. 42 lakhs and the government accepted all these notes. During the Great Depression in 1929-33, there was a financial crisis in the country and all the three joint-stock commercial banks had to liquidise their assets.

After the establishment of the joint-stock commercial banks, three Presidency Banks were established. These Banks were the Bank of Bengal instituted in the year 1806, with a capital of Rs. 50 lakhs of which Rs. 10 lakhs were subscribed by the Government; the Bank of Bombay established in 1840 with a capital of Rs. 52 lakhs of which Rs. 3 lakhs were subscribed by the government. But this Bank went into liquidation in 1868 and a new Bank of Bombay was set up in
the same year with a capital of Rs. 100 lakhs. The Bank of Madras was instituted in 1843 with a capital of Rs. 30 lakhs of which Rs. 3 lakhs were subscribed by the government. The East India Company by virtue of subscription, obtained the right to appoint some of the Directors as well as the Secretary and Treasurers. The Presidency Banks had the monopoly of note issue subject to certain limitations. They also acted as Banker to the government. The majority of shares of the three Banks were subscribed by the Europeans.\textsuperscript{48}

In 1860 an Act was passed permitting the institution of more Banks. In 1862, the right of the Presidency Banks to issue currency notes was taken over by the government but the Presidency Banks continued to use government balances without paying any interest on them as an act of compensation.\textsuperscript{49}

The collapse of the first Bank of Bombay in 1868 led to the passing of the Presidency Banks Act, 1876. The government withdrew its capital from Presidency Banks and gave up the right of the appointment of Directors, Secretaries and Treasuries of the Presidency Banks. These Banks however, retained the monopoly of government banking. In this connection, new restrictions were imposed on the Banks to safeguard the interests of the government and the depositors as a whole. The Banks were not permitted to deal in foreign bills, to lend for more than six months and to lend against immovable property. Even though, the Presidency Banks acted as bankers' Bank, they could not be called

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governments' Banks because the government had the significant portion of the cash balances in district treasuries and sub-treasuries scattered throughout the country. The Presidency Banks hold the idle cash of other banks and provided them with financial assistance in times of need. The Presidency Banks provided direct finance by advancing loans and indirectly by discounting the hundis brought to them by shroffs.50

In spite of the restrictions imposed on the operations of the Presidency Banks, they made rapid progress. There was a considerable increase in the amount of deposits collected by them, especially during the years prior to World War I. The amount of cash at the disposal of the Presidency Banks was higher than that of other joint-stock Commercial Banks. The government always kept its cash with the Presidency Banks and conducted its business through them. The banking transactions carried on by the Presidency Banks can hardly be over-emphasized and they acquired a high position in the banking scenario of the country.51

During 1860 to 1874, attempts were made by the government to convert the Bengal Bank into a "Bank of India".52 The Secretary and Treasurer of the Bank of Bengal placed a proposal before the government regarding the amalgamation of all the three Presidency Banks. But the government of India did not accept it. The Allahabad Bank and Alliance Bank of Shimla were established in 1885 and 1875 respectively. Both these Banks were incorporated under
European Management. The first Bank of limited liability managed by Indians was the Oudh Commercial Bank set up in 1881. The Punjab National Bank was set up in 1894 and the People’s Bank of India in 1901 through the efforts of Lala Har Kishan Lal.

**Imperial Bank of India**

The Fowler Currency Committee of 1899 suggested the establishment of a Central Bank but the government of India under Lord Curzon rejected it. Moreover, the Presidency Banks did not like the idea of amalgamation and desired to keep their individuality. In 1913 the Chamberlain Commission advocated the appointment of an expert committee to study the whole issue. At the same time people in India emphasized the creation of a Central Bank. With these pressures, the Presidency Banks withdrew their opposition and finally the Imperial Bank of India was set up in 1921 by the amalgamation of all the three Presidency Banks along with their branches and paid-up capital of Rs. 3,314 crores.

After the amalgamation of the three Presidency Banks to form the Imperial Bank of India, four things followed. First, the London office of the Imperial Bank of India was established. Secondly, the government handed over all the general banking activities to the Imperial Bank. Thirdly, the Imperial Bank was to open 100 branches. Fourthly, the Governor-General in council was given powers to issue instructions to the Imperial Bank on important matters.
The Imperial Bank enjoyed a high position in the entire banking world because of its satisfactory resources, experience in banking transactions as also in the field of trade and commerce. It acted at the same time as the government’s Bank. All this gave rise to serious talks for converting the Imperial Bank into the Central Bank of the country. But majority of Indian nationals did not like this idea. This is because of various reasons. First, the Imperial Bank was a commercial bank with a high spirit of competition with the other existing commercial banks. Secondly, the Imperial Bank was incorporated by Europeans and therefore had certain anti-national attitudes. It was reluctant to lend to those industries which were owned 100% by Indians. Moreover, it never recruited Indians to higher posts in the banks and in most cases never favoured Indians. Ultimately, the Hilton-Young Commission of 1920 totally rejected the idea of making the Imperial Bank the Central Bank, and decided that it should remain only a big and strong commercial bank.

The Swadeshi movement started in the year 1903 and the movement gave a big push to banking as the number of banks with paid-up capital and reserves of over Rs.5 lakhs had increased to 18. These banks had the total deposits of Rs. 22 crores. The continuous increase in the capital and deposits of banks is shown in table 2:1 on the next page.

From the table 2:1 we can see that the development of banking was rapid in the first decade of the century but after that the trend was static. This is because of the outbreak of
famines in Bengal, United Provinces and Bombay during 1912-1914.

**TABLE 2:1**

**BANKING DEVELOPMENT FROM 1906 TO 1913**

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Banks</th>
<th>Capital and Reserves (Rs. in lakhs)</th>
<th>Deposits (Rs. in Lakhs)</th>
<th>Cash Balance (Rs. in lakhs)</th>
<th>Ratio of Cash Balance to Deposit(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1906</td>
<td>9</td>
<td>190</td>
<td>1150</td>
<td>149</td>
<td>13</td>
</tr>
<tr>
<td>1907</td>
<td>11</td>
<td>292</td>
<td>1400</td>
<td>194</td>
<td>14</td>
</tr>
<tr>
<td>1908</td>
<td>14</td>
<td>309</td>
<td>1626</td>
<td>245</td>
<td>15</td>
</tr>
<tr>
<td>1909</td>
<td>15</td>
<td>354</td>
<td>2049</td>
<td>279</td>
<td>14</td>
</tr>
<tr>
<td>1910</td>
<td>16</td>
<td>376</td>
<td>2566</td>
<td>280</td>
<td>11</td>
</tr>
<tr>
<td>1911</td>
<td>18</td>
<td>412</td>
<td>2591</td>
<td>362</td>
<td>14</td>
</tr>
<tr>
<td>1912</td>
<td>18</td>
<td>426</td>
<td>2726</td>
<td>400</td>
<td>15</td>
</tr>
<tr>
<td>1913</td>
<td>18</td>
<td>364</td>
<td>2259</td>
<td>400</td>
<td>18</td>
</tr>
</tbody>
</table>


The well-known banks of the present time like the Indian Bank of Madras, the Bank of Mysore, the Bank of Baroda and the Bank of India came into being during the Swadeshi movement period. Other Indian banks set up during this period like the Indian Specie Bank, the Bengal National Bank, the Credit Bank of India, the Bombay’s Merchant Bank, the Upper Bank of India, and other banks,\(^\text{57}\) could not carry on their work and they failed. The number of Banks which failed in 1913 was 12; in 1914, 22; in 1915, 11; in 1916, 13; in 1917, 9; in 1918, 7; in 1919, 4; in 1920, 3; in 1921, 7, in 1922, 15, in 1923, 20; and in 1924, 18.\(^\text{58}\) The failure of the 141 Banks dealt a severe blow to banking development in India.
The failure of banks appeared not only in the period between 1913 and 1924 but also in the period during 1925-36. Such banks were the People's Bank of Northern India and the Tata Industrial Bank of Shimla which were set up in 1932. In 1936 another 40 banks failed. There were many factors that led to the collapse of so many banks. According to the Central Banking Enquiry Committee such factors were: inefficient directors, faulty management, unprofitable investment, inadequate paid-up capital and reserves, a mixture of banking and non-banking business, absence of proper proportion between authorised, subscribed and paid-up capital, low percentage of cash to total deposits, absence of knowledgeable directors and managers, misuse of bank's funds for personal gains, ignorance about the banking business among the public, political, communal and business rivalry among bankers, absence of stricter government regulation and control over commercial banks in the country. Besides these, the other responsible factor was the absence of co-operation between the joint-stock Banks. The Presidency Banks were going their own way and were not willing to help other banks like the Bank of Bengal which refused to lend to other banks.

In the midst of all this chaos a need was felt for the creation of a Central Bank. As mentioned earlier, this need had been felt for a pretty long time. Ultimately the Reserve Bank of India was actually set up in April, 1934.
Banking Development During 1939-49

After the setting up of the Reserve Bank of India in 1935, the growth of banking in the country was remarkable. The total number of banks including the Imperial Bank increased from Rs. 1,035 in 1938 to 2,717 by the end of 1949. Their deposits also increased from Rs. 238 crores to 1,093 crores during the same period. The main reason for the growth of banks is the abundant supply of funds. Funds in those days could not be utilised for setting up industries because of scarcity of capital goods. Therefore, all the funds available were used in setting up new banks. The main banks which were set up during this period were the Bharat Bank, the Delhi Bank and the United Commercial Bank. The progress of banking during this period was significant but the banking system was not free from deficiencies. Such defects included mal-management of bank accounts, cut-throat competition, and unhealthy branch expansion. Consequently, many banks failed. The number of default banks during this period was 444.

The partition of the country during India's Independence had a great impact on its banking system. Prior to the partition, the banks were run by the Hindus. On the eve of the conflict between the Hindus and the Muslims, most of the banks in Punjab led by the Punjab National Bank and run by the Hindus transferred their head-quarters from West Punjab to East Punjab and Delhi. The bank in West Punjab was forced to wind up due to the continued disturbances.
The Government of India with the help of the Reserve Bank of India (RBI) and the application of the Reserve Bank of India Act, 1934 was able to minimise the crisis among the Punjab banks. The RBI was given power to supervise the banks and hence most of the banks survived with the help rendered by the RBI. More power was given to RBI by the passing of the Banking Companies (Inspection) Ordinance Act, 1946. The provisions of this Act also enabled the RBI to close the banks which were beyond recovery and to save other banks at the right time. The mushroom growth of banks was checked with the passing of the Banking Companies (Restriction) Act in 1946. Prior to the year 1949, all the commercial banks in the country were governed by some of the provisions of the Indian Companies Act, 1913. These provisions suffered from certain loopholes and hence there was a necessity for a wider conservative legislation. In 1949, a major action was taken which was very important from the point of view of structural reforms in the banking sector. The Banking Companies Act came into force on 16th March, 1949, which gave the RBI extensive regulatory power over the commercial banks. This Act was renamed the Banking Regulation Act, 1949 in the year 1966 to cover the Co-operative Banks. The objectives of this Act was to prevent bank failures, to avoid cut throat competition, to ensure balanced development, to regulate bank credit and working of banks, to safeguard the interests of depositors, to strengthen the banking system, to control foreign banks, to provide quick and easy liquidation and to have a specific legislation containing comprehensive provisions relating to the business
of banking in India. The first provision of the Act gives the definition of Banking and Banking Company. According to Sec 4(b) of the Act, banking is defined as "accepting for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise". Sec 5(c) of the Act gives the definition of banking company as "any company which transacts the business of banking in India". The Act was amended from time to time to meet the changing requirements in the economy.

Banking Development During 1949-1970

The Indian banking system has made rapid progress since Independence. In the two decades following the enactment of the Banking Regulation Act, 1949, the Indian Banking progressed in many respects. It not only grows geographically but also functionally. After Independence, India inherited the banking system and even the Indian banking laws based on the English laws. This was a period which witnessed the economic development of the country in accordance with the objectives of the Five Year Plans. The banking system and the RBI tried their best to adapt themselves to the changes in the economy after the launching of the First Five Year Plan in 1951. The RBI regulated credit so that it could reach the priority sectors in the economy and did whatever it could to consolidate and strengthen the banking structure. The RBI was also empowered to amalgamate the banks. The failure of a number of banks in the early 1960s made it necessary to amend the Banking Regulation Act, 1949 to give the RBI the
right to order for the amalgamation of a banking company with other banks. As a result of the operation of the Act along with the process of the amalgamation, there was a decline in the number of non-scheduled commercial banks and their offices as the smaller banks were merged with the bigger banks. The RBI which is vested with greater powers of control over the banks started collecting data on various aspects of banking.

The development of banking in India during the 20 year period from 1950 to 1970 may be seen in the table 2:2 on the next page.

The table 2:2 reveals an annual increase in the number of branches in the country. During the 20 year period, the SBI branches exhibits a growth of 452%. The number of branches of the SBI Subsidiaries had also increased from year to year except for 1962 which remained constant for two years at 519. The table also shows that the branches of other Indian banks reflects a fluctuating trend from 1950 to 1953 followed by an annual increase in the succeeding five years and a decline in 1960. From 1961 onwards there was an annual increase in the number of the other Indian banks' branches. The number of foreign banks' branches remained constant at 64 from 1950 to 1953 followed by a fluctuating trend in the succeeding four years. The number remained constant for two years at 67 in 1958 and then declined to 66 in the following year, and remained constant for two years. The number of scheduled banks' branches reveals a fluctuating trend from 1950 to 1954.
The number of non-scheduled banks' branches exhibits an annual decrease from 1951 to 1970. The decline is because many of these banks having subsequently fulfilled the conditions laid down by the RBI Act, 1934 and were included in the second schedule of the said Act and are termed scheduled banks.

### TABLE 2:2

**BANKING DEVELOPMENT DURING 1950-1970**

(***Number of Bank Branches***)

<table>
<thead>
<tr>
<th>Year</th>
<th>State Bank of India</th>
<th>Subsidiaries of SBI</th>
<th>Other Indian Banks</th>
<th>Foreign Banks</th>
<th>Number of Scheduled Banks</th>
<th>Number of Non-Scheduled Banks</th>
<th>Total Number of Scheduled and Non-Scheduled Bank offices</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>382</td>
<td>-</td>
<td>2317</td>
<td>64</td>
<td>2765</td>
<td>1203</td>
<td>3968</td>
</tr>
<tr>
<td>1951</td>
<td>391</td>
<td>-</td>
<td>2191</td>
<td>64</td>
<td>2646</td>
<td>1473</td>
<td>4119</td>
</tr>
<tr>
<td>1952</td>
<td>408</td>
<td>-</td>
<td>2199</td>
<td>64</td>
<td>2671</td>
<td>1369</td>
<td>4040</td>
</tr>
<tr>
<td>1953</td>
<td>422</td>
<td>-</td>
<td>2181</td>
<td>64</td>
<td>2670</td>
<td>1357</td>
<td>4021</td>
</tr>
<tr>
<td>1954</td>
<td>453</td>
<td>-</td>
<td>2228</td>
<td>67</td>
<td>2746</td>
<td>1286</td>
<td>4032</td>
</tr>
<tr>
<td>1955</td>
<td>480</td>
<td>-</td>
<td>2292</td>
<td>65</td>
<td>2838</td>
<td>1247</td>
<td>4085</td>
</tr>
<tr>
<td>1956</td>
<td>536</td>
<td>-</td>
<td>2350</td>
<td>66</td>
<td>2953</td>
<td>1240</td>
<td>4193</td>
</tr>
<tr>
<td>1957</td>
<td>620</td>
<td>-</td>
<td>2576</td>
<td>67</td>
<td>3263</td>
<td>1112</td>
<td>4375</td>
</tr>
<tr>
<td>1958</td>
<td>711</td>
<td>-</td>
<td>2846</td>
<td>67</td>
<td>3623</td>
<td>982</td>
<td>4605</td>
</tr>
<tr>
<td>1959</td>
<td>823</td>
<td>-</td>
<td>3033</td>
<td>66</td>
<td>3922</td>
<td>925</td>
<td>4847</td>
</tr>
<tr>
<td>1960</td>
<td>901</td>
<td>490</td>
<td>2690</td>
<td>66</td>
<td>4150</td>
<td>789</td>
<td>4939</td>
</tr>
<tr>
<td>1961</td>
<td>946</td>
<td>519</td>
<td>2854</td>
<td>69</td>
<td>4390</td>
<td>622</td>
<td>5012</td>
</tr>
<tr>
<td>1962</td>
<td>1002</td>
<td>519</td>
<td>3005</td>
<td>71</td>
<td>4608</td>
<td>565</td>
<td>5173</td>
</tr>
<tr>
<td>1963</td>
<td>1069</td>
<td>566</td>
<td>3283</td>
<td>82</td>
<td>5004</td>
<td>487</td>
<td>5491</td>
</tr>
<tr>
<td>1964</td>
<td>1143</td>
<td>608</td>
<td>3658</td>
<td>86</td>
<td>5499</td>
<td>329</td>
<td>5828</td>
</tr>
<tr>
<td>1965</td>
<td>1267</td>
<td>653</td>
<td>3890</td>
<td>90</td>
<td>5902</td>
<td>232</td>
<td>6134</td>
</tr>
<tr>
<td>1966</td>
<td>1378</td>
<td>692</td>
<td>4203</td>
<td>90</td>
<td>6382</td>
<td>229</td>
<td>6611</td>
</tr>
<tr>
<td>1967</td>
<td>1488</td>
<td>751</td>
<td>4455</td>
<td>106</td>
<td>6782</td>
<td>213</td>
<td>6995</td>
</tr>
<tr>
<td>1968</td>
<td>1543</td>
<td>832</td>
<td>4946</td>
<td>111</td>
<td>7446</td>
<td>203</td>
<td>7649</td>
</tr>
<tr>
<td>1969</td>
<td>1660</td>
<td>942</td>
<td>6100</td>
<td>125</td>
<td>8832</td>
<td>181</td>
<td>9013</td>
</tr>
<tr>
<td>1970</td>
<td>2108</td>
<td>1144</td>
<td>6625</td>
<td>130</td>
<td>11006</td>
<td>142</td>
<td>11148</td>
</tr>
</tbody>
</table>

**Source:** Sandhu B.S. *Banking and Rural Development: Promises and Performance,* (Deep & Deep Publications, 1996) p.35.
In the year 1951, the total number of scheduled banks' branches in India was 4263. Most of these banks existed in capital cities and urban centres and only about 700 branches operated in rural areas. The Madras state (now Tamil Nadu) had the highest number of branches of about 557. Out of this number, 92 were in Madras city alone. The Uttar Pradesh had the second largest number of branches with 442. The total deposits mobilised in the state were Rs. 70.89 crores and the advances were Rs. 45.04 crores. In the third position was Maharashtra with 433 branches. The Bombay city itself had 159 branches. West Bengal had the fourth largest number of branches with 222. Out of this, 197 branches were in the Calcutta city alone. On the other extreme the states of Assam and Orissa had only 32 and 15 branches respectively.

Nationalisation of Imperial Bank

The State Bank of India (SBI), the biggest commercial bank in the country, was formed on 1st July, 1955 with the passing of the State Bank of India Act, 1955 by taking over the assets and liabilities of the Imperial Bank of India. The setting up of the State Bank of India (SBI) was the outcome of the recommendations of the All-India Rural Credit Survey Committee appointed by the Reserve Bank of India in 1951. The Committee recommended the establishment of a state bank with adequate number of branches spread throughout the country providing sufficient remittance facilities for other banks and following a policy in accordance with the national goals and objectives of planned economic development. The SBI therefore came into existence with 92% of its shares
subscribed by the RBI, and had the distinction of becoming the first state-owned commercial bank in the country. The main motive behind the establishment of the SBI is to take banking to the countryside. In view of this necessity the SBI was required to function as a development agency besides performing the traditional functions of a commercial bank. In addition to the development agency function, the SBI was entrusted with the task of being the RBI's agent. The RBI shall appoint the SBI as its sole agent at all places in India where the RBI does not have an office or branch of its banking department provided there is a branch of the State Bank or branch of its a subsidiary bank. Hence the SBI now has the right to receive and make payments on behalf of the Central and the State Governments.

The State Bank group comprising of State Bank of Hyderabad, State Bank of Indore Jaipur, State Bank of Bikaner and Jaipur, State Bank of Mysore, State Bank of Travancore, State Bank of Saurashtra and State Bank of Patiala was created in 1960 after the passing of the State Bank of India (Associate Banks) Act in 1959. These banks opened new offices in semi-urban, rural and unbanked areas. This attempt yielded good results and their relative share in total deposits increased.

**Lending Policy & Deposit Insurance**

The period also witnessed a change in the lending policy of commercial banks. The major part of their credit had gone to commerce and large and medium scale industries. Industries
accounted for 68 percent of the commercial bank credit in 1968 as against 34 percent in 1951. Judged on the basis of deposit mobilisation, commercial banks made considerable progress during this period. The deposits of scheduled banks excluding State Bank of India and its Associate Banks increased from Rs. 843 crore in 1950-51 to Rs. 5,028 crores in 1969-70. The share of the commercial banks deposits owned by the household sector in the total savings in financial assets rose from 1.94 percent in 1950-51 to 7.14 percent in 1965-66. An important step taken up in the country in January, 1962 was the introduction of a system of deposit insurance. The system administered by the Deposit Insurance Corporation whose capital of Rs.1 crore is owned entirely by the Reserve Bank of India and India is the second country to develop this system. The insurance cover was originally a modest sum of Rs. 1,500 in respect of each depositor in each bank. The cover was raised to Rs. 5,000 in 1968 and further to Rs. 10,000 in 1970.67

Agricultural Finance

Another important step taken was to enlarge the commercial banks involvement in agricultural finance. The Agricultural Finance Corporation Limited was set up as a joint venture by the leading commercial banks to provide credit facilities to the priority agricultural projects and to encourage commercial banks in supporting the agricultural sector. Right from the First Five Year Plan launched in 1951, the emphasis on the objective of raising food production. The Intensive Agricultural Development Programme was
introduced in selected districts in the country. Investments were made by the state on research work for developing hybrid varieties of different crops. As a result, the Green Revolution took place in the country. The area under cultivation expanded along with the expansion of irrigation facilities. But the financial assistance to the agricultural sector provided by commercial banks was not adequate. In 1968, only 0.4 percent of the total advances was extended to this sector. Hence, it was felt necessary for the commercial banks to be brought under social control, so that they would contribute to economic development.

Social Banking

Prior to the year 1969 all the banking companies operating in the country except the SBI, were private sector Banks. These Banks like any other business companies aimed at maximising private profit. A demand for the nationalisation of commercial banks was raised over and over again by the Congressmen and the Communists. This demand was based on the ground that the commercial banks had been owned and controlled by a few persons and thus contributed in a big way to the growth of monopolies and concentration of economic and political power. It was also alleged that the banks discriminated between small and big business units and in most cases neglected the agricultural sector. The resources of commercial banks were being misused by directors for promoting only those units in which they were interested instead of promoting common interests of the society. It was
felt that nationalisation was the only way to solve the problems of banking in the private sector.

The concept of nationalisation was rejected by the Government of India at the first instance and in its place the government introduced a social control system of Banks. Under the social control system, the lending policy of Banks was guided by National Credit Council (NCC) headed by a Finance Minister. The first task of the commercial banks was first to meet the necessities of the farmers and small business units. However, immediately after the introduction of social control, an important decision was taken by Mrs Indira Gandhi, the former Prime Minister of India for nationalising 14 of the major Commercial Banks. The President of India promulgated an ordinance on the 19th July 1969 nationalising these fourteen major Commercial Banks in India each with deposits worth Rs. 50 crore or more. The ordinance was replaced by an Act of the Parliament on the 9th of August, 1969. Some prominent shareholders challenged the Act in the Supreme Court as they alleged that it lacked constitutional validity. The Supreme Court pronounced the verdict on the 10th of Feb 1970 that the Act is unconstitutional and hence 'null and void' as it makes hostile discrimination and allows for 'unfair compensation'. The rejection of the Act compelled the government to promulgate again an Ordinance on 14th February, 1970 nationalising the said fourteen Commercial Banks with retrospective effect from 19th July 1969. The second ordinance was replaced by an Act called the Banking Companies (Acquisition and Transfer

According to the provisions of the Banking Companies Act, 1970, the ownership and management of the 14 major commercial banks has been transferred to the Government of India. The independent identity of each of these Banks is maintained and they are allowed to conduct their business in their old names, but the words "The" and "Limited" were deleted from their new names. The Act also empowers the Government of India to amalgamate any of the acquired Banks bank with another nationalised bank or any other bank, and for the transfer of the whole or a part of a new bank to any other bank or vice versa.

The Banks which were nationalised on 19th July, 1969 are the following:

(i) the Central Bank of India;
(ii) the Bank of India;
(iii) the Punjab National Bank;
(iv) the Bank of Baroda
(v) the United Commercial Bank,
(vi) the Canara Bank
(vii) the United Bank of India
(viii) the Dena Bank
(ix) the Syndicate Bank,
(x) the Union Bank of India,
(xi) the Allahabad Bank,
(xii) the Bank of Maharashtra,
(xiii) the Indian Bank,
(xiv) the Indian Overseas Bank,
Banking Development in Post Nationalisation Period:
Lead Bank Schemes -

The main objective of Bank nationalisation was the expansion of credit facilities to all sectors of the economy and to do away with regional disparities. Other objectives were removal of poverty with branch network mobilisation of deposits, meeting the credit needs of neglected sectors, growth of new entrepreneurs and improving the management efficiency of the Banks. A number of measures were adopted in helping the nationalised Banks to play an effective role in economic development. The then Governor of the RBI had appointed a committee under the chairmanship of F.K.F. Nariman in August 1969 to prepare a programme in creating adequate banking facilities especially in districts and regions where such facilities were lacking. The RBI accepted the recommendation of the Committee for the 'Lead Bank' Scheme. This Scheme was initiated in 1970 and under this scheme, the districts were allotted to the State Bank Group, fourteen nationalised Banks and 3 private Indian Banks. The main responsibility of the Lead Bank was to prepare District Credit Plans to fill up the credit gaps estimated in all the districts in the country. The District Credit Plans were formulated and implemented by the nationalised Banks with the support of non-nationalised Banks and the state governments.
Banks and Rural Development

After nationalisation, the role and functions of Bank underwent a great change. The major task of the nationalised Bank is to extract saving from the rural masses and to channelise the accumulated funds into productive channels. This will boost upliftment, progress and prosperity of the rural sector. The Commercial Banks started functioning in the neglected sectors like agriculture and allied activities and shifted their attention from the urban to the rural sector. However, the planners were not satisfied with the progress achieved by the nationalised commercial banks in reaching the weaker sections. This led the government of India to formulate programmes like the Small Farmers Development Agency and the Marginal Farmers, and the Agriculture Labourers' Development Agency. The Government of India recommended the establishment of Regional Rural Banks (RRBs) in supplying banking facilities to certain specified groups in rural areas.

The Regional Rural Banks made their first appearance after the passing of the Regional Rural Banks Act, 1975. These banks have been in the public sector since their very inception. The main objectives of the RRBs are to develop the rural economy. Thus about 91% of the country's banking system is now under the public sector.
Second Dose of Nationalisation

On the 15\textsuperscript{th} April 1980 the other six Commercial Banks in the private sector were nationalised. The six Banks are:

1. The Andhra Bank Ltd.
2. Corporation Bank Ltd,
3. The New Bank of India Ltd,
4. The Oriental Bank of Commerce Ltd,
5. The Punjab and Sind Bank Ltd,
6. Vijaya Bank Ltd,

The second dose of nationalisation widened the coverage of the public sector banks and their number increased to 28 comprising the S.B.I and its subsidiaries.

Even after the nationalisation of Banks, the Indian banking industry is still primitive in practice and outlook. This caused the setting up of National Institute of Bank Management, Bombay and many Bankers' Training Colleges for conducting training and research work. It is possible for nationalised banks to become effective instruments in mobilising saving and distributing credit and to operate in line with the national goals and objectives. It is also possible for them to strengthen and support investment in industry and agriculture if they are properly managed. On the other hand, if they lack managerial competence and effectiveness, it may prove dangerous for the economy and it may also lead to a transfer of deposits from the nationalised banks to the smaller banks in the private sector.
**Branch Expansion**

The post-nationalisation period has seen a rapid expansion in the branch network of commercial banks. The banks have given special attention to providing credit facilities in under banked regions and in the neglected sectors of rural economy like agriculture and allied activities and they also shifted their emphasis from urban to rural sector. There has been also a spectacular expansion of bank's branches. The number of branches of all scheduled commercial banks increased from 8,262 to 53,840 during the 18 years of post-nationalisation period. The number increased further to 61,742 in 1994. Besides the increase in the number of branches, there has also been a considerable increase in the deposits of commercial banks. During the 18 years of the post-nationalisation period, the deposits increased from Rs 4,646 crores in the 1969 to Rs 1,07,345 crores in 1987. The deposits rose to Rs 2,30,458 crores in March 1992. As in the case of deposits, there was a huge spurt in advances. Advances of scheduled banks increased from Rs. 3,599 crores in 1969 to Rs. 63, 753 crores in 1987 and rose further to Rs. 1,24,788 crores in March 1992. 

The considerable expansion of bank offices is also due to the role played by the Lead Bank Scheme initiated immediately after the nationalisation in 1969. Among the newly opened offices, the State Bank Group and the nationalised Banks accounted for more that 94 percent. However, after the nationalisation of 14 Banks in 1969 a
deliberate policy has been adopted to outreach banking to rural and less developed areas. As a result of this, the percentage of Bank offices in rural areas has increased from 22.4 percent in June 1969 to 52.7 percent in March 1996. In the same period the percentage of bank offices in urban areas and metropolitan towns declined from 37.5 percent to 26.1 percent of the total bank offices in the country.

The metropolitan cities have been able to attract most of the commercial banks in all countries and India is no exception to this. Until the nationalisation of 14 Banks, eight metropolitan cities (Mumbai, Calcutta, Chennai, Delhi, Hyderabad, Ahmedabad, Kanpur and Bangalore) accounted for more than 50 percent of the deposits of commercial banks. In the post-nationalisation period the deposits in the metropolitan centres now account for less than 40 percent of aggregate deposits.

The amount of deposit mobilisation depends very much on the level of economic development particularly industrialisation. The capacity of the people to save depends on the growth of industries and trade. It is because of this reason that Maharastra leads all other states in terms of deposits mobilisation. Maharastra is followed by West Bengal, Delhi, Uttar Pradesh, Gujarat and Tamil Nadu. These six states have together mobilised more than 60 percent since nationalisation. Small states like Sikkim, Mizoram, Arunachal Pradesh, Manipur, Meghalaya, Nagaland and Tripura are still lagging behind and therefore their capacity to mobilise Bank
deposits is very little. However in terms of percentage growth during the post-nationalisation period, relatively less developed states have done better. This is due to the spread of banking facilities to less developed and backward states.

**Development-Oriented Banking**

The concept of banking has undergone a great change. In the past, the concept of banking was confined to acceptance of deposits and granting of loans but in the post-nationalisation period banks are development-oriented. The Joint-stock banks are now catering to the needs of industrial and agricultural finance. The state is making great efforts to support agriculture and the commercial banks have been asked to enter into the field of agriculture finance activity.

In the post-nationalisation period, the main objective behind advancing credit is to reach the neglected sectors which were accorded priority status. The priority sector includes agriculture, small industry, small transport, retail-trade, small business professionals and self-employed persons. The banks are asked by the government to follow a ‘Target-Oriented Approach’ in advancing credit to these sectors. Initially the target was placed at 33 percent of the total credit which was subsequently raised to 40 percent.

The nationalised commercial banks have been playing a significant role in rural and urban areas. The Reserve Bank of India in its report of banking in India (1985-86) has stated, “The main objective of the policy would be to achieve a
coverage of 17,000 population per Bank office in rural and semi-urban areas of each block to provide banking facilities in those pockets of rural areas where there are wide spatial gaps. In the period of 23 years after nationalisation there was an over 800 percent increase in the number of Bank branches and the most remarkable progress was made in rural areas.

Despite the number of banks being large, the area uncovered by commercial banking system is still vast. There has been little competition between the banks. The public sector banks, which accounted for more than 90 percent of the banking business, had little incentive to compete. The commercial banks are anxious to open branches in unbanked areas but they face problems like the lack of organisations, non-recovery of loans and the hesitancy of the staff to settle down in rural areas. The commercial banks still have a long way to go.

No doubt there has been a remarkable banking growth at the all-India level but unfortunately this did not lead to a balanced growth at the inter-state level. This is evident from the table 2:3 on the next page which shows the position as on December 1980.

From the table 2:3 it appears that by and large the more advanced states have a higher C-D ratio than the less developed states in the country. There are fifteen states below the national average of 66.6 percent and this reveals the fact that the deposits mobilised in these states are flowing out to other states.
<table>
<thead>
<tr>
<th>States</th>
<th>Deposits Rs. in crores</th>
<th>Credit Rs. crores Per capita (Rs)</th>
<th>Credit-Deposit Ratio(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Andhra Pradesh</td>
<td>1862</td>
<td>1384</td>
<td>74.3</td>
</tr>
<tr>
<td>Assam</td>
<td>340</td>
<td>156</td>
<td>45.3</td>
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<tr>
<td>Bihar</td>
<td>1556</td>
<td>636</td>
<td>40.8</td>
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<tr>
<td>Gujarat</td>
<td>2364</td>
<td>1491</td>
<td>58.1</td>
</tr>
<tr>
<td>Haryana</td>
<td>654</td>
<td>469</td>
<td>71.3</td>
</tr>
<tr>
<td>Himachal Pradesh</td>
<td>206</td>
<td>69</td>
<td>33.3</td>
</tr>
<tr>
<td>Jammu &amp; Kashmir</td>
<td>377</td>
<td>118</td>
<td>31.2</td>
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<tr>
<td>Karnataka</td>
<td>1933</td>
<td>1449</td>
<td>74.9</td>
</tr>
<tr>
<td>Kerala</td>
<td>1455</td>
<td>983</td>
<td>67.5</td>
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<tr>
<td>Madhya Pradesh</td>
<td>1172</td>
<td>653</td>
<td>55.7</td>
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<td>Maharashtra</td>
<td>6957</td>
<td>5482</td>
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</tr>
<tr>
<td>Manipur</td>
<td>16</td>
<td>6</td>
<td>37.5</td>
</tr>
<tr>
<td>Meghalaya</td>
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<td>8</td>
<td>16.0</td>
</tr>
<tr>
<td>Nagaland</td>
<td>20</td>
<td>5</td>
<td>25.0</td>
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<tr>
<td>Orissa</td>
<td>430</td>
<td>254</td>
<td>59.0</td>
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<td>Punjab</td>
<td>1952</td>
<td>845</td>
<td>43.2</td>
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<tr>
<td>Rajasthan</td>
<td>843</td>
<td>569</td>
<td>67.4</td>
</tr>
<tr>
<td>Sikkim</td>
<td>5</td>
<td>-</td>
<td>NA</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>2523</td>
<td>2374</td>
<td>94.0</td>
</tr>
<tr>
<td>Tripura</td>
<td>35</td>
<td>18</td>
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<td>Uttar Pradesh</td>
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<tr>
<td>Andaman &amp; Nicobar Island</td>
<td>9</td>
<td>2</td>
<td>22.2</td>
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<td>Arunachal Pradesh</td>
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<td>Chandigarh</td>
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<tr>
<td>Dadra Nagar Haveli</td>
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<td>1</td>
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<td>3650</td>
<td>3008</td>
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<td>Goa, Daman &amp; Diu</td>
<td>323</td>
<td>128</td>
<td>39.6</td>
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<tr>
<td>Lakshadweep</td>
<td>1</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Mizoram</td>
<td>9</td>
<td>1</td>
<td>11.1</td>
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<tr>
<td>Pondicherry</td>
<td>58</td>
<td>33</td>
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<tr>
<td>All India</td>
<td>37307</td>
<td>24455</td>
<td>66.6</td>
</tr>
</tbody>
</table>

Source: (i) RBI. Report on Trend and Progress of Banking in India:1982-83
(ii) RBI Bulletin, June 1982
Banking Development in the 1990’s

After 20 years of bank nationalisation and after achieving a tremendous growth, the banking system has entered a stage of consolidation. There has already been a diversification of banking activities, a standard measure of liberalisation and a step towards upgradation of technology. On 1st April, 1989, the Service Area Approach was implemented to make rural lending more productive. This could be done by meeting the local and genuine needs of the villagers and promoting deposit mobilisation. It was also expected that the approach would increase bank credit and the communication between bank officials and local development agencies. Several steps and measures have been taken up for effective implementation of the approach. Such steps are field study tours and discussions at various levels in the RBI, NABARD and the Commercial Banks. Extensive training and research work was also conducted to equip branch managers in preparing reports and credit plans.

The Bank credit plans were required to be updated and made more realistic. The control offices of each bank were asked to investigate the progress and were rendered help if necessary so that the plans may be launched in time with effect from April 1st, 1990.73

The successful implementation of the Service Area Approach can bring about a drastic change in the credit planning process and this will have a great impact on production, productivity and income in the economy
particularly in rural areas. The need for a co-ordinated approach at the local levels cannot be exaggerated.

The growth of deposits was slow at the beginning of 1995-96 but revived in the second half of the year due to the decrease in the interest rate of term deposits. In addition to this there was an increase in the inflow of funds through Foreign Institutional Investors (FIIs) which lead to an increase in net investment. It amounted to Rs. 3,637.8 crores during January-March, 1996. This contributed to an increase in deposits in the last quarter of 1995-96.

During the first half of 1996-97, between March 29, 1996 and September 27, 1996, the aggregate deposits increased by Rs. 27.926 crores (6.4 percent) despite a fall in demand deposits. Aggregate deposits had recorded an increase of Rs.11,740 crores i.e., 3.0 percent in the corresponding period of 1995.74

The bank credit expanded during 1995-96 by Rs. 42,454 crores (20.1 percent) besides a rise of Rs. 47,144 crores (28.7 percent) recorded in the previous year, whereas it expanded by Rs. 51,322 crores (25.3 percent) between March 17, 1995 and March 29, 1996. There was a decline in food credit of Rs. 2,484 crores (20.2 percent) as against an expansion of Rs. 1,368 crores (12.5 percent) during the previous year. On the other hand there was a significant expansion in non-food credit of scheduled commercial banks of Rs. 54,684 crores (28.9 percent) during 1995-96. This was mainly due to the
progress in the industrial sector. The credit-deposit ratio and the non-food credit-deposit ratio reached the peak levels of 90.4 percent and 95.7 percent respectively in 1995-96. As on 31st March 1999, the aggregate deposits and the aggregated credit of scheduled commercial banks stood at Rs. 7,17,271 crores and Rs. 3,68,837 crores respectively.

The present structure of scheduled commercial banks comprised the State Bank of India and its subsidiaries (8), nationalised commercial banks (19), private sector banks (34), regional rural banks (196) and foreign banks (41). As on March 31, 1998, the total number of branches of scheduled commercial banks stood at Rs. 64,267. Of these, 32,890 were in rural areas.

**Banking and Financial Reforms in India**

Over the succeeding decades, many distortions gradually infected the Indian banking and financial system. Therefore, in August 1991 the Narasimham Committee was appointed to look into these distortions and to suggest reforms to correct them. The formal announcement of the first initiatives of the reforms was made in 1991-92 in the First Report of the Narasimham Committee which submitted its second Report in 1998. During the interval between 1991-92 to 1998, much progress was made in the building up of a financial system which can cope with the challenges of a more competitive and open economy.
The Narasimham Committee identified two major causes behind the distortions in the financial system. These were (1) Directed Investment and Credit Programmes, and (2) Political Interference. These two were the main reasons that not only reduced the profitability of the banks but also increased their expenditure. Besides these, central directions and control of the banks had undermined their supervision, inspection and audit. The end results were a decline in labour productivity and low standards of customer service. The reform measures were thus adopted to straighten out these distortions.

Since 1991-92, the reforms have had a very favourable impact and much progress has been made. Though the Cash Reserve Ratio (CRR) level is still higher, the medium target of 25% set for the Statutory Liquidity Ratio (SLR) and 10% for the CRR has been, by and large, achieved. Some other measures of reform adopted have been the relaxation of entry and exit norms, a reduction of public ownership in the banking industry and allowing banks access to the capital market for meeting their fund requirements. The gradual liberalisation of interest ratio was another step for reform. Another category of reform related to the safety aspects of the financial system are income recognition norms, assets classification, fulfilling minimum capital adequacy standard through re-capitalisation and devising of a supervisory framework. Then in 1993, the Recovery of Debts Act was passed for the prompt adjudication and recovery of debts.
Besides the above-mentioned measures, a number of reforms have been adopted with regard to the Development Financial Institutions (DFIs) and the Money and Capital markets. Many DFIs have been granted permission to access the domestic and international markets. Several of them have raised funds at variable interest rates thus liberalising their interest regime. Because of these measures the DFIs can now provide a number of new products and services to fulfill the requirements of industrial enterprises. There has also come about a diversification in the financial services sector. The DFIs now follow the predential norms and achieved the capital adequacy rate of 8% in March 1996. The Recovery of Debts Act has been made applicable to them also.

The RBI is trying to reduce the difference between various sections of the money market as well the variations in the rates of interest by bringing out reforms from time to time. A secondary market has been developed and new instruments have been introduced. The Money Market Mutual Funds and the Discount and Finance House of India Limited have been established.

The above-mentioned reforms have had thorough and far reaching effects and have almost revolutionised the Indian Financial System. In 1998, the Narasimham Committee submitted its Second Report, reviewing the progress of the reform introduced since 1991-92. The Second Report also made two very important new recommendations. These related to (1) the merger of strong units of banks and (2) adoption of
the "narrow-banking" concept to rehabilitate weak banks. It also repeated those recommendations which were rejected by the Government in its First Report. These were the creation of an Asset Reconstruction Fund, a reduction in priority sector (social) lending, recommendations for streamlining the procedures and the modus operandi of banks through modernisation and upgradation of technology. Besides, the Report repeated its earlier recommendation of depoliticisation of appointments to the Boards of Directors and their Chairman. The political interference being identified as one of the main causes of distortions in the financial system, both the First and Second Reports stressed on professionalism in bank management.

The strive towards the implementation of stricter prudential norms should in no way cause anxiety to the depositors with regard to their deposits. No doubt, all the measures taken would protect their interest. But bank employees felt that the restoration of the financial position of the banking industry lies very much in their own interest. The overall improvements in the financial strength of all the banks is required to improve their service conditions.

The process of strengthening the banking system has to be a continuing process. The first problem that has to be looked into is to bring down the high level of the Non-Performing Assets (NPAs). In order to tackle this problem the creation of a limited Asset Reconstruction Fund for the smaller weak banks is very necessary. Secondly, The
Government should pave the way for "universal banking" with a three-tier structure. Banks which could hold more Government securities should be encouraged. Thirdly, rationalisation of the interest rates is the need of the hour and for this a Reserve Bank Reference Rate of Interest should be evolved. Fourthly, to enhance the production of agriculture and small scale industries, directed credit programmes are still necessary in the development process. Fifthly, side by side with the public sector banks, the private sector banks both Indian and foreign, should be allowed to operate in order to develop an element of competition. Last but not the least there is a need to review and update the Banking Laws. Moreover, review of the regulations is also desirable to ensure that the burden of the regulatory system is not excessive.

The banks existed in Meghalaya before the State attained its statehood in 1972. The banks which transacted banking activities before the year 1972 were the State Bank of India, the Bank of Baroda, the Central Bank of India, the Punjab National Bank, the United Bank of India and the United Commercial Bank. The total number of banks' offices at the end of December 1972 was 17.

Concluding Remarks

All the states in the country including Meghalaya have experienced a steady banking growth in the last few years particularly after the nationalisation of banks. There has been a tremendous increase in the number of banks, branches, deposits and advances and more and more areas have been
covered. It is important to note that most of the rural needs have been catered. The role of banks has undergone a revolutionary change after nationalisation. The bankers have realised that they have to strive towards achieving the social and national objectives. They are now not only dealers in money but are also providing a variety of services required for developing the economy. There is no denying the fact that among all the banking companies, the nationalised banks have contributed a lot to the development of the economy. Unfortunately, in the past few years many nationalised banks have incurred huge losses. Among these, are the Bank of India, the Central Bank of India, the United Bank of India and the UCO Bank. During 1994, the total loss of these banks stood at Rs. 1089.15 crores, Rs. 7119.3 crores, Rs. 618.06 crores and Rs. 546.45 crores respectively.\(^9\)

The Government has now recognised the need to make banking industry more competitive. It has thus made certain policy changes such as deregulation of interest rates and dilution of consortium lending requirements. Moreover, banking has been opened up to the private sector. Till end of February, 1994 the R.B.I. received 140 applications for setting up new private banks. However, only 19 applicants have fulfilled all formalities. The RBI, has so far given approval only to ten applicants. For a speedy development of an economy particularly the priority sector, it is important for the public sector banks to continue and function side by side with the privately owned banks.
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