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An exploratory study on evolution of banking in India

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Abstract: This research is carried out with an aim to know that how banks are evolving all over the India to facilitate financial transactions and customer service. The data collection is based on secondary data available over the internet, books and literature available related to the banks. The researchers have found that there is a need emerge of financial institution to become financial intermediary for facilitating financial transactions and banks are evolved as a medium to facilitate such financial transactions. The evolution takes place from many phases all over the world and in India evolution takes place from 1786 to till date with the emergence of thousands of Public Sector Banks, Private Sector Banks, Cooperative Banks, Regional Rural Banks and Foreign Banks for facilitating financial services and customer satisfaction.

Keywords: Bank, Banking, Public Sector Banks, Private Sector Banks, Cooperative Banks, Regional Rural Banks, Foreign Banks.

I. INTRODUCTION OF BANK, BANKING AND ITS HISTORY

The word bank was borrowed in Middle English from Middle French banquet, from Old Italian banca, from Old High German banc, bank "bench, counter". Benches were used as desks or exchange counters during the Renaissance by Florentine bankers, who used to make their transactions atop desks covered by green tablecloths.

One of the oldest items found showing money-changing activity is a silver Greek drachm coin from ancient Hellenic colony Trapezus on the Black Sea, modern Trabzon, c.350–325 BC, presented in the British Museum in London. The coin shows a banker's table (trapeze) laden with coins, a pun on the name of the city. In fact, even today in Modern Greek the word Trapeza (Τράπεζα) means both a table and a bank.

Another possible origin of the word is from the Sanskrit words (ब्यय) 'byaya' (expense) and 'onka' (calculation) = byaya-onka. This word still survives in Bangla, which is one of Sanskrit's child languages. ব্যায় + অঙ্ক = ব্যাঙ্ক . Such expense calculations were the biggest part of mathematical treatises written by Indian mathematicians as early as 500 B.C.

The word “Bank” is originally derived from German word “Bank” meaning a joint stock fund which was Italianized into “Banco” when the German’s were masters of a great part of Italy. This appears to be more possible.

Banking activities were sufficiently important in Babylonia in the second millennium B.C. that written standards of practice were considered necessary. These standards were part of the Code of Hammurabi – the earliest known formal laws. Deposits were not of money but of cattle, grain or other crops and eventually precious metals. Nevertheless, some of the basic concepts underlying today’s banking system were present in these ancient arrangements. A wide range of deposits was accepted, loans were made, and borrowers paid interest to lenders.[1]

Similar banking type arrangements could also be found in ancient Egypt. These arrangements stemmed from the requirement that grain harvests be stored in centralized state warehouses. Depositors could use written orders for the withdrawal of a certain quantity of grain as a means of payment. This system worked so well that it continued to exist even after private banks dealing in coinage and precious metals were established.

Modern-day banking can be traced to practices in the Medieval Italian cities of Florence, Venice, and Genoa. The Italian bankers made loans to princes, both to finance wars and their lavish lifestyles, and to merchants engaged in international trade. The Bardi and Peruzzi families were dominant in Florence in the 14th century and established branches in other parts of Europe to facilitate their trading activities. [2]

Much of the international business of the medieval banks was carried out through the use of bills of exchange. At the simplest level, this involved a creditor providing local currency to the debtor in return for a bill stating that a certain amount of another currency was payable at a future date – often at the next big international fair. Because of the church prohibition on directly charging interest, the connection between banking and trade was essential. The bankers would take deposits in one city, make a loan to someone transporting goods to another city, and then take repayment at the destination. The repayment was usually in a different currency, so it could easily incorporate what is essentially an interest payment, circumventing the church prohibitions. For example, a Florentine bank would lend 1000 florins in Florence requiring repayment of 40,000 pence in three months in the bank's London office. In London, the bank would then loan out the 40,000 pence to be repaid in Florence at a rate of 36 pence per florin in three months. In six months, the bank makes 11.1 percent – that's an annual rate of 23.4 percent. It is also interesting to note that a double-entry bookkeeping system was used by these medieval bankers and that payments could be executed purely by book transfer. [3]

Banking in the modern sense of the word can be traced to medieval and early Renaissance Italy, to the rich cities in the north like Florence, Lucca, Siena, Venice and Genoa. The Bardi and Peruzzi families dominated banking in 14th century Florence, establishing branches in many other parts of Europe. One of the most famous Italian banks was the Medici Bank, set up by Giovanni di Bicci de' Medici in 1397. The earliest known state deposit bank, Banco di San Giorgio (Bank of St. George), was founded in 1407 at Genoa, Italy.

Bank is a financial institution and a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly by loaning or indirectly through capital markets. A bank is the connection between customers that have capital deficits and customers with capital surpluses. Due to their influence within a financial system and an economy, banks are generally highly regulated in most countries. Most banks operate under a system known as fractional reserve banking where they hold only a small reserve of the funds deposited and lend out the rest for profit. They are generally subject to minimum capital requirements which are based on an international set of capital standards, known as the Basel Accords. The oldest bank still in existence is Monte dei Paschi di Siena, headquartered in Siena, Italy, which has been operating continuously since 1472. It is followed by Berenberg bank of Hamburg (1590) and Sveriges Riksbank of Sweden (1668).Banking in its modern sense evolved in rich cities of Renaissance Italy, such as Florence, Venice and Genoa. In the history of banking, a number of banking dynasties—among them notably Medici, Fugger, Welser, Berenberg, Baring and Rothschild—have played a central role over many centuries.

During the 17th and 18th centuries the Dutch and British improved upon Italian banking techniques. A key development often credited to the London goldsmiths around this time was the adoption of fractional reserve banking. [4]

By the middle of the 17th century, the civil war had resulted in the demise of the goldsmiths' traditional business of making objects of gold and silver. Forced to find a way to make a living, and having the means to safely store precious metal, they turned to accepting deposits of precious metals for safekeeping. The goldsmith would then issue a receipt for the deposit. At first, these receipts circulated as a form of money. But eventually, the goldsmiths realized that since not all of the depositors would demand their gold and silver simultaneously, they could issue more receipts than they had metal in their vault.

Banks became an integral part of the US economy from the beginning of the Republic. Five years after the Declaration of Independence, the first chartered bank was established in Philadelphia in 1781. [5]

At first, bank charters could only be obtained through an act of legislation. But, in 1838, New York adopted the Free Banking Act, which allowed anyone to engage in banking business as long as they met certain legal specifications. As free banking quickly spread to other states, problems associated with the system soon became apparent. For example, banks incorporated under these state laws had the right to issue their own bank notes. This led to a multiplicity of notes – many of which proved to be worthless in the all too common event of a bank failure.

The collapse of the Ohio Life Insurance and Trust Company and a bank panic in the fall of 1857 led to an economic crisis. More than 5,000 businesses failed during the first year of the panic.

The collapse of Jay Cooke and Co., the largest bank in the U.S. at that time, in September 1873 triggered a panic on the stock exchange. Cooke's bank was the exclusive agent for the sale of Northern Pacific Railroad bonds. When the firm could not sell a sufficient number of railroad bonds to investors to cover its obligations, the stock market reacted negatively, and runs on several other large financial institutions led to their failure. The Coinage Act of 1873 depressed the price of silver, hurting the interests of U.S. silver mines and further contributing to the country's economic problems. This economic crisis led to a recession that lasted until 1879.

Some important dates and events making significant impact on the history of banking: [6]

1837: Michigan and New York pass the first free banking laws

1846: The Independent Treasury System is established.

1863: Congress passes the National Banking Act in USA

1865: The Civil War ends and the nation has a dual banking System.

1873: The collapse of a large bank leads to a recession; the country undergoes repeated financial crises through the rest of the century.

1908: Congress sets up the National Monetary Commission to look into the country's financial system.

1913: The Federal Reserve Act establishes a new central bank for the nation—the Federal Reserve System.

II. Research Objective

- To do exploratory study on evolution of banking in India.

III. Indian Banking History

Banking roots in India are found from 1786. From 1786 to this date, we can discuss the history of Indian Banking in some phases [7]:

Phase 1: Early phase of Indian banks, from 1786 to 1969

The first bank in India, the General Bank of India, was set up in 1786. Bank of Hindustan and Bengal Bank followed. The East India Company established Bank of Bengal (1809), Bank of Bombay (1840), and Bank of Madras (1843) as independent units and called them Presidency banks. These three banks were amalgamated in 1920 and the Imperial Bank of India, a bank of private shareholders, mostly Europeans, was established. Allahabad Bank was established, exclusively by Indians, in 1865. Punjab National Bank was set up in 1894 with headquarters in Lahore. Between 1906 and 1913, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. The Reserve Bank of India came in 1935.

During the first phase, the growth was very slow and banks also experienced periodic failures between 1913 and 1948. There were approximately 1,100 banks, mostly small. To streamline the functioning and activities of commercial banks, the Government of India came up with the Banking Companies Act, 1949, which was later changed to the Banking Regulation Act, 1949 as per amending Act of 1965 (Act No. 23 of 1965). The Reserve Bank of India (RBI) was vested with extensive powers for the supervision of banking in India as the Central banking authority.

Phase 2: Nationalization of banks and the banking sector reforms, from 1969 to 1991

The government took major initiatives in banking sector reforms after Independence. In 1955, it nationalized the Imperial Bank of India and started offering extensive banking facilities, especially in rural and semi-urban areas. The government constituted the State Bank of India to act as the principal agent of the RBI and to handle banking transactions of the Union government and state governments all over the country. Seven banks owned by the Princely states were nationalized in 1959 and they became subsidiaries of the State Bank of India. In 1969, 14 commercial banks in the country were nationalized. In the second phase of banking sector reforms, seven more banks were nationalized in 1980. With this, 80 percent of the banking sector in India came under the government ownership.

PHASE 3: NEW PHASE OF INDIAN BANKING SYSTEM, WITH THE REFORMS AFTER 1991

This phase has introduced many more products and facilities in the banking sector as part of the reforms process. In 1991, under the chairmanship of M Narasimham, a committee was set up, which worked for the liberalization of banking practices. Now, the country is flooded with foreign banks and their ATM stations. Efforts are being put to give a satisfactory service to customers. Phone banking and net banking are introduced. The entire system became more convenient and swift. Time is given importance in all money transactions.

NATIONALIZATION PROCESS

- 1955: Nationalization of State Bank of India
- 1959: Nationalization of SBI subsidiaries
- 1969: Nationalization of 14 major banks
- 1980: Nationalization of seven banks with deposits over Rs 200 Corer

IV. CURRENT STATUS OF VARIOUS TYPES OF BANK IN INDIA

In India, banks are segregated in different groups. Each group has its own benefits and limitations in operations. Each has its own dedicated target market. A few of them work in the rural sector only while others in both rural as well as urban. Many banks are catering in cities only. Some banks are of Indian origin and some are foreign players.

BANKS IN INDIA CAN BE CLASSIFIED INTO:

- Public Sector Banks.
- Private Sector Banks.
- Cooperative Banks.
- Regional Rural Banks.
- Foreign Banks.

One aspect to be noted is the increasing number of foreign banks in India. The RBI has shown certain interest to involve more foreign banks. This step has paved the way for a few more foreign banks to start business in India. Reserve Bank of India (RBI) The central bank of the country is the Reserve Bank of India (RBI). It was established in April 1935 with a share capital of Rs 5 crore on the basis of the recommendations of the Hilton Young Commission. The share capital was divided into fully paid shares of Rs 100 each, which was entirely owned by private shareholders in the beginning. The government held shares of nominal value of Rs 220,000. The RBI commenced operation on April 1, 1935, under the Reserve Bank of India Act, 1934. The

Act (II of 1934) provides the statutory basis of the functioning of the Bank. The Bank was constituted to meet the following requirements:

- Regulate the issue of currency notes.
- Maintain reserves with a view to securing monetary stability.
- Operate the credit and currency system of the country to its advantage.

V. CONCLUSION

The researcher has found that banking is one of the essential and prime services required all over the world for performing various financial transactions. The evolution of banking services was found in various countries of the world very long ago. In India banking roots are found from 1786 and have grown rapidly in last few centuries. Today there are thousands of banks like Public Sector Banks, Private Sector Banks, Cooperative Banks, Regional Rural Banks and Foreign Banks are providing financial services all over the India and focusing on customer services for maximizing customer satisfaction.

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AUTHOR(S) PROFILE

Dr. Jyoti U. Rajyaguru, has over 25 years of rich experience of teaching to students of commerce and computer science. She is a commerce post graduate and also has active interest in teaching computer science courses to various students of commerce. She has completed her Ph.D on broad area of E-Banking and study of bank consumers. Along with teaching she takes active interest in students’ development and counseling. She is invited by different institutions as expert in the area of commerce, computers and arts. She also contributes actively in designing new courses and curriculum in the area of commerce and other related domain.