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NATIONALIZATION OF INDIAN BANKS BY – ARPITA DAGA

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Introduction

This is the main turning point in the history of Indian banks. After nationalization all banks were under the control of central government. Without a sound and effective banking system in India it cannot have a healthy economy. The banking system of India should not only be hassle free but it should be able to meet new challenges posted by the technology and any other external and internal factors.

For the past three decades India's banking system has several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to only metropolitans or cosmopolitans in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main reasons of India's growth process.

The government's regular policy for Indian bank since 1969 has paid rich dividends with the nationalization of 14 major private banks of India.[1]
Not long ago, an account holder had to wait for hours at the bank counters for getting a draft or for withdrawing his own money. Today, he has a choice. Gone are days when the most efficient bank transferred money from one branch to other in two days. Now it is simple as instant messaging or dials a pizza. Money has become the order of the day.

The first bank in India, though conservative, was established in 1786.[2] From 1786 till today, the journey of Indian Banking System can be segregated into three distinct phases. They are as mentioned below:

- Early phase from 1786 to 1969 of Indian Banks.[3]
- Nationalization of Indian Banks and up to 1991 prior to Indian banking sector reforms.
- New phase of Indian Banking System with the advent of Indian Financial & Banking Sector Reforms after 1991.

Phase I

The General Bank of India was set up in the year 1786. Next came Bank of Hindustan and Bengal Bank. The East Indian Company established bank of Bengal (1809), Bank of Bombay (1840) and Bank of Madras (1843) as independent units and called it Presidency Banks. These three banks were amalgamated in 1920 and Imperial Bank of India was established which started as private shareholders banks, mostly Europeans shareholders. In 1865 Allahabad Bank was established and first time exclusively by Indians, Punjab National Bank Ltd. was set up in 1894 with headquarters at 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. 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 1100 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 Banking Regulation Act 1949 as per amending Act of 1965 (Act No. 23 of 1965). Reserve Bank of India was vested with extensive powers for the supervision of banking in India as the Central Banking Authority. During those day's public has lesser confidence in the banks. As an aftermath deposit mobilization was slow.

[1] The Government's regular policy for Indian bank since 1969 has paid rich dividends with the nationalization of 14 major private banks of India.
[2] The first bank in India was established in 1786.
[3] Early phase from 1786 to 1969.

Abreast of it the savings bank facility provided by the Postal department was comparatively safer. Moreover, founds were largely given to traders.

Phase II

Government took major steps in this Indian Banking Sector Reform after independence. In 1955, it nationalized Imperial Bank of India with extensive banking facilities on a large scale especially in rural and semi-urban areas. It formed State Bank of India to act as the principal agent of RBI and to handle banking transactions of the Union and State Government Seven banks forming subsidiary of State Bank of India was nationalized in 1960 on 19th July, 1969, major process of nationalization was carried out. It was the effort of the then Prime Minister of India, Mrs. Indira Gandhi. 14 major commercial banks in the country were nationalized.

Second phase of nationalization Indian Banking Sector Reform was carried out in 1980 with seven more banks. This step brought 80% of the banking segment in India under Government ownership.
The following are the steps taken by the Government of India of Regulate Banking Institutions in the Country:

- 1949: Enactment of Banking Regulation Act.
- 1955: Nationalization of State Bank of India.
- 1959: Nationalization of SBI subsidiaries.
- 1961: Insurance cover extended to deposits.
- 1969: Nationalization of 14 major banks.
- 1971: Creation of credit guarantee corporation.
- 1975: Creation of regional rural banks.
- 1980: Nationalization of seven banks with deposits over 200 crore.[4]

After the nationalization of banks, the branches of the public sector bank India rose to approximately 800% in deposits and advance took a huge jump by 11,000%. Banking in the sunshine of Government ownership gave the public implicit faith and immense confidence about the sustainability of these institutions.

Phase III

This phase has introduced many more products and facilities in the banking sector in its reforms measure. In 1991, under the chairmanship of M. Narasimham, a committee was set up by his name which worked for the liberalization of banking practices.

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 is introduced. The entire system became more convenient and swift. Time is given more importance than money. The financial system of India has shown a great deal of resilience. It is sheltered from any crisis triggered by any external macroeconomics shock as other East Asian Countries suffered. This is all due to a flexible exchange rate regime, the foreign reserves are high, the capital account is not yet fully convertible, and bank and their customers have limited foreign exchange exposure.

Need For Nationalization of Banks

Bank nationalization was a political act and as such the motives for it will have to be found on its sphere. But the policy was founded on economic principles the most influential part of it was RAJ (1974).

"if the dimensions of the problem introduced by market imperfection in the allocation of resources were fully recognized, and the objective of the development programmer kept in mind one would have less hesitation being shown in nationalizing all commercial banks in country and an using them directly for more optimal distribution of finance in economy. For there are important reasons why baking enterprise maximizing their profits would not

[4] 1980: Nationalization of seven banks with deposits over 200 crore.

venture out in these areas and sector of activity to which high priority needs to be attached from a larger social and economic point of view.[5]

RAJ (1974:308)

- Compelling banks to carry out a larger social role.
- It needs to be recognized that the very basis of profit making in banking industry is the development of habit of deposit money.
- The profits of commercial banks depend upon the proportion of their earning assets to the idle cash reserves they have hold their profits are higher in this case. That's why they have a natural bias to advancing credit to the sector which has already developed banking habits.
- By letting the private player s to operate in the state, the former is merely permitting to make profits where the whole responsibility for social responsibility has to be borne by state at the cost e.g. general public.
- Commercial bank was hardly advancing any loan to social sector.

Merits of Nationalization

1. The intervention of the state in the functioning of the banking sector itself. The ownership of the State gave a new confidence to the savers and being backed by a sovereign the normal suspicious associated with the capabilities of the bankers in the private sector were gone.
2. Banking ceased to be selective. The entry barriers that existed for customers to bank, social economic and political were lowered. This resulted in a massive quantitative expansion of the bank customer base as well as in the nature of services provided.
3. The reach of banking widened. Absence of concern for profitability and targeting made banks to expand rapidly in un-banked areas thereby the entire country was linked to banking activity.
4. The expansion of banks also expanded the economy. The entire infrastructure that required was built by themselves or by the citizens for their use.
5. A large employment base was created. Young men and women mostly from middle and poorer sections of society but qualified with the requisites got into the banking system and we see the results today.
6. Customers got acquainted with banking practices faster than it would otherwise have taken.
7. The well intentioned policies channeled through the banks helped the borrower clientele with a generous disposition.
8. The savings of the community had an efficient channel which otherwise would not have had the benefit of aiding transactions.
9. State intervention to some extent distorted the banking sector. The domination of the State has had a negative effective on the contribution of the banking sector as a whole to the economy. Absence of profitability, non-realization of its potential as a business and also the deterioration in service has all affected citizens.
10. The intervention by the State and excessive domination and intervention by the bureaucracy and polity into the functioning of banks has led to deterioration on economic efficiency, which runs counter to the principles of a good Government.

Effects of Nationalization of Indian Industry

- The two decades since nationalization of banks witness the transformation of the Indian banking scenario. The total number of branches which were 8000 in 1969 increased to 60,000 in 1990. Such expansion was the most rapid in rural sector.
- The share of rural offices has increased from 17.6% in 1969 to 56% in 1990.
- The share of rural areas in total deposits rose from about 3% to 15% in the same period.
- The rise in share of credit was spectacular from 1.5% in 1969 to 6.3% in 1989.

[5] RAJ (1974:308).

In all the two decades since the nationalization of commercial banking in India saw banks being taken from its urban confines to vast rural stretches. The expansion of banking into rural areas meant a phenomenal expansion in terms of number of deposits and loan accounts.

- The total number of loan accounts shows a rapid increase from about 4 million in 1970 to 60 million in 1990.
- In terms of agriculture accounts the increase was about 1 million in 1970 to 10 million in early 1980.
- Transport and trade also show significant increase.
- Totally neglected areas like small artisans, small scale industry also gets a significant place.
- By early 1980's the share of agriculture in credit has risen to 17%, transport operators about 5% and small scale sector about 12%.
- The regional distribution of branches was also shifted away from Maharashtra, South India and Gujarat to rest of the country.
- The sharp increase in cash reserve ratio from about 8.3% to 16.8% during the period of 1977 to 1990's.
- It is much evident that initial result of taking credit to rural areas was taking money out of banks but much later with the development of deposit habit that cash outflow tend to decrease. Therefore the nationalization of banks had and still has a great effect on industry banking industry.

Conclusion

The future outlook of the Indian banking industry is that a lot of action is set to be seen with respect to M & A's, with consolidation as a key to competitiveness being the driving force. Both the private sector banks and public sector banks in India are seeking to acquire foreign banks. As an example, the State Bank of India, the largest bank of the country has major overseas acquisition plans in its bid to make itself one of the top three Banks in Asia by 2008, and among the top 20 globally over next few years. Some of the PSU banks are even planning years we would also see strong cooperative banks merging with each other and weak cooperative banks merging with stronger ones.

While there would be many benefits of consolidation like size and thereby economies of scale, greater geographical penetration, enhanced market image and brand name, increased bargaining power, and other synergies, there are also likely to be risks involved in consolidation like problems associated with size, human relations problems, dissimilarity in structure, systems and the procedures of the two organizations, problem of valuation etc. which would need to be tackled before such activity can give enhanced value to the industry.

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