Learn the Evolution of the Banking System in India for Bank Exams

For those gearing up for **bank exams**, comprehending the evolution of the **banking system** in India is indispensable. This understanding not only offers historical context but also provides valuable insights into the contemporary financial ecosystem. Our comprehensive guide aims to unravel the dynamic journey of **India's banking sector**, from its inception to the present day.

Throughout this exploration, we will uncover the pivotal milestones, regulatory transformations, and emerging trends that have played a crucial role in shaping the Indian banking landscape. Whether you are a dedicated banking aspirant or a finance professional seeking to enhance your financial acumen, this resource is designed to equip you with the essential knowledge needed to excel in bank exams. By delving into the intricacies of the evolving banking system in India, you'll not only enhance your chances of success in examinations but also gain a deeper appreciation of the nation's financial history and its relevance in the modern world.

Banking System in India

The Indian banking system is a complex and diverse network of institutions that provide a wide range of financial services to individuals, businesses, and the government. The sector is dominated by public sector banks, which are owned and controlled by the government. However, private sector banks and foreign banks are also playing an increasingly important role.

The Reserve Bank of India (RBI) is the central bank of India and is responsible for regulating and supervising the banking sector. It also sets monetary policy and manages the country's foreign exchange reserves. We will discuss about it later in this blog.

The banking system mobilizes savings from individuals and businesses and uses these savings to provide loans to businesses and individuals. This credit is essential for economic growth. The banking system also facilitates payments between individuals and businesses. This is essential for commerce.

In recent years, the Indian banking sector has been facing a number of challenges, including **non-performing assets (NPAs)**, which are loans that are unlikely to be repaid. However, the sector is expected to continue to grow in the coming years, driven by economic growth, population growth, and increasing financial literacy.

Now it’s time to read and understand all the topics related to it in detail and to have in-depth knowledge of the History of Banks, their functions and RBI. So, let's start with the **Evolution of Banking**.

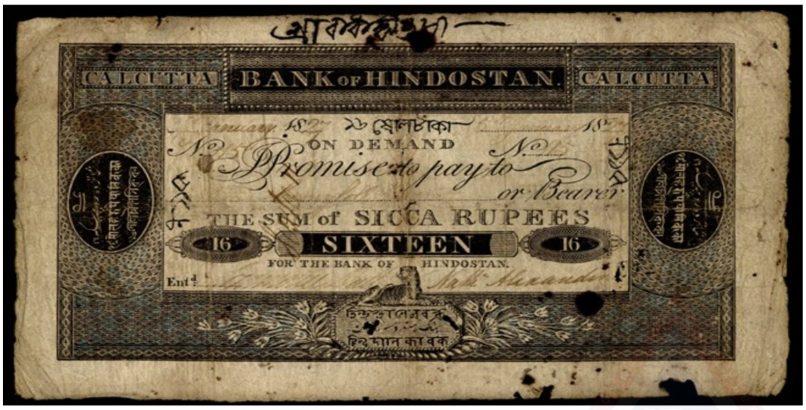
Evolution of Banking in India

The Indian banking system has undergone a remarkable evolution over the centuries, transforming from a fragmented and largely unregulated sector to a robust and dynamic financial powerhouse. This transformation has been driven by a series of key milestones, each of which has played a pivotal role in shaping the modern Indian banking landscape. Banks in India have evolved a lot, before and after independence. So, we will discuss them chronologically so that you can understand it better.

Asutosh Mukherjee Road, College Para, Hathi More, Siliguri, West Bengal
+91 - 8436586516, +91-8436900456
thedhronas@gmail.com
thedronas.com

The banks established in pre-independent India were:

- **Bank of Hindustan (1770):** The Bank of Hindustan, established in Calcutta, was set up by Alexander & Company (British Company). It is considered the first bank in India. However, it faced financial difficulties and was liquidated in 1832.

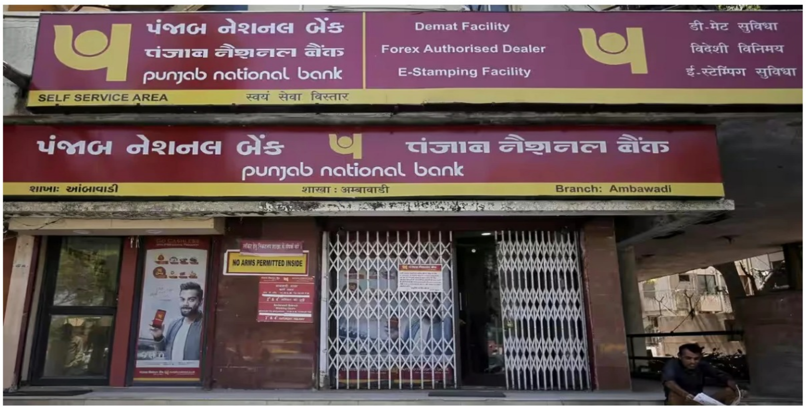


[Source: Wikipedia]

- **General Bank of India (1786):** The General Bank of India was a bank founded in Calcutta in 1786, and ceased operations on March 31st, 1791. It was the sixth oldest bank in India.
- **Oudh Commercial Bank (1881):** The Oudh Commercial Bank, established in 1881 in Faizabad, was the first commercial bank in India having limited liability and an entirely Indian board of directors governed on the basis of loans. It failed in 1958.
- **Bank of Bengal (1809):** Founded in 1809, the Bank of Bengal was the first bank in India to be granted a charter. It played a pivotal role in financing trade and commerce, and it later became the central bank of India in 1921.
- **Bank of Bombay (1840):** Established in 1840, the Bank of Bombay was the second of the three Presidency Banks established by the British East India Company. It served as a commercial bank and a government treasury, facilitating trade and economic development in the western region of India.
- **Bank of Madras (1843):** Formed in 1843 through the amalgamation of several regional banks, the Bank of Madras served as the third Presidency Bank in British India. It played a crucial role in promoting trade and commerce in the southern region of India.

Other Banks:

- **Allahabad Bank (1865):** set up, exclusively by Indians, also the oldest surviving bank before merger in 2020.
- **Punjab National Bank (1894):** First and oldest Swadeshi Bank, started with Indian capital and run solely by Indians. It was established by a group of prominent Indians and **Lala Lajpat Rai** was the first person to open an account.



[Source: Zee Business]

The partition of Bengal on the order of British Governor General, Lord Curzon, spurred a second wave of banking in India. This swadeshi movement gave Indian industry a boost called **Swadeshi banks** to fund swadeshi enterprises.

By 1913, there were 451 banking companies established in India and the notables among them are:

- **Bank of India (1906):** Founded in 1906, the Bank of India is one of the largest and most respected banks in India, with a strong national presence and a significant international footprint. It was nationalized in 1969.
- **Central Bank of India (1911):** Established in 1911 by Sir Sorabji Pochkhanawala, the Central Bank of India played a pivotal role in financing trade and commerce, and it later became the central bank of India in 1921. Sir Pherozesha Mehtawas the first Chairman of a truly '**Swadeshi Bank**'.
- **Canara Bank (1906):** Founded in 1906, Canara Bank is one of the oldest and largest nationalized banks in India, with a strong presence in the southern region of the country.
- **Corporation Bank (1906):** Established in 1906, the Corporation Bank was a nationalized bank that served the needs of the agricultural and small-scale industries sectors in India. It merged with Canara Bank in 2009.
- **Bank of Baroda (1908):** Founded in 1908, the Bank of Baroda is one of the largest and most respected banks in India, with a strong national presence and a significant international footprint. It was established by Sayajirao Gaekwad III. Its aim was to provide Institutional credit to his subjects. It was nationalized in 1969.
- **Vijaya Bank (1931):** Established in 1931, Vijaya Bank was a nationalized bank that focused on serving the needs of the rural and semi-urban population in India. It merged with Bank of Baroda in 2019.
- **Bank of Maharashtra (1935):** Founded in 1935, the Bank of Maharashtra was a nationalized bank that played a key role in financing agriculture and rural development in the state of Maharashtra, India.

Asutosh Mukherjee Road, College Para, Hathi More, Siliguri, West Bengal
+91 - 8436586516, +91-8436900456
thedhronas@gmail.com
thedronas.com

[Source: Bar and Bench]

[Note: During 1913-18, as many as 94 banking institutions failed.**]**

Reasons for the failure of many major banks during the pre-independence period:

Several factors contributed to the failure of many major banks during the pre-independence period in India. These factors include:

- **Inadequate capital:** Many banks were established with insufficient capital, making them vulnerable to economic shocks and financial mismanagement.
- **Over-reliance on deposits:** Banks were heavily reliant on deposits from the public, which were often unstable and subject to withdrawal panics.
- **Lack of diversification:** Banks often concentrated their lending in specific sectors, making them vulnerable to risks associated with those sectors.
- **Ineffective risk management:** Banks often lacked adequate risk management practices, failing to properly assess the creditworthiness of borrowers and manage their exposure to various risks.
- **Absence of regulatory oversight:** The banking sector was not adequately regulated during the pre-independence period, allowing banks to operate without proper oversight and accountability.
- **Economic instability:** The Indian economy was subject to frequent economic fluctuations and disruptions, which negatively impacted the stability of banks.
- **Political and social unrest:** The political and social climate during the pre-independence period was often turbulent, creating uncertainty and instability that affected the banking sector.
- **Corruption and mismanagement:** Instances of corruption and mismanagement within bank management also played a role in the failure of some banks.

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thedhronas@gmail.com
thedronas.com

These factors combined to create a challenging environment for banks in the pre-independence period, leading to the failure of many institutions. The establishment of the **Reserve Bank of India** in 1935 and the introduction of banking regulations have helped to improve the stability and resilience of the Indian banking sector in the post-independence era.

So, let's talk about the **Reserve Bank of India (RBI)**.

Reserve Bank of India (RBI)

The Reserve Bank of India (RBI), established as a shareholders' bank on April 1, 1935, functions as the central bank of India. The RBI's primary objectives include regulating the issuance of currency, maintaining financial stability, and overseeing the banking sector. It also acts as the government's banker and manages the country's foreign exchange reserves.

Prior to the establishment of the RBI, many banks failed due to inadequate capital, reliance on deposits, lack of diversification, ineffective risk management, and insufficient regulation. The RBI's creation aimed to address these issues and enhance the stability of the Indian banking system.

Since its inception, the RBI has played a significant role in the development and modernization of the Indian banking sector. It has implemented various reforms and policies that have contributed to financial inclusion, technological advancements, and the overall growth of the banking industry. The RBI continues to evolve and adapt to the changing economic landscape, ensuring the stability and resilience of the Indian banking system.

[Source: InvestoPower]

If you want to know more about the Reserve Bank of India (RBI) in detail, just click on the embedded link.

Post-Independence Period (1947 - till date):

Taking lessons from the pre-independence period and taking notice of the fact that a majority of the banks were in urban areas, the government passed the Banking Regulation Act, 1949. As a result, banking services could be spread to rural areas and goals of financial inclusion were implemented. We will discuss about this in detail in our next blog in which we will discuss the Nationalization, Privatization of the Banks etc.

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thedhronas@gmail.com
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In conclusion, delving into the evolution of the banking system in India is not merely a requirement for acing bank exams; it is a journey through the heart of the nation's financial history. By understanding the past, we gain the tools to comprehend the present and anticipate the future. Our guide has provided a condensed yet comprehensive overview of this dynamic journey, from its roots to its current state. Armed with this knowledge, you are better prepared to navigate the complex world of banking and finance.

We hope that this resource has not only enriched your exam readiness but also ignited a lasting curiosity about the ever-evolving landscape of India's banking system. So, as discussed earlier, we will discuss the Nationalization of the Banks. Till then, stay tuned!

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thedhronas@gmail.com
thedronas.com