

Indian Financial System – Commercial Banking System

Legal Definition of Banking

- Defined under the **Banking Regulation Act, 1949**
- Banking = Accepting deposits for lending/investment, repayable on demand/otherwise, withdrawable by cheque, draft, or order.

Classification of Commercial Banks in India

A. Based on Ownership

(1) Public Sector Banks (PSBs)

- The majority stake held by the Government of India
- 12 PSBs after consolidation (post-2019 mergers)
- Example: SBI, PNB, Bank of Baroda
- Role: Financial inclusion, priority sector lending

(2) Private Sector Banks

- The majority stake is held by private shareholders
- Old Private Banks (e.g., Karur Vysya Bank)
- New Private Banks (post-1991 reforms)

Prominent post-liberalization banks:

- **HDFC Bank**
- **Axis Bank**
- **ICICI Bank**
- **IndusInd Bank**
- **Kotak Mahindra Bank**
- **Yes Bank**
- **Bandhan Bank**
- **IDFC First Bank**

(3) Foreign Banks

- Incorporated outside India but operates branches in India
- Examples:
 - **Citibank**
 - **HSBC**
 - **Bank of America**

(4) Regional Rural Banks (RRBs)

- Established in 1975
- Joint ownership: Centre (50%), State (15%), Sponsor Bank (35%)
- Focus: Rural credit & priority sector

Historical Evolution of Banking in India

Phase 1: Pre-Independence (Before 1947)

- ~600 banks existed
- First bank: **Bank of Hindustan (1770)** – Closed in 1832
- First commercial bank: Oudh Commercial Bank
- Surviving 19th-century banks:
 - **Allahabad Bank**
 - **Punjab National Bank**

Features:

- Presidency Banks
- Weak regulation
- Frequent bank failures

Phase 2: Post-Independence (1947–1991)

Major Developments:

- Nationalization (1969 & 1980)
- Financial inclusion focus
- Priority sector lending

Creation of Specialized Institutions:

- **NABARD** (Agricultural credit)
- **Export-Import Bank of India** (Trade finance)

Objective:

- Extend banking to rural & neglected sectors

Phase 3: LPG Era (1991–Present)

- Liberalization, Privatization, Globalization
- Entry of new private banks
- Foreign banks expansion
- Digital banking revolution (UPI, Core Banking)

Key features:

- Competition & efficiency
- Decline in new nationalizations
- Technology-led banking

Scheduled vs Non-Scheduled Banks

Scheduled Banks

Listed in the 2nd Schedule of the **Reserve Bank of India Act, 1934**

Conditions:

- Minimum paid-up capital: ₹5 lakh
- Maintain CRR with RBI

Benefits:

- Refinancing facility from the RBI
- Clearinghouse membership
- Currency chest facility

Include:

- PSBs
- Private Banks
- Foreign Banks
- RRBs

Non-Scheduled Banks

- Not listed in RBI Act 2nd Schedule
- Maintain CRR with themselves
- Smaller capital base (< ₹5 lakh historically)
- Limited operational area
- Higher risk profile

Functions of Commercial Banks

(1) Accepting Deposits

Types:

- Current Deposits → No/low interest
- Savings Deposits → Moderate interest
- Fixed/Time Deposits → Higher interest

Mobilizes savings → Capital formation

(2) Lending & Investment

Methods:

- Loans & Advances
- Overdraft facility
- Cash Credit
- Discounting Bills of Exchange/Hundi

Investments:

- Government Securities
- Shares & Debentures
- Gold & Insurance-backed lending

(3) Credit Creation (Money Creation)

- Banks lend more than deposits (Fractional Reserve System)
- Deposits → Loans → New Deposits
- Multiplier Effect

Formula:

Money Multiplier = $1 / \text{CRR}$

(4) Agency & Utility Functions

- Locker facility
- Collection of bills
- Payment of insurance premiums
- Trustee & executor services
- Foreign exchange dealings