ISSN: 2350-0328
International Journal of Advanced Research in Science, Engineering and Technology
Vol. 6, Special Issue , August 2019
International Conference on Recent Advances in Science, Engineering, Technology and Management at Sree Vahini Institute of Science and Technology-Tiruvuru, Krishna Dist, A.P

Nationalisation of the Commercial Banks

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ABSTRACT: The present paper aims to analyse the impact of 'Nationalisation' on the functioning of the commercial banks. It tries to seek the questions like- whether the nationalisation of banks is desirable or not. Nationalisation of increased so much that it is unsafe to leave in private hands. Banks by advancing loans to the speculators and non priority sector can create extinction in the economy. So banks were nationalized for the larger interests of the nation.

KEYWORDS: Nationalisation, commercial banks, banks law

I. INTRODUCTION

Banks are the custodians of the public money but they were in the clutches of the private brands. The officials of the banks carried out unfair means to earn profits. Public interest was completely ignored. The savings of the people were used to be employed for their own business. The nationalisation of banks becomes extremely needed in order to protect the customers from the unfair games played by the bankers. The nationalisation of banks was not an easy step to take. Like any other movement, it too had some pros and cons. It too was appraised as well as criticized.

The paper therefore aims at elucidating the various achievements, merits of nationalisation and its impact on various sectors of economy. The progressive nationalisation of banks has increased the role of public sector banking in the country. Without a sound and effective banking system in India we cannot have a healthy economy. The banking system in India should not only be hassle free but it should be able to meet new problems posed by any business environment factors. Therefore, nationalisation of banks has emerged the various in banking sector

II. OBJECTIVES

The main objectives of the study are:
To study the objectives behind nationalisation of banks.
To study the impact of nationalisation on functioning of commercial bank.
To study the pre and post nationalisation period.
To analyse the merits and demerits of nationalisation.
To study the achievements and criticism of nationalisation.

III. RESEARCH METHODOLOGY

The present research study is mainly a doctrinal and analytical. Keeping this in view the conventional method of using secondary data consisting of books, journals, libraries, etc. have been used. As the study is doctrinal in nature, historical and doctrinal methods are adopted because it is not possible to study purely by experimental method. The relevant material is collected from the secondary sources. Materials and information are collected by legal sources like books on Banking Law. Materials are also collected from print and electronic media. From the collected material and information, research proposes to critically analyze the topic of the study and tries to reach the core aspects of the study.

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IV. STUDY OF NATIONALISATION & IT'S PHASES

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 metropolitan or cosmopolitan 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 1969has paid rich dividends with the rationalization of 14 major private banks of India. .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 the 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. 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.
• 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 Reforms after 1991.

To make this write-up more explanatory, I prefix the scenario as Phase I, Phase II, and Phase III.

PHASE-I-

The General Bank of India was set up in the year in 1786. Next came Bank of Hindustan and Bengal Bank. The East India 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 European 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 Banking Authority.

During those days, public has lesser confidence in the banks. As an aftermath deposit mobilization was slow. Abreast of its saving bank facility provided by the Postal department was comparatively safer. Moreover, funds were largely given to traders.

PHASE-II-

Government of India took major steps in this Indian Banking Sector Reforms 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 all over the country S even 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 India were nationalized. Second phase of nationalization Indian Banking Sector Reform was carried out in 1980 with 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 to 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 crores.

ISSN: 2350-0328

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After the nationalization of banks, the branches of the public sector bank India rose to approximately 800% in deposits and advances 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 banks and their customers have limited foreign exchange exposure.

V. NATIONALISATION OF BANKS

After independence the Government of India (GOI) adopted planned economic development for the country (India). Accordingly, five year plans came into existence since 1951. This economic planning basically aimed at social ownership of the means of production. However, commercial banks were private sectors those days. In 1950-51, there were 430 commercial banks. The Government of India had some social objectives of planning. These commercial banks failed helping the government in attaining these objectives. Thus the government decided to nationalize 14 major commercial banks on 19th of July, 1969. All commercial banks with a deposit base over Rs.50 crores were nationalized. It was considered that the banks were controlled by business houses and failed in catering to the credit needs of poor sections such as cottage industry, village industry, farmers, crafts men, etc. The second dose of nationalization came in April1980when banks were nationalized.

The nationalization of banks in India took place in 1969 by Mrs. Indira Gandhi the then prime minister. It nationalized 14 banks then. These banks were mostly owned by businessmen and even managed by them. They are: [a] Central Bank of India [b] Bank of Maharashtra [c] Dena Bank [d] Punjab National Bank [e] Syndicate Bank [f] Canara Bank [g] Indian Bank [h] Indian Overseas Bank [i] Bank of Baroda [j] Union Bank [k] Allahabad Bank [l] United Bank of India [m] UCO Bank [n] Bank of India

Before the steps nationalization of Indian banks, only State Bank of India (SBI) was nationalized. It took place in July 1955 under the SBI Act of 1955. Nationalization of seven state bank of India (formed subsidiary) took place on 19th July, 1960. The State Bank of India is India's largest commercial bank and is ranked one of the top five banks worldwide. It serves 90 million customers through a network of 9,000 branches and it offers – either directly or through subsidiaries- a wide range of banking services.

The second phase of nationalization of Indian banks took place in 1980. Seven more banks were nationalized with deposits over 200 crores. Till this year, approximately, 80% of the banking segment in India was under government ownership. After the nationalization of banks in India, the branches of the public sector banks rose to approximately 800% in deposits and advances took a huge jump by 11,000%. Thus, the years in which nationalization of banks took place were-

- 1948: Soon after Independence, RBI was nationalized.
- 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 200 crores.

VI. NEED FOR NATIONALISATION OF BANKS

The need for the nationalization was felt mainly because private commercial banks were not fulfilling the social and development goals of banking which are so essential for any industrializing country. Despite the enactment of the Banking Regulation Act in 1949 and the nationalization of the largest bank, the State Bank of India, in 1955, the expansion of commercial banking had largely excluded rural areas and small-scale borrowers.

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The developing goals of financial intermediation were not being achieved other than for some favoured large industries and established business house. Whereas industry's share in credit disbursed by commercial banks almost doubled between 1951 and 1968, from 34% to 68%, agriculture received less than 2% of total credit. Other key areas such credits to exports and small-scale industries were also neglected.

The stated purpose of bank nationalization of bank was to to ensure that credit allocation occur in accordance with plan priorities. Nationalization took place in two phases, with a first round in 1969 covering 14 banks followed by another in 1980covering 7 banks. Currently, there are 27 nationalized commercial banks.

Initially, the focus on the physical extension of banking services. There is no doubt that the achievement has been impressive by any standards. From only 8261 in June 1969, the number of branches of commercial banks increased to 65,521 in 2000. (Indeed, they had increased to even more, as we shall see, the "reforms" of the nineties caused a decline in the number of rural branches.) The expansion of rural branches was especially noteworthy. The population covered by a branch decreased from 65,000 in 1969 to 15,000 in 2001. There were associated increase in both deposits and credit flow.

VII. OBJECTIVES BEHIND NATIONALISATION OF BANKS IN INDIA

According to the Banking Companies Act 1970, the aim of the nationalisation of banks in India is "to control the heights of the economy and to meet progressively and serve better the needs of development of the economy in conformity with national policies and objectives." The nationalization of commercial banks took place with an aim to achieve to following major objectives. More specifically, the important objectives of bank nationalisation as outlined by the prime minister in the parliament on July 21,1969 are :

• **Social Welfare**: It was the need of the hour to direct the funds for the needy and required sectors of the Indian economy. Sector such as agriculture, and small village industries were in need of funds for their expansion and further economic development. to ensure that the operations of the banking system are guided by large social purpose and are subject to close public regulation.

• **Controlling Private Monopolies:** Prior to nationalization, many banks were controlled by private business houses and corporate families. It was necessary to check these monopolies in order to ensure a smooth supply of credit to socially desirable sections.

• **Expansion of banking:** In a large country like India, the number of banks existing those days was critically inadequate. It was necessary to spread banking across the country. It could be done through expanding banking network in the un- banked areas.

• **Reducing Regional Imbalance:** In a country like India where we have a urban-rural divide; it was necessary for banks to go in the rural areas where the banking facilities were not available. In order to reduce this regional imbalance nationalization was justified.

• **Priority Sector Lending**: In India, the agriculture sector and its allied activities were the largest contributors to the national income. Thus these were labeled as the priority sectors. But unfortunately, they were deprived of their due share in the credit. Nationalization was urgently needed for catering funds to them.

• **Developing Bank Habits:** In India, more than 70% population used to stay in rural areas. It was necessary to develop the banking habit among such a large population.

• **Mobilise savings:** Nationalisation aimed at mobilizing the savings of the people to the largest possible extent and to utilize them for productive purposes.

• **Productive sector:** Nationalization ensures that the needs of productive sectors of the economy and in particular those of farmers, small skill industries and self employed professional groups are made.

• **Creating fresh oppurtinity:** It aims to actively foster the growth of new and progressive entrepreneur and create fresh oppurtinity for hitherto neglected and backward areas in different parts of the country.

• **To curb speculative activities**: It also focuses on curbing the use of bank credit for speculative and other unproductive purposes.

VIII. THE BANK NATIONALISATION CASE

Rustam cawasjee cooper v. Union of India- In this landmark case, the constitutional validity of the Banking Companies Act, 1969 was challenged in the Supreme Court. The Supreme Court, by a majority of 10:1, declared the Action valid and unconstitutional because its provisions relating to the statutory transfer of undertaking were void as they impaired the fundamental guarantee under Article 31(2) of the constitution. The majority judgment held that-

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a)"The Act is within the legislative competence of parliament but it makes hostile discrimination against the named banks in that it prohibits the named banks from carrying on banking business and even new banks may be formed which may be engaged in banking business.

b) In reality, it resists the named banks from carrying on business other than banking as defined in Sections(5)b of the Banking Regulations Act, 1949; and

c) That the violates the guarantee of compensation under Article 31(2) in that it provides for giving certain amounts determined according to principles which are not relevant in the determination of compensation of the undertaking of the named banks and by the methods prescribed the amounts which cannot be regarded as compensation."

INDIA? - HAS NATIONALISATION ACTUALLY BENEFITTED CRITICAL ANALYSIS

Every coin has two sides. Hence nationalization too has its own pros and cons. There are certain arguments which favour it and certain other arguments which are against it.

ARGUMENTS IN FAVOUR –

1. Speculative activities:

Previously, the funds of the banks were mostly used for hoarding and speculative activities. Anti social elements were able to receive the bank loans to make large profits by creating artificial shortages of essential goods. Such misuse bank resources would be controlled by the nationalisation of banks. Before nationalization, the commercial banks in India used to give loan to unscrupulous persons who used to indulge inspeculation of essential commodities.

2. Threat to democracy:

Some of the banks had started giving money to politicians for contesting elections, under one or the other pretext. Consequently money started playing an important role in the elections and had it continued it would have been a serious threat to the very existence of the democracy.

3. Financing the priority sectors:

The banks were ignoring national priorities and the economic policies which were mooted by the government could not succeed. It was necessary to provide adequate finance to the Agriculturalists and to the educated unemployed. After nationalization the banks have started working in accordance with the policies of the government.

4. Ownership and control of a few:

Indian banks were owned and controlled by a few big shareholders. They generally influenced the pattern of allocation of bank credit in accordance with their own interest. According to an unpublished Reserve Bank sample survey, at the end of 1965, of the total equity capital of Rs 21.4 crores of 9 large banks, about 40% was held by only 33 accounts and the rest by more than 88,000 accounts. The nationalization of banks would bring banks under the control of government for meeting the general interest of the public.

5. Concentration of wealth and power:

The banks in India were controlled by a few industrial houses which used the public funds of the banks to build up large industrial estates. According to an estimate in mid-sixties 70% of total industrial advances went to only 1% of the number of borrow accounts, each with credit outstanding of over Rs. 5 lakh, whereas 12 % of the accounts with credit outstanding of less than Rs. 10,000 each received only 4% of the total. This led to the growth of wealth and power in few hands.

6. Credit to directors:

The resources of the banks were made available to the directors of these banks at concessional rates. These directors also had connecting with other business concerns. According to an official survey, 188 persons serving on the boards of 20 leading banks had 1452 directorships of other companies also. In this way, the funds of the banks were not utilized for the economic development of the country but for the promotion of the interest of the directors. Bank nationalisation would check favourable attitude of the banks towards directors.

7. Discrimination against small business:

Indian banks had adopted a general policy of providing finance to large industries> small businesses were not able to approach these banks for meeting their credit needs and were usually discriminated against. Nationalization was favored in order to extend financial help to the small business units.

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8. Indifference to agricultural sector:

The agricultural sector was almost ignored by the commercial banks. Most of the banks and their branches existed in the urban areas and were catering the needs of the industry and trade. Little efforts were made by the banks to meet the credit requirement of agriculture which is the backbone of Indian economy. Nationalization of banks was hoped to contribute to the development of agriculture.

9. Financing Economic Plans:

It was argued that the nationalized banks would make their resources available to the government for financing economic plans of the country .in this way , the banks contribute to the development of the economy.

10. Safety of depositors:

Nationalization Will provide 100% safety to the deposits of the people. This will inspire public confidence in the banking system and thus increase the bank deposits. :some other arguments given in favor of the nationalization of banks are as follows:

(a)Nationalization 11. Other argument eliminates wasteful competition and raises the efficiency of the working of the banks.

(b) Integrated monetary policy and its effective implementation requires unified control of both the central and the commercial banks.

(c) Nationalization of banks is necessary for achieving socialism: nationalization of industry is not possible without bank nationalization.

IX. ARGUMENTS AGAINST

1. Low deposit level : Banks or any other public dealing institution if nationalized results in frustration among the people because the institution becomes inefficient and does not bother about the public. This may result in less deposit and loss of confidence in public.

2. Less Confidence: After nationalization the commercial banks have become an effective tool in the hands of the ruling party. The party in power forces the bank to give loans to the supporters of their party and can also get money for contesting elections on one or the other pretext. Under such circumstances the nationalization of the banks has gone against the interest of the common man.

3. Decreasing in Efficiency: Only 20 banks have been nationalized and the government has justified its action by saying that nationalization of all the banks was not necessary because they wanted the publicsector and the private sector banks to compete with each other. In fact there can be no competition between the public sector and private sectors banks as it is between public sector industries because the Reserve Bank controls monetary activities of the Commercial Bank in the country. The experience of other nationalizes institution indicates that the nationalisation of the commercial banks will reduce the efficiency of these banks. Moreover, political interference will also impair the smooth working of these institutions.

4 Uncontrolled Monopolise: The root cause of the growth of the monopolies and the concentrations of wealth and power lies in the existing economic system. Therefore, the remedy requires the changing and reforming of the economic system and not the nationalization of banks.

5. Risky Lending to Agriculturist: Extending loans to agriculture and small scale industries is risky and less remunerative. Such loans are against the sound banking rules and may weaken the economy viability of these institutions.

6. No need of security to deposits: It is pointed out that there is no need to provide 100% security to the depositors in India through nationalization of banks. Institutions like Indian Deposit Insurance and CREDIT Guarantee Corporation are functioning quite efficiently and providing enough relief to the deposition.

7. Burden of Compensation: Nationalization involves large amounts of money to be paid as compensation to the shareholders. This puts additional financial burden on the government. Moreover, it is also argued that nationalization will not bring much revenue to the state.

8. Nationalization is no socialism: It is argued that nationalization may not lead to socialism. State capitalism is not socialism. Moreover, there is a general tendency to trat public property not as sacred national property, but as no one’s property. As such, it is misused and destroyed like anything.

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X. CONCLUSION

Nationalised banks are also called the government banks in India and work to provide social welfare to Indian public. They mare responsible for direction funds to the needy and variousm sectors like agricultures and small industries for expansion as well as economic development.

The present working and future prospects of Indian banking system can be summed up as follows:

• Nationalisation has taken banking service to rural and remote areas.
• It has awaken the rural masses about the need and usefulness of banking service.
• It has helped enormously speedy transfer of funds from one place to another.
• It has provided thousand of job opportunities to the educated youth.
• It has made credit available to neglected people like agricultural labours, small traders at reduced interest rate.
• It has helped to free the rural poor from the clutches of money lenders.
• It has ensured adequate and timely credit for agricultural and forming operations.
• Priority sector advances ensured adequate supply of credit to weaker sections of the society like village artisans, labourers, scheduled cast and tribes.
• It has helped export sector to obtain cheap credit.
• It has ensured even supply of credit to various industrial activities.
• It has avoided diversion of funds for harmful activities like speculation in shares, holding of essential commodities investment in real estate etc.
• It has removed concentration of wealth in the hands of you industrialists.
• It has ensured use of public money (deposits of public money) for social and desirable purposes.
• It has removed regional disparity in economy development.
• It has helped implementation of various welfare measures formulated by the government.

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