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## An economic analysis of nationalization as a process of financial inclusion

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### **Abstract:**

Financial inclusion is defined as the availability and equality of opportunities to access financial services. It refers to a process by which individuals and businesses can access appropriate, affordable and timely financial products and services. These include banking, loan, equity and insurance products. Financial inclusion efforts typically target those who are unbanked and under banked and directs sustainable financial services to them. Financial inclusion is understood to go beyond merely opening a bank account. A normal perception is that, the concept of financial inclusion emerged and became prominent only after 2005. But a careful analysis of commercial banks nationalization process which took place during 1969, has already sown the seeds of financial inclusion in our country. The process of nationalization was inevitable, so as to safeguard the Indian economy from the evils of financial arrangements of our country, which were prevalent during that time. There was a high concentration of commercial banks only to few places and loans and advances were given only to a handful of people. There was absolutely no standardisation of guidelines, which are supposed to be followed, while lending a loan or an advance. During that situation, nationalizing them (a process in which, the ownership and control was transferred from private to government) was the only solution. But a careful analysis of the achievement observed after nationalization reveals the fact that, the process of nationalization also carried the seeds of financial inclusion, bringing those unbanked people under the ambit of banking services. This paper tries to analyse the causes, the process and achievement of nationalization scheme, which took place in India, during 1969.

**Key words:** Financial Inclusion, Banks nationalization, Unbanked, Loans and banking services.

**Introduction:**

Bank refers to a financial institution which receives funds from the public and gives loans and advances to those who need them. The Indian Banking Regulation Act of 1949 – Section 5 (1) defines bank as “Accepting of deposit of money from the public, for the purpose of lending or investment, repayable on demand or otherwise and withdrawable by cheque draft, order or otherwise”. Section 6 of the same act states that, a bank apart from above foresaid functions provides various subsidiary services to customers such as collection of cheques, drafts and bills, remittance of fund, acceptance and safe custody deposits etc., But the above definition was not comprehensive, as it didn't include all branches of activities that a bank performs. Therefore definition of Sir John Paget is considered to be the comprehensive one, which quotes “No person or body corporate or otherwise can be a banker, who doesn't take deposit account, take current a/c, issue and pay cheques and collect cheques, crossed and uncrossed, for his customer and one claiming to be a banker must profess himself to be one, the public must accept him as such and finally banking should be his main business”. There are many types of banks, like industrial banks, agricultural banks, exchange banks, commercial banks, etc. The ones we generally refer to are commercial banks. They perform all forms of banking businesses and deal in financial trade and commerce.

The First Commercial Bank, “Bank of Hindoostan” was established in India in the year 1770. But it was maintained and managed by Britishers. The first Indian commercial bank was “The Oudh Commercial Bank” and was established in 1881. During this time, the Britishers, for the convenience of administration had divided India into three Provinces. They are Province of Bombay, Culcutta and Madras. In each these province, they had established a Presidency Bank. Later, these three presidency banks were merged into one and named as “The Imperial Bank of India’ on 27<sup>th</sup> Jan 1921. Later on this Imperial Bank of India was nationalised and renamed as ‘The State Bank of India’ on 1<sup>st</sup> July 1955. This was the first commercial bank, nationalized in our country. Nationalisation is a process of taking over the control and ownership from private to government. The process of nationalization was inevitable, because, these private commercial banks were flooded with numerous drawbacks. Therefore, this paper makes an attempt to highlight, the intention and objectives of nationalization, which primarily aimed at financial inclusion, bringing and offering banking services to the masses.

The Indian banking system, at the time of its attaining independence, had a well developed mechanism. It had 645 banks with more than 4,800 branch offices. However, the role of these banks did not extend to meet the societies' social needs. While these banks could cater to the requirements of the big industries, the desirable sectors like agriculture and small scale industries were often neglected. Therefore, nationalization was observed to be only panacea for achieving national equality. Some of the prominent reasons, which led to nationalization of Indian banking sector were:

*Removal of private ownership* of commercial banks and concentration of economic power: Prior to nationalisation, banks were controlled by business houses which used the savings of the public for their own personal benefits by financing selected projects that would benefit them. This resulted in concentration of wealth in the hands of a few. The small units and other priority sectors were deprived of funds. Thus, it was important to nationalise banks in the interest of the country.

*To reach out to non urban areas:* Prior to nationalisation, branches were opened in cities, thus neglecting the semi urban and rural areas. This not only led to concentration of banking facilities in urban areas, but also in depriving these facilities to a major chunk of our population. Out of about 5.6 lakh villages in India, only 5,000 were served by commercial banks. Ahmadabad, Mumbai, Kolkata, Delhi and Chennai had about 1/7<sup>th</sup> share in the number of branch offices and 50% share of bank deposits and bank credit. This led to the slow growth of the rural areas.

*Low advances to agricultural sector:* The banks advanced finances to commerce and industry, increasing their share in the scheduled bank's advances from 70% in 1951 to 87% in 1968. Agriculture accounted for only 2.2% of the total advances.

*Violation of norms:* Commercial banks often granted loans to those industries which did not appear in the priority list. This was against the norm and priorities laid down in the plans.

*Speculative activities:* Commercial banks encouraged socially undesirable activities like hoarding, black marketing, etc. against high rates of interest.

*Ignoring the priority sectors:* Apart from neglecting the agricultural sector, the needs of other sectors such as export, small-scale industries etc. were unmet.

### **Objectives of Nationalisation**

The objectives of nationalisation were as follows:

- Removal of control by a few
- Provision of adequate credit for agriculture, small scale industries and export sector
- Encouraging a new class of entrepreneurs
- Giving a professional touch to management
- Provision of banking services in backward areas by opening new branches
- Enforcing discipline in the commercial banks and complying with national priorities

Therefore, when Indira Gandhi was the Prime Minister of the country, her government took one daring decision of nationalizing 14 commercial banks, who had a total deposits and reserves of 50 crores of more than that. (1) Central Bank of India (2) Bank of India (3) Indian Bank (4) Union bank of India (5) United Commercial Bank (6) United Bank of India (7) Dena Bank (8) Syndicate bank (9) Punjab National Bank (10)

Allahabad Bank (11) Bank of Baroda (12) Canara Bank (13) Bank of Maharashtra (14) Indian Overseas Bank – these 14 commercial banks were nationalised on 19<sup>th</sup> July 1969.

The process of nationalization did not stop over here. Instead, the on a large scale, the second phase of nationalization started again on 14<sup>th</sup> March 1980, the Government has nationalised 6 more commercial banks. They are: - (1) Punjab and Sindh bank (2) Vijaya Bank (3) Andhra Bank (4) Corporation Bank (5) New Bank of India (6) Oriental Bank of Commerce. This time the criteria was, those banks, which had a total deposits and reserves of Rs. 200 crores or more than that. But later on New bank of India was merged with Punjab National Bank. Hence finally, the total number of nationalised commercial banks was 19.

While inclusive banking began, in spirit, with the nationalization of banks in 1969 and 1980 in India, the real thrust on Financial Inclusion (FI) came in 2005 when the Reserve Bank of India (RBI) highlighted its significance in its annual policy statement of 2005-06. It urged banks to work towards reaching out to the masses, offering banking services down to the hinterland. The worrying fact was the mass exclusion of people from the formal banking system that hindered economic growth at the bottom of the pyramid. Then onwards RBI began to persuade banks to include financial inclusion as a business objective. Globally, financial inclusion is considered as a critical indicator of development and well-being of a society. As a result of renewed thrust on financial inclusion, an inclusive financial system is widely recognized in policy circles as a proactive measure and has become a basic priority in many countries – including India. Financial inclusion is considered as an effective means to sustainable economic growth and is intended to ensure that each citizen of the country is able to use their earnings as a national financial resource for redeployment in productive sectors of the economy. Such pooled financial resources can be channelized to develop enterprises, fueling the nation's progress. This underlying theme has brought financial inclusion in the spotlight and it has come to occupy centre-stage in financial intermediation.

Financial inclusion as a policy initiative entered the banking lexicon only after the recommendations of the Rangarajan Committee in 2008. It began to attract the attention of stakeholders when banks realized the significance of connecting with more people for business growth. The span of financial services included provision of basic savings accounts, and access to adequate credit at affordable costs to vulnerable groups such as the excluded sections of the society and low-income households. The experience of microfinance units in India and abroad shows that vulnerable groups who pay usurious interest rates to local moneylenders, can also be worthy borrowers of banks. One of the broader objectives of financial inclusion is to pull the poor community out of the net of exploitative moneylenders. But despite such emphasis, the penetration of banking services was initially mostly confined to urban areas and major cities, after which they started spreading to the hinterland. Financial inclusion thus became an integral part of the business domain of banks, with RBI advising all public and private banks to submit a board-approved, three-year FI Plan (FIP) starting from April 2010. These plans broadly included self-set targets in terms of bricks-and-mortar branches in rural areas, clearly indicating coverage of unbanked villages with population above 2,000 and those with population below

2,000; deployment of Business Correspondents (BCs) and use of electronic/kiosk modes for provision of financial services; opening of no-frills accounts; and so on. For the dispensation of credit, Kisan Credit Cards (KCC), General Credit Cards (GCC), and other specific products designed to cater to the financially excluded segments, were introduced. Such accelerated microcredit was part of priority sector lending schemes of banks. Further, banks were advised to integrate FIP's with their business plans and to include the criteria on financial inclusion as a parameter in the performance evaluation metrics of their staff. Among associated developments, RuPay – an Indian domestic debit card – was introduced on 26 March 2012 by the National Payments Corporation of India (NPCI). It has been a game changer in creating better digital infrastructure and enabled faster penetration of debit card culture.

### Progress of financial inclusion:

Faster implementation of financial inclusion programmes is seen after 2010-11. Commercial banks opened new rural branches, increased coverage of villages, set up ATMs and digital kiosks, deployed BCs, opened no-frills accounts, and provided credit through KCCs and GCCs. The introduction of core banking technology and proliferation of alternate delivery channels aided the process of inclusion on a larger scale. The statistics on key banking network give a sense of the pace of progress of banking outreach as part of FI.

Parameters	March 2010	March 2016	March 2017
Number of banks branches in Villages	33,378	51,830	50,860
Number of Business Correspondents	34,174	5,31,229	5,43,472
Number of other forms of banking touch points	142	3,248	3,761
Total number of Banking Touch points	67,694	5,86,307	5,98,093
Number of BSBDA (in Millions)	73	469	533
Deposits in BSBDA (amount in Rs. Billions)	55	636	977

Source: RBI website.

In the last 7-8 years, banks have expanded their presence, and differentiated banks – payments banks and small finance banks – are set to take this further. When banks began pursuing three-year financial inclusion policies, innovations in providing better access to appropriate financial products and services came up. There was more focus on making banking accessible to vulnerable groups. Mainstream institutional players integrated fairness and transparency as part of their offerings, with basic products well-understood by the masses. As a result, financial inclusion became a critical factor for inclusive growth and development. Banks also realised that it can be an effective means for cross-selling and business growth.

The progress of implementation of financial inclusion has to be measured to decide on future policy framework. It is believed that when banks embarked on the formal journey of financial inclusion, hardly 40% of Indian adults had savings accounts, with only a small fraction receiving credit from the banking system. Though there is lack of concrete data on the achievement levels, informal data suggest that about 62% of adult

Indians are now covered. India's first financial inclusion index was launched in 2013 based on four critical dimensions: (i) branch penetration, (ii) deposit penetration, (iii) credit penetration, and (iv) insurance penetration. The last dimension was added for the first time to make the index much more comprehensive. CRISIL Inclusix measures progress on FI down to the level of each of the 666 districts in the country in 2013 (as against 717 now). The index is based on data provided by RBI, the Micro-Finance Institutions Network (MFIN), and the Insurance Information Bureau of India.

### **Shortcomings of commercial banking in India**

Although commercial banks have come a long way after nationalisation of banks, they still suffer from the following shortcomings.

**Insufficient growth:** Though commercial banks have spread to every nook and corner of the country, their growth is still insufficient considering the huge population of India. Rural areas have just 38% of the bank branches where more than 70% population of the country resides.

**Regional imbalances:** States like Arunachal Pradesh, Jammu and Kashmir, Uttaranchal, Manipur and Tripura still have lesser number of banks on an average when compared to other states. Even in well banked states like Maharashtra, West Bengal and Tamil Nadu, if metropolitan cities are excluded, the population per bank office is larger than the average of these states.

**Bad debts and over dues:** Most of the commercial banks suffer from excessive over dues, bad and doubtful debts which have adversely affected the capacity of a bank to lend money. Bad and doubtful debts of commercial banks, called non-performing assets (NPA's) which were more than Rs. 50,000 crore in 1997-98 have increased to Rs. 70,000 crore in 2001-02. However, the gross NPAs have fallen due to strict credit norms followed by the banks. The gross advances also have fallen from 10.5% in 2001-02, 2.3% in 2010-11.

**Deterioration of quality of service:** With the passage of time, the quality of service rendered by commercial banks has deteriorated. This has affected their overall efficiency. Also the staffs are in disciplined and there is no proper system of accountability and control over the banks located in rural areas.

**Falling profitability:** Although the absolute profits have increased, their profitability ratio has fallen considerably. This is due to

- Lesser interest on Government borrowings from banks
- Subsidisation of credit to priority sector
- Rapid branch expansion
- Blocked funds in low-term, low-yielding securities resulting from directed credit programmes of banks
- Absence of competition
- Huge expenditure resulting from over staffing and mushrooming of non-viable branches

**Lack of professionalism:** Banks lack expertise in the areas of merchant banking and agricultural financing. There is a need of a professional approach in these areas.

**Conclusion:**

The term 'financial inclusion' was explicitly used for the first time in the Annual Policy Statement for 2005-06. It observed that there were legitimate concerns in the banking practices that tended to exclude vast sections of population. To bring them under the banking services ambit, nationalized laid the foundation stone, as it paved the path and played key role in attracting the deposits and disbursing the loans to include vulnerable section in the financial services sector. The business correspondents have done their job as well by the way of linking the people to bank. Financial inclusion will strengthen financial deepening and provide resources to the banks to expand delivery of credit. The trend of increasing commercialization of agriculture and rural activities should generate greener pastures and banks should examine the benefits of increasing penetration therein.

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