# Introduction

The banking system in India is the backbone of its economy, acting as a crucial intermediary that manages money and facilitates financial transactions for individuals and businesses.

## A Brief History of Banking in India

The history of banking in India can be divided into several phases:

## 1. The Early Phase (Pre-Independence)

**The Beginning**: Modern banking started in the late 18th century with institutions like the Bank of Hindustan (1770). The British East India Company later established the Presidency Banks (Bank of Calcutta, Bank of Bombay, and Bank of Madras).

**The Imperial Bank:** These three Presidency Banks were merged in 1921 to form the Imperial Bank of India. This bank acted as a central bank until the formal establishment of the regulator.

**The Central Bank:** The Reserve Bank of India (RBI) was established in 1935 to regulate banks and manage the country's currency.

**Indian-Owned Banks:** Key banks like the Punjab National Bank (PNB) were established by Indians in the late 19th and early 20th centuries, marking the rise of indigenous banking.

## 2. The Nationalisation Phase (Post-Independence to 1991)

After independence, the government felt private banks were focusing too much on urban areas and big businesses, neglecting rural areas and agriculture. To correct this, the government nationalised the Imperial Bank of India, renaming it the State Bank of India (SBI) in 1955. More significantly, 14 major private commercial banks were nationalised in 1969, followed by six more in 1980. The primary goal was to bring banking services to the common person (especially in rural areas) and ensure that credit was available for key sectors like agriculture and small-scale industries.

## 3. The Liberalisation Phase (1991 to Present)

Following the economic crisis of 1991, India introduced major economic reforms. This led to the entry of new, modern private sector banks (like HDFC Bank, ICICI Bank), increasing competition and improving customer service and technology.

**Technological Push:** This era saw a major shift towards digital banking, ATMs, and recent innovations like the Unified Payments Interface (UPI), making transactions instant and widespread.

## Importance of Banking in the Economy

The banking system is essential for a thriving modern economy. Its main functions act as vital links for economic activity:

## 1. Mobilising Savings and Channelling Investments

Banks collect the small, unused money (savings) from many people and combine it into a large pool of funds, which is then given out as loans.

**Example:** A salaried person deposits a portion of their monthly income (their savings) into a bank account. The bank uses this money to give a home loan to a family, helping them buy a house (an investment). This is how banks move 'idle' money into 'active' use, fueling economic growth.

## 2. Providing Credit (Loans)

Banks are the main source of funds for businesses and individuals who need money for immediate expenses or growth.

**Example:**

* A farmer gets a crop loan to buy seeds and fertiliser before the harvest.
* A student gets an education loan to pay university fees.
* A small entrepreneur gets a business loan to buy new machinery or open a new outlet.
* Without these loans, all these important activities would slow down or stop, directly impacting jobs and production.

## 3. Facilitating Transactions

Banks provide safe and efficient ways to transfer money, replacing old, slow methods like carrying large amounts of cash.

**Example:** When you use a debit card, net banking, or UPI to pay for groceries or send money to a friend, you're using the bank's system to complete a transaction instantly and securely. This ease of payment is critical for commerce and trade.

## 4. Implementing Government and RBI Policy

The RBI uses banks to control the amount of money flowing in the economy, helping to manage inflation (rising prices) and growth.

**Example:** If the RBI wants to slow down inflation, it can increase the interest rates banks charge on loans. This makes borrowing more expensive, so people and businesses borrow less, reducing the overall money supply and cooling down prices. Banks are the channel through which this policy takes effect.

In essence, Indian banks transform scattered savings into productive capital, ensure a smooth flow of money, and support the growth of everything from agriculture to large industries, making them indispensable to the nation's economic progress.

## Classification of Banks in India

The Indian banking system is classified into different groups based on their function, ownership, and adherence to central bank rules.

### 1. Scheduled vs. Non-Scheduled Banks

| Basis for Comparison | Scheduled Banks | Non-Scheduled Banks |
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| **Meaning** | Scheduled banks are those banks which have a minimum paid-up capital of Rs 5 lakhs that does not harm depositor's interests. | Non-scheduled banks are those in India that are not subject to the RBI's norms and regulations or those that do not fall under the category of scheduled banks. |
| **Second Schedule** | Registered in the Second Schedule to the RBI act 1934. | Not listed in the 2nd scheduled of RBI act, 1934. Registered under Companies Act 1956 (2013). |
| **Cash Reserve Ratio** | Maintained with RBI. | They maintain such reserves themselves, not with RBI. |
| **Borrowing** | These banks are permitted to borrow money from the RBI at the bank rate for regular banking purposes. | These banks are not authorized to borrow money from the RBI for routine banking purposes, unless in an emergency or exceptional circumstance. |
| **Regulation** | Strictly regulated by RBI. | Not strictly regulated by RBI. |
| **Returns** | They offer higher returns to their depositors. Thus, these banks are required to maintain a higher CRR. | These are private institutions that primarily offer loans and other forms of credit to individuals and businesses |
| **Safety and Security** | They are safe and secure. | They are less safe and secure than scheduled banks. |
| **Membership of Clearing house** | They can become members of the clearing house. | They cannot become members of the clearing house. |

| Types of Banks | Explanation | Functions | Importance | Examples and Head quarters |
|---|---|---|---|---|
| **Commercial Banks** | A commercial bank is a business that provides common financial services to the public& other businesses, with the main goal of making a profit.<br>It is of 3 types<br>1) Public Sector Banks<br>2) Private Sector Banks<br>3) Foreign Banks | Accepts deposits & advancing loans. They also engage in credit creation.<br>Providing locker facilities offering foreign exchange services.<br>Clearing checks and making bill payment in your behalf & issuing Debit/Credit cards. | They are the engine of the economy. They take idle savings & turn them into investments which create jobs and other economic activities. | JPMorgan Chase (HQ: USA)<br>ICBC(HQ: China)<br>HSBC (HQ: UK) |
| | **Public Sector Banks**<br>Banks where the majority stake (over 50%) is held by the government. They prioritize social welfare and financial inclusion over maximum profit. | Accepts deposits, give loans (especially to priority sectors like agriculture, small businesses), facilitate government schemes, handle foreign exchange. | Crucial for financial inclusion, ensuring banking services reach remote areas, implementing government development and welfare programs, and maintaining financial stability. | State Bank of India (SBI)—(HQ; Mumbai)<br>Punjab National Bank (PNB)-(HQ; New Delhi)<br>Bank of Baroda (BOB)-(HQ; Vadodara) |
| (i) | **Private sector Bank**<br>Banks where the majority stake is held by private individuals or corporate entities. Their main objective is to | Offer a wide range of services including deposits, loans, credit cards, wealth management, and investment banking. Often | Drive competition and efficiency in the banking sectors, introduce innovative products, provide better technology-driven customer | HDFC Banks (HQ; Mumbai),<br>ICICI Bank (HQ; Mumbai),<br>Axis Bank (HQ; Mumbai) |

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| | maximise profit for their stakeholders. | utilize modern technology for customer services. | service, and cater to corporate and high-net-worth individual needs. | |
| (ii) | **Foreign Banks** Banks that are headquartered in a foreign country but operate their branches in India. | Focus mostly on wholesale banking, trade finance, corporate lending, foreign exchange services, and wealth management, especially for international trade and multinational companies. | Bring international expertise and best practices, facilitate foreign trade and cross-border investments, and increase competition, which benefits the entire banking system. | Standard Chartered Bank (Global HQ: London), HSBC Bank (Global HQ: London), Citibank (Global HQ: New York) |
| **Regional Rural Banks (RRBs)** | Banks specially created to serve rural areas. They are jointly owned by the Central Government, State Government, & a Sponsor Bank. | Provide credit & basic banking services to small & marginal farmers, agricultural labourers, artisans,& small entrepreneurs in villages. | Key for financial inclusion in remote areas. They fill the gap where large commercial banks may not operate, boosting the rural economy & reducing poverty. | Baroda UP Bank; (HQ-Gorakhpur), Maharashtra Gramin Bank; (HQ-Aurangabad) |
| **Development Financial Institutions (DFIs)** | Financial institutions that provide long-term funds & specialized finance, primarily for large-scale, high-risk projects that promote economic growth. | Offer long-term project finance for infrastructure & industrial development. They also provide technical | Accelerate economic development by ensuring essential, large-scale projects get the money they need, which traditional | SIDBI (HQ-Lucknow)' NABFID (HQ-Mumbai), IIFCL (HQ-Delhi) |

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| | | assistance & project analysis. | commercial banks can’t risk. | |
| **Payments Banks** | Banks that focus only on deposits & payments, primarily through digital channels. They are not allowed to lend money or issue credit cards. | Accept deposits up to a set limit & issue ATM/Debit cards. | Promote a less-cash economy & provide easy accessible banking to low income groups, migrant workers,& small businesses through mobile technology. | Fino Payment Banks (HQ-Mumbai), Post Payment Banks (IPPB): (HQ- New Delhi), NSDL(HQ-Mumbai) |
| **Small Finance Banks** | Private sector banks that perform all basic banking activities but are mandated to focus on lending to sections of the population generally not served by traditional banks. | Accept deposits and provide loans, mainly to small industries, small & marginal farmers, & other parts of the unorganised sector. | Promote inclusive growth by providing credit to micro-entrepreneurs & underserved communities, helping them grow their businesses & integrate into the formal financial system. | Suryoday Small Finance Bank (HQ-Navi Mumbai)’, Ujjivan Small Finance Bank (HQ-Bengaluru), Small Finance Bank ( HQ-Thrissur) |
| **Co-operative Banks** | A co-operative Bank is a financial institution owned by its members, who are also its customers. They work on the principle of one person one vote for the management decisions, and their main goal is mutual help rather than maximum profit. | **Deposit Services:** Accepting savings, fixed and recurring deposits from members and non-members. **Credit & Loans:** Providing loans for farming, small businesses, housing and personal needs, | **Financial Inclusion:** Crucial for providing affordable banking & credit to the poor, farmers & small traders in remote areas. **Reducing Indebtedness:** Protects the rural population from high-interest loans | Saraswat Co-operative Bank (HQ- Mumbai, Maharashtra), Cosmos Co-operative Bank (HQ- Pune, Maharashtra) State Co-operative Bank (HQ: State Capital). |

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| | | often at a lower interest rates than private lenders. **Rural & Microfinance:** Being the primary source of credit for agriculture and rural activities where big commercial banks have limited reach. | charged by local moneylenders. **Local Development:** Encourages saving habits & channels money toward productive local economic activities. | |

The Indian banking sector has undergone a massive transformation in the last 5–10 years, shifting its focus from managing bad debts to embracing a comprehensive digital infrastructure.

Here are the most significant recent reforms, explained simply:

## 1. The Big Cleanup: Dealing with Bad Loans (NPAs)

For many years, the biggest problem for Indian banks was the huge amount of Non-Performing Assets (NPAs), or "bad loans," which were loans that borrowers couldn't or wouldn't repay.

## A. Insolvency and Bankruptcy Code (IBC)

Introduced in 2016, the IBC is a powerful legal framework that dictates what happens when a company fails to repay its loans. It gives banks and lenders a clear, time-bound process (usually about 270 days) to resolve the issue. Before the IBC, loan recovery was slow, often taking years in court. The IBC provides a credible threat: if a company defaults, its owner can lose control of the business. This fear has led many borrowers to repay or restructure their loans before the case goes to the IBC, dramatically improving credit discipline.

## B. "Bad Bank" (NARCL-IDRCL Structure)

The government established the National Asset Reconstruction Company Limited (NARCL) and the India Debt Resolution Company Limited (IDRCL). NARCL is essentially a "Bad Bank." Banks sell their most difficult, large bad loans (over ₹500 crore) to NARCL. NARCL takes these bad loans off the banks' balance sheets, allowing the banks to focus on giving out new, good loans. IDRCL then manages and tries to recover the money from those bad loans. It cleans up bank balance sheets in a single go, freeing up their capital and reducing the risk burden, which allows them to lend more confidently and support economic growth.

## 2. The Digital Leap: Infrastructure & Inclusion

The second major area of reform is the creation of a powerful digital financial ecosystem that aims to provide universal and paperless access to finance.

### A. Unified Payments Interface (UPI)

Launched in 2016, UPI is an instant real-time payment system that allows users to link multiple bank accounts to a single mobile application (like PhonePe or Google Pay) and make instant transfers 24/7 using just a mobile number or a QR code. UPI has revolutionized retail payments, enabling billions of small, instant transactions every month, from a street vendor to a large mall. It has created a cashless economy at the grassroots level, making banking instantly accessible to everyone with a smartphone.

### B. Account Aggregator (AA) Framework

A secure, consent-based system that allows you to share your financial data (like bank statements, tax returns, and insurance details) digitally and securely between different regulated financial institutions. It's like a digital locker for your data. If you apply for a loan, you use the AA app to digitally approve sharing your bank statements with the lender for a few hours. The data is encrypted and cannot be seen or stored by the Account Aggregator itself. It allows quick, paperless, and secure access to loans. For a small business with no fixed collateral, their digital transaction history becomes their creditworthiness, making it easier for them to get formal credit.

### C. Licensing New Banks (SFBs and PBs)

The RBI created licenses for Small Finance Banks (SFBs) and Payments Banks (PBs) (around 2015-2016). This reform created specialist banks to target segments that commercial banks often ignore. SFBs provide proper loans to small entrepreneurs, and PBs provide digital wallets and payment services to those who primarily use cash. This is a targeted approach to financial inclusion.

## 3. Governance and Consolidation

These reforms focused on making Public Sector Banks (PSBs) stronger, better managed, and more competitive.

**A. Mega-Mergers of Public Sector Banks**

The government undertook a large-scale consolidation drive, merging several smaller Public Sector Banks into a handful of larger entities (e.g., merging 10 banks into 4 in 2020). The goal was to create fewer, but stronger banks with larger balance sheets, better economies of scale, and the capacity to finance mega-projects, making them globally competitive and professionally managed.

**B. Capital Infusion and Governance Reform**

The government consistently pumped money (recapitalization) into Public Sector Banks to ensure they meet international capital standards (Basel norms) and can absorb losses from bad loans. Alongside this, reforms were made to improve their governance and make the boards more professional. This has made the government-owned banks financially resilient and better managed, ensuring they continue to play a strong role in the financial system without the constant threat of collapse.