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Name of Paper: Money and Financial System

**Topic – Meaning and Functions of Commercial Bank
and it's role for economic development of a developing
country.**

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Introduction

There is no unanimity of opinion about the origin of the word 'Bank'. According to some monetary expert, the word 'Bank' is derived from German equivalent word of monte was BANKE, in Italian BANCO and in French BANKE and in English Bank. The origin of the word Bank was from Italian word Banco whose meaning was 'Bench', upon the early moneylenders used to display their coins and transact business across the bench in the market place. Bank in past used to be known as Seths, Shroffs, goldsmiths etc. Banks are indispensable in every walk of life. Banks are the nerve centre of trade, commerce, business of an economy. Bank plays a very important role in the economic development of all the nations of the world. In fact banking is the life blood of trade commerce and business.

Meaning and Definition of Bank.

A bank as understood in the present day world, in simple language, it is an institution which deals in money. Broadly speaking banks draw surplus money from the persons who are in a position to use it for productive purposes.

The important definition of Bank can be studied under the following heading.

- 1) General Definitions
- 2) Functional Definitions
- 3) Legal Definitions

I. General Definitions

According to Prof. Sayers – ‘Bank is an institution whose debts (bank deposits) are widely accepted in settlement of other people’s debt to each other.

Kinley – Bank is an institution which grants loan to the needy persons and receives deposit from the public.

Crowther – The trading of the bank is to obtain loan and to give securities.

Gilbert – Bank is a trader of capital or monry.

II. Functional Definition-

According to Webster Dictionary: Bank is an institution which works in money an organisation where money is deposited and discounting facilities are given and money is transferred from one place to another place.

III. Legal Definition –

According to Banking Regulation Act 1949, ‘The word Banking as ‘ the accepting, for the purpose of lending or investing of deposits of money from the public, repayable on demand or otherwise and with draw able by cheque, draft, order or otherwise. From the above definitions of bank we come to the conclusion that bank is an institution which deals in cash and credit.

Features of a Bank.

1. Dealing in Money: Bank is a financial institution which deals with other peoples’s money i.e. money given by depositors.

2. Individual/ Firm / Company: A bank may be a person, firm or a company. A banking company means a company which is in business of banking.
3. Acceptance of Deposits: A bank accepts money from the people in the form of deposits, which are usually repayable on demand or after the expiry of a fixed period. It gives safety to the deposits of its customers. It also acts as a custodian of funds of its customers.
4. Giving Advances : A bank lends out money in the form of loans to those who require it for different purposes
5. Payment and Withdrawal: A bank provides easy payment and withdrawal facilities to its customers in the form of cheques and drafts. It also brings bank money in circulation. This money is in the form of cheques, drafts etc.
6. Agency and Utility Services : A bank provides various banking facilities to its customers. They include general utility services and agency services.
7. Profit and Service Orientation: A bank is a profit seeking institution having a service oriented approach.
8. Ever Increasing Functions : Banking is an evolutionary concept. There is continuous expansion and diversification as regards the functions, services and activities of a bank.
9. Connecting Link : A bank acts as a connecting link between borrowers and lenders of money. Banks collect money from those who are in need of money.
10. Banking Business : A bank's main activity should be to do business of banking which should not be subsidiary to any other business.
11. Name Identity : A bank should always add the word 'Bank' to its name to enable people to know that it is dealing in money.

Commercial Bank

A commercial bank is a type of bank that provides short term services such as accepting deposits, making business loans and offering basic investment products

that is operated as a business for profit in short bank, borrow to lend. Culberston says commercial banks are those institutions which provides short term loan to the trade and create money. Hence , commercial banks are those banks which trade in money and credit with the object of earning profit.

Functions of commercial Banks.

The functions of commercial bank have been divided in to three categories.

- Main Functions
- Secondary Functions
- Social Functions

A. Main Functions -

The main functions of commercial bank are as follow.

- i) **Accepting Deposits:** The commercial bank accepts deposits from the public in the form of following Accounts.
 - A) Current Deposits: Bank provides withdrawing facility many times in a day and no interest is given in this account. It is very useful for traders.
 - B) Fixed Deposits: In this account money is deposited for a particular period of time. The interest rate is higher and other account. The banks are free to utilise the deposited amount for that particular period and depositor can withdraw the amount after expiry of period.
 - C) Saving account : This account is very useful for small amount saver people and they can deposit their saving money into the bank. There are restriction imposed on withdrawal on this. Customers can use cheque for withdrawal provided by bank.
 - D) Recurring Deposit : It is fixed income monthly deposit scheme which allows investors to earn steady returns on investment. Interest on recurring deposits is compounded and calculated quarterly. The interest rates are similar to the fixed deposit interest rates.
 - E) Home Savings Account: This small safe account provided to the customer, who earns less money and they may deposit money on their will and convenience of bank and less interest provided to customer.
- ii) **Granting Loans:** Granting loans is an another important function of bank. In practical loans are given for productive purposes. The bank charges various rate of interest on the different loans. They may be on following forms
 - a. Cash Credit – the loan is granted on the hypothecation of assets and sanctioned amount is deposited in the account of the borrowers.They can withdraw needed amount on their wishes.

- b. Overdraft : An overdraft facility allows customers to use or withdraw money from their account upto the approved limit most of the banks offer an overdraft limit depending on the customer's existing relationship with the bank. Bank also charges the interest and fees on exceeding the overdraft limit of the account.
- c. Loans and Advances : These loans are given in form of a certain amount and credited in the account of the borrower. The interest is charged on the whole amount of loan taken by the borrower.
- d. Investment in Government Securities: Bank may purchase govt. securities and it is supposed to be a safe method of giving loan to the Government.
- e. Discounting of Bills : Bank discounts the bills and provides money on it. Bank keeps the documents till the date of maturing and after maturity gets the whole amount.
- f. Credit Creation : Credit creation is the business of banks and in this regard they provide more amount in the form of loans.

B. Secondary Functions:

This includes two types of functions like

- i) Agency Function
 - ii) General Utility Function
- i) Agency Functions: Bank provides these functions under the order of their customers and charges commission for it. The important agency work are as under.
 - a. Collection of payment
 - b. Payment on behalf of customers
 - c. Sale and purchase of securities
 - d. Remittance of money
 - e. Trust Functions
 - f. Collection of Dividend and Interest.
 - ii) General Utility Function: Bank provides many general utility functions and they are
 - a. Custody of Valuables.
 - b. Letter of Credit like Traveller's cheques.
 - c. Transportation of Goods
 - d. Collection of Business Information
 - e. Underwriting of Loans
 - f. Provision of Foreign Exchange
 - g. Economic Position

C. Social Functions-

The social functions of commercial banks are as under.

1. Increase in Capital Productivity
2. Remittance of Money
3. Finance Management
4. Capital Formation
5. Allocation of Resources
6. Increase in Employment
7. Facilities in Payment
8. Monetary System
9. Custodian Services
10. Help to Government
11. Services to Customers
12. Encouragement in Foreign Trade
13. Stability in Economic Life
14. Special Economic Advice
15. Development of Entrepreneurs.

Role of Commercial Banks for economic development of a developing country.

The following points highlight the top eight roles of commercial banks in a developing country.

1. Mobilising Savings for Capital Formation:

People in developing countries have low incomes but the banks induce them to save by introducing variety of deposit schemes to suit the needs to individual depositors. To mobilize dormant savings and to make them available to the entrepreneurs for productive purposes, the development of a sound system of commercial banking is essential.

2. Existence of a Large Non-monetized Sector:

A developing economy is characterized by the existence of a large non-monetized sector, particularly, in the backward and inaccessible areas of the country. The existence of this non-monetized sector is a hindrance in the economic development of the country. The banks by opening branches in rural and backward areas can promote the process of monetization in the economy.

3. Financing Industrial Sector:

Commercial Banks provide short-term and medium- term loans in the industry. In India, they undertake financing of small scale industries and also provide hire-purchase finance. These banks not only provide finance for industry but also help in developing the capital market which is underdeveloped in such countries.

4. They Help in Monetary Policy:

The Commercial Banks help the economic development of a country by following the monetary policy of the Central Bank. The Central Bank is dependent upon those Commercial Banks for the success of the monetary management in keeping with requirements of a developing economy.

5. Commercial Banks Help in Financing Internal and External Trade:

The banks provide loans to wholesalers and retailers to stock goods in which they deal. They also help in the movement of goods from one place to another by providing all types of facilities such as discounting and accepting bills of exchange, providing overdraft facilities, issuing drafts etc. They help by giving finance both exports and imports of developing countries.

6. Provision for Long-term Finance for the Improvement of Agriculture:

Normally, commercial banks grant short-term loans to the trade and industries in developed countries. But in developing countries new businesses and improvement in agriculture need long-term loans for proper development. Therefore, the commercial banks should change their policies in favour of granting long-term loans to trade and industries.

7. They Help in Financing various Consumers' Activities:

People in developing countries do not possess sufficient financial resources to buy costlier goods like house, scooter, refrigerator etc. They help by giving loans to purchase these items which raises the standard of living of the people in developing countries

8. Need for Sound Banking System:

For the improvement of the banking system in a developing country the following points need special stress:

(i) In developing countries, there should be proper facility of cheap remittance facilities to enable the movement of funds from one place to another, so as to meet the requirements of trade and industry.

(ii) It should always be remembered that in developing countries loans should be given for productive purposes only and not for consumption and speculative purposes.

(iii) It will be better and encouraging if long-term credit is given to agriculture and small scale industries.

(iv) The use of cheques, drafts etc. is popularized among the people.

If the above written facts are taken into consideration commercial banks can play a useful role in promoting the economic development in developing countries

short answer type Questions.

1. What do you know about bank ?
2. Explain the main functions of commercial bank.

Long Answer type Question.

1. What is the meaning of commercial bank ? Explain the functions of commercial bank.
2. Explain the importance role of commercial bank in developing countries

End

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