International Journal of Academic Research
ISSN: 2348-7666; Vol.3, Issue-9(1), September, 2016
Impact Factor: 3.656; Email: drtvramana@yahoo.co.in

The Role of Banks in Indian Economy

M. Subramanyiam Reddy, Assit. Professor, Periyar Institute of Management Studies, *Periyar University, Salem.*

Dr. N. Rajendhiran, Professor and Director, Periyar Institute of Management Studies, Periyar University, Salem

Abstract
Banks play a vital role in the economic development of a country. They accumulate the idle savings of the people and make them available for investment. They also create new demand deposits in the process of granting loans and purchasing investment securities. They facilitate trade both inside and outside the country by accepting and discounting of bills of exchange. Banks also increase the mobility of capital. Commercial banks are the most effective way to generate the credit flow of money in markets. Co – operative Banks are the most effective way develop the small-sized units organized in the co- operative sector which operate both in urban and non-urban regions. And Development banks also play the effective role in industrial development in particular. There is acute shortage of capital in India. The banks can play an important role in promoting capital formation, in controlling speculation in maintaining a balance between requirements and availabilities and in direct physical resources into desired channels. Research is based upon the secondary date which provide the findings on banks and how it helpful in economic development. So this research will helpful in finding out that how banks are helpful in credit flowing, employment generations in rural areas and how it will contribute in development of Indian economy.
Keywords: *Economic Development, Commercial banks, Co – operative banks and Development banks.*

Introduction:

A bank is a financial institution that accepts deposits from the public and creates credit. Lending activities can be performed either directly or indirectly through capital markets. Due to their importance in the financial system and influence on national economies, banks are highly regulated in most countries.

A Banking system provides a safe place to save excess cash, known as deposits. Supplies liquidity to the economy by loaning this money out to help businesses grow and to allow consumers to purchase consumer products, homes, cars etc.

Definition of Bank

The bill of exchange Act 1882 (England) defines "A bank includes a body of persons, whether incorporated or not, who carry on the business of banking"

From this definition it is clear to us that any institution, which performs the various banking functions, may be termed as bank. But in practice it is found that many banking functions wary from time to time and country to country. It is not possible on the part of a single bank to perform all the banking functions at a time. So there originated numbers of specialized banks with the objective of performing one or more functions. As for example, Central Bank, Commercial bank, Industrial Bank, Agricultural Bank, Co-operative Bank etc., are seen in the practical field.

Dr. Herbert L. Hart has defined a banker as

"A banker is one who in the ordinary course of business honors cheques drawn upon him by persons for whom he receives money on current account"

According to Sir John Paget

"No one and nobody corporate and otherwise can be a banker who does not (i) take deposit accounts (ii) take current accounts (iii) issue and pay cheques drawn upon him(iv) collect cheques crossed and uncrossed for his customers"

Hilton banking commission defines bank or banker in the following words:

"Every person, firm or company using in the description or its title, bank or banker or banking and accepting deposits of money subject to withdrawal by cheque, draft or order"

In view of the above definitions, a simple and short definition can be given as

"Bank is an institution, which deals in money and credit"

Banks, which deals in money and credit. An intermediary, which handles other people's money both for their advantage and to its own profits. A financial institution that links the flow of funds from savers to the users. Plays an important role in the economy of any country as they hold the saving of the public.

History of Banking in India:

Phase I

- Three presidency banks were established in Calcutta (1806) in Bombay (1840) and in Madras (1843)
- In the early part of 20th century, on account of the Swadeshi movement a number of joint stock banks were established by Indians like Bank of India, Bank of Baroda and Central Bank of India.
- In 1921 the three presidency banks were merged and the Imperial Bank of India was created
- During the period 1900 to 1925 many banks failed, and hence a Central Banking Enquiry Committee formed in 1929 to trace the reasons for the failure of such banks.
- The Reserve Bank of India Act was passed in 1934 and the RBI came into existence in 1935 and RBI was nationalized in 1949
- The Banking Regulation Act,1949 gave wide powers to RBI to act as the regulator for banks in India

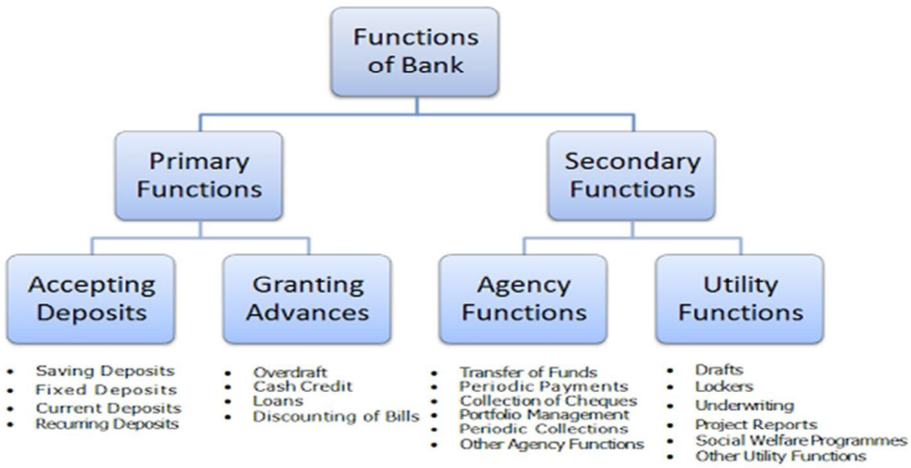
Phase II:

- In 1955 State Bank of India became the successor to the Imperial Bank of India. Under the State Bank of India Act,1955.
- In 1959 State Bank of India (Subsidiary Banks) Act was passed to enable SBI to take over State Associated banks as SBI's subsidiaries
- In 1969 the Government of India nationalized 14 major commercial banks having deposits of Rs.50 crore or more
- In 1975 Regional Rural Banks were established under RRB Act 1976, which was preceded by RRB Ordinance in 1975
    - In 1980 six more commercial banks were nationalized, with a deposit of Rs.200 crore or more

Phase III

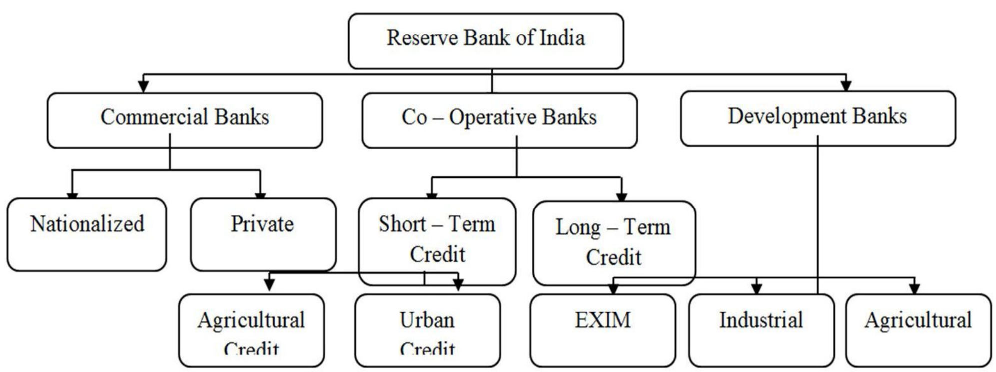
- In the liberalised, privatised and globalised environment, banks operating in India have diversified their banking activities by offering Banking facilities like:
  - – Merchant banking
  - – ATMs/Credit Cards/Internet banking/Mobile Banking
  - – Factoring
  - – Third Party Service

Functions of Banks:



Sources: Wikipedia.com.

Structure of Banks in India



Broad Classification of Banks in India

1) **The RBI:** The RBI is the supreme monetary and banking authority in the country and has the responsibility to control the banking system in the country. It keeps the reserves of all scheduled banks and hence is known as the "Reserve Bank".

2)

3) **Public Sector Banks:**

- State Bank of India and its Associates (8)
- Nationalized Banks (19)
- Regional Rural Banks Sponsored by Public Sector Banks (196)

3) **Private Sector Banks:**

- Old Generation Private Banks (22)
- Foreign New Generation Private Banks (8)
- Banks in India (40)

4) **Co-operative Sector Banks:**

- State Co-operative Banks
- Central Co-operative Banks
- Primary Agricultural Credit Societies
- Land Development Banks
- State Land Development Banks

5) **Development Banks:** Development Banks mostly provide long term finance for setting up industries. They also provide short-term finance (for export and import activities)

- Industrial Finance Co-operation of India (IFCI)
- Industrial Development of India (IDBI)
- Industrial Investment Bank of India (IIBI)
- Small Industries Development Bank of India (SIDBI)
- National Bank for Agriculture and Rural Development (NABARD)
- Export-Import Bank of India

Commercial Bank:

A commercial bank is a financial institution that provides various financial service, such as accepting deposits and issuing loans. Commercial bank customers can take advantage of a range of investment products that commercial banks offer like savings accounts and certificates of deposit. The loans a commercial bank issues can vary from business loans and auto loans to mortgages.

Commercial banks comprising public sector banks, foreign banks, and private sector banks represent the most important financial intermediary in the Indian financial system. The largest commercial Banks in India is SBI.

All the commercial banks are affiliated with the state and federal laws, depending on the services they provide and how they are organized, these banks are also monitored by the Federal Reserve System. These banks provide a huge range of functions such as issuing cheques, demand deposits, fixed deposits, loans and buying and selling of foreign exchange. All the commercial Bank branches has unique **IFSC code** for processing inter and intra bank transaction.

The functions of a Commercial Banks:

Primary Functions:

1. **Savings account:** This bank account is used for the purpose of saving money though the account has to maintain a minimum balance in his account to avail the services if cheque facilities.
2. **Current account:** This kind of account is used for the purpose of making payments. A customer can withdraw and deposit money from this account which is subject to a minimum

required balance. If a customer wants to close his current account, then he has to pay the interest to the respective bank. The facility of cash credit is also allowed in current accounts.

3. **Loans and Advances:** All the commercial banks are required to keep a certain portion of the deposits as legal reserves and this amount is used to provide loans and advances to people. Individuals and firms can easily borrow this money from banks who charge an interest amount on the loan

Commercial bank provides different kinds of loans, such as:

- Loan to a firm or a person against some collateral security.
- Loan in installments (against some security)
- Overdraft facility.

Secondary Functions:

Agency Services:

The customers can ask the bank to accept the payments on their behalf, the relation between the customer and banker is same as of a principal and agent. The services provided by the banks are:

The bank collects drafts, cheques and bills on the behalf of the customer.

They can exchange the domestic currency with foreign currency as per the rules and regulations. Such as in the case of the death of a customer, the bank can execute the will.

They can act as executors/trustees to their customer.

General utility services:

The commercial banks also provide some other services to their customers, such as:

- Transferring money
- Merchant banking
- Credit cards
- Safeguarding valuables and money
- Automatic teller machines.

This is the reason why commercial bank holds a great importance in keeping the economy stable and active at the same time.

Co – Operative Banks:

Co-operative banks are small-sized units organized in the co- operative sector which operate both in urban and non-urban regions. These banks are traditionally centered on communities, localities and work place groups and they essentially lend to small borrowers and businesses. The term Urban Co-operative Banks (UCBs), though not formally defined, refers to primary cooperative banks located in urban and semi-urban areas.

These banks, until 1996, could only lend for non- agricultural purposes. As at end-March 2011, there were 1,645 UCBs operating in the country, of which majority were non-scheduled UCBs. Moreover, while majority of the UCBs were operating within a single State, there were 42 UCBs having operations in more than one State. However, today this limitation is no longer prevalent. While the co-operative banks in rural areas mainly finance agricultural based activities including farming, cattle, milk, hatchery, personal finance, etc. along with some small scale industries and self-employment driven activities, the co-operative banks in urban areas mainly finance various categories of people for self-employment, industries, small scale units and home finance.

These banks provide most services such as savings and current accounts, safe deposit lockers, loan or mortgages to private and business customers. For middle class users, for whom a bank is where they can save their money, facilities like Internet banking or phone banking is not very important. Although they are not better than private banks in terms of facilities provided, their interest rates are definitely competitive. However, unlike private banks, the documentation process is lengthy if not stringent and getting a loan approved quickly is rather difficult. The criteria for getting a loan from a UCB are less stringent than for a loan from a commercial bank.

The co-operative banking sector is divided into the following categories.

- State co-operative Banks
- Central co-operative banks
- Primary Agriculture Credit Societies

Functions of Co-operative Banks

Co-operative banks also perform the basic banking functions of banking but they differ from commercial banks in the following respects

1. Commercial banks are joint-stock companies under the companies' act of 1956, or public sector bank under a separate act of a parliament whereas co-operative banks were established under the co-operative society's acts of different states.
2. Commercial bank structure is branch banking structure whereas co-operative banks have a three tier setup, with state co-operative bank at apex level, central / district co-operative bank at district level, and primary co-operative societies at rural level.
3. Only some of the sections of banking regulation act of 1949 (fully applicable to commercial banks), are applicable to co-operative banks, resulting only in partial control by RBI of co-operative banks and
4. Co-operative banks function on the principle of cooperation and not entirely on commercial parameters.

A. Cooperative banks in India finance rural areas under:

- Farming
- Cattle
- Milk
- Hatchery
- Personal finance

B. Cooperative banks in India finance urban areas under:

- Self-employment
- Small scale units
- Home finance
- Consumer finance
- Personal Finance

Some facts about Cooperative banks in India

- Some cooperative banks in India are more forward than many of the state and private sector banks.

- According to NAFCUB the total deposits & lending of Cooperative Banks in India is much more than Old Private Sector Banks & also the New Private Sector Banks.
- This exponential growth of Co operative Banks in India is attributed mainly to their much better local reach, personal interaction with customers, and their ability to catch the nerve of the local clientele

Development Banks:

A development bank may be defined as a financial institution concerned with providing all types of financial assistance to business units in the form of loans, underwriting, investment and guarantee operations and promotional activities-economic development in general and industrial development in particular.

A development bank is basically a term lending institution. It is a multipurpose financial institution with a broad development outlook. The industrial finance corporation of India, the first development bank was established in 1948. Subsequently many other institutions were set-up. Ex. IDBI, IFCI, SIDBI etc.

The nine important functions of development banks in India are as follows:

1. To promote and develop small-scale industries (SSI) in India.
2. To finance the development of the housing sector in India.
3. To facilitate the development of large-scale industries (LSI) in India.
4. To help the development of agricultural sector and rural India.
5. To enhance the foreign trade of India.
6. To help to review (cure) sick industrial units.
7. To encourage the development of Indian entrepreneurs.
8. To promote economic activities in backward regions of the country.
9. To contribute in the growth of capital markets.

1. Small Scale Industries (SSI)

Development banks play an important role in the promotion and development of the small-scale sector. Government of India (GOI) started Small industries Development Bank of India (SIDBI) to provide medium and long-term loans to Small Scale Industries (SSI) units. SIDBI provides direct project finance, and equipment finance to SSI units. It also refinances banks and financial institutions that provide seed capital, equipment finance, etc., to SSI units.

2. Development of Housing Sector

Development banks provide finance for the development of the housing sector. GOI started the National Housing Bank (NHB) in 1988.

NHB promotes the housing sector in the following ways:

1. It promotes and develops housing and financial institutions.
2. It refinances banks and financial institutions that provide credit to the housing sector.

3. Large Scale Industries (LSI)

Development banks promote and develop large-scale industries (LSI). Development financial institutions like IDBI, IFCI, etc., provide medium and long-term finance to the corporate sector. They provide merchant banking services, such as preparing project reports, doing feasibility studies, advising on location of a project, and so on.

4. Agriculture and Rural Development

Development banks like National Bank for Agriculture & Rural Development (NABARD) helps in the development of agriculture. NABARD started in 1982 to provide refinance to banks, which provide credit to the agriculture sector and also for rural development activities. It coordinates the working of all financial institutions that provide credit to agriculture and rural development. It also provides training to agricultural banks and helps to conduct agricultural research.

5. Enhance Foreign Trade

Development banks help to promote foreign trade. Government of India started Export-Import Bank of India (EXIM Bank) in 1982 to provide medium and long-term loans to exporters and importers from India. It provides Overseas Buyers Credit to buy Indian capital goods. It also encourages abroad banks to provide finance to the buyers in their country to buy capital goods from India.

6. Review of Sick Units

Development banks help to revive (cure) sick-units. Government of India (GOI) started Industrial investment Bank of India (IIBI) to help sick units.

IIBI is the main credit and reconstruction institution for revival of sick units. It facilitates modernization, restructuring and diversification of sick-units by providing credit and other services.

7. Entrepreneurship Development

Many development banks facilitate entrepreneurship development. NABARD, State Industrial Development Banks and State Finance Corporations provide training to entrepreneurs in developing leadership and business management skills. They conduct seminars and workshops for the benefit of entrepreneurs.

8. Regional Development

Development banks facilitate rural and regional development. They provide finance for starting companies in backward areas. They also help the companies in project management in such less-developed areas.

9. Contribution to Capital Markets

Development banks contribute the growth of capital markets. They invest in equity shares and debentures of various companies listed in India. They also invest in mutual funds and facilitate the growth of capital markets in India.

Conclusion:

The Banking industry is playing vital role in Economic Development in India; Banks are quite important to the economy and are involved in such economic activities as issuing money, settling payments, credit intermediation, maturity transformation and money creation in the form of fractional reserve banking.

In general, what banks do is pretty easy to figure out. For the average person banks accept deposits, make loans, provide a safe place for money and valuables, and act as payment agents between merchants and banks. Banks can distribute these savings through loans among enterprises which are connected with economic development. In this way, they promote the development of agriculture, trade and industry.

It is difficult to see how, in the absence of banks, could small savings be stimulated or even made possible. It is also difficult to see who would distribute these savings among entrepreneurs. It is through the agency of the banks that the community's savings automatically flow into channels which are productive.

The banks exercise a degree of discrimination which not only ensures their own safety but which makes for optimum utilization of the financial resources of the community. We see that in India the period of economic development has coincided with a phenomenal increase in bank deposits— and bank offices.

Thus, the banks have come to play a dominant and useful role in promoting economic development by- mobilizing the financial resources of the community and by making they flow into the desired channels. The Indian banks are now playing a very active role in fostering economic development of the country.

References:

http://kalyan-city.blogspot.in/2012/04/what-are-functions-of-development-banks.html

http://businessbanking.o-z-g.com/2012/07/types-function-of-co-operative-banks.html
http://indianbankdetails.com/blog/commercial-bank-and-its-functions/

https://www.scribd.com/doc/21923483/role-of-banks-in-indian-economy