International Journal of Academic Research
ISSN: 2348-7666; Vol.7, Issue-2(2), February, 2020
Impact Factor: 6.023; Email: drtvramana@yahoo.co.in

An analysis on Significance of Banking System

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Abstract: The process of credit supply enables the Government to implement various schemes of development. The banks also help the planning commission to achieve targets through their co-ordination in working with the Commission. By providing credit to the needy in the country-side, they help the balancing of the economic development, and thereby, decentralize it, their working also indirectly helps the Government to solve many problems like shortage of savings, rising prices, unemployment, unbalanced development, lack of entrepreneurship etc. They also help Government in reducing the social cost of supplying currency to the public.

1. Introduction

Institutional finance is the lifeblood of modern economic system without which no system can survive. The banking system is an integral part of any economy. It is one of the many institutions that impinges on the economy and affect its performance. Economists have expressed a variety of opinions on the effectiveness of the banking systems in promoting or facilitating economic development. As an economic institution, the bank is expected to be more directly and more positively related to the performance of the economy than most non-economic institutions[8]. Banks are considered to be the mart of the world, the nerve centre of economies, finance of a nation and the barometer of its economic perspective[9]. They are not merely dealers in money but are in fact dealers in development. Banks are important agencies for the generation of savings of the community. They are also the main agents of credit. They divert and employ the funds to make possible fuller utilisation of the resources of a nation. They transfer funds from different regions where it is available in plenty to where it can be efficiently utilised: the distribution of funds between regions pave the way for the balanced development of the different regions. They are thus catalytic agents that create opportunities for the development of the resources to speed up the tempo of economic development.

2. Significance of Banking System

2.1. Banking and Economic Development

Banking is a multifaceted concept. It indicates the integration of financial transitions of credit and borrowings of the industries which include small-scale, business, micro-credit agriculture, household and other sectors of the economy[10].

Cameron Rondo(1972), Banking and Economic Development- Some Lessons of History, Oxford University Press , New York, p.7.
[9] Sharma B.P.(1974) The Role of Banks in India ' s Developing Economy, S. Chand & Co ., New Delhi , pp.85-86
[10]Vasudevan, A.(2003) "Central Banking for Emerging Market Economics", Academic Foundation, New Delhi and "Money & Banking" , pp. 77-98.

Banking system occupies an important place in a nation's economy as it is one of the critical factors of infrastructures. A banking institution is indispensable in a modern society, as it plays a pivotal role in the economic development and forms the core of the money market in any country. Further, the expansion of banking system depends upon the relationship of banker and customers of the various sectors.

In India, the money market is still characterized by the existence of both the organized and unorganized segments. Institutions in organized money market have grown significantly and are playing an increasingly important role. The unorganized sector, comprising the moneylenders and the indigenous bankers caters to the credit needs of a large number of persons especially in the countryside.[11] For financing agriculture and allied activities in the rural areas, along with co-operative credit societies and central co-operative banks, commercial banks had begun their active participation after the nationalization of major banks in 1969.[12] Long and medium-term credit to the farmers is provided by another specialized institution, namely, the land development banks, which have a two-tier structure such as primary land development banks at the state and national level. The National bank for Agriculture and Rural Development (NABARD) is the full-fledged apex institution in the field of agriculture and rural development.[13]

In the field of industrial finance, the government has put drastic efforts and established many financial institutions like Industrial Development Bank of India (IDBI), State Financial Corporation (SFC), Small-Scale Industrial Development Corporation (SIDC), Industrial Credit Investment Corporation of India (ICICI), Industrial Re-construction Bank of India (IRBI) etc., They are established with a view to meet the financial requirements of the industries. Some other financial institutions like the Life Insurance Corporation of India (LIC), General Insurance Corporation of India (GIC), Unit Trust of India (UTI) etc., are carrying on their business by investing in the corporate, Government and Semi-Government sectors.[14] All these banks are concentrating mainly on medium and long term loans although; in the process they have neglected the small business to a large extent.

The commercial banks are the oldest institutions among the banking institutions in the organized sector, having a wide network of branches, commanding utmost public confidence and having a lion's share in the total banking operations by attracting the customers through various deposits, savings and other schemes.

The contribution of banking sector towards the process of economic development can be described as under.

2.3. Development of Financial Infrastructure

[11]Dreze, J. and Amartya Sen.(1997) "Indian Economic Development and Social Opportunity", Oxford University Press, New Delhi, pp. 67-72.
[12] RBI Report on Trend and Progress of Banking in India, 1970, p. 61.
[13]Rangarajan, C. (1982) "Innovations in Banking – The Indian experiences: impact on Deposits and Credit" Oxford and IBH Publishing Co., New Delhi, pp. 89-90.
[14]Simha, S.L.M. (Ed)(1973). "Reforms of the Banking System", Institute for Financial Management Research, pp.165-169.

Commercial Banks, a major part of the financial infrastructure, provide both 'saving intermediation' and 'money-market intermediation'. This process brings about consistency among the assets preferences of the households, the ultimate savings units, the liability preferences of business firms and the fundamental investing units. This is being facilitated by the ability of these banks and the size of the money market to emit liabilities with risk attributes that households' prefer to absorb, while absorbing assets instruments with risk attributes that business firms prefer to produce. The development of commercial banking also helps the money market to grow, for its progress would be the progress and expansion of the money market[15]. Thus, these banks are important as they provide the basic financial infrastructure, which facilitates uninterrupted functioning of the economic system.

2.4. Capital Formation

Capital formation has been one of the important requirements for economic development. It requires the real savings of the community to be invested in the production of capital goods. It is here that commercial banks can play a pivotal role as intermediaries by bridging the gap between savings and investments. Banks, as "repositories of peoples' savings" mobilize small and scattered savings of the community, and as 'surveyors of credit', channelize the savings so mobilized into the production of capital goods and, thereby, facilitate capital-formation.[16] In other words, funds lying idle with savers and small funds scattered far and wide with marginal savers are mobilized and potential savers are encouraged to save with commercial banks. Besides, they transfer funds from the savers to the investors for more profitable use by providing mobility to capital funds through its savings and money market intermediations. Thus, commercial banks provide:[17]

(i) lucrative opportunities of investment to the savers

(ii) funds for investment to the entrepreneurs, and

(iii) Capital-formation to the country.

2.5. Entrepreneurial Development

The mere act of saving and its mobilization cannot result in the formation of capital unless it is invested in the production of capital goods. This requires an adequate number of entrepreneurs. The entrepreneurial ability may be defined as the propensity of man to take calculated risks with confidence so as to make his enterprise a success. And the Commercial banks have got an important role to play in this field of

[15]Brahmanad, P.R.(October 30, 1994) "Freeing banks to lend more", The Hindu Business Line, pp.22-25.

[16] Levine, Ross (1997), "Financial Development and Economic Growth: Views and Agenda", Journal of Economic Literature, 35(2).

[17]Janakiraman, R(1995). "Indian Banking By 2000 A.D", edited by Vinayakam, N, KanishkaPublishers, Delhi, p. 23.

entrepreneurial development. Commercial banks encourage entrepreneurial ability in two ways:[18]

2.6. Credit and Purchase of Goods and Services

A commercial banking system provides more credit than its primary resources through the process of credit-creations, of course, within the limits set in by the volume of primary deposits, the necessary liquidity requirements and the size of the money market. Commercial banks, through their process of creation of credit, bridge the gap between actual savings and desired savings warranted for a rapid rate of economic development. The absence of desired savings otherwise would have limited the productive activities in the economy to the extent that the savings are actually available for investment.[19] Apart from this, the gap is also bridged by mobilising actual savings of the community which would otherwise be reduced due to major imperfections in the financial markets and the consequent immobility of funds including small and scattered savings – lying either idle or spent on luxury goods, jewellery, and other unproductive purposes.

2.7. Stabilizes the Prices

The erratic behavior of prices is not helpful in the steady and rapid rate of economic growth. It demands stability of prices of goods and services. Commercial banking system, through its decisions either to provide or not to provide credit, has also got an important role to play in stabilizing prices. The direction of the flow of credit has an important bearing on price stability. Credit, which stimulates production, has one type of impact and credit[20]. Even the credit, which goes to production purposes, can have different repercussions depending on the time lag between the increase in demand and the increase in supply, which the credit generates. If too much credit goes to longer gestation uses, it can have an adverse effect on the price level.

2.8. Towards Government

Commercial Banks facilitate the activation of the Government motive force for economic development. They provide help in generating finance to the Government through various methods like direct credit to the Government, various Government agencies and through subscribing public debt and investing money in various Government securities. This process of credit supply enables the Government to implement various schemes of development. The banks also help the planning commission to achieve targets through their co-ordination in working with the Commission. By providing credit to the needy in the country-side, they help the balancing of the economic development, and thereby, decentralize it, their working also indirectly helps the Government to solve many problems like shortage of savings, rising

[18]Srinvasan. R. and Sriram, M.S (June 2005). "Micro-Finance and Introduction", IIMB Management Review, Unpublished Ph.D. Thesis, pp. 201-205.
[19]Khandelwal, B.N. (1965) "Exchange Banking in India", Jhalani Publications Delhi, pp. 63-64.
[20] Cameron, R (1972). "Banking and Economic Development", Some lessons of History, Oxford University Press, New York, pp 165-169.

prices, unemployment, unbalanced development, lack of entrepreneurship etc. They also help Government in reducing the social cost of supplying currency to the public[21].

Thus, the banking industry has been playing various roles in the transformation of the development process of the economy through branch expansion, deposit mobilization, priority sector lending etc., This has resulted in the conversion of class banking into mass banking.

2.9. Trade Development: The commercial banks provide capital, technical assistance and other facilities to businessmen according to their need, which leads to development in trade. In this modern era trade and commerce plays a vital role among several countries. So, the money transaction should be user friendly. Modern Banks helps the customers to transfer or receive funds anywhere over the world. A well developed banking system provides various attractive services like mobile banking, internet banking, debit cards, credit cards etc. And they help in quick and smooth banking transactions. So, bank helps to develop trade and commerce.

2.10. Agriculture Development: Agricultural sector is one of the integral parts of any economy. Food self sufficiency is the major challenge and goal of any country. Modern bank promote agricultural sector by providing loans and advances with low rate of interest compared to other loans and advances schemes. Commercial banks finance the most important sector of the developing economics i.e. agriculture, short, medium and long-term loans are provided for the purchase of seeds and fertilizer, installation of tube wells, construction of warehouses, purchase of tractor and thresher etc.

2.11. Industrial Development: The countries, which concentrated on industrial sector made rapid economic development. South Korea, Malaysia, Taiwan, Hong Kong and Indonesia have recently developed their industrial sector with the help of commercial banks.

2.12. Promote Saving Habits of the People: Bank attracts depositors by introducing attractive deposit schemes and providing rewards or return in the form of interest. Banks providing different kinds of deposit schemes to its customers. It enables to create banking habits or saving habits among people.

3. Conclusion

During the last six decades, the performance effectiveness of the nationalized banking, industrial business in India is significant. Customers those have various occupations are most productive resources of the Banks. Banks invest their major share of profits in the development of their customers. These includes service activities both financial and non-financial activities. They help the customers to boost up their deposit mobilisation and promote their role in the Banking sector.

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