ROLE OF INDIAN BANKING SECTOR IN THE ECONOMIC GROWTH AND DEVELOPMENT

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ABSTRACT

In a developing country the function ofthe regulation of the flow of credit by central bank is of the utmost importance. This isespecially true when economic development is planned. The plan lies down priorities and on the basis of these priorities. The development of various sectors has to take place. Regulation of credit then becomes an important instrument. Whereby the central bank prevents credit from flowing into those sectors which are not given priority in the plan and at the same time. Credit is channelized into the sectors which claim top priority. The effectiveness of the central bank's credit control measures.Howeverdepends upon the extent to which commercial banks have spread their network in the various sectors of the economy. As well developed commercial banking system; therefore facilitates the regulation of credit by the central bank and thus aids economic development.

Through their activity of credit creation. Commercialbanks facilitate the expansion and contraction of the total supply of money. Similarlyby transferring funds from one place to another. They can adjust the supply of credit to the demand for it in different regions. As well as in the different sectors of the economy. Thus they serve to make money supply more elastic. The elasticity of the supply of money is very important for the smooth functioning of the economy. As well as for economic development. Just as capital is one important factor that mustgrow if the economy is to develop, enterprise is another important factor that must growand help the economy to develop. This requires the expansion of the entrepreneurial class which is willing to accept risks and challenges. Many times, it so happens that there is people who have the qualities of a promising entrepreneur, but they do not have the money or capital to. Put their plans into practice. Hence, banks have an important function to perform. They can scrutinize and select the plans of enthusiastic entrepreneurs and make finance

available to them. Thus, by promoting enterprise, banks can help rapid economic development. Development of trade and commercepromotes industrialization by causing theexpansion of the market and widening of thehinterlands that supply raw materials to industries. Commercial banks provide short-term credit to trade and commerce. They provide remittance facilities. They help the expansion of the bill-market. All these banking services help the expansion of trade and commerce. This in turn aids economic growth and development.

KEYWORDS
Banking System, Banking Sector, Economic Growth & Development, Banking Technology.

INTRODUCTION

The banking industry in India has a huge canvas of history, which covers the traditional banking practices from the time of Britiesher of the reform period, nationalization to privatization of banks and now increasing numbers of foreign banks in India. Therefore, Banking in India has been through a long journey. The banking industry in India has also achieved a new height with the changing times. Nevertheless, the fundamental aspects of banking i.e. trust and the confidence of the people on the institution remain the same. The majority of the banks are still successful in keeping with the confidence of the shareholders as well as other stakeholders. However, with the changing dynamics of banking business brings new kind of risk exposure.

Indian Banking Industries played vital role in the economic development of India. Banking is an integral part of the modern economy. But the nature and functions of modern banks have evolved over a long period of time. The idea of banking evolved with the idea of money. Banking business is mainly linked to lending. Money lender is to be found in every society-ancient or modern; advanced or backward.

The banking system of a country occupies a pivotal role in functioning and development of a country's economy. In fact, it lies at the core of the money market and also plays a complementary role in supporting the capital market. We must therefore, take a comprehensive view of the structure of the banking system in India.

It is necessary to remember that the structure of the banking and financial system of any country is neither created at one stroke, nor is it permanent for all times to come. The fact of the matter is that various institutions get evolved over a period of time, either through the trial and error method adopted by the people or at the instance of the Government. A look at the structure of the Indian Banking system would show how various institutions have evolved as and when such a need arose and both at the instance of the Government, as well as on the initiative of the people engaged in financial activities.

CONCEPTUAL BACKGROUND

Thus, it is clear that the origin of modern banking is to be found in the business of merchants, money-lenders and goldsmiths. They gradually adopted various functions of a bank. With an increase in the volume of business, the business passed on from individuals- to public limited companies. Because such institutions were necessary in the years following the industrial and commercial revolutions, they experienced rapid growth during the second half of the nineteenth century. With the turn of the century, the growth of banking had already become a necessary concomitant of economic development and in many ways a precondition of economic development!

Some important stages in the evolution of modern banking in India are as follows:

When the English traders came to India, they had problem of raising working capital due to the language barrier. Theref,dre, they established Agency Houses which combined trading with banking. One agency house established the first bank in India called the Bank of Hincusten in 1770. Later on, many banks were established. But they disappeared as fast as they were born. Anybody could then start a bank. The field was free for all. The East India Co., the ruler of India, took initiative in establishing Presidency Banks by contributing 20% of their share capital to meet its own demand. for funds. Accordingly, Bank of Bengal, Bank of Bombay and Bank of Madras were established in 1806, 1840 and 1943 respectively. In 1884, banks were allowed to be established on the principle of limited liability. In due course, this encouraged establishment of banks. By the turn of the century, many banks with the initiative of Indians were established. Punjab National Bank, Allahabad Bank, Bank of Baroda are some of the banks then established. Many foreigners also came in the field of Indian banking. To meet the competition of foreign banks, the three Presidency Banks were amalgamated and a powerful Imperial Bank of India was established in 1921 with its network of branches all over the country. This bank was later nationalised in 1955 and it is today's State Bank of India. This is a prestigious bank as the Government is its customer.

Though there was boom in banking, due to absence of any regulation and facility of timely assistance there were recurrent bank failures. This resulted in suspicion about banks in the minds of the people. They stayed away from banks. The need for a separate Central Bank was emphasised by the Hilton Young Commission. Accordingly, the RBI was established in 1935 to perform all the functions of a Central Bank. It was modeled on the pattern of the Bank of England. But it did not have much power of regulation. The period was also critical one due to the great depression and the subsequent Second World War. The RBI could not do much about banking. These two important steps were taken in 1949. Immediately after independence wide powers of regulation and control were given to the RBI and by making use of those powers the RBI was successful in making Indian banking trustworthy. Soon, bank failures became a thing of the past and India's banks progressed under the guidance of the RBI. Many malpractices, deficiencies and drawbacks were sought to be removed by the RBI. Another significant step was taken in 1969 by nationalising 14 big Indian banks. Then six more banks were nationalised in 1980. The nationalisation of banks brought about a sea-change in the policies, attitudes, procedures, functions and coverage of banks. Indian banks are now being prepared to become international players. These are the stages through which Indian banking developed.

OBJECTIVES OF THE RESEARCH STUDY

The present research study was carried out with following objectives in view:

1. To study the Role of Banking System in the Economic Growth and Development.
2. To study the Importance of Banking System in an Economy.
3. To suggest some measurablesuggestions Banking System in the Economic Growth and Development in India.

RESEARCH METHODOLOGY

The present research study uses the most recent available published secondary data. To achieve the above stated objectives, the secondary data was used. The secondary data that are mainly used are published in annual reports of various banks and survey reports of leading business magazines. The secondary data was also used from various reference books related to Banking System, Banking Sector, Economic Growth & Development, Banking Technology, New Age Banking Technology, Information Technology, Marketing, Banking, Finance, Commerce, Management etc. For the said research study the secondary data is also collected from the various National and International Research Journals which are related to Commerce, Management, Marketing and Finance.

For the said research study the data pertaining to the above objectives was collected and reviewed the literature on the topic concerned. The literature was thus collected by visiting various libraries. The Secondary data is also collected from various websites.

HYPOTHESIS OF THE RESEARCH STUDY

The said research study is carried out with the following hypothesis in view:

H-1 In early days, Indian Banking Industries played vital role in the economic development of India and also banking is an integral part of the modern economy.

H-2 Recent years, in a developing country the function ofthe regulation of the flow of credit by central bank is of the utmost importance, this isespecially true when economic development is planned.

IMPORTANCE OF BANKING SYSTEM IN ECONOMY

In performing the various functions, commercial banks render a variety of services to the economy in general and to the business community in particular. These services are as under :

(1) Functioning as an Intermediary: Banks act as intermediaries between the savers and investors. We have already seen that banks prompt the people to save money by offering them a guaranteed return in the form of interest. Thus, they bring the savings of people together and they also make loans available to those who are in need of credit. Thus, banks act as agents to bring the saving public and the investing public together, and thus act as intermediaries.

This is a very important function and can be performed by banks because on the one hand, they stand guarantee to the depositors about the return of their savings end similarly, undertake the responsibility of recovering the loaned amount; and on the other hand,· make the money available to the borrowers.

(2) Helping Economic Development : Banks help the economic development of a country. These banks can very well see the profitability or otherwise, of any investment in development projects. Depending on the changes of the profitability of the project, banks provide or deny credit to them. Thus, indirectly, they help the economic development of a country.

(3) Mobilization of Capital : The commercial banks are in a position to transfer capital from one part of the country to another part of the country or to other countries. Thus, they impart mobility to capital.

When capital is transferred from one part of the country to another, geographical mobility is provided. But sometimes, banks also help to provide occupational mobility. If anyone wants to withdraw capital from one business and wants to transfer it to another business, banks can help him to do it because they also deal in shares.

(4) Encouragement to Trade and Industry : By providing loans to traders and Industrialists, commercial banks encourage their activities. Industrialists need working capital. Traders need short-term accommodation for purchase of stocks. All such needs are met by bank credit.

(5) Promotion of the Habit of Thrift : Banks promote the habit of thrift among the people, by making available to them, facilities for the safe-keeping and safe investment of their hard-earned savings. The depositors get interest and their money, which would have remained idle, is used for productive purposes.

(6) Channelization of Savings and Investment : Banks perform the function of channelizing the savings into various fields of investment. The individual savers are not aware of the opportunities of investment. Similarly, they are not in a position to decide as to which fields of investment are safe and which are not. The commercial banks are better judges of this. Similarly, by advancing credit or denying credit they indirectly channelize the investment of funds into proper and productive fields of investment.

(7) Imparting Liquidity to Non-liquid Assets : Commercial banks advances loans to borrowers against different types of securities. For example, they advance loans against the security of gold ornaments or gold bullion. These are non-liquid assets which are transformed into liquid resources by the commercial banks. The same is the case with other non-liquid assets.

(8) Creating and Dealing in Bank Money : Most of the commercial banks claim that they do not create money but only deal in money. But this is not true because in the process of dealing in money, they create money; and bank money is in circulation on a very large scale in modem economies. An example will make the process of the creation of bank money very clear. When a person is given a loan by a bank, normally, the person is allowed to operate a bank account to the extent of the amount of credit given to him. The person makes his own payments by issuing cheques. The cheques drawn on the bank are accepted in settlement of payments and they continue to perform the functions of money. Thus, banks in the process of advancing loans, also create money.

(9) Equitable Distribution of Funds Savings are not equitably distributed throughout the country. Those regions which are advanced have larger funds; while the backward regions are short of funds. Banks collect funds where they are available and provide them to the regions where they are needed. Thus, they serve to distribute funds equitably.

(10) Influence on Rates of Interest : Banks influence the market rates of interest as they provide loans for various terms. A higher rate for a particular type of lending induces the banks to enter that field and the market rate then comes down: Thus, a uniform interest rate structure is brought into existence as a result of the activities of bank.

ROLE OF BANKING SYSTEM IN THE ECONOMIC GROWTH ANDDEVELOPMENT

The role of banking system in the economic growth & development can be explained as follows:

(1) Capital Formation: Economic development requires an increase in the rate of capital formation. For this purpose, it is necessary that the rate of savings increases. Commercial banks can and do serve a very useful purpose in raising the level of aggregate savings. In the first place, commercial banks can provide objective conditions in which people feel that their savings will be secure in the hands of the banks. This sense of security induces people to save and thus, total savings increase. Secondly, for want of proper opportunities, people in low income groups are not able to save. But by operating savings accounts, commercial banks provide an opportunity to small savers to save and invest in productive fields. This is another factor that leads to an increase in total savings. Finally, the commercial banks device a number of schemes offering attractive benefits to the customers. Thus, they are able to mobilize larger amounts of savings.

(2) Monetization of Debts : Commercial banks serve to increase investable funds by offering to monetize debts if and when required by creditors. Thus, people who have savings may hold back a part of them as a precaution against unforeseen circumstances. But banks offer their services whereby people can hand over their bonds, securities, shares, etc., to the banks against which they (the people) can borrow and meet their needs of cash. This is known as monetization of debts it serves to increase the level of investment; since. with a banking system ready to monetize debts. it is no longer necessary for the people to hold back any cash for unforeseen needs. They can invest all their investable funds.

(3) Regional Balance : If the banking system in a developing economy has a network of branches. it can help economic development in another way. The banks can transfer surplus funds from regions where they are abundant to those regions which are starved of capital. For example.the branches of a bank in well developed urban centers can collect large amounts of savings. because the savings potential of these centres is very high. The same savings.through branches in underdeveloped areas. can be made available to investors in such areas. This distribution of funds opens up new fields of investment. Thus.the banking system not only paves the way of economic development between the advanced and the backward regions in a country. but also helps to correct the imbalance in development between the advanced and backward regions of the country.

(4) Consultancy Services: Besides, commercial banks may also provide financial guidance to entrepreneurs, advise them on the feasibility of their projects and furnish necessary information regarding various sources of finance, technical help, marketing services, etc. These services which are incidental to the usual banking function, go a long way in encouraging the development of agriculture, small-scale industries and other types of minor business.

(5) Modernization of Business : Commercial banks represent the modern organised sector and they are themselves following modern methods of management, accounting, project-evaluation and so on. When business units from the unorganised sector approach commercial banks for accommodation, they are exposed to these modern business practices. Thus, for example an agriculturist, a minor industrialist or any other small businessman has to submit his project to the bank to forecast the demand for his product and has to prepare his budget. By doing all these things he gets an intimation to the modern business practices which he may adopt in the management of his business. This, obviously, has a salutory effect in a developing economy.

(6) Regulation of Economic Activity : In a developing country. the function of the regulation of the flow of credit by central bank is of the utmost importance. This is especially true when economic development is planned. The plan lays down priorities. and on the basis of these priorities. the development of various sectors has to take place. Regulation of credit then becomes an important instrument. whereby the central bank prevents credit from flowing into those sectors which are not given priority in the plan. and at the same time. credit is channelized into the sectors which claim top priority. The effectiveness of the central bank's credit control measures. however. depends upon the extent to which commercial banks have spread their network in the various sectors of the economy. As well developed commercial banking system; therefore.facilitates the regulation of credit by the central bank and thus aids economic development.

(7) Influence on Interest Rates: As important institutions in the money market. commercial banks can influence the supply of money. By supplying more or less credit. they can exert a significant influence on the I?arket rates of interest. They also thereby influence the choice of the people between holding more or less of liquid assets. This further influences the rates of interest. A cheap money policy with low interest rates stimulates economic development.

(8) Elastic Money Supply : Through their activity of credit creation. commercial banks facilitate the expansion and contraction of the total supply of money. Similarly. by transferring funds from one place to another. they can adjust the supply of credit to the demand for it in different regions. as well as in the different sectors of the economy. Thus.they serve to make money supply more elastic. The elasticity of the supply of money is very important for the smooth functioning of the economy. as well as for economic development.

(9) Promotion of Enterprise: Just as capital is one important factor that must grow if the economy is to develop, enterprise is another important factor that must grow and help the economy to develop. This requires the expansion of the entrepreneurial class which is willing to accept risks and challenges. Many times, it so happens that there are people who have the qualities of a promising entrepreneur, but they do not have the money or capital to. put their plans into practice. Hence, banks have an important function to perform. They can scrutinize and select the plans of enthusiastic entrepreneurs and make finance available to them. Thus, by promoting enterprise, banks can help rapid economic development.

(10) Development of Trade and Commerce: Development of trade and commerce promotes industrialization by causing the expansion of the market and widening of the hinterlands that supply raw materials to industries. Commercial banks provide short-term credit to trade and commerce. They provide remittance facilities. They help the expansion of the bill-market. All these banking services help the expansion of trade and commerce. Which in turn aids economic development?

SUGGESTIONS

Measurablesuggestions banking system in the economic growth and development are given bellow :

1. Due to modern technology, unemployment may be increased. So the Voluntary Retirement Scheme or Compulsory Retirement Scheme may be started by banks.
2. The routine work may hamper due to breakdown of machinery. But due to modern machines, and modern technologies the strength of the bank can be increased.
3. In the era of globalization, privatization and liberalization this technology is much helpful, so, it is necessary to acquire new and modern techniques by the banks. The necessary modifications about furniture, fixtures, lighting and keeping machineries may be made as per requirements and as per the space available.
4. The customers are interested in maintaining contact with the bank for long periods. Therefore, according to the changing needs the customers may be identified and appropriate schemes for meeting their needs may be developed.
5. For smooth running of computer system the generator sets maybe provided to all branches of Banks. Due to generator sets the computer data will not be corrupted.
6. To appoint young, energetic and trained employees to face the challenges of new age.
7. There may be parking facility, drinking water, toilet facility, newspapers for customers.
8. Customers may be provided with writing facility for filling in the necessary forms of the bank.
9. Follow-up of recovery of loans may be done properly, as this will become the customers alert about repayment
10. Loan applications may be carefully scrutinized so that loans would be properly sanctioned for genuine purpose only.

11. For increasing the amount of deposit, the bank may try to disburse the loan to the borrowers under the head loan against deposit.

CONCLUSION

Through their activity of credit creation. Commercialbanks facilitate the expansion and contraction of the total supply of money. Similarlyby transferring funds from one place to another. They can adjust the supply of credit to the demand for it in different regions. As well as in the different sectors of the economy. Thus they serve to make money supply more elastic. The elasticity of the supply of money is very important for the smooth functioning of the economy. As well as for economic development. Just as capital is one important factor that mustgrow if the economy is to develop, enterprise is another important factor that must growand help the economy to develop. This requires the expansion of the entrepreneurial class which is willing to accept risks and challenges. Many times, it so happens that there is people who have the qualities of a promising entrepreneur, but they do not have the money or capital to. Put their plans into practice. Hence, banks have an important function to perform. They can scrutinize and select the plans of enthusiastic entrepreneurs and make finance available to them. Thus, by promoting enterprise, banks can help rapid economic development. Development of trade and commercepromotes industrialization by causing theexpansion of the market and widening of thehinterlands that supply raw materials to industries. Commercial banks provide short-term credit to trade and commerce. They provide remittance facilities. They help the expansion of the bill-market. All these banking services help the expansion of trade and commerce. This in turn aids economic growth and development.

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