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Commercial Banks: Some Reflections

Economics

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ABSTRACT

COMMERCIAL banks are distinguished from other financial institutions primarily by their acceptance of demand deposits. Deposits provide them with funds but their responsibility for the liquidity and safety of the deposits limits the use of these funds. The privilege of receiving deposits is accompanied by an elaborate framework of legal and supervisory controls designed to protect depositors and govern the monetary effects of demand deposits. In addition, most states have adopted laws that set ceiling rates on various types of consumer credit extended by commercial banks. Consumer credit is a relatively new and, in most cases, still a minor outlet for the funds of banks. Commercial banks held $18.8 billion of consumer credit at the end of 1959, but this amounted to only 10 per cent of their total loans and investments. The importance of consumer credit at individual banks varies widely.

Historical View of Commercial Banks

Banking means accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdraw able by cheques, draft, order or otherwise. A commercial bank is a financial intermediary which collects credit from lenders in the form of deposits and lends in the form of loans. A commercial bank holds deposits for individuals and business in the form of checking and savings accounts and certificates of deposit of varying maturities while a commercial bank issues loans in the form of personal and business loans as well as mortgages. The term commercial bank came about as a way to distinguish it from an "Investment bank". The primary difference between a commercial bank and its counterpart is that a commercial bank earns revenue by issuing primary loans from its pool of deposits while an investment bank brings debt and equity offerings to market for a fee. Among its assets, including loans, a commercial bank holds a portfolio of other securities to generate proprietary income.

Bank provides loans to businesses, consumers and non-business institutions. Early commercial banks were limited to accepting deposits of money or valuables for safekeeping and verifying coinage or exchanging one jurisdiction's coins for another's. By the 17th century most of the essentials of modern banking, including foreign exchange, the payment of interest, and the granting of loans, were in place. It became common for individuals and firms to exchange funds through bankers with a written draft, the precursor to the modern check. Because a commercial bank is required to hold only a fraction of its deposits as cash reserves, it can use some of the money deposited by its customers to extend loans. Commercial banks also offer a range of other services, including savings accounts, safe-deposit boxes, and trust services.

Objectives of Commercial Banks

The main objective of commercial banks are to maintain higher profitability by maintaining circular and efficient flow of amount of money deposited by the customers and the lenders. Commercial banks contribute to the economic cycle by keeping the money circulation among households, government and corporate businesses. The commercial banks lend money to the economic agents through their various products and services by earning interest income on the borrowed money. For that, they design their short term and long term loans and other products to cater to the need of customers while enhancing their own returns in order to attract more customers and build profitable relationships with the new and existing customers.

Importance of Commercial banks

The banks play a very important role for the economic development of the country. The importance can be examined as under. "Increase in saving: The people deposit their savings into the banks and the bank pays reasonable profit on these savings. Increase in investment: The money which is collected by the bank is lent to businessman and industrialist. The increase in the investment increase the level of employment.

Increase in employment:

The banks advance loan to the investors. As a result, the industrial units are setup in different parts of the country. Hence the level of employment is increased. Transfer of money: When the people want to transfer their money from one place to another place, they get traveler cheque and the bank draft from the bank. Loan to Government: When the government needs funds to complete the public works programs, the banks provide loans to it. Capital formation: The process of the capital formation is completed with the financial of commercial banks. So banks increase capital formation. Balanced developed: When the banks provide loans to the less developed areas, the chances of progress and development are increased in the areas. Saving in metals: When the payments are made through currency notes and credit instruments, the precious metals are saved.

Agricultural credit by Commercial Banks

The role of the commercial banks in rural/agricultural credit was negligible before nationalization of banks in 1969. In 1951-52 their finance to agriculture was only 0.9 per cent, and it was 2.2 per cent in March 1968. The All India Rural Credit Survey Committee (AIRCSC) 1954 had concluded that there was no alternative to the co-operative form of organization[12]. In 1965, the informal Group on Institutional Arrangement for Agricultural Credit emphatically stressed that one could not look to the commercial banks for providing a satisfactory system of supplementary and transitional basis for any large scheme for the farming community in India conditions. The following were some of the reasons enlisted for the failure of commercial banks in meeting the rural credit needs.

Commercial banks in India which had their origin under the British were urban-oriented with the limited objectives of catering to the needs of trade, commerce and industry. Therefore, agriculture rarely figured in their transactions.

Agricultural financing in its nature was risky because of wide variations and uncertainties in income and the absence of suitable security except land, which was subjected to various legal and other procedural complications. The commercial banks did not wish to get entitled with them.

Ill-trained and in-experienced staff in dealing with agricultural financing, the banking staff was not prepared to take risk.

Their recovery performance was very poor.

There was huge demand for bank credit from the non-agricultural sector.

Absence of an enterprising attitude in the banks to finance agriculture and their unsuitable loan policy and procedures made cultivators reluctant to borrow from the banks.

After two decades of independence, the commercial banks have entered into this field to extend liberal credit to the farming sector. They have been financing agriculture since the nationalization of big banks in 1969. Before 1969, these banks were serving primarily the needs of cities and big towns. Using of commercial banks credit to help small farmers holds rich potential[13]. Agriculture appeared to the commercial banks as an unattractive sector owing to certain characteristics of agricultural sector, namely limited amount of money involved in arranging agriculture inputs inadequate securities for loans, low returns and poor repayment capacity.

The nationalization of banks was a major step for canalizing credit to various sectors of economy of which agriculture is one of the major sectors. The concern of banking industry is not only rested with flow of credit to agriculture, but also with the socio-economic development of the rural area with a view to generate adequate productive employment and reduce poverty. In spite of significant achievements by the banking industry, there is still scope to extend credit facilities to agriculture sector in a much greater manner.

After the introduction of financial sector reform in the nineties, the Reserve Bank of India (RBI) directed these banks to lend 30 per cent of net bank credit to agriculture (including indirect finance not exceeding 4.5 per cent of total credit). With this shift in priorities, these banks failed to get a viable proposition in financing agriculture and as such they were able to reach an estimated outstanding agriculture credit to the tune of Rs.80000 crores constituting 14 per cent to net bank credit. Since corporate view rural markets with a huge potential for growth, the government officials and policy makers should consider lending for agricultural is a boost in order to create a huge market for agribased industries too. Accordingly, the government has announced that agriculture credit provided by banks should be increased by 30 per cent and reach an outstanding level of Rs.1,05,000 crores by March 2005. Each of the rural and semi-urban branches of the commercial banks is expected at least 100 new farmers in to its fold during the current financial year. As against the ambitious announcements of the government of doubling agriculture credit in coming years to me it is essential to take an overview of trends of flow of institutional credit to agriculture during the last 10 years. Institutional credit has grown at the rate of 13 to 14 per cent in the recent past. Learning from the past experiences, agriculture financing needs a marketing outlets by the banks as agriculture is under transformation. International trade in agriculture products is poised for faster growth and this sector offers big opportunity for banking business.

Among the essential pre-requisites for achieving significant progress in the agricultural sector, credit occupies an important place. Several studies have emphasized the role of finance in agricultural development. Hence, a large network of institutions has been established and canalized in the direction of agricultural financing, particularly in the developing countries. These institutions have shown a tremendous progress with regard to branch expansion, deposit mobilization and credit disbursement to agriculture. However, there are good number of problems encountered in agricultural financing. Various studies have been conducted by the research organizations, academicians and economists to assess the problems of agricultural finance in India.

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