

## Bank: Definition, Evolution and Development.

### Functions and Roles of Central Bank and Commercial Bank and their relationship.

#### Definition of Bank:

Different Authors and Economists have given some structural and functional definitions on Bank from different angles:

“ Bank is a financial intermediary institution which deals in loans and advances”--- **Cairn Cross**.

“ Bank is an institution which collects idle money temporarily from the public and lends to other people as per need.”----**R.P. Kent**.

“ Bank provides service to its clients and in turn receives perquisites in different forms.”--- **P.A. Samuelson**.

“ Bank is such an institution which creates money by money only.”-----**W. Hock**.

“ Bank is such a financial institution which collects money in current, savings or fixed deposit account; collects cheques as deposits and pays money from the depositors' account through cheques.”-----**Sir John Pagette**.

Indian Company Law 1936 defines Bank as “ a banking company which receives deposits through current account or any other forms and allows withdrawal through cheques or promissory notes.”

#### Objectives of Bank:

1. To establish as an institution for maximizing profits and to conduct overall economic activities.
2. To collect savings or idle money from the public at a lower rate of interests and lend these public money at a higher rate of interests.
3. To create propensity of savings amongst the people.
4. To motivate people for investing money with a view to bringing solvency in them .
5. To create money against money as an alternative for enhancing supply of money.
6. To build up capital through savings.
7. To expedite investments.
8. To extend services to the customers.
9. To maintain economic stability by means of controlling money market.
10. To extend co-operation and advices to the Govt. on economic issues.
11. To assist the Govt. for trade& business and socio-economic development.
12. To issue and control notes and currency as a central bank.
13. To maintain and control exchange rates as a central bank.

#### Meaning and Origin of Bank:

The word 'Bank' is widely and extensively used and circulated. The 'Bank' in English carries the same meaning in Bengali. The origin of English word 'Bank' came into being (when, where and how) which could not be specifically identified. The history regarding the origin of 'Bank', even after the twelfth century, is not also clear which has been based on guesses. According to some writer the word 'Bank' was derived from 'Banco', 'Bancus', 'Banque' or 'Banc' all of which mean a bench upon which the mediaeval European Money-lenders and Money –Changers used to display their coins. Anyhow this word has been in use from the middle ages in connection of a bank. In the words of German writer W. Frankace, a long stool or bench was said to be replaced by Bank, Bangke etc. in the Scandinavian and Mid-

European countries. Again, Dutch and French words 'Banque', 'Bangko' were used to mean stool or bench and in course of time the word 'Bank' came into effect.

In the Mediaeval age Italian states were sound and solvent economically and commercially. At that time a group of people used to conduct business of transaction of money sitting on a stool or bench which was replaced by 'Banco,' 'Banko' 'Banca', 'Bangk', 'Bancus', 'Banc' etc. It is assumed that the word 'Bank' was originated from these words.

In the later age, an English writer Macleod challenged the above concepts.

His contention was that the money-lenders and money-changers used to display their coins which were not termed as 'Banco', 'Banque', 'Banke', 'Banca'. However, Banco in Italy and Banke in German and Australia were understood as public debt or issue of paper money. In his opinion, these words were used for the purpose of economic activities of different countries of Europe. Another British writer Chamber, in his Twentieth Century Dictionary, very clearly stated that the word 'Bank' is derived from Banca and Banque. The French still uses 'Banque' in place of the word 'Bank'.

In the mid of twelfth century Italian states were under political turmoil and in 1150 Venice was afflicted with enemies. As a result, the Government introduced public debt/ collective credit/ forced subscribed loan @ 5% compulsorily on the public for meeting economic crisis. During that time this loan was called Banke, Banco, Compara, Monte etc. So many thinkers think that the German word 'Banke' and the Italian word 'Banco' have been transformed into English word 'Bank'.

## **1.2: Source and Origin of Modern Banking:**

Banking-experts pass their opinion that banking system was introduced from the primitive stages of human civilization in some way or other in the world. While reviewing historical backgrounds of social, economic and religious activities of ages, origin of modern banking

can be better known. From different angles the source and origin of modern banking can be justified:

### **1. Introduction of coins:**

From the ancient times coins were introduced in different countries as a medium of exchange. So, banking system was in vogue for preservation and safety of coins. The discovery of archaeological symbols have intensified the arguments. At that time excess residual coins were kept with the religious and local elite persons for the purpose of extending help to the needy poor people. Gradually, this became a profitable business for the businessmen and money-lenders.

### **2. Different Civilization:**

At different stages of human civilization, many evidences were recorded for the existence of banks and coins. The archaeological symbols are the evidences of this statement. During Indus Civilization (5000-2000) coins were available in Mohenjodaro of Pakistan, in Egypt coins were found in mummy of Pyramid. In Bangladesh coins of ancient civilization were found at Moynamati of Comilla and Paharpur of Bogra.

### **3. Expansion of business and trade:**

The expansion of business and trade played a vital role for the advancement of modern banking. Because of the fact that in the middle age Indo- sub-continent, Middle-East and Europe progressed tremendously and thus banking business improved for their smooth functioning of transaction.

### **4. Various Religions and Religious books:**

A lot of information regarding banking business were incorporated in the Quran, the Bible, the Bedh and the Mahabharat.

## 5. The contributions of Goldsmith, money-lenders and the businessmen:

For the growth and development of banking business the Goldsmiths, Money-lenders(mahajan) and businessmen had positive roles.

### (a) The Goldsmiths:

From the very ancient periods the Goldsmiths, over and above their own activities, used to act as custodians of the surplus funds of the general people of the society. For that reason they were recognized as a symbol of honesty, sincerity, solvency and security. On receipt of money they used to issue receipts and on return of money they used to take acknowledgements. Later on, these receipts were treated deposit slip and cheque respectively. The deposits receipts were undoubtedly acceptable and popular as notes of the Goldsmiths and afterwards converted into bank notes. Besides these, they used to lend money with interest to the needy people and thus, the words interest and profit were introduced. In the middle ages, the Goldsmiths became very rich and affluent. At one time Goldsmiths used to deposit their money with the treasury of England. During the regime of King, the First Charles, in 1640, the reserve funds of the Goldsmiths with London Tower were confiscated and they had to pay penalty for taka two lacs pounds. Then they left gold business and got involved with banking business. Thus, the Goldsmiths had a definite role for the advancement of modern bank.

### (b) The Money-Lenders:

The Money-Lenders(Mahajan) also played an important role for the growth and development of modern banking. They used to keep surplus money of the people and refund those in case of need. Later, they took it as a profession. They used to pay interest to the depositors and earn interest on loans. They also used to take security, mortgage against loan. In Europe they were called Medici, Bengkuci, Piti, Missouri and in Indian subcontinent Seth, Chetti, Multani, Kabuliwala were the Mahajans. In Europe, most of the Mahajans were jews. Amongst them

Shylock of Italy was one of them. Besides, Medici of Lombardi was the world-famous. Lombardi Street in London was recognized after the name of Medici. Patheh Chand was also famous in India. The Emperor Farook Shayar ornamented him with the title of world banker.

### (c) Businessmen:

Business Class also played vital role for the growth and development of modern banking. From the ancient periods the Business Class were trustworthy to the general people. They were honest, faithful and solvent. As a result, general people used to deposit money to them for the safety and security of fund. In course of time they were involved in money-lending business. The businessmen of seven-hills of Rome were world-famous.

## Brief History of Banking system of Bangladesh and Indo-Pak Subcontinent.

For the growth and development of modern banking, Indo-Pak Subcontinent have a positive role. With the gradual evolution of ages banking activities have got momentum

### (a) The Ancient Era:

Many Economists and Experts have expressed their opinion that banking business have been going on since ancient era. Many evidences are found with the archaeological symbols of Harappa and Mohenjodaro. From different religious scriptures we find a lot of information regarding modern banking activities.

### (b) The Moghal Era:

The banking system has been extensively developed during the Moghal Era. During that time government treasury was formed. The Govt. introduced gold and silver coins of different denominations named 'Ashrafi'. Thus banking system has been developed. During that period 'Seth Family' was world famous. They used to conduct business through agency house. Among the local bankers marwari, multani, kabuliwala, sharaf, chetti etc. worth mention. In the

seventeenth century , English Tradesmen were involved with them. In 1700 The Hindustan Bank was established as a joint venture bank.

**(c) The British Era:**

The expansion program of the modern bank started when the English took power of India. In 1784 the Bengal Bank introduced paper currency notes and gold coins of different denominations. Later, in 1787 General Bank of India, in 1806 Bank of Bengal, in 1840 Bank of Bombay and in 1843 Bank of Madras were established. With merging of three banks, the Imperial Bank of India was established in 1920 and in 1935 the Reserve Bank of India came into being.

**(d) The Pakistan Era:**

In 1947 during the separation of India, 639 branches of different banks were the parts of Pakistan. Besides, Head Offices of Habib Bank Limited and Muslim Commercial Bank Limited were transferred to Karachi. In 1948 the State Bank of Pakistan was established.

**(e) The Bangladesh Era:**

Bangladesh came into being in 1971. Since then a branch of state bank of Pakistan stationed at Dhaka was declared Central Bank of Bangladesh named as Bangladesh Bank under Special Act. Excepting other banks, Head Offices of two banks e.g. Eastern Mercantile Bank Limited(1959) and Eastern Banking Corporation Limited(1965) were at Dhaka which were renamed as Pubali Bank Limited and Uttara Bank Limited respectively. In this country of 14 crores people about 57 banks ( Govt. bank 4; Local private 30; Foreign 12; specialized 7 and others 4) with about 5500 branches and about 1,10,000 officers / staff; are functioning for socio-economic development.

With two banks as above many branches of more than 10 banks were located in Bangladesh. When the Non- Bangali owners had left the country the disastrous condition of banks in Bangladesh knew no bounds. The fact remains that most of the bankers and staff were non-bangalies. Consequently, the management and control of all such banks were reposed on Bangladesh Government. In 1972 Government, pursuant to Presidents' Order 26, had nationalized all banks. The banking system of Bangladesh came to a standstill. After nationalization the banks were renamed as under:

Sl.	Former Name	Present Name
01.	The National Bank of Pakistan The Bank of Bhowalpur Limited, The Premier Bank Limited	Sonali Bank (Sonali Bank Limited)
02	The United Bank Limited The Union Bank Limited	Janata Bank ( Janata Bank Limited)
03.	The Habib Bank Limited Commerce Bank Limited	Agrani Bank ( Agrani Bank Limited)
04.	The Muslim Commercial Bank Limited The Standard Bank Limited The Australasia Bank Limited	Rupali Bank (Rupali Bank Limited)
05.	The Eastern Mercantile Bank Limited	Pubali Bank Limited
06.	The Eastern Banking Corporation Limited	Uttara Bank Limited

The Bank Company Act 1991 has been revised and the banks are functioning as per guidelines contained therein.

## Commercial Bank and Central Bank: Their functions and mutual relationships

In common parlance, Bank means Commercial Bank and its functions. Central Bank is a separate entity and plays distinctive roles. The function of a Bank is to collect deposits from the public and lend those deposits for the development of Agriculture, Industry, Trade and Commerce. Bank pays interest at lower rates to the depositors and receives interests on loans and advances from them at higher rates. In modern banking, Bank carries out many other activities, e.g. creation of debts and money, transmission of money from one country to another country, increase of foreign trade, preservation of valuables in safe custody etc. Thus, Bank earns profits through executing various types of activities.

### Commercial Bank:

Historically, commercial bank came into being for its commercial purpose. The inception of modern banking is the outcome of commercial bank. In the words of Professor Roger, "the bank which deals with money and money's worth with a view to earning profit is known as 'Commercial bank'."

Professor Hart says, "A banker is one who, in the ordinary course of business, honours cheques drawn upon him by persons for and for whom he receives money on current account."

### The objectives of a commercial bank:

1. To establish as an institution for maximizing profits and to conduct overall economic activities.
2. To collect savings or idle money from the public at a lower rate of interests and lend these public money at a higher rate of interests.
3. To create propensity of savings amongst the people.
4. To motivate people for investing money with a view to bringing solvency in them .
5. To create money against money as an alternative for enhancing supply of money.
6. To build up capital through savings.
7. To expedite investments.
8. To extend services to the customers.
9. To maintain economic stability by means of controlling money market.
10. To extend co-operation and advices to the Govt. on economic issues.
11. To assist the Govt. for trade& business and socio-economic development

### The functions of commercial bank are given below:

#### A: General Functions:

##### 1. Receiving Deposits:

The first and foremost function of commercial bank is to receive or collect deposits from the public in different forms of accounts e.g. current, savings, term deposits. No interest is charged in the current account, lower rate of interest is charged in the savings account and comparatively higher interest rates charged in fixed deposits. Thus, commercial bank builds up customer network.

##### 2. Accommodation of loans and advances:

Commercial Bank attaches much importance to providing loans and advances at a higher rates than the deposit rates and thus earns profits on it. Working capital is accommodated to the borrower for expansion and smooth running of business. In the similar manner, commercial bank extends financial accommodation for the development of agriculture

and industry. Credit accommodation is provided to the entrepreneurs for reviving sick and old industries as per Govt. directives. Thus, commercial bank also extends welfare services to the people at large.

### **3. Creation of Loan Deposits:**

Commercial Bank not only receives deposits from public and accommodates loans to public but also creates loan deposits. For example: while disbursing loans as per sanction stipulation, the amount of loan is credited to the borrower's account. The borrower may not withdraw the full amount at a time. The residual amount i.e. balance left in the account creates loan deposits.

### **4. Creation of medium of exchange:**

Central Bank has got exclusive right to issue notes. On the other hand, Commercial Bank creates medium of exchange by issuing cheques. Like notes, cheque is transferrable being popularly used in the banking transactions.

### **5. Contribution in foreign trade:**

Commercial Bank plays a vital role in expediting foreign exchange and foreign trade business e.g. import, export etc. It contributes greatly in the economy through import finance and export finance and thus, earn foreign exchange for the country.

### **6. Formation of capital:**

Commercial Bank extends financial assistance for the formation of capital in the trade, commerce and industry in the country which expedites its economic development.

### **7. Creation of Investment Environment:**

Commercial Bank plays a significant role in creating investment environments in the country.

## **B. Public Utility Functions:**

In modern banking, commercial bank executes public utility services:

### **1. Remittance of Money:**

Remittance of money to the public from one place to another is one of the functions of commercial bank. Remittance is effected in the form of demand draft, telegraphic transfer etc. through different branches and correspondents home and abroad.

### **2. Help in trade and commerce:**

Commercial Bank helps expand trade and commerce. In inland and foreign trade customers are allowed credit accommodation in the form of letter of credit, bill purchased and discounted etc.

### **3. Safe custody of valuables:**

Commercial Bank introduces 'locker' services to the customers for safe custody of valuables e.g. documents, shares, securities etc.

### **4. Help in Foreign Exchange business:**

While opening letter of credit, commercial bank obtains credit report of the suppliers and thus help expedite import and export business.

### **5. Act as a Referee:**

Commercial Bank acts as a referee for and on behalf of the customers.

#### **6. Act as an Adviser:**

Commercial Bank provides valuable advice to the customers on different products, business growth and development, feasibility of business and industry.

#### **7. Collect utility service bills:**

As a social commitment, Commercial Bank collects utility service bills e.g. water, electricity, gas, telephone etc. from the public.

#### **8. Purchase and sale of prize bonds, sanchaya patra, shares etc.**

Commercial Bank undertakes to purchase and sale of prize bonds, sanchaya patra, shares etc. as a part of social commitment.

#### **9. Help people travel abroad:**

Commercial Bank helps customers in traveling abroad through issuance of travelers cheques, drafts, cash etc. in favour of the customers.

### **C. Agency Functions:**

Besides above stated functions, commercial bank acts as a representative of the customers.

#### **1. Collection and payment:**

Commercial Bank is engaged in collection and payment of cheque, bill of exchange, promissory notes, pension, dividends, subscription, insurance premium, interest etc. on behalf of the clients.

#### **2. Purchase and sale of shares and securities:**

Commercial Bank is entrusted with the responsibility of purchase and sale of shares and securities on behalf of the customers.

#### **3. Maintenance of secrecy:**

Maintenance of secrecy is one of the most important functions of commercial bank.

#### **4. Act as a trustee:**

Commercial Bank acts as a trustee on behalf of the customer.

#### **5. Economic Development and Welfare activities:**

Commercial Bank contributes much for the welfare and economic development of the country.

### **Central Bank:**

The bank which governs banking system and money market is Central Bank. The primary function of a central bank is to assist Government in formulating economic policy, in controlling and conducting money-market and also controlling bank' credit. Some specialized Bankers, Economists and thinkers have given different definitions:

“ A central bank is a bank whose essential duty is to maintain stability of the monetary standard.”

In the words of Decock, " The central bank is a banking system in which a single bank has either a complete or a residuary monopoly of note issue."

Professor Hatley says, "Central Bank is the lender of the last resort."

### **Functions of Central Bank:**

The functions of central bank are different from other banks. The following functions of central bank are stated below:

#### **A. Traditional or general functions:**

##### **1. Issue of notes and coins:**

The first and foremost function of central bank is to issue notes and coins as per needs of the public and requirement of business and commerce. As per rules, notes are issued against gold, silver and foreign currency. Bangladesh Bank (Central Bank) keeps foreign currency reserves as security against issuance of notes. Bangladesh Bank unilaterally reserves the right to issue notes.

The arguments in its favour are as follows:

- (a) To maintain equilibrium in quantity between notes and currency issue
- (b) To maintain equilibrium in size, types and values of notes and currency
- (c) To maintain stability in rates of exchange both inland and foreign
- (d) To create confidence on the people
- (d) To control money market.

##### **2. Government Bank:**

Central Bank acts as banker and economic adviser of the Government. The central bank conducts and maintains Government accounts for all Government receipts and payments.

##### **3. Banker's Bank:**

Central Bank acts as banker's bank. As a rule, all scheduled and commercial banks have to maintain Statutory Liquidity Reserve(SLR) 18% with Bangladesh Bank(CRR: 5% and Bonds & Securities 13%).

##### **4. Lender of the last Resort:**

In case of financial crisis of the commercial banks, central bank acts as a lender of the last resort through lending against first class securities, bill of exchange etc.

##### **5. Reservoir of foreign currency:**

Central Bank maintains Foreign Currency Reserve. For the purpose of control of foreign currency, the following factors are responsible:

- (a) For issuance of notes
- (b) For payments of liabilities
- (c) For payments of debts.

##### **6. Clearing House:**

Central Bank acts as a Clearing House for settlement of inter bank transactions.

## 7. Credit Control:

Credit Control is one of the major functions of central bank. The following are the ways of controlling credit:

- (a) Change in bank rates
- (b) Open market operation
- © Change ( increase or decrease) in reserve- ratio
  
- (d) Selective credit
- (e) Direct influence
- (f) Moral suasion
- (g) propaganda.

## B. Purposeful functions:

### (a) Control Currency Market:

Central Bank acts as a controller and guardian of the currency market. For the purpose of formation, control and maintenance of currency market and for its overall development, central bank is the pioneer.

### (b) Stabilize Exchange Rate:

Central Bank maintains stability of the foreign currency exchange rates by means of controlling credit. Stable exchange rates position helps create favourable balance of trade and acceptability of stable currency gets momentum in the international market.

### (c) Maintain Gold Standard:

Central Bank is responsible for maintenance and control of gold reserve.

### (d) Stabilize Price-Level:

Fluctuations and frequent changes of price-level affect economic growth. With a view to making good of the economic imbalances and crisis situations, central bank takes necessary measures for stabilizing price-level.

### (e) Stabilize business activities:

Central Bank formulates credit policy and with this spirit, central bank takes necessary steps to protect economic depression for stabilizing business activities.

### (f) Employment opportunities:

Central Bank takes initiatives for creating employment opportunities by means of credit-control mechanism.

## C. Expansion and Development Functions:

### (a) Development of Agriculture Sector:

Central Bank formulates policy for expansion of Agri-sector for the purpose of economic upliftments in the country.

### (b) Development of Industry Sector:

### (c) Development of natural resources:

Central Bank plays vital role for tapping natural resources which may lead to economic growth.

## D. Other Functions:

### (a) Adviser and Representative of Government:

Central Bank advises Government on economic issues and sometimes acts as a representative of the Government.

(b) Economic Research:

Central Bank conducts various economic research works and formulates policies for economic development. Central Bank conducts survey on different economic issues for the knowledge of the general public of the country.

**Distinguish between Central Bank and Commercial Bank:**

Central Bank and Commercial Bank are both financial institutions. But they have got distinguishing features. Central Bank is meant for national welfare and Commercial Bank is meant for earning profits. The following points of distinction between central bank and commercial bank:

Sl.	Points of distinction	Central Bank	Commercial Bank
01.	<b>Formation</b>	Central Bank is the sole banking Institution which is established through ordinance or special law of the Government.	Commercial Bank is formed on the basis of Banking Company Laws.
02.	<b>Ownership</b>	Central Bank is established under Government ownership.	Commercial Bank is established under both govt. and private Ownership.
03.	<b>Purpose</b>	To earn profit is not the main purpose of central bank. Its main purpose is to control credit system and money market.	The main purpose of commercial bank is to earn profit. Recovery of loan is the main stay for generation of profit.
04.	<b>Number</b>	In a country there is only one Central Bank.	In a country there may be more number of commercial banks.
05.	<b>Control</b>	Central bank is conducted exclusively under Government control.	Commercial Bank is conducted under central bank's control.
06.	<b>Government Influence</b>	Government has direct influence on Central Bank.	Government has indirect influence On Commercial Bank through Central Bank.
07.	<b>Currency Market</b>	Central Bank organizes, controls and administers currency market.	Commercial Banks are the members of the currency market.
08.	<b>Competition</b>	Central Bank does not compete with other banks.	Commercial Bank has to face to face lot of competition.
09.	<b>Representative</b>	Central Bank represents the country or state.	Commercial Bank represents the Customers.
	<b>Foreign Branch</b>	Central Bank has no branch abroad.	Commercial Bank may have many Branches abroad.
	<b>Note issue</b>	Note issue is the primary function of central bank.	Commercial Bank cannot issue notes.
	<b>Credit control</b>	Central Bank controls credit.	Commercial Bank assists central bank In controlling credit.
	<b>Clearing House</b>	Central Bank acts as a clearing house for settlement of inter-bank transactions.	Commercial banks are the members of the clearing house. They settle transactions through clearing house.
	<b>Lender of</b>	In case of any crisis, central bank Last resort lends commercial bank as a last resort.	Commercial Bank gets assistance from central bank in case of need.
	<b>Nature Of work</b>	Central bank is not engaged in general banking activities i.e. to receive deposits, to lend, to create loan etc.	Commercial bank is engaged in receiving deposits, paying money, creating loan etc.
	<b>Foreign Exchange</b>	Central Bank controls foreign exchange.	Commercial bank helps central bank in controlling foreign exchange.
	<b>Investments</b>	Central bank does not Make any investment for profitability purpose.	Commercial bank makes investments in various sectors for the purpose of profitability.
	<b>Refinance Facility</b>	Central bank refinances commercial bank against first class securities, bill of exchange.	Commercial bank takes refinance facility from the central bank.
	<b>Development work</b>	Central Bank formulates policy on development Work.	Commercial bank participates in the development program Initiated by the central bank.