

# Banking System

## The Process of evolution

- Goldsmiths developed the practice of accepting people's gold for safe custody.
- The experience taught the goldsmith two basic facts
- First there is no need to worry about returning exactly the same piece of gold.
- Secondly goldsmith noticed that the depositors never came to take back their gold at the same time.
- Thus receipts issued by the goldsmith became medium of exchange.
- The first bank was formed in Geneva in 1578.

## Banks

Bank is a financial intermediary dealer in loans and debts.

History of banking is closely related to the history of money.

## Types of Banks

### 1. Central Bank:

- The need of central banks was felt after the world war 1.
- A conference was held in Brussels in 1920 and it was decided that every country must setup its own central bank.
- Now, almost all the countries have their own central banks working in the best national interest.
- A central bank is a specialized institution whose customers are commercial banks
- Central bank issues currency and handles govt transactions
- Central bank is bank of all the banks.

### 2. Commercial Bank:

- A commercial bank is an institution that accepts deposits and uses the proceeds to make loans.
- The main objectives of commercial banks is to make profits.
- Commercial banks take deposits at low rate of interest and lend that money at high interest rate.
- NBP, HBL, UBL, MCB,

### 2.2. Functions of Commercial Bank:

#### ▪ Primary Functions:

- ✓ Accepting Deposit (C/A, S/A, F/A)
- ✓ Advancing Loans

#### ▪ Secondary Functions:

- ✓ Agency Functions (Collection of Dividends, Cheques, Funds Transfers)
- ✓ General Utility Services (Providing Lockers, L/C services, providing trade info)
- ✓ Miscellaneous (collection Zakat, utility bills, hajj services)

### **2.3.Role in Economic Development:**

- Capital Formation
- Expansion of credit
- Financing priority sectors.
- Implementation of Monetary Policy.
- Expansion of Trade.

### **2.4. Negotiable Instruments:**

- Promissory Note
- Bill of Exchange
- Cheque
- Bank Draft: issue one branch of the bank to another branch of the same bank

### **2.5. Letter of Credit:**

- A letter of credit is just a guarantee given by one bank to the exporter.
- The guarantee ensure that he will received payments of his goods.
- It also ensure to the importer that payment to the exporter will only be made when goods have been received.
  - ✓ Parties involved in L/C

### **3. Industrial Bank:**

- Industrial banks provide loans to industrial sectors.
- They provide medium, short and long term loans to various industries.
- They provide finances for the setting up of new industrial units.
- IDBP (industrial development bank of pakistan)

### **4. Co-operative Banks:**

- Co-operative banks are the banks that are setup by inhabitant of particular class.
- The purpose behind is to provide credit facilities to the residents of that area.
- Punjab provincial cooperative bank.

### **5. Agricultural Bank:**

- Banks that are engaged in the financing of agriculture and rural sector.
- They also helped in the growth of agro based, small scale and cottage industry.
- Sole object to promote macro-economic growth in rural areas.

### **6. Investment Bank:**

- Investment banks are those which provide finances for the sale and purchase of stocks and shares.
- Aim is to keep capital market alive.
- They helped in the underwriting of shares and debentures of new companies.
- IGI Investment bank, First Dawood Investment bank, Escorts investment bank

### **7. Exchange Bank:**

- Bank branches with their head offices abroad are called exchange banks.
- These banks have the primary function of dealing in foreign exchange.

#### **8. Mortgage bank:**

- Mortgage banks provide finances against fixed assets like land and buildings.
- The finances are usually longterm.
- In Pakistan we do not have any specialized mortgage bank.
- Mortgage bank of Spain, mortgage bank of Austria.

#### **9. Islamic Bank:**

- Banks which are working under shariah.
- It is an interest free banking system.
- Meezan bank, Al Barakah, Bank Islami.

### **Historical background of Banking sector in Pakistan**

- In March 1947, there were 487 branches situated in the area which now comprises Pakistan.
- But after independence many banks closed their branches.
- On 30 June 1948 there were only 195 bank branches left in Pakistan.
- At the time of independence, it was decided that RBI would continue to function as the central bank of both Pakistan and India.
- RBI order of 1947 states, that Indian currency notes will continue to be legal tender both in Pakistan and India.
- RBI functioned as a central bank of Pakistan until April 1948.
- RBI did not work fairly for Pakistan, refused to transfer 55 crores which Pakistan entitled to receive the proportionate share of reserves of undivided India.

### **Establishment of SBP**

- SBP order was promulgated by the Governor General of Pakistan on 12 May 1948.
- The SBP started operations on July 1, 1948.
- Pakistani currency notes were issued in Oct 1948.
- Initially only 5, 10, and 100 rupee notes were issued.
- Banking Companies Act was passed in 1948.
- At that time only two banks were operating in Pakistan, HBL and Australian Bank.

### **Development of Banking System in Pakistan**

- HBL was established on Aug 25, 1941. It enjoys the status of Banker to Quaid-e-Azam, Muslim League Fund and Pakistan Funds. Now HBL has branches almost in 175 countries.
- MCB was established in July 19, 1947 at Calcutta. Shifted to Pakistan after independence.
- NBP was established in Nov 1949. In 1974 it took the place of BWP.
- Pakistani banking system is comprised of 35 banks.
- Banking Law Review Commission (BLRC), Banking Act 2006.

### **Phases in Banking Sector**