



Main Functions of Commercial Banks and their Impact on the Economy of the Country

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Abstract: The banking sector is an integral part of the economy. Hence this sector plays a key role in the wellbeing of the economy. A weak banking sector not only jeopardizes the long-term sustainability of an economy, it can also be a trigger for a financial crisis which can lead to economic crises. The role of banks in an economy has received attention since the 18th century. This article examines the importance of banks in country's economy and discusses main functions of their activities.

Keywords: banking system, commercial banks, loan facilities ,profit-making, financial institution, money withdrawal , interest rate.

INTRODUCTION

Banking history of Uzbekistan and Banks play a major role in the development of economic system of the country . In any banking system, the knowledge of the structure and the major functions of banks is very crucial because banking is an extremely important part of our economics. Banks are those organizations that collect money from “customers” for the purpose of investments while providing the customers with an interest rate. Each country has commercial banks as well as state banks. A commercial bank is a kind of financial institution that carries all the operations related to deposit and withdrawal of money for the general public, providing loans for investment, and other activities. These banks are profit-making institutions and do business only to make a profit.

The main purpose of commercial banks is to provide financial services to the general public and also provide loan facilities to the business which helps in ensuring economic stability and growth of the economy. The two primary characteristics of a commercial bank are lending and borrowing. The bank receives the deposits and gives money to various projects to earn interest (profit). The rate of interest that a bank offers to the depositors is known as the borrowing rate, while the rate at which a bank lends money is known as the lending rate.

Therefore, we can say that credit creation is the most important purpose of commercial banks. There are several functions of banking operation which are considered as primary and secondary function.

The primary functions of any bank are followings:

Accepting Deposits:

Deposits are the amount of money that a customer hands over to the bank. This is known as making a deposit. The deposits are of a few types namely: Saving Deposit, Fixed Deposit, Current

Deposit, and the Recurrent Deposit. The various deposit schemes are based on the type of deposit and the frequency of depositing.

Types of deposits are:

❖ **Current Deposits:** The depositors of such deposits can withdraw and deposit money whenever they desire. Since banks have to keep the deposited amount of such accounts in cash always, they carry either no interest or very low rate of interest. These deposits are called as Demand Deposits because these can be demanded or withdrawn by the depositors at any time they want. Such deposit accounts are highly useful for traders and big business firms because they have to make payments and accept payments many times in a day.

❖ **Fixed Deposits:** These are the deposits which are deposited for a definite period of time. This period is generally not less than one year and, therefore, these are called as long term deposits. These deposits generally carry a higher rate of interest because banks can use these deposits for a definite time without having the fear of being withdrawn.

❖ **Saving Deposits:** In such deposits, money up to a certain limit can be deposited and withdrawn as per use of customer. In a saving deposit, the amount and the rate of interest are low. Withdrawals are also allowed but only in a limited number. Similarly, the fixed deposit is a fixed sum that one gives to the bank for a certain agreed time. The withdrawals are not allowed before the completion of the time of the fixed deposit.

❖ **Granting Loans and Advances:** The bank lends people money on a time-interest basis. Each loan amount is passed by the bank after due consideration and securing the bank's profit. The bank also gives advances to its customers.

Banks charge interest from the borrowers and this is the main source of their income. Banks advance loans not only on the basis of the deposits of the public rather they also advance loans on the basis of depositing the money in the accounts of borrowers. In other words, they create loans out of deposits and deposits out of loans. This is called as credit creation by commercial banks.

❖ **Over-Draft:** Banks advance loans to its customer's up to a certain amount through over-drafts, if there are no deposits in the current account. For this banks demand a security from the customers and charge very high rate of interest.

❖ **Discounting of Bills of Exchange:** This is the most prevalent and important method of advancing loans to the traders for short-term purposes. Under this system, banks advance loans to the traders and business firms by discounting their bills.

❖ **Investment of Funds:** The banks invest their surplus funds in three types of securities—Government securities, approved securities and other securities. Government securities include both, central and state governments, such as treasury bills, national savings certificate etc. Other securities include securities of state associated bodies like electricity boards, housing boards, debentures of Land Development Banks units of UTI, shares of Regional Rural banks etc.

❖ **Lending of Funds:** Another important activity is lending funds to customers in the form of loans and advances, cash credit, overdraft and discounting of bills, etc. Loans are advances that a bank extends to his customers with or without security for a specified time and at an agreed rate of interest. Further, the bank credits the loan amount in the customers' account which he withdraws as per his needs. Under the cash credit facility, the bank offers its customers a facility to borrow cash up to a certain limit against the security of goods. Further, an overdraft is an arrangement that a bank offers to customers wherein a temporary facility is offered to overdraw from the current account without any security. The limit is pre-specified. Additionally, banks also discount and purchase bills. In both of these cases, a bank credits the amount of the bill in the customer's account after deducting discounts and commissions.

Secondary functions of banks

One of the secondary functions of the Bank are either selling gold coins to the public or selling insurance products and selling mutual fund products etc.

Following are the important secondary functions of the Banks:

❖ Agency Functions: The bank is an agent for its customers in a way that it invests on behalf of its customers. Acting as the agent of the customer the bank may transfer funds, the collection of cheques, periodic payments, portfolio management, periodic collections, and several other agency functions. Customers give their consent for performing such functions. The important functions of these types are as follows:

❖ Banks collect cheques, drafts, bills of exchange and dividends of the shares for their customers.

❖ Banks make payment for their clients and at times accept the bills of exchange: of their customers for which payment is made at the fixed time.

❖ Banks pay insurance premium of their customers. Besides this, they also deposit loan installments, income-tax, interest etc. as per directions.

❖ Banks purchase and sell securities, shares and debentures on behalf of their customers.

❖ Banks arrange to send money from one place to another for the convenience of their customers.

Miscellaneous Functions

Besides the functions mentioned above, banks perform many other functions of general utility. The General Utility Functions are also called as Social development functions. In some areas, the banks will help you with all the transactions that you will have to do during a course of time.

The General Utility Functions are as follows:

❖ Banks make arrangement of lockers for the safe custody of valuable assets of their customers such as gold, silver, legal documents etc.

❖ Banks collect necessary and useful statistics relating to trade and industry.

❖ For facilitating foreign trade, banks undertake to sell and purchase foreign exchange.

❖ Banks advise their clients relating to investment decisions as specialist

❖ Bank does the under-writing of shares and debentures also. (Underwriting services are provided by some large financial institutions, such as banks, insurance companies and investment houses, whereby they guarantee payment in case of damage or financial loss and accept the financial risk for liability arising from such guarantee)

❖ Banks issue letters of credit. (A letter of credit, or "credit letter" is a letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make a payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase.)

❖ During natural calamities, banks are highly useful in mobilizing funds and donations.

In conclusion each country or state has state and commercial banks which represents the main economic and fiscal policy of a country.

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