

VET FIRST GRADE COLLEGE

JP Nagar, Bangalore-78

Subject: Indian Financial System

Topic: Commercial Bank Functions

By Rajath H S

Asst. Prof. Department of commerce

MEANING OF BANK

An establishment authorized by a government to accept deposits, pay interest, clear checks, make loans, act as an intermediary in financial transactions, and provide other financial services to its customers.

Meaning & Definition of Commercial Bank

A commercial bank is a profit-based financial institution that grants loans, accepts deposits, and offers other financial services, such as overdraft facilities and electronic transfer of funds.

According to Culbertson,

“Commercial Banks are the institutions that make short term loans to business and in the process create money.”

TYPES OF COMMERCIAL BANK

Commercial banks are of three types, which are as follows:

(a) Public Sector Banks:

Refer to a type of commercial banks that are nationalized by the government of a country. In public sector banks, the major stake is held by the government. In India, public sector banks operate under the guidelines of Reserve Bank of India (RBI), which is the central bank. Some of the Indian public sector banks are State Bank of India (SBI), Corporation Bank, Bank of Baroda, Dena Bank, and Punjab National Bank.

(b) Private Sector Banks:

Refer to a kind of commercial banks in which major part of share capital is held by private businesses and individuals. These banks are registered as companies with limited liability. Some of the Indian private sector banks are Vysya Bank, Industrial Credit and Investment Corporation of India (ICICI) Bank, and Housing Development Finance Corporation (HDFC) Bank.

(c) Foreign Banks:

Refer to commercial banks that are headquartered in a foreign country, but operate branches in different countries. Some of the foreign banks operating in India are Hong Kong and Shanghai Banking Corporation (HSBC), Citibank, American Express Bank, Standard & Chartered Bank, and Grindlay's Bank. In India, since financial reforms of 1991, there is a rapid increase in the number of foreign banks. Commercial banks mark significant importance in the economic development of a country as well as serving the financial requirements of the general public.

Functions of Commercial Banks:

The functions of commercial banks (as shown in Figure-1) are discussed as follows:

(a) Primary Functions:

(i) Accepting Deposits:

There are two types of deposits as follows:

- * **(1) Demand Deposits:**

- * Refer to kind of deposits that can be easily withdrawn by individuals without any prior notice to the bank. In other words, the owners of these deposits are allowed to withdraw money anytime by simply writing a check. These deposits are the part of money supply as they are used as a means for the payment of goods and services as well as debts. Receiving these deposits is the main function of commercial banks.

- * **(2) Time Deposits:**

- * Refer to deposits that are for certain period of time. Banks pay higher interest on time deposits. These deposits can be withdrawn only after a specific time period is completed by providing a written notice to the bank.

(3) Advancing Loans:

Refers to one of the important functions of commercial banks. The public deposits are used by commercial banks for the purpose of granting loans to individuals and businesses. Commercial banks grant loans in the form of overdraft, cash credit, and discounting bills of exchange.

(b) Secondary Functions:

Refer to crucial functions of commercial banks. The secondary functions can be classified under three heads, namely, agency functions, general utility functions, and other functions.

*** These functions are explained as follows:**

*** (1) Agency Functions:**

*** Implies that commercial banks act as agents of customers by performing various functions, which are as follows:**

- * **(i) Collecting Checks:**

- * Refer to one of the important functions of commercial banks. The banks collect checks and bills of exchange on the behalf of their customers through clearing house facilities provided by the central bank.

- * **(ii) Collecting Income:**

- * Constitute another major function of commercial banks. Commercial banks collect dividends, pension, salaries, rents, and interests on investments on behalf of their customers. A credit voucher is sent to customers for information when any income is collected by the bank.

- * **(iii) Paying Expenses:**

- * Implies that commercial banks make the payments of various obligations of customers, such as telephone bills, insurance premium, school fees, and rents. Similar to credit voucher, a debit voucher is sent to customers for information when expenses are paid by the bank.

General Utility Functions:

(i) Providing Locker Facilities:

Implies that commercial banks provide locker facilities to its customers for safe keeping of jewellery, shares, debentures, and other valuable items. This minimizes the risk of loss due to theft at homes.

(ii) Issuing Traveler's Checks:

Implies that banks issue traveler's checks to individuals for traveling outside the country. Traveler's checks are the safe and easy way to protect money while traveling.

(iii) Dealing in Foreign Exchange:

Implies that commercial banks help in providing foreign exchange to businessmen dealing in exports and imports. However, commercial banks need to take the permission of the central bank for dealing in foreign exchange.

(iv) Transferring Funds:

Refers to transferring of funds from one bank to another. Funds are transferred by means of draft, telephonic transfer, and electronic transfer.

(3) Other Functions:

(i) Creating Money:

Refers to one of the important functions of commercial banks that help in increasing money supply. For instance, a bank lends Rs. 5 lakh to an individual and opens a demand deposit in the name of that individual.

Bank makes a credit entry of Rs. 5 lakh in that account. This leads to creation of demand deposits in that account. The point to be noted here is that there is no payment in cash. Thus, without printing additional money, the supply of money is increased.

(ii) Electronic Banking:

Include services, such as debit cards, credit cards, and Internet banking.