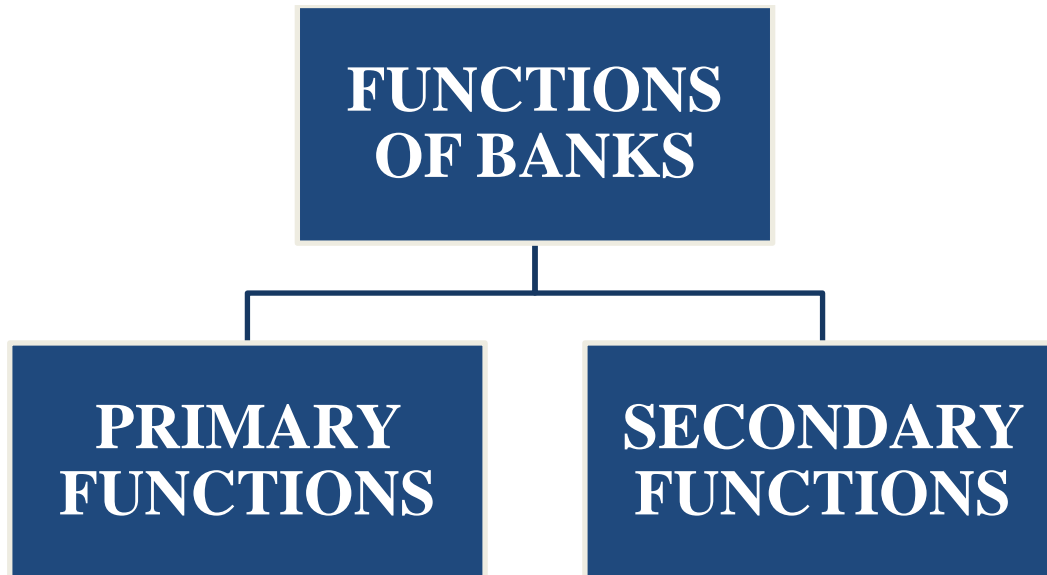


# FUNCTIONS OF BANKS

Bank is a lawful organization, which accepts deposits that can be withdrawn on demand. It also lends money to individuals and business houses that need it.



## 1) PRIMARY FUNCTIONS

The primary functions of a commercial bank include:

- a) Accepting deposits
  - b) Granting loans and advances
- a) **Accepting Deposits:** The most important activity of a commercial bank is to mobilize deposits from the public. People who have surplus income and savings find it convenient to deposit the amounts with banks. Depending upon the nature of deposits, funds deposited with bank also earn interest. Thus, deposits with the bank grow along with the interest earned. If the rate of interest is higher, public are motivated to deposit more funds with the bank. There is also safety of funds deposited with the bank.
- b) **Granting Loans and Advances:** The second important function of a commercial bank is to grant loans and advances. Such loans and advances are given to members of the public and to the business community at a higher rate of interest than allowed by banks on various deposit accounts. The rate of interest charged on loans and advances varies according to the purpose and period of loan and also the mode of repayment.

**Loans:** A loan is granted for a specific time period. Generally commercial banks provide short-term loans. But term loans, i.e., loans for more than a year may also be granted. The borrower may be given the entire amount in lump sum or in installments. Loans are generally granted against the security of certain assets. A loan is normally repaid in installments. However, it may also be repaid in lump sum.

**Advances:** An advance is a credit facility provided by the bank to its customers. It differs from loan in the sense that loans may be granted for longer period, but advances are normally granted for a short period of time. Further the purpose of granting advances is to meet the day-to-day requirements of business. The rate of interest charged on advances varies from bank to bank. Interest is charged only on the amount withdrawn and not on the sanctioned amount.

### **Types of Advances**

Banks grant short-term financial assistance by way of cash credit, overdraft and bill discounting. Let us learn about these.

- i. **Cash Credit:** Cash credit is an arrangement whereby the bank allows the borrower to draw amount up to a specified limit. The amount is credited to the account of the customer. The customer can withdraw this amount as and when he requires. Interest is charged on the amount actually withdrawn. Cash Credit is granted as per terms and conditions agreed with the customers.
- ii. **Overdraft:** Overdraft is also a credit facility granted by bank. A customer who has a current account with the bank is allowed to withdraw more than the amount of credit balance in his account. It is a temporary arrangement. Overdraft facility with a specified limit may be allowed either on the security of assets, or on personal security, or both.
- iii. **Discounting of Bills:** Banks provide short-term finance by discounting bills that is, making payment of the amount before the due date of the bills after deducting a certain rate of discount. The party gets the funds without waiting for the date of maturity of the bills. In case any bill is dishonored on the due date, the bank can recover the amount from the customer.

## **2) SECONDARY FUNCTIONS**

In addition to the primary functions of accepting deposits and lending money, banks perform a number of other functions, which are called secondary functions. These are as follows:

- Issuing letters of credit, traveler's cheque, etc.
- Undertaking safe custody of valuables, important document and securities by providing safe deposit vaults or lockers.

- Providing customers with facilities of foreign exchange dealings.
- Transferring money from one account to another; and from one branch to another branch of the bank through cheque, pay order, demand draft.
- Standing guarantee on behalf of its customers, for making payment for purchase of goods, machinery, vehicles etc.
- Collecting and supplying business information.
- Providing reports on the credit worthiness of customers.
- Providing consumer finance for individuals by way of loans on easy terms for purchase of consumer durables like televisions, refrigerators, etc.
- Educational loans to students at reasonable rate of interest for higher studies, especially for professional courses.