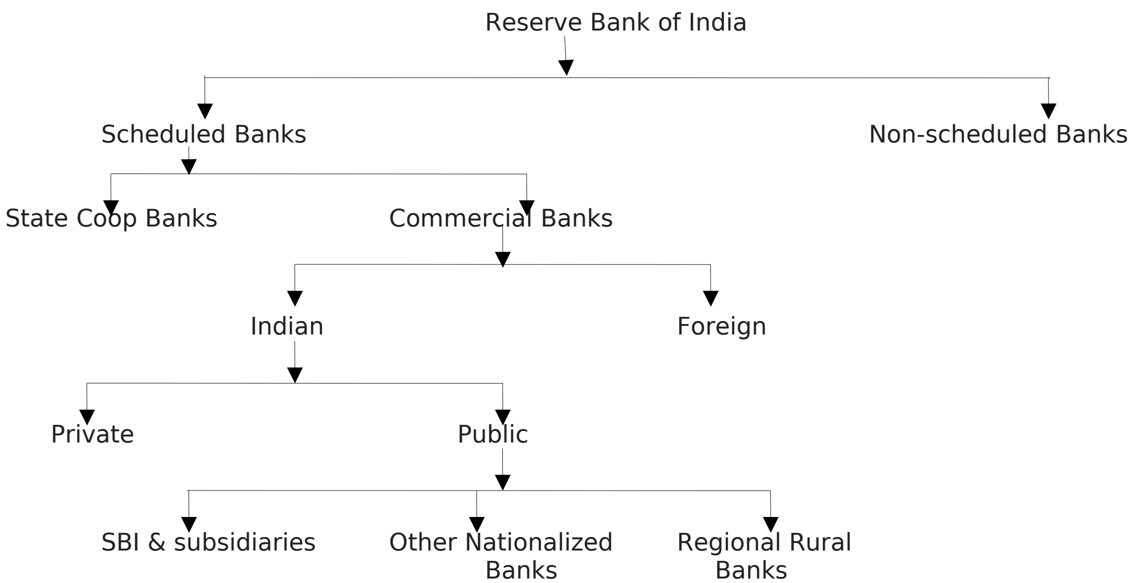
Commercial banks

A bank is a financial institution which deals with deals with deposits and advances and other related services. It receives money from those who want to save it in the form of deposits and lends to those who need it. Banks that accepts deposit from the general public and gives loan to customers and traders are called commercial banks.

Therefore the primary functions of commercial bank in India are accepting deposits from the public and granting credit to all sectors of the economy after making provisions for reserves as per the RBI regulations. Apart from receiving and lending functions, commercial banks undertake various secondary or incidental functions such as agency services and general utility services.

Structure of Banking system in India



Scheduled Commercial Banks are those which are listed in the IInd Schedule of the Reserve Bank Act, 1934.

Nationalized banks include State Bank of India and its associates and 27 public sector scheduled banks (majority shares held by Govt. of India and listed on the stock exchange).

The functions of commercial banks are explained below:

PRIMARY FUNCTIONS:
- Collection of deposits
- Making loans and advances

Collection of deposits: The primary function of commercial banks is to collect deposits from the public. Such deposits are of three main types: current, saving and fixed.
Current account is used for business purposes. A customer can deposit and withdraw money from the current account subject to a minimum required balance. If the customer overdraws the account, he may be required to pay interest to the bank. Cash credit facility is allowed in the current account.
Savings account is an interest yielding account. Deposits in savings account are used for saving money. Savings bank account-holder is required to maintain a minimum balance in his account to avail of cheque facilities.
Fixed or term deposits are used by the customers to save money for a specific period of time, ranging from 7 days to 3 years or more. The rate of interest is related to the period of deposit. For example, a fixed deposit with a maturity period of 3 years will give a higher rate of return than a deposit with a maturity period of 1 year. But money cannot be usually withdrawn before the due date. Some banks also impose penalty if the fixed deposits are withdrawn before the due date. However, the customer can obtain a loan from the bank against the fixed deposit receipt.

Loans and advances: Commercial banks have to keep a certain portion of their deposits as legal reserves. The balance is used to make loans and advances to the borrowers. Individuals and firms can borrow this money and banks make profits by charging interest on these loans. Commercial banks make various types of loans such as:

1. Loan to a person or to a firm against some collateral security;
2. Cash credit (loan in installments against certain security);
3. Overdraft facilities (i.e. allowing the customers to withdraw more money than what their deposits permit); and
4. Loan by discounting bills of exchange.

Secondary functions

- Agency services
- General utility services

Agency Services: The customers may give standing instruction to the banks to accept or make payments on their behalf. The relationship between the banker and customer is that of Principal and Agent. The following agency services are provided by the bankers:

1. Payment of rent, insurance premium, telephone bills, installments on hire purchase, etc. The payments are obviously made from the customer's account. The banks may also collect such receipts on behalf of the customer.
2. The bank collects cheques, drafts, and bills on behalf of the customer.
3. The banks can exchange domestic currency for foreign currencies as per the regulations.
4. The banks can act as trustees / executors to their customers. For example, banks can execute the will after the death of their clients, if so instructed by the latter.

General Utility Services: The commercial banks also provide various general utility services to their customers. Some of these services are discussed below:

1. **Safeguarding money and valuables:** People feel safe and secured by depositing their money and valuables in the safe custody of commercial banks. Many banks look after valuable documents like house deeds and property, and jewellery items.
2. **Transferring money:** Money can be transferred from one place to another. In the same way, banks collect funds of their customers from other banks and credit the same in the customer's account.
3. **Merchant banking:** Many commercial banks provide merchant banking services to the investors and the firms. The merchant banking activity covers project advisory services and loan syndication, corporate advisory services such as advice on mergers and acquisitions, equity valuation, disinvestment, identification of joint venture partners and so on.
4. **Automatic Teller Machines (ATM):** The ATMs are machines for quick withdrawal of cash. In the last 10 years, most banks have introduced ATM facilities in metropolitan and semi-urban areas. The account holders as well as credit card holders can withdraw cash from ATMs.
5. **Traveler's cheque:** A traveler's cheque is a printed cheque of a specific denomination. The cheque may be purchased by a person from the bank after making the necessary payments. The customer may carry the traveler's cheque while travelling. The traveler's cheques are accepted in banks, hotels and other establishments.
6. **Credit Cards:** Credit cards are another important means of making payments. The Visa and Master Cards are operated by the commercial banks. A person can use a credit card to withdraw cash from ATMs as well as make payments to trade establishments.

In developing countries like India commercial banks perform certain promotional / developmental activities. For example, nationalized banks in India provide credit to the top priority sectors of the economy such as agriculture, and small-scale and cottage industries. In this way commercial banks help to promote the socio-economic development of the country.

Role of Commercial Banks in economic development

1. Mobilizing savings for capital formation:
The commercial banks help in mobilizing savings through network of branch banking. People in developing countries have low incomes but the banks induce them to save by introducing variety of deposit schemes to suit the needs of individual depositors. They also mobilize idle savings of the rich people. By mobilizing savings, the banks channelize them into productive investments. Thus they help in the capital formation of a developing country.

2. Financing industry:
The commercial banks finance the industrial sector in a number of ways. They provide short-term, medium-term and long-term loans to industry. In India, the commercial banks undertake short-term and medium-term financing of small scale industries, and also provide hire- purchase finance. Besides, they underwrite the shares and debentures of large scale industries. Thus they not only provide finance for industry but also help in developing the capital market too.

3. Financing trade:
The commercial banks help in financing both internal and external trade. The banks provide loans to retailers and wholesalers to stock goods in which they deal. They also provide facilities such as discounting and accepting bills of exchange, providing overdraft facilities, issuing drafts, etc. Moreover, they finance both exports and imports by providing foreign exchange facilities to importers and exporters of goods.

4. Financing agriculture:
The commercial banks help the large agricultural sector in a number of ways. They provide loans to traders in agricultural commodities. They open a network of branches in rural areas to provide agricultural credit. They provide finance directly to agriculturists for the marketing of their produce, for the modernization and mechanization of their farms, for providing irrigation facilities, for developing land, etc.
They also provide financial assistance for animal husbandry, dairy farming, sheep breeding, poultry farming, pisciculture and horticulture. The small and marginal farmers and landless agricultural workers, artisans and petty shopkeepers in rural areas are provided financial assistance through the regional rural banks in India. These regional rural banks operate under a commercial bank. Thus the commercial banks meet the credit requirements of all types of rural people.

5. Financing consumer activities:
Majority of the population in developing countries have low incomes and do not possess sufficient financial resources to buy durable consumer goods. The commercial banks advance loans to consumers for the purchase of such items as two-wheelers, refrigerators, etc. Home loans are also provided so that people can purchase or construct their own homes. In this way commercial banks help in raising the standard of living of the people.

6. Financing employment generating activities:
The commercial banks finance employment generating like loans for the education of young person’s studying in engineering, medical and other vocational institutes of higher learning. They advance loans to young entrepreneurs, medical and engineering graduates, and other technically trained persons in establishing their own business. Such loan facilities are being provided by a number of commercial banks in India. Thus the banks not only help in human capital formation but also in increasing entrepreneurial activities in developing countries.

7. Help in monetary policy:
The commercial banks help the economic development of a country by faithfully following the monetary policy of the central bank. In fact, the central bank depends upon the commercial banks for the success of its policy of monetary management in keeping with requirements of a developing economy.

Thus the commercial banks contribute much to the growth of a developing economy by granting loans to agriculture, trade and industry, by helping in physical and human capital formation and by following the monetary policy of the country.