

Lesson 15

Banking

While walking in the streets of any town or city you might have seen some signboards on buildings with names-Canara Bank, Punjab National Bank, State Bank of India, United Commercial Bank, etc. What do these names stand for? Did you ever try to know about them? If you enter any such building you will find some kind of a business office. You will see some employees sitting behind counters dealing with visitors standing in front of them. You will find that some are depositing money at one counter while some are receiving money at another counter. Behind the counters in the office you will see tables and chairs occupied by officers. On one side of the office you will also see a chamber (small partitioned room) where the manager is sitting with papers on his table. This is the office of a 'Bank'.

Let us know in detail about banks and their activities.

15.1 Objectives

After studying this lesson, you will be able to:

- state the meaning of 'bank';
- explain the role of 'banking';
- identify the different types of banks; and
- describe the functions of a commercial bank.

15.2 Meaning of Bank

You know people earn money to meet their day-to-day expenses on food, clothing, education of children, housing, etc. They also need money to meet future expenses on marriage, higher education

of children, house building and other social functions. These are heavy expenses, which can be met if some money is saved out of the present income. Saving of money is also necessary for old age and ill health when it may not be possible for people to work and earn their living.

The necessity of saving money was felt by people even in olden days. They used to hoard money in their homes. With this practice, savings were available for use whenever needed, but it also involved the risk of loss by theft, robbery and other accidents. Thus, people were in need of a place where money could be saved safely and would be available when required. Banks are such places where people can deposit their savings with the assurance that they will be able to withdraw money from the deposits whenever required. People who wish to borrow money for business and other purposes can also get loans from the banks at reasonable rate of interest.

Bank is a lawful organisation, which accepts deposits that can be withdrawn on demand.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

Banks also render many other useful services – like collection of bills, payment of foreign bills, safe-keeping of jewellery and other valuable items, certifying the credit-worthiness of business, and so on.

Banks accept deposits from the general public as well as from the business community. Any one who saves money for future can deposit his savings in a bank. Businessmen have income from sales out of which they have to make payment for expenses. They can keep their earnings from sales safely deposited in banks to meet their expenses from time to time. Banks give two assurances to the depositors –

- a. Safety of deposit, and
- b. Withdrawal of deposit, whenever needed

On deposits, banks give interest, which adds to the original amount of deposit. It is a great incentive to the depositor. It promotes saving habits among the public. On the basis of deposits banks also grant loans and advances to farmers, traders and businessmen for productive purposes. Thereby banks contribute to the economic development of the country and well being of the people in general. Banks also charge interest on loans. The rate of interest is generally higher than the rate of interest allowed on deposits. Banks also charge fees for the various other services, which they render to the business community and public in general. Interest received on loans and fees charged for services which exceed the interest allowed on deposits are the main sources of income for banks from which they meet their administrative expenses.

The activities carried on by banks are called banking activity. ‘Banking’ as an activity involves acceptance of deposits and lending or investment of money. It facilitates business activities by providing money and certain services that help in exchange of goods and services. Therefore, banking is an important auxiliary to trade. It not only provides money for the production of goods and services but also facilitates their exchange between the buyer and seller.

You may be aware that there are laws which regulate the banking activities in our country. Depositing money in banks and borrowing from banks are legal transactions. Banks are also under the control of government. Hence they enjoy the trust and confidence of people. Also banks depend a great deal on public confidence. Without public confidence banks cannot survive.

15.3 Distinction between banks and moneylenders

You may be thinking that a bank is like a moneylender who provides funds to borrowers and charges interest on the loan. But it is not so. A bank is quite different from a moneylender. A bank performs two main functions. Firstly, it accepts deposits, and on that basis it lends money. The moneylenders, on the other hand, advance money out of their own private wealth and usually do not accept deposits from others. The following table shows the distinction between a bank and moneylender.

Basis	Banks	Moneylenders
1. Entity	Bank are organised institutions.	Moneylenders are individuals.
2. Activity	Banking activities include acceptance of deposits as well as lending of money.	Activities of moneylender may not include acceptance of deposits.
3. Clients	Banks meet the needs of people in general and the business community in particular.	Moneylenders meet the needs of agriculturists and poor people.
4. Security	Banks accept tangible and personal security against loans.	Moneylenders generally accept gold, jewellery or land as security for giving loan.
5. Process of recovery of loans.	The process of recovery is flexible.	The process of recovery is rigid and strict.
6. Interest Rate	Interest charged by banks on loan is governed by RBI.	Rate of Interest is decided by the moneylender and is normally very high.

15.4 Role of Banking

Banks provide funds for business as well as personal needs of individuals. They play a significant role in the economy of a nation. Let us know about the role of banking.

- It encourages savings habit amongst people and thereby makes funds available for productive use.
- It acts as an intermediary between people having surplus money and those requiring money for various business activities.
- It facilitates business transactions through receipts and payments by cheques instead of currency.

- It provides loans and advances to businessmen for short term and long-term purposes.
- It also facilitates import export transactions.
- It helps in national development by providing credit to farmers, small-scale industries and self-employed people as well as to large business houses which lead to balanced economic development in the country.
- It helps in raising the standard of living of people in general by providing loans for purchase of consumer durable goods, houses, automobiles, etc.

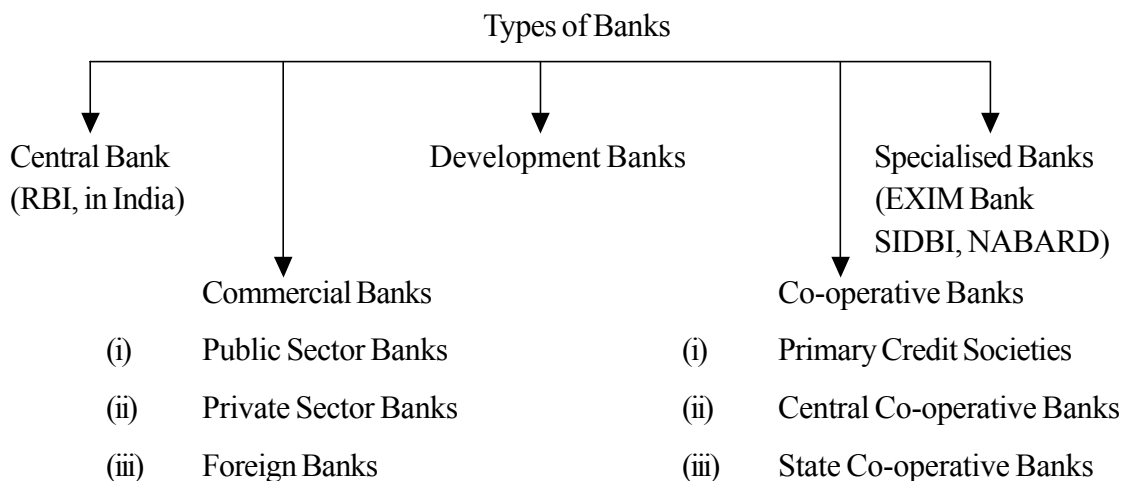
Intext Questions 15.1

Fill in the blanks with suitable word (s):

- A bank accepts deposits from people and _____ money to those who need it for various purposes.
- Banks act as _____ between people having surplus money and those borrowing money.
- Banking facilitates business activities and is considered as an important auxiliary to _____.
- Banks facilitate payment through _____ instead of currency.
- A _____ advances money out of his own private wealth and generally does not accept deposits from others.

15.5 Types of Banks

There are various types of banks which operate in our country to meet the financial requirements of different categories of people engaged in agriculture, business, profession, etc. On the basis of functions, the banking institutions in India may be divided into the following types:



Now let us learn about each of these banks in detail.

a) Central Bank

A bank which is entrusted with the functions of guiding and regulating the banking system of a country is known as its Central bank. Such a bank does not deal with the general public. It acts essentially as Government's banker, maintain deposit accounts of all other banks and advances money to other banks, when needed. The Central Bank provides guidance to other banks whenever they face any problem. It is therefore known as the banker's bank. The Reserve Bank of India is the central bank of our country.

The Central Bank maintains record of Government revenue and expenditure under various heads. It also advises the Government on monetary and credit policies and decides on the interest rates for bank deposits and bank loans. In addition, foreign exchange rates are also determined by the central bank.

Another important function of the Central Bank is the issuance of currency notes, regulating their circulation in the country by different methods. No other bank than the Central Bank can issue currency.

b) Commercial Banks

Commercial Banks are banking institutions that accept deposits and grant short-term loans and advances to their customers. In addition to giving short-term loans, commercial banks also give medium-term and long-term loan to business enterprises. Now-a-days some of the commercial banks are also providing housing loan on a long-term basis to individuals. There are also many other functions of commercial banks, which are discussed later in this lesson.

Types of Commercial banks: Commercial banks are of three types i.e., Public sector banks, Private sector banks and Foreign banks.

- (i) **Public Sector Banks:** These are banks where majority stake is held by the Government of India or Reserve Bank of India. Examples of public sector banks are: State Bank of India, Corporation Bank, Bank of Baroda and Dena Bank, etc.
- (ii) **Private Sectors Banks:** In case of private sector banks majority of share capital of the bank is held by private individuals. These banks are registered as companies with limited liability. For example: The Jammu and Kashmir Bank Ltd., Bank of Rajasthan Ltd., Development Credit Bank Ltd, Lord Krishna Bank Ltd., Bharat Overseas Bank Ltd., Global Trust Bank, Vysya Bank, etc.
- (iii) **Foreign Banks:** These banks are registered and have their headquarters in a foreign country but operate their branches in our country. Some of the foreign banks operating in our country are Hong Kong and Shanghai Banking Corporation (HSBC), Citibank, American Express Bank, Standard & Chartered Bank, Grindlay's Bank, etc. The number of foreign banks operating in our country has increased since the financial sector reforms of 1991.

Public Sector Banks comprise 19 nationalised banks and State Bank of India and its 7 associate banks.

c) Development Banks

Business often requires medium and long-term capital for purchase of machinery and equipment, for using latest technology, or for expansion and modernization. Such financial assistance is provided by Development Banks. They also undertake other development measures like

subscribing to the shares and debentures issued by companies, in case of under subscription of the issue by the public. Industrial Finance Corporation of India (IFCI) and State Financial Corporations (SFCs) are examples of development banks in India.

d) Co-operative Banks

People who come together to jointly serve their common interest often form a co-operative society under the Co-operative Societies Act. When a co-operative society engages itself in banking business it is called a Co-operative Bank. The society has to obtain a licence from the Reserve Bank of India before starting banking business. Any co-operative bank as a society is to function under the overall supervision of the Registrar, Co-operative Societies of the State. As regards banking business, the society must follow the guidelines set and issued by the Reserve Bank of India.

Types of Co-operative Banks

There are three types of co-operative banks operating in our country. They are primary credit societies, central co-operative banks and state co-operative banks. These banks are organized at three levels, village or town level, district level and state level.

- (i) **Primary Credit Societies:** These are formed at the village or town level with borrower and non-borrower members residing in one locality. The operations of each society are restricted to a small area so that the members know each other and are able to watch over the activities of all members to prevent frauds.
- (ii) **Central Co-operative Banks:** These banks operate at the district level having some of the primary credit societies belonging to the same district as their members. These banks provide loans to their members (i.e., primary credit societies) and function as a link between the primary credit societies and state co-operative banks.
- (iii) **State Co-operative Banks:** These are the apex (highest level) co-operative banks in all the states of the country. They mobilise funds and help in its proper channelisation among various sectors. The money reaches the individual borrowers from the state co-operative banks through the central co-operative banks and the primary credit societies.

e) Specialised Banks

There are some banks, which cater to the requirements and provide overall support for setting up business in specific areas of activity. EXIM Bank, SIDBI and NABARD are examples of such banks. They engage themselves in some specific area or activity and thus, are called specialised banks. Let us know about them.

- i. **Export Import Bank of India (EXIM Bank):** If you want to set up a business for exporting products abroad or importing products from foreign countries for sale in our country, EXIM bank can provide you the required support and assistance. The bank grants loans to exporters and importers and also provides information about the international market. It gives guidance about the opportunities for export or import, the risks involved in it and the competition to be faced, etc.

- ii. **Small Industries Development Bank of India (SIDBI):** If you want to establish a small-scale business unit or industry, loan on easy terms can be available through SIDBI. It also finances modernisation of small-scale industrial units, use of new technology and market activities. The aim and focus of SIDBI is to promote, finance and develop small-scale industries.
- iii. **National Bank for Agricultural and Rural Development (NABARD):** It is a central or apex institution for financing agricultural and rural sectors. If a person is engaged in agriculture or other activities like handloom weaving, fishing, etc. NABARD can provide credit, both short-term and long-term, through regional rural banks. It provides financial assistance, especially, to co-operative credit, in the field of agriculture, small-scale industries, cottage and village industries handicrafts and allied economic activities in rural areas.

Intext Questions 15.2

Identify the type of bank being talked about in each of the following statements:

- (a) The bank that undertakes to subscribe to shares and debentures of a company in case of under subscription.
 - (b) The bank that provides assistance and guidance for export of products abroad.
 - (c) The bank formed by a group of people to serve their common interest.
 - (d) The bank that issues currency notes.
 - (e) The commercial bank where the government holds majority stake.
-

15.6 Functions of Commercial Banks

The functions of commercial banks are of two types.

- (A) Primary functions; and
- (B) Secondary functions.

Let us discuss details about these functions.

(i) Primary functions

The primary functions of a commercial bank include:

- a) Accepting deposits; and
- b) Granting loans and advances.

a) **Accepting deposits**

The most important activity of a commercial bank is to mobilise 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) Grant of 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.

i) 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 instalments. Loans are generally granted against the security of certain assets. A loan is normally repaid in instalments. However, it may also be repaid in lump sum.

ii) 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.

a) Cash Credit

Cash credit is an arrangement whereby the bank allows the borrower to draw amount upto 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.

b) 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.

c) 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 dishonoured on the due date, the bank can recover the amount from the customer.

ii) 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-

- a. Issuing letters of credit, travellers cheque, etc.
- b. Undertaking safe custody of valuables, important document and securities by providing safe deposit vaults or lockers.
- c. Providing customers with facilities of foreign exchange dealings.
- d. Transferring money from one account to another; and from one branch to another branch of the bank through cheque, pay order, demand draft.
- e. Standing guarantee on behalf of its customers, for making payment for purchase of goods, machinery, vehicles etc.
- f. Collecting and supplying business information.
- g. Providing reports on the credit worthiness of customers.
- i. Providing consumer finance for individuals by way of loans on easy terms for purchase of consumer durables like televisions, refrigerators, etc.
- j. Educational loans to students at reasonable rate of interest for higher studies, especially for professional courses.

Intext Questions 15.3

State which of the following statements are True and which are false. Write 'T' for True and 'F' for a False statement:

- (a) Loans and advances are both granted by banks to customers for a long period of time.
- (b) Banks keep our jewellery and important documents safe with them.
- (c) Banks grant loans to students for their studies at reasonable interest rate.
- (d) Discounting of bills is done by banks free of cost.
- (e) Through overdraft, a customer can withdraw more money than the amount in his/her bank account.

15.7 E-banking (Electronic Banking)

With advancement in information and communication technology, banking services are also made available through computer. Now, in most of the branches you see computers being used to record banking transactions. Information about the balance in your deposit account can be known through computers. In most banks now a days human or manual teller counter is being replaced by the Automated Teller Machine (ATM). Banking activity carried on through computers and other electronic means of communication is called 'electronic banking' or 'e-banking'. Let us now discuss about some of these modern trends in banking in India.

- **Automated Teller Machine**

Banks have now installed their own Automated Teller Machine (ATM) throughout the country at convenient locations. By using this, customers can deposit or withdraw money from their own account any time.

- **Debit Card**

Banks are now providing Debit Cards to their customers having saving or current account in the banks. The customers can use this card for purchasing goods and services at different places in lieu of cash. The amount paid through debit card is automatically debited (deducted) from the customers' account.

- **Credit Card**

Credit cards are issued by the bank to persons who may or may not have an account in the bank. Just like debit cards, credit cards are used to make payments for purchase, so that the individual does not have to carry cash. Banks allow certain credit period to the credit cardholder to make payment of the credit amount. Interest is charged if a cardholder is not able to pay back the credit extended to him within a stipulated period. This interest rate is generally quite high.

- **Net Banking**

With the extensive use of computer and Internet, banks have now started transactions over Internet. The customer having an account in the bank can log into the bank's website and access his bank account. He can make payments for bills, give instructions for money transfers, fixed deposits and collection of bill, etc.

- **Phone Banking**

In case of phone banking, a customer of the bank having an account can get information of his account, make banking transactions like, fixed deposits, money transfers, demand draft, collection and payment of bills, etc. by using telephone .

As more and more people are now using mobile phones, phone banking is possible through mobile phones. In mobile phone a customer can receive and send messages (SMS) from and to the bank in addition to all the functions possible through phone banking.

Intext Questions 15.4

Match the statement in column A with the word(s) / terms in column B:

Column A	Column B
(a) The banking facility that helps us to make payments out of our bank account without actually carrying money with us.	(i) ATM
(b) The banking facility enabling us to deposit or withdraw cash 24 hours a day.	(ii) Phone Banking

- | | |
|--|-------------------|
| (c) The facility that helps us to perform banking transactions over the Internet. | (iii) Credit Card |
| (d) We can get information about the balance in our bank account over the mobile phone using this facility | (iv) Debit Card |
| (e) The facility that enables us to make payment for purchase of goods by taking credit from the bank | (v) Net Banking |

15.8 What You Have Learnt

- A bank is an institution that accepts deposits from public and lends money to the people who need it.
- Banking is an important auxiliary to trade.
- Banks encourage savings and act as an intermediary between depositors and borrowers.
- They help in credit transactions, facilitate export and import, help in national development and raise people's standard of living.
- Types of banks
 - The Central Bank, RBI in India, acts as the government banker and issues currency notes in the country. It also acts as the banker's bank.
 - The Commercial Banks provide short and medium term loans and charge interest on it. They are of three types – Public Sector Banks, Private Sector Banks and Foreign Banks.
 - Development banks lend funds to business for medium to long term.
 - Co-operative banks are formed to serve common interest of members. In India, we have Primary Credit Societies (village level), Central co-operative Banks (district level) and State Co-operative Banks (State level).
 - EXIM Bank provides guidance and support to exporters and importers.
 - NABARD helps in financing agricultural and other rural activities.
- Functions of Commercial Banks:
 - Primary functions include accepting deposits, granting loans, advances, cash, credit, overdraft and discounting of bills.
 - Secondary functions include issuing letter of credit, undertaking safe custody of valuables, providing consumer finance, educational loans, etc.
- E-banking: With advancement in information and communication technology, banking is performed electronically through Credit Card, Debit Card and ATM, etc.

15.9 Terminal Exercise

1. Define the term 'Bank'.
2. What is meant by 'Banking'?
3. Give two examples each of (a) Private Sector Commercial Banks; and (b) Foreign Banks, in India.
4. What facility is provided by credit cards to a bank's customers?
5. What is meant by cash credit?
6. What function does 'Development Bank' perform?
7. Explain the role of banking in about 100 words.
8. What is meant by Central Bank?
9. What are the functions performed by (a) EXIM Bank; and (b) NABARD.
10. Give any four secondary functions of a commercial bank.
11. Explain the primary functions of a commercial bank.
12. Explain the different types of commercial bank giving example of each.
13. Distinguish between banks and moneylender on the basis of (i) Entity; (ii) Security; (iii) Activity; and (iv) Clients.
14. Describe the functions performed by a commercial bank.
15. Explain the recent development in the field of banking by giving examples of the latest facilities being offered to customers.
16. What is meant by co-operative bank? Explain the types of co-operative banks in India.

15.10 Key to Intext Questions

- 15.1 (a) lends, (b) intermediary / middleman, (c) trade, (d) cheque,
(e) moneylender
- 15.2 (a) Development Bank, (b) EXIM Bank, (c) Co-operative Bank
(d) Central Bank, (e) Public Sector Bank
- 15.3 (a) F, (b) T, (c) T, (d) F, (e) T
- 15.4 (a) (iv), (b) (i), (c) (v), (d) (ii), (e) (iii)

Activity For You

- Make a list of Banks operating in your locality and classify them according to their functions.