COMMERCIAL BANKS

A commercial bank is a typical financial institution that accepts as well as deposits from the general public and also, they give loans for the purposes of consumption activities and investment activities, to make their own profit.

Commercial banks are profit-based institutions that offer financial services like loans, as well as services like deposits, electronic transfers of funds, etc. to their customers. Commercial banks have a significant role in a country's economy as these organizations fulfil the short and mid-term financial requirements of industries.

The functions of commercial banks are primarily based on a business model of accepting public deposits and utilizing that fund for various investment purposes. Such functions can be classified into two categories, primary and secondary functions.

FUNCTIONS OF COMMERCIAL BANK

Primary Functions

- **Accepting Deposits –** Commercial banks accept deposits from their customers in the form of saving, fixed, and current deposits.
- **Savings Deposits –** Savings deposits allow a customer to credit funds towards their accounts for up to a certain limit. These deposits are preferred by individuals with a fixed income, utilized to create savings over time.
- **Fixed Deposits –** Fixed deposits come with a predetermined lock-in period. Fixed deposits are also referred to as time deposits as the funds are deposited for a specific time frame.
- **Current Deposits –** Current deposits allow account holders to deposit and withdraw money whenever necessary. In some cases, current accounts also offer overdrafts until a pre-specified limit to individuals and businesses.
- **Providing Loans –** One of the main functions of commercial banks is providing credit to organizations and individuals, and profit from the earned interest. Usually, banks retain a small reserve for their expenses while offering the remaining amount to customers as various types of short and long-term credits.

- **Credit Creation –** A unique function of commercial banks is credit creation. Instead of offering liquid cash, banks create a line of credit and transfer the loan to a business or commercial body all at once.

Secondary Functions

The following can be considered as the secondary functions of commercial banks –

- **Providing locker Facilities –** Commercial banks provide locker facilities to customers who want to store valuables safely. Locker facilities eliminate the impending risk of theft or loss, which prevail when kept at home.
- **Dealing in Foreign Exchange –** Commercial banks help provide foreign exchange to individuals and organizations that export or import goods from overseas. However, only certain banks which have the license to deal in foreign exchange are eligible for such transactions.
- **Exchange of Securities –** Another function of commercial banks is to trade in bonds and securities. Customers can purchase or sell the units from the financial institution itself, which offers more convenience than alternate approaches.
- **Discounting Bills of Exchange –** The main function of a commercial bank in today's date is to discount bills of businesses. Bill discounting is considered a profitable investment for banks. Bills create a steady flow of funds, while not becoming a risky venture during payment as it is considered as a negotiable instrument. These also do not involve the financial institution in any litigation.
- **Bank as an Agent –** Commercial Bank and its Function also require them to provide finance-related services to

customers, fulfilling the role of an agent. These services usually include –

- Acting as an administrator, trustee, or executor of a customer-owned estate.
- Assisting customers with tax returns, tax refunds, and other similar tasks.
- Serving as a platform to pay premiums, repay loan installments, etc.
- Offering a platform for electronic transaction of funds, processing of cheques, drafts, bills, etc.

TYPES OF COMMERCIAL BANKS

Public Sector Banks

Public sector banks refer to a type of financial institution that is state-owned by the corresponding Government. A significant part of the share of such organizations is held by the Government. In India, the Reserve Bank of India, which acts as the central bank, creates operating guidelines for the public sector banks.

Private Sector Banks

Private sector banks are financial institutions registered as companies with limited liabilities. The major part of the share capital of such companies is owned by individuals or private businesses.

Foreign Banks

Foreign banks are financial institutions that are operating overseas within a foreign nation. Post the financial reform of India (in 1991), there was a marked increase in the number of foreign banks on Indian soil. They are essential for the economic development of a nation.

CENTRAL BANKS

In the banking system, the central bank is recognized as the most powerful financial institution. It is considered to be an important part of a country's economic and financial structure. The central bank is an independent authority in charge of supervising, regulating, and stabilizing the country's monetary and banking framework. The Reserve Bank of India is the country's central bank. It was founded in 1935. Central banks are in charge of ensuring the country's Financial Stability and Economic sovereignty.

The meaning of central bank is a financial institution that has the privilege of producing and distributing money (and credit) for a country or a group of countries. The central bank, in the modern economy, is also responsible for regulating member banks and formulating monetary policies. This article will acquaint you with the importance of the central bank with a focus on the functions of the central bank of India.

FEATURES OF CENTRAL BANK

The basic nature of Central banks is that they are non-market-based and also anti-competitive institutions. The key features of a central bank are:

- Most central banks are centralized though there could be central banks that are not government agencies.
- Even if the central government does not own a central bank, the law establishes and protects the privileges of a central bank.
- It has a legal monopoly status that enables it to issue cash and banknotes as opposed to private commercial banks that can issue only demand liabilities, for example, checking deposits.

FUNCTIONS OF CENTRAL BANK

- **Currency Regulation:** RBI exclusively prints currency notes, except for 1 rupee notes issued by the Ministry of Finance.
- **Government Banking and Advisory:** RBI handles government deposits, payments, foreign currency transactions, and advises on monetary policies and economic matters.
- **Commercial Banks' Custodian:** RBI acts as a custodian and lender of cash reserves for commercial banks, ensuring smooth fund transfers and cheque clearances.
- **Foreign Exchange Management:** RBI manages foreign exchange reserves, stabilizing exchange rates by buying and selling foreign currencies and gold.
- **Lender of Last Resort:** RBI provides collateral advances or rediscounts to financial entities during crises, preventing a financial collapse.
- **Credit Control:** RBI regulates credit flow through quantitative and qualitative methods, tightening monetary policies to curb inflation.
- **Transfer and Settlements:** RBI acts as a clearinghouse, facilitating fund transfers and settlements among commercial banks, maintaining a system for mutual claims.