Scheduled Commercial Banks

The scheduled banks are those which are included in the second schedule of the RBI Act, 1934. These banks have a paid-up capital and reserves of an aggregate value of not less than Rs. 5 lakhs, they have to satisfy the RBI that their affairs are carried out in the interest of their depositors.

All commercial banks (Indian and foreign), regional rural banks, and state cooperative banks are scheduled banks.

RBI categorized scheduled commercial banks as:

- Public Sector Banks
- Private sector banks
- Foreign Banks

Commercial banks mobilize savings of general public and make them available to large and small industrial and trading units mainly for working capital requirements.

Commercial banks in India are largely Indian-public sector and private sector with a few foreign banks. The public sector banks account for more than 92 percent of the entire banking business in India—occupying a dominant position in the commercial banking. The State Bank of India and its 7 associate banks along with another 19 banks are the public sector banks.

Role and Importance of Commercial Banks

1) **Accelerate the Rate of Capital Formation:** Banks help in allocation of funds and ensure optimum utilization of savings by encouraging the habits of savings in the economy. These savings are effectively allocated among the ultimate users of funds, i.e., investors for productive investment. So, savings of people result in capital formation which forms the basis of economic development.

2) **Provision of Finance and Credit:** Commercial banks are a very important source of finance and credit for trade and industry. The activities of commercial banks are not only confined to domestic trade and commerce, but extend to foreign trade also.

3) **Develop Entrepreneurship:** Banks promote entrepreneurship by underwriting the shares of new and existing companies and granting assistance in promoting new ventures or financing promotional activities. Banks finance sick (loss-making) industries for making them viable units.

4) **Promote Balanced Regional Development:** Commercial banks provide credit facilities to rural people by opening branches in the backward areas. The funds collected in developed regions may be channelised for investments in the under developed regions of the country. In this way, they bring about more balanced regional development.

5) **Help to Consumers:** Commercial banks advance credit for purchase of durable consumer items like Vehicles, T.V., refrigerator etc., which are out of reach for some consumers due to their limited paying capacity. In this way, banks help in creating demand for such consumer goods.

6) **Banks create credit:** Credit creation done by banks is the basis of economic development of a modern capitalist society.

7) **Influence on Rates of Interest:** Banks influence the market rates of interest as they provide loans for various terms. A higher rate for a particular type of lending induces the banks to enter that field and the market rate then comes down: Thus, a uniform interest rate structure is brought into existence as a result of the activities of bank.

In India, scheduled commercial banks are of three types:

(i) Public Sector Banks:

These banks are owned and controlled by the government. The main objective of these banks is to provide service to the society, not to make profits. State Bank of India, Bank of India, Punjab National Bank, Canada Bank and Corporation Bank are some examples of public sector banks.

Public sector banks are of two types:

(a) SBI and its subsidiaries;

(b) Other nationalized banks.

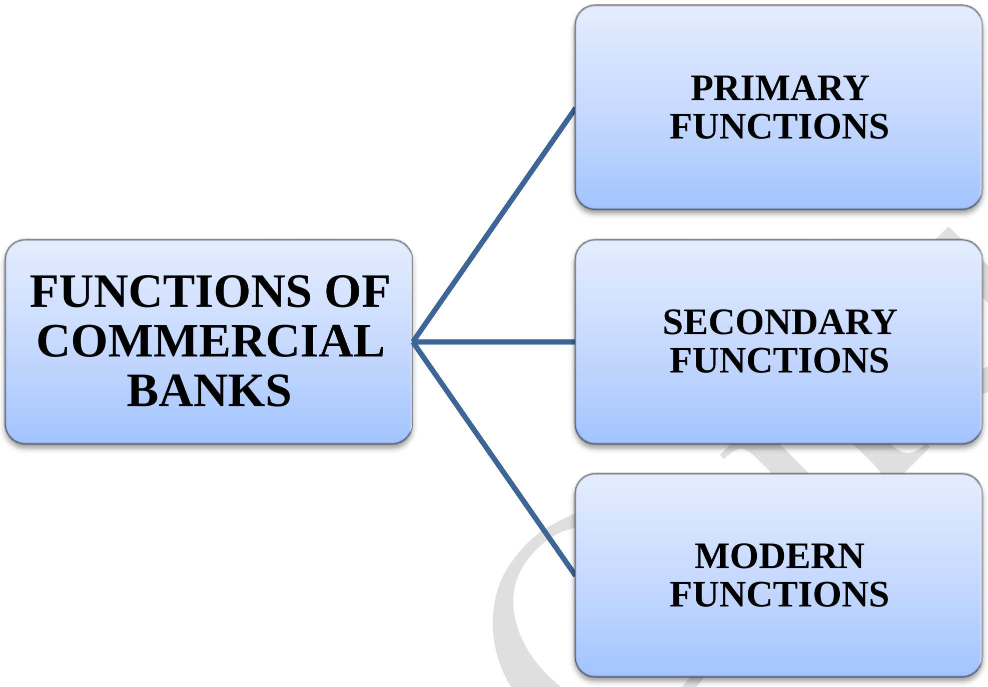
(ii) Private Sector Banks:

These banks are owned and controlled by private businessmen. Their main objective is to earn profits. ICICI Bank, HDFC Bank, IDBI Bank is some examples of private sector banks.

(iii) Foreign Banks:

These banks are owned and controlled by foreign promoters. Their number has grown rapidly since 1991, when the process of economic liberalization had started in India. Bank of America, American Express Bank, Standard Chartered Bank are examples of foreign banks

FUNCTIONS OF COMMERCIAL BANKS



1) PRIMARY FUNCTIONS

a) Accepting Deposits

Accepting deposits is the main function of a commercial bank. Banks accept deposits of money from people who have surplus money. Banks offer the following types of deposit schemes to attract money from all quarters of public.

- **Fixed deposits:** Under fixed deposits schemes, people deposit their money for a period from six months to five years; and fixed deposit is repayable by bank only after the expiry of the specified period. In fact, the longer is the period of deposit; the higher is the rate of interest.

- **Savings deposits:** The aim of savings deposits scheme is to mobilize the small savings of the public. A person can open a savings bank account, by depositing a small amount of money. He/she can withdraw money from his/her account and also make additional deposits.

  However, there may be restrictions on the number of withdrawals and the amount to be withdrawn, in a given period. The rate of interest on saving deposits is lower than payable on fixed deposits.

- **Recurring deposits:** The aim of recurring deposit scheme is to encourage regular savings by people. A person can deposit a fixed amount say Rs. 100, every month for a fixed period. The amount deposited, together with interest, is repayable on maturity.

- **Current deposit accounts:** Current deposit accounts are opened by businessmen. The account holder can deposit and withdraw money, whenever required. No interest is paid on current deposit accounts. Rather, a certain charge is made by the bank from the account holder, for the services provided by the bank.

b) Lending Function

- **Loans:** Banks advance a certain sum of money to a customer; which is called a loan. A loan, by a bank, is granted against some security or mortgage. Normally banks do not advance loans for long periods. However, of late, there is a change in this policy.

- **Overdraft:** Under the overdraft facility, a customer having a current account is allowed to withdraw more than what he has deposited. The excess amount withdrawn by the customer is known as overdraft. The overdraft is allowed up to a certain limit and for an agreed period. Interest is charged by the bank on the overdrawn amount.

- **Cash credit:** Under cash credit scheme, a loan limit is sanctioned and a cash credit account is opened in the name of the borrower. The borrower can withdraw money from the account from time to time – subject to the sanctioned limit. Interest is charged by the bank on the amount actually withdrawn by the borrower, and not on the sanctioned amount.

- **Discounting of bills:** Under this form of lending money, banks en-cash customers' bills of exchange, before they become actually due for payment. For this, banks charge what is known as a nominal discount.

2) SECONDARY FUNCTIONS

a) Collection of cheques and bills: Banks collect cheques of their customers drawn on other banks; and credit their proceeds to the accounts of their customers. Banks also collect bills of exchange on behalf of their customers from the acceptors of bills on due dates; and credit the proceeds to the accounts of their customers.

b) Agency functions: Banks, under instructions of the customers:

- Undertake to pay insurance premium
- Collect dividend, interest etc. on their investments
- Undertake to buy or sell shares, debentures etc. on behalf of their customers.

c) **Provision of remittance facilities:** Banks provide remittance facilities for transfer of funds from one place to another, usually through bank drafts. The banks charge commission for issuing bank drafts.

d) **Issuing letters of credit:** Letters of credit are most useful in import trade. They give a proof of the credit worthiness of the importer. A letter of credit issued by the importer's bank contains an undertaking by the bank to honor the bills of exchange drawn by the exporter on the importer up to the amount specified, in the letter of credit.

e) **Letter of reference:** Through a letter of reference, a bank provides information about the financial condition of the customer to traders of the same country or other countries.

f) **Traveler's cheques:** Banks provide the facility of traveler's cheques to their customers who are travelling. With this facility, the customer need not carry cash (which is risky) with him and can travel safety.

g) **Lockers facility:** Banks provide lockers facility to their customers, where customers can keep their gold, silver ornaments and important documents safely.

3) MODERN FUNCTIONS

a) **Electronic Funds Transfer System (EFTs):** This system enables employers to transfer salary/wages to the accounts of employees directly from the company (i.e. employer) bank account.

b) **Automated Teller Machines (ATMs):** It is freestanding self-service terminal. To use an ATM, one has to insert a plastic card into the terminal and then enter an identification code. The machine responds by giving cash, taking deposits and handling other simple banking transactions.

c) **Credit card:** Credit card enables the card holders to have overdraft facilities of a certain amount. It can be used (by cardholders) for making payments of goods and services. Credit cards are issued to selected customers of the bank. The credit card is a plastic card having the photo identity and signatures of the customer. It includes the issuing bank's name and validity period of the card.

d) **Debit card:** Debit cards are issued by bank to those customers who keep deposits with it. The card holder can buy goods from the designated retail store and make payment through his/her debit card. A debit card is a plastic card, bearing banks' name and customer's name, identity and signatures.

e) **Collection of information:** Banks collect information about trade and industry and supply it to interested parties. They also offer advice on financial matters.