A study of Commercial banking and its function

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Abstract

A commercial bank is a type of financial institution that provides services like accepting deposits, making business loans, and offering basic investment products. The term commercial bank can also refer to a bank, or a division of a large bank, which precisely deals with deposits and loan services provided to corporations or large or middle-sized enterprises as opposed to individual members of the public or small enterprises. For example, Retail banking, or Merchant banks. A commercial bank can also be defined as a financial institution that is licensed by law to accept money from different enterprises as well as individuals and lend money to them. These banks are open to the mass and assist individuals, institutions, and enterprises. Basically, a commercial bank is the type of bank people tend to use regularly. They are formulated by federal and state laws on the basis of the coordination and the services they provide.

key words: Commercial , Enterprises, Services, Financial, Management etc.

Introduction

The management of commercial banking activities from risk management perspective. The prime focus of this subject is to manage major risks such as interest rate risk, credit risk, liquidity risk and operational risk faced by the banks to maximize the dual objectives of commercial banks i.e. profitability and liquidity. Mostly it deals with the management of deposits, lending activities, investments, bank capital, bank liquidity and off-balance sheet activities. It also covers the use of derivatives and asset backed securities such as credit derivatives etc. to manage the market risk. In addition to this, it also covers the basic features and role of commercial banks, regulatory aspects related to banking activities and evaluation techniques to measure financial performance of banks.

Function of Commercial Bank:

The functions of commercial banks are classified into two main divisions.

(a) Primary functions –

•**Accepts deposit –** The bank takes deposits in the form of saving, current and fixed deposits. The surplus balances collected from the firm and individuals are lent to the temporary required of commercial transactions.

•**Provides Loan and Advances –** Another critical function of this bank is to offer loans and advances to the entrepreneurs and businesspeople and collect interest. For every bank, it is the primary source of making profits. In this process, a bank retains a small number of deposits as a reserve and offers (lends) the remaining amount to the borrowers in demand loans, overdraft, cash credit and short-run loans, etc.

•**Credit Cash-** When a customer is provided with credit or loan, they are not provided with liquid cash. First, a bank account is opened for the customer and then the money is transferred to the account. This process allows a bank to create money.

(b) Secondary functions –

•**Discounting bills of exchange** – It is a written agreement acknowledging the amount of money to be paid against the goods purchased at a given point of time in the future. The amount can also be cleared before the quoted time through a discounting method of a commercial bank.

•**Overdraft Facility** – It is an advance given to a customer by keeping the current account to overdraw up to the given limit.

•**Purchasing and Selling of the Securities** – The bank offers you with the facility of selling and buying the securities.

•**Locker Facilities** – Bank provides lockers facility to the customers to keep their valuable belonging or documents safely. Banks charge a minimum of an annual fee for this service.

•**Paying and Gather the Credit** – It uses different instruments like a promissory note, cheques and bill of exchange.

Types of Commercial Banks:

There are three different types of commercial banks.

• **Private Bank** – It is one type of commercial banks where private individuals and businesses own a majority of the share capital. All private banks are recorded as companies with limited liability. Such as Housing Development Finance Corporation (HDFC) Bank, Industrial Credit and Investment Corporation of India (ICICI) Bank and Yes Bank, etc.

• **Public Bank** – It is that type of bank that is nationalised, and the government holds a significant stake. For example, Bank of Baroda, State Bank of India (SBI), Dena Bank, Corporation Bank and Punjab National Bank.

•**Foreign Bank** – These banks are established in foreign countries and have branches in other countries. For instance, American Express Bank, Hong Kong and Shanghai Banking Corporation (HSBC), Standard & Chartered Bank and Citibank, etc.

Types of Credit Offered by Commercial Banks:

A commercial bank offers short-term loans to individuals and organizations in the form of bank credit, which is a secured loan carrying a certain rate of interest.

Bank Loan:

Bank loan may be defined as the amount of money granted by the bank at a specified rate of interest for a fixed period of time. The commercial bank needs to follow certain guidelines to extend bank loans to a client. For example the bank requires the copy of identity and income proofs of the client and a guarantor to sanction bank loan. The banks grant loan to clients against the security of assets so that, in case of default, they can recover the loan amount. The securities used against the bank loan may be tangible or intangible, such as goodwill, assets, inventory, and documents of title of goods.

The advantages of the bank loan are as follows:

a. Grants loan at low rate of interest

b. Involves very simple process of loan granting

c. Requires minimum document and legal formalities to pass the loan

d. Involves good customer relationship management

e. Consumes less time because of modern techniques and computerization

f. Provides door-to-door facilities

Cash Credit:

Cash credit can be defined as an arrangement made by the bank for the clients to withdraw cash exceeding their account limit. The cash credit facility is generally sanctioned for one year but it may extend up to three years in some cases. In case of special request by the client, the time limit can be further extended by the bank.

The extension of the allotted time depends on the consent of the bank and past performance of the client. The rate of interest charged by the bank on cash credit depends on the time duration for which the cash has been withdrawn and the amount of cash.

The advantages of the cash credit are as follows:

a. Involves very less time in the approval of credit

b. Involves flexibility as the cash credit can be extended for more time to fulfill the need of the customers.

c. Helps in fulfilling the current liabilities of the organization

d. Charges interest only on the amount withdrawn by the customer. The interest on cash credit is charged only on the amount of cash withdrawn from the bank, not on the total amount of credit sanctioned.

The cash credit is one of the most important instruments of short-term financing but it has some limitations.

These limitations are mentioned in the following points:

a. Requires more security for the approval of cash

b. Imposes very high rate of interest

c. Depends on the consent of the bank to extend the credit amount and the time limit

Bank Overdraft:

Bank overdraft is the quickest means of the short-term financing provided by the bank. It is a facility in which the bank allows the current account holders to overdraw their current accounts by a specified limit. The clients generally avail the bank overdraft facility to meet urgent and emergency requirements. Bank overdraft is the most popular form of borrowing and do not require any written formalities. The bank charges very low rate of interest on bank overdraft up to a certain time.

The advantages of the bank overdraft are as follows:

a. Involves no documentation for the extension of overdraft amount

b. Imposes nominal interest on the overdraft amount

c. Charges fee only on the amount exceeding the account limit

The disadvantages of the bank overdraft are as follows:

a. Incurs high cost for the clients, if they fail to pay the amount of overdraft for a longer period of time

b. Hampers the reputation of the organization, if it fails to pay the amount of overdraft on time

c. Allows the bank to deduct overdraft amount from the customers' accounts without their permission

Discounting of Bill:

Discounting of bill is a process of settling the bill of exchange by the bank at a value less than the face value before maturity date. According to Sec. 126 of Negotiable Instruments, "a bill of exchange is an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at fixed or determinable future time a sum certain in money to order or to bearer."

The facility of discounting of bill is used by the organizations to meet their immediate need of cash for settling down current liabilities.

Conditions laid down by the bank for discounting of bill are as follows:

a. Must be intended to specific purpose

b. Must be enclosed with the signature of the two persons (company, bank or reputed person)

c. Must be less than the face value

d. Must be produced before the maturity period.

Conclusion

Banks are the heart-beat of a nation's economy and provide an overview of how the country's economic growth and financial activities will perform. All major banks are considered commercial according to the basic structure as provided in the Reserve Bank of India Act 1934. However, there are other categories in banking like Small Finance bank, Payments bank and Co-operative bank under the scheduled bank category. Commercial banks can further be categorized into Public Sector banks, Private sector banks, Foreign Banks, and Regional Rural Banks. Commercial banks are regulated under the Banking Regulation Act 1949 and enable a bank to carry out business operations of keeping money as deposits and grant loans to the public, corporates and the government itself. Commercial banks in India are the backbone of all major economic activities in the country, whether it is for the citizens to keep their hard-earned money safely or get loans whenever they need funds for important things like a home, wedding, a car or for business. It won't be an analogy to say that banks and businesses run hand in hand, as without adequate credit support, businesses find it hard to flourish, and vice versa.

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