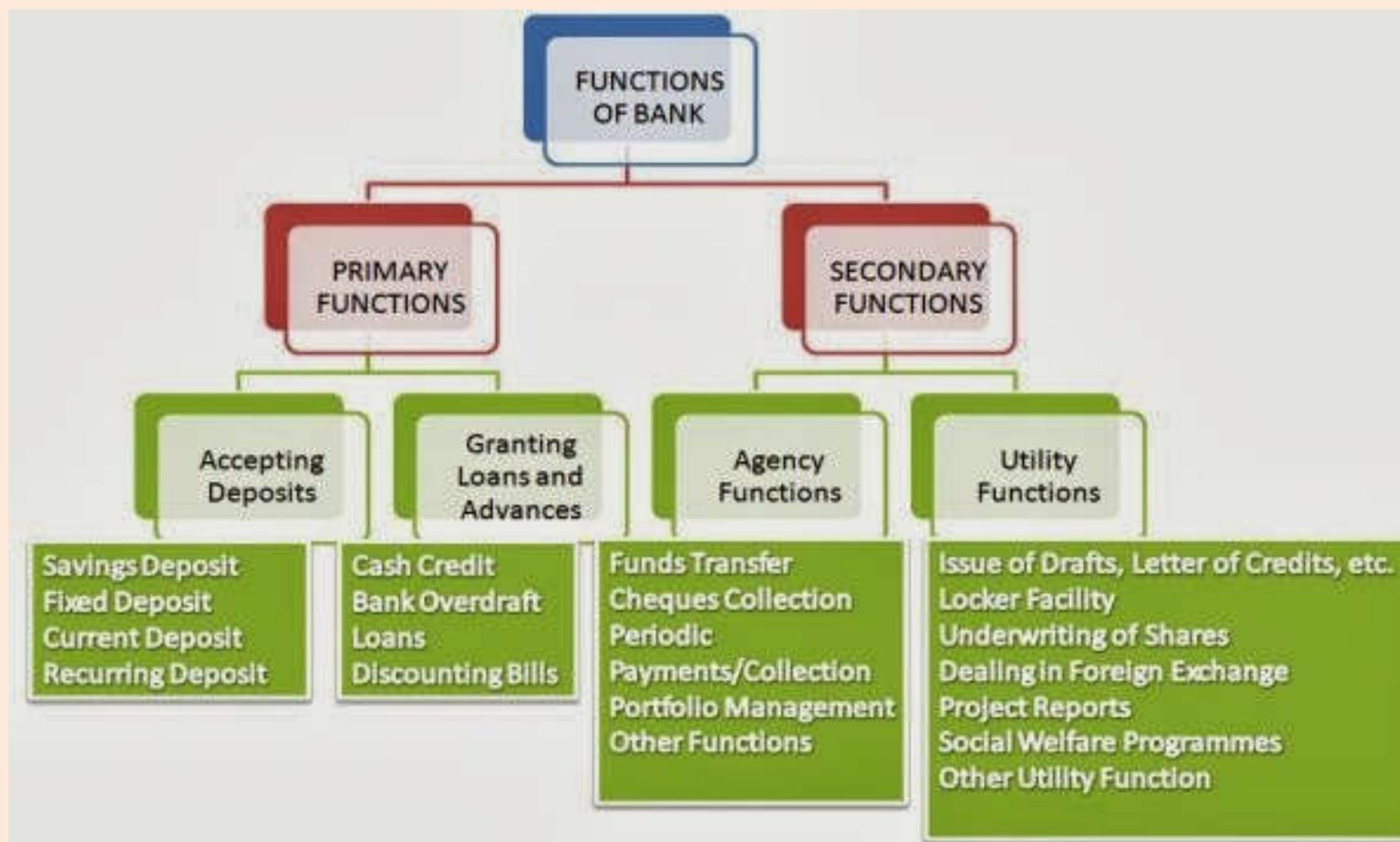


B Com (EM) - III Sem – Financial Services,
Banking and Insurance (FSBI)

1.2 Banking definition and functions of
Commercial Banks



Banking: Under English common law, a banker is defined as a person who carries on the business of banking by conducting current accounts for his customers, paying cheques drawn on him/her and also collecting cheques for his/her customers.

As per Section 5(b) of the Banking Regulation Act, 1949 , "banking" means the accepting, for the purpose of lending or investment, of

deposits of money from the public, repayable on demand or otherwise, and withdrawals by cheque, draft, order or otherwise.

Functions of Commercial Banks:

1. Primary Commercial Banking Functions:

Commercial banks have two important banking functions. One is accepting deposits and other is advancing loans.

A) Deposits:

One of the main functions of a bank is to accept deposits from the public. Deposits are accepted by the banks in various forms.

i. Current Account Deposits:

Current Accounts are usually opened by businessmen who have a number of regular transactions with the bank, both deposits and

withdrawals. There is no restriction on number and amount of deposits. There is also no restriction on withdrawals. No interest is paid on current deposits.

ii. Saving Account Deposits:

Saving Accounts are opened by salaried and other less income people. There is no restriction on number and amount of deposits and

withdrawals are subject to certain restrictions. It earns Interest but less than fixed deposits. It encourages saving habit among salary earners and others. Saving deposits are an important source of funds for banks.

iii. Fixed Account Deposits:

Deposits in fixed account are time deposits. Money under this account is deposited for a

certain fixed period of time varying from 15 days to several years. A high rate of interest is paid. If money is withdrawn before expiry date, the depositor receives lower rate of interest.

iv. Recurring Account Deposits:

In Recurring deposit, a specified amount is regularly deposited by account holder, at an interval of usually a month. This is to form the

habit of small savings among the people. At the end of maturity period, the account holder gets a substantial amount. Interest on this type of deposit is almost equal to fixed deposits.

B) Loans and Advances:

Banks not only mobilize money but also lend to its credit worthy customers for maximizing profit.

a. Discounting of Bills:

When the holder of the bill is not in a position to wait till the maturity of the bill and requires cash urgently, he sells the bill of exchange to

bank. Bank advances credit by discounting bills of exchange, government securities or any other approved financial instruments. The bank purchases the instruments at a discount.

b. Money at Call:

Banks also grant loans for a very short period, generally not exceeding 7 days. Such advances are repayable immediately at a short notice

hence they are called as Money at Call or Call money. These loans are given to dealers or brokers in stock market against Collateral Securities.

c. Direct Loans:

Loans are given to customers against the security of moveable properties. Their maturity varies from 1 to 10 years. Interest has to be paid

on entire loan amount sanctioned. Loans are of many types like: - personal loans, term loans, call loans, participative loans, collateral loans, agricultural credit etc.

2. Secondary/Non-banking Functions:

Banks gives various forms of services to public. Such services are termed as non- banking or secondary functions:

A) Agency Services:

Banks perform certain functions on behalf of their customers. While performing these services, banks act as agents to their customers,

hence these are called as agency services.

Important agency functions are:

i. Collection:

Commercial banks collect cheques, drafts, bills, promissory notes, dividends, subscriptions, rents and any other receipts which are to be received by the customer. For these services banks charge a nominal amount.

ii. Payment:

Banks also makes payments on behalf of their customers like paying insurance premium, rent, taxes, electricity and telephone bills etc for such services commission is charged.

iii. Trustee, Executor and Attorney:

As a trustee, a bank becomes the custodian and manager of customer funds. Bank also acts as

executor of deceased customer's will. As an Attorney the banks sign the documents on behalf of customer.

B) Utility Services:

Modern Commercial banks also performs certain general utility services for the community, such as

i. Letter of Credit:

Banks also deal in foreign trade. They issue letter of credit and provide guarantee to foreign traders for the soundness of their customers.

ii. Guarantor:

Banks offer a guarantee of payment on behalf of importer to facilitate imports with deferred payments.

iii. Locker Facility:

Safe Lockers are provided to the customers so that they can deposit their valuables like Jewellery, Securities, Shares and other documents with the bank.