



COMMERCIAL BANKS: FUNCTIONS AND SERVICES

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ABSTRACT

Commercial banks are organized on a joint stock company system, primarily for the purpose of earning a profit. They can be either of the branch banking type, as seen in most of the countries, with a large network of branches, or of the unit banking types, as seen mainly in the USA, where a bank's operations are confined to a single office or to a few branches within a strictly limited area. Although, the commercial banks attract deposits of all kinds- current, savings and fixed their resources and chiefly drawn from current deposits which are repayable on demand. So, they attach much importance to the liquidity of their investments and as such they specialise in satisfying the short-term credit needs of business rather than the long-term. This paper focuses on the study of functions and services of Commercial Banks.

KEYWORDS: Commercial Banks, Deposit Mobilisation, Financial Intermediaries, Money Lending.

INTRODUCTION

Banking system is one of the many institutions that impinge on any economy affect its performance for the better or the worse. In what measure a given banking system contributes to economic development depends upon the governing policy. Economists have expressed a wide variety of opinions on the effectiveness of banking system in promoting or facilitating economic development. Schumpeter, the first modern economist to study the relationship, regarded banking system as one of the two key agents (the other being entrepreneurship) in the whole process of development. Banks are considered to be the most important of all the financial intermediaries in the financial system of a country.

The importance of banking institutions is felt rather deeply in the underdeveloped economies in the sense that this economics are usually short of capital and the task of mobilisation of resources and their channelization to the priority sector belongs to such institutions. The importance of banks in stimulating the economic growth is evident from the fact in some of the countries, the government had to establish these institutions to provide facilities for expecting the development projects.

FUNCTIONS AND SERVICES OF COMMERCIAL BANKS

The two essential functions of a commercial bank may best be summarised as the borrowing and the lending of money. They borrow money by taking all kinds of deposits. Deposits may be received on current account whereby the banker incurs the obligation to repay the money on demand. Interest is not payable on current account deposits. When deposits are received on savings bank account as well, the bank undertakes the obligation to repay them on demand. Interest is usually allowed on savings bank deposits although there are usually restrictions on the total amount that can be withdrawn and /or the number of times withdrawals are allowed during a defined period. When deposits are received on fixed deposit accounts, the banker incurs the obligation to repay the customer together with an agreed rate of interest in return for the right to demand from him and agreed period of notice for withdrawals. In addition, an new banking account, which

is similar to saving bank account, known as flexi bank account has been introduced by banks. Thus, a commercial bank mobilizes the savings of the society. This money is then provided to those who are in need of it by granting overdrafts or fixed loans or by discounting bills of exchange or promissory notes. In short, the primary function of a commercial bank is that of a broker and a dealer in money. By discharging this function efficiently and effectively, a commercial bank renders a very valuable service to the community by increasing the productive capacity of the country and thereby accelerating the pace of economic development. It gathers the small savings of the people, thus reducing the quantity of idle money to the lowest limits. Then, it combines these small holdings in amounts large enough to be profitably employed in those enterprises where they are most called for and most needed. Here it makes capital effective and gives industry the benefits of capital, both of which otherwise would have remained idle. For instance, take the practice of discounting bills of exchange. By converting future claims into present money, the commercial bank bridges the time element between the sale and the actual payment of money. This will enable the seller to carry on his business without any hindrance; and the buyer will get enough time to realize the money.

Thus, a commercial bank receives deposits which it has to repay according to its promise and makes them available to those who are really in need of them. The bank is actually distributing its deposits between the borrowers and its own vaults. Herein, lies the most delicate of the functions of a commercial bank.

Besides these two main functions, a commercial bank performs a variety of other functions which may broadly be grouped under two main heads, viz., the agency services and the general utility services.

AGENCY SERVICES

A commercial bank provides a range of investment services. Customers can arrange for dividends to be sent to their bank and paid directly into their bank accounts, or for the bank to detach coupons from bearer bonds and present them for payment and to act upon announcements in the press of drawn bonds, coupons payable, etc. Orders for the purchase or sale of stock exchange securities are executed through the banks' brokers who will also give their opinions on securities or lists of securities. Similarly, banks will make applications on behalf of their customers for allotments arising from new capital issues, pay calls as they fall due and ultimately obtain share certificates or other documents of title. On certain agreed terms, the banks will allow their names to appear on approved prospectuses or other documents as bankers for the issue of new capital; they will receive applications and carry out other instructions.

A commercial bank undertakes the payment of subscriptions, premium, rent, etc., on behalf of its customers. Similarly, it collects cheques, bills of exchange, promissory notes, etc., on behalf of its customers. It also acts as correspondent or representative of its customers, other banks and financial corporations.

Most of the commercial banks have an Executor and Trustee Department'. Some may have affiliated companies to deal with this branch of business. They aim to provide a complete range of trustee, executor or advisory services for a small charge. The business of banks acting as trustees, executors, administrators, etc., has continuously expanded with considerable usefulness to their customers. By appointing a bank as an executor or trustee of his/her will, the customer secures the advantage of continuity, avoiding to have made changes, impartiality in dealing with beneficiaries and in the exercise of discretions and the legal and specialized knowledge pertaining to executor and trustee services. When a person dies without making a will, the next-of-kin can employ the bank to act as administrator and to deal with the estate in accordance with the rules relating to intestacies. Alternatively, if a testator makes a will but fails to appoint an executor, or if an executor is unable or unwilling to act, the bank can usually undertake the administration with the consent of the persons who are immediately concerned. Banks will act solely or jointly with others in these matters, as also in the case of trustee for stocks shares, funds, properties or other investments. Under a declaration of trust, a bank undertakes the supervision of investments and distribution of income; a customer's investments can be transferred into the bank's name or control, thus enabling it to act immediately upon a notice rights issue, allotment letters, etc. Alternatively, where it is not desired to

appoint the banks as nominee, these services may still be carried out by appointing the bank as attorney. Where business is included in an estate or trust, a bank will provide for its management for a limited period, pending its sale to the best advantage as a going concern or transfer to a beneficiary.

Private companies wishing to set up pension funds may appoint a bank as custodian, trustee and investment advisor, while retaining the administration of the scheme in the hands of the management of the fund.

Most banks will undertake the preparation of income tax returns on behalf of their customers and claim for the recovery of overpaid tax. They also assist the customers in checking the assessments. In addition to the usual claims involving personal allowances and reliefs, claims are prepared on behalf of residents abroad, minors, charities, etc.

GENERAL UTILITY SERVICES

These services are those in which the bank's position is not that of an agent for his customer. They include the issue of credit instruments like letter of credit and travellers' cheques, the acceptance of bills of exchange, the safe custody of valuables and documents, the transaction of foreign exchange business, acting as a referee as to the respectability and financial standing of customers, providing specialized advisory service to customers, etc.

BANKER'S DRAFTS AND LETTERS OF CREDIT

By selling drafts or orders and by issuing letters of credit, circular notes, travellers' cheques, etc., a commercial bank is discharging a very important function. A banker's draft is an order, addressed by one office of a bank to any other of its branches or by any one bank to another, to pay a specified sum to the person concerned. A 'letter of credit' is a document issued by a banker, authorizing some bank to whom it is addressed, to honour the cheques of a person named in the document, to the extent of a stated amount in the letter and charge the same to the account of the grantor of the letter of credit. A letter of credit includes a promise by the issuing banker to accept all bills of exchange to the limit of credit. When the promise to accept is conditional on the receipt of documents of title of goods, it is called a 'documentary letter of credit'. When the promise is unconditional, it is called a 'clean letter of credit'. Letters of credit may again be classified as revocable and irrevocable. A 'revocable letter of credit' is one which can be cancelled at any time by the issuing banker. But the banker will still be liable for bills negotiated before cancellation. An 'irrevocable letter of credit' is generally intended for travellers who may require money in different countries, they may be divided into 'travellers letter of credit' and 'guarantee letters of credit'. A 'travellers letter of credit' carries the instruction of the issuing bank to its foreign agents to honour the beneficiary's drafts, cheques, etc., to a stated amount which it undertake to meet on presentation. While issuing a 'guarantee letter of credit', the bank secures a guarantee for reimbursement at an agreed rate of interest, or it may insist on sufficient security for the grant of credit. There is yet another type which is known as 'revolving credit'. Here the letter is so worded that the amount of credit available automatically reverts to the original amount after the bills negotiated under them are duly honoured.

CIRCULAR NOTES, TRAVELLERS CHEQUES, CIRCULAR CHEQUES

Circular notes are cheques on the issuing banker for certain round sums in this own currency. On the reverse side of the circular note is a letter addressed to the agents specifying the name of the holder and referring to a letter of indication in his hands, containing the specimen signature of the holder. The note will not be honoured unless the letter of indication is presented. Travellers' cheques are documents similar to circular notes with the exception that they are not accompanied by any letter of indication. Circular cheques are issued by banks in certain countries to their agents abroad. These agents sell them to intending visitors to the country of the issuing bank.

Safe Custody of Valuables

Another important service rendered by a modern commercial bank is that of keeping in safe custody valuables such as negotiable securities, jewellery, documents of title, wills, deed-boxes, etc. Some branches are also equipped with specially constructed strong rooms, each containing a large number of private steel safes of various sizes. These may be used for a small fee. Each user is provided with the key of an individual safe and thus not only obtains protection of his/her valuables but also retains full personal control over them. The safes are accessible at any time during banking hours, and often longer.

Night Safes

For shopkeepers and other customers who handle large sums of money after banking hours, 'night safes' are available at many banks. Night safe takes the form of a small metal door on the outside wall of the bank, accessible from the street, behind which there is a chute connecting with the bank's strong room. Customers who require this service are provided with a leather wallet, which they lock before placing in the chute. The wallet is opened by the customer when he calls at the bank the next day to get the contents credited to his account.

EFT (Electronic Funds Transfer) Service

Another important service which is of comparatively recent origin is the Electronic Funds Transfer (EFT) service. This is a service under which funds are transferred electronically over the telephone, either nationally or internationally. International funds transfers from applicant to beneficiary are made in as little as a few seconds. The international network known as "SWIFT" (Society for Worldwide Interbank Financial Telecommunications), an organization promoted by banks and financial institutions around the world, is utilized to facilitate the speedy transfer of funds across international destinations without any paper work and expeditious efficiency. SWIFT is the largest network in the world which has around 4,800 users in 130 countries. This is a path breaking technology that will ultimately pave the way for paperless banking. In addition to the service which it renders to individual customers, it will go a long way in curing the corporate sector's headaches of cash management in multiple locations.

Overseas Trading Services

Recognition of overseas trade has encouraged modern commercial banks to set up branches specializing in the finance of foreign trade. Banks in some countries have taken interest in export houses and factoring organizations. Assisted by banks affiliated to them in overseas territories, they are able to provide a comprehensive network of services for foreign banking business, and many transactions can be carried through from the start to finish by a home bank or subsidiary. In places where banks are not directly represented by such affiliated undertaking, they have working arrangements with correspondents so that the banks are in a position to undertake foreign banking business in any part of the world.

The banks provide more than just a means for the settlement of debts between traders, both at home and abroad for the goods they buy and sell. They are also providers of credit and enable the company to release the capital which would otherwise be tied up in the goods exported. An outline of some of the services provided by banks for overseas traders is given.

For centuries, the bill of exchange has been one of the chief means of settlement in trade. Its function is to enable a seller or exporter of goods to obtain cash as soon as possible after the dispatch of goods, and yet enable the buyer or importer to defer payment until the goods reach him or later.

There are many ways in which trade may be financed with bills of exchange. Two common ways are:

1. The exporter will draw a bill of exchange on the importer, or, by arrangement between the parties, on the importer's bank, for the amount of the exporter's invoice for the goods. Shipping documents (usually the invoice, marine insurance policy and the 'bill of lading' which is the shipowner's receipt for the

- goods) which will convey title to the goods are attached to the bill of exchange. The exporter will sell (negotiate in technical terms) the bill with the documents to a local banker. The receipt of the documents of title along with the bill means that, in effect, goods are in possession. Thus, the bank will be willing to pay the exporter practically the full amount of his invoice and bill. The bank will immediately forward the bill and the documents to its banking correspondents or agents in the importer's country to be presented to the importer, or the importer's bank as the case may be, for payment if the bill is payable on demand, or for acceptance if the bill is a 'term bill'.
2. The importer's bank, at its request, will arrange for its banking correspondent or agents in the exporter's country to accept a term bill drawn on them by the exporter, and to be accompanied by shipping documents mentioned in (1) above. (such an arrangement is an example of 'opening credit' which is mentioned below). When the bill is accepted, it will be returned to the exporter who can either keep it until the period of the bill expires and then claim payment from the accepting bank, or, as is more likely in practice, sell the bill to his own or other bank, upon accepting the bill, will detach the shipping documents and send them to the importer's bank.

If a bill is payable on demand (i.e., a 'demand bill'), the importer, or his bank on his behalf if the bill is drawn on that bank, has to pay the whole amount when the bill is presented.

If the bill is drawn payable at a later date (i.e., a 'time bill' or a 'term bill'), for example three months after presentation, it is, upon presentation, accepted by the importer if it is drawn on him, or by his bank on his behalf if it is drawn on it by special arrangement. But the importer is not called upon to pay until the three months are up.

Usually, the arrangement between the buyer and the seller will be that the shipping document which accompany the bill are to be detached upon payment or acceptance of the bill by the importer or by a bank on his behalf. The documents thus become available to the buyer so that he can take delivery of the goods when the ship arrives, resell them in the ordinary way; and from the proceeds recoup himself or his bank, or make funds available to meet the bill when it matures.

An overseas buyer may arrange through his bank in the home country to open a documentary credit in favour of the seller. This is an undertaking that the bank will honour draft drawn in accordance with the terms of credit, if accompanied by stipulated shipping documents, insurance policies, etc., and presented not later than the date of expiry of the credit. The terms usually cover the nature, price and quantity of the goods, the method of shipment, the documents to be attached and the date by which shipment must be effected. The creditor may undertake payment of a demand draft or acceptance of a term draft. It may be expressed in home currency or in foreign currency, this depending on the condition of sale. It may be either revocable or irrevocable. The former may be cancelled at any time but the latter cannot be cancelled without the consent of both the parties. Therefore, an irrevocable credit provides much greater protection to the exporter.

If, for instance, a foreign importer has no account with an Indian bank, he will open the credit with his local bank, the exporter may, however, prefer to receive a corresponding advice that the credit is opened from an Indian bank. Consequently, it is usual for the foreign bank to instruct its Indian banking correspondent to advise the credit to the exporter. As an additional safeguard, an Indian exporter may require his bank not only to advise but also to undertake responsibility by adding its confirmation. This is known as a 'confirmed credit'. Having received the advice on shipment of the goods, the exporter must lodge the documents within the time allowed by the credit. If the documents are in order as stipulated in the credit, the exporter will receive immediate payment if it provides for sight payment. If it calls for a bill drawn payable after sight, the bank will accept the bill which will then be available for discount. If, for any reason, the exporter is unable to present the documents he must request the importer to instruct the relevant bank to extend or amend the credit.

In case where it is not possible to arrange a documentary credit and the arrangement is for payment to be made only when the goods have been sold, a bank can usually undertake the dispatch of the shipping documents and arrange the goods to be warehoused and insured in the name of a correspondent bank, pending delivery of the goods in part or in whole to the exporter's agent against payment. The correspondent bank will then remit proceeds of sales as and when they are made by the agent. Exporters who are dealing with first-class agents may be prepared to ship their goods on open account. In such cases, the exporter usually sends the documents directly by air mail to the consignee, who acts as his agent for the sale of the goods. Remittances, in order to avoid the inconveniences of collection, may be by a cheque on an Indian bank or by a telegraphic transfer.

INFORMATION AND OTHER SERVICE

As part of their comprehensive banking services, many banks act as a major source of information on overseas trade in all its aspects. Some banks produce regular bulletins on trade and economic conditions at home and abroad, and special reports on commodities and markets. In some cases, they invite enquiries from those wishing to extend their foreign trade and are able through their correspondents to furnish the names of reputable and interested dealers of goods and commodities and to advise on the appointment of suitable agents. For businessmen travelling abroad, letters of introduction indicating the purpose of journey undertaken, can be issued addressed to banking correspondents in the various centres it is proposed to visit. In this way, it is often possible to establish new avenues of business. On request, banks obtain confidential opinions on the financial standing of companies, firms or individuals at home or overseas for customers for the purpose of business.

Commercial banks furnish advice and information of trace, outside its scope. If it is desired to set up a subsidiary or branch overseas (or, for an overseas company to set up in the home country) they provide detailed information on local legal requirements on company formation, tax requirements, exchange control and insurance, helping to establish contact with local banking organizations.

CONCLUSION

To sum up, the services rendered by a modern commercial bank is of inestimable value. It constitutes the very life blood of an advanced economic society. In the words of Walter Leaf: "The banker is the universal arbiter of the world's economy".

Like other financial intermediaries, commercial banks act as mobilisers of public savings for their productive utilisation. However, the mechanism they provide for performing this function is fundamentally different from that of other institutions. A commercial bank is the only institution which accepts funds from the public in the form of demand deposits, i.e., deposit accounts which are subject to withdrawal by the owner on demand and subject to transfer to a third party by means of a cheque. A clear line of demarcation, therefore, exists in the functions of a commercial bank and all other financial institutions. Deposits with other financial institutions do not circulate as money, while those in the commercial banks do. In the field of lending also, commercial banks have specialised in providing funds to the business community with a view to satisfying their working capital needs. The provision of short-term loan by means of cash credit, discounting bills, hundis, promissory notes and other debt instruments distinguishes commercial banks from other financial intermediaries. In the process of the acceptance of deposits and provision of loans, commercial banks create money. This too is a characteristic feature of their function which sets them apart from other financial institutions.

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