FACULTY OF JURIDICAL SCIENCES

Lecture-16

COMMERCIAL BANKS

The term commercial bank refers to a financial institution that accepts deposits, offers checking account services, makes various loans, and offers basic financial products like certificates of deposit (CDs) and savings accounts to individuals and small businesses. A commercial bank is where most people do their banking.

Commercial banks make money by providing and earning interest from loans such as mortgages, auto loans, business loans, and personal loans. Customer deposits provide banks with the capital to make these loans.

- Commercial banks offer consumers and small to mid-sized businesses with basic banking services including deposit accounts and loans.
- Commercial banks make money from a variety of fees and by earning interest income from loans.
- Commercial banks have traditionally been located in physical locations, but a growing number now operate exclusively online.
- Commercial banks are important to the economy because they create capital, credit, and liquidity in the market.

Commercial banks are an important part of the economy. Not only do they provide consumers with an essential service, but they also help create capital and liquidity in the market.

They ensure liquidity by taking the funds that their customers deposit in their accounts and lending them out to others. Commercial banks play a role in the creation of credit, which leads to an increase in production, employment, and consumer spending, thereby boosting the economy.

As such, commercial banks are heavily regulated by a central bank in their country or region. For instance, central banks impose reserve requirements on commercial banks. This means banks are required to hold a certain percentage of their consumer deposits at the central bank as a cushion if there's a rush to withdraw funds by the general public.

Commercial banks provide basic banking services and products to the general public, both individual consumers and small to mid-sized businesses. These services include checking and savings accounts, loans and mortgages, basic investment services. Banks make money from service charges and fees. These fees vary based on the products, ranging from account fees (monthly maintenance charges, minimum balance fees, overdraft fees, non-sufficient funds (NSF) charges), safe deposit box fees, and late fees. Many loan products also contain fees in addition to interest charges.

Banks also earn money from interest they earn by lending out money to other clients. The funds they lend come from customer deposits.

<u>TYPES OF COMMERCIAL BANKS</u>

There are three different types of commercial banks-

Private bank –: It is a 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, Yes Bank, and more such banks.

Public bank –: It is a type of bank that is nationalized, 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, Citibank, and more such banks.

<u>FUNCTIONS OF COMMERCIAL BANKS</u>

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

(a) **Primary functions**

<u>Accepts deposit</u>: 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 requirements of the commercial transactions.

<u>Provides loan and advances</u>: Another critical function of this bank is to offer loans and advances to the entrepreneurs and business people, 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, short-run loans, and more such banks.

<u>Credit cash</u>: 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 the 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: A bank provides locker facilities to the customers to keep their valuables or documents safely. The banks charge a minimum of an annual fee for this service.

Paying and gathering the credit: It uses different instruments like a promissory note, cheques, and bill of exchange.