SCHOOL OF COMMERCE, DAVV INDORE

SESSION (JAN. – JUNE 2020)

M.Com.(BM) 2 YEARS II SEM

SUUBJECT: SPECIAL ACCOUNTS FOR BANKING FIRM

Unit II- Advancing functions of Bank

Functions of Commercial Banks: - Primary functions include accepting deposits, granting loans, advances, cash, credit, overdraft and discounting of bills. - Secondary functions include issuing letter of credit, undertaking safe custody of valuables, providing consumer finance, educational loans, etc.

Functions of Commercial Banks The main functions of commercial banks are accepting deposits from the public and advancing them loans.
The following points highlight the top six functions of commercial banks.

The functions are:

1. Accepting of Deposits
2. Advancing Loans
3. Credit Creation
4. Financing Foreign Trade
5. Agency Services
6. Miscellaneous Services to Customers.

The details of the following functions:

1. **Accepting of Deposits**:

Generally, the banks accept four types of deposits from the public which are as follows:

(a) Current Account or Demand Deposit:

Under this account the depositor can withdraw the money whenever he requires it. Normally no interest is paid by the bank because the bank cannot utilise this money in earning and he must keep himself ready to meet the demand of the customer. He must keep cent per cent reserve against the deposit. In this account the depositor has to maintain minimum balance. Occasionally a small interest is paid to the people who keep large balances.

Under this account the depositor is not free to withdraw any amount like current account. He can withdraw only a specified sum of money in a week. Here the depositor gets less interest in comparison to Fixed Account.

(c) Fixed or Time Deposit Account:

Under this account deposits are accepted for a fixed period say one, two, four or five years or above. The money deposited in this account cannot be normally withdrawn before the expiry of the agreed period. The rate of interest on this account is higher than on other accounts.

(d) Home Safe Account:

Under this account a safe is provided by the bank to the customers. Safe is locked and the bank keeps the key with him. Customers put their small savings in the safe and after two to three months the customers take the safe to the bank where the banker unlocks it before the customer and makes credit in the customer’s account. A nominal rate of interest is allowed to the customer.

2. **Advancing Loans:**

A bank lends a certain percentage of cash lying in deposits on higher interest rate than it pays to the depositors. This is how it earns profits and carries on its business.

The bank advances loan in the following manner:

(a) Cash Credit:

This type of loan is granted to businessmen against certain specified securities. To a new customer, a loan account has to be opened from where the money is withdrawn by cheque but he pays interest on the full amount.

(b) Call Loans/Money at Call and Short Notice:

They are very short-term loans and are mostly given to bill brokers for 15 days. They are advanced against first class securities. This can be recalled at a very short-notice.

(c) Overdraft:

Overdraft is the facility extended by the banker to draw a sum greater than the balance lying in his current account. The businessman is charged interest only on that amount by which his current account is actually withdrawn and not by the full amount of the overdraft sanctioned.

(d) Discounting Bills of Exchange:

If a creditor wants money immediately and has a bill of exchange, the bank gives his money by discounting the bill of exchange. The banker deposits the amount of the bill in the current account of bill-holder after deducting the rate of interest for the period of the loan which is normally not more than 90 days. When the bill matures the bank gets payment from the banker.

3. **Credit Creation**:

Credit creation is one of the most important functions of the commercial banks. In order to earn profit the bank accept deposits and advance loans by keeping a small cash in reserve to meet the day to day needs of the customers.

When a bank gives loan, it opens an account in the name of the loan taker and does not pay him in cash but allows him to draw the money according to his requirements. By granting a loan, the bank creates credit or deposit.

4. **Financing Foreign Trade**:

A commercial bank helps in foreign trade by financing his customers and by accepting foreign bills of exchange. The bank encourages the documents like D/A (Documents against acceptance) and D/P (Documents against payments) in foreign payments. Further, it transact foreign exchange business and buys and sells foreign currency.

5. **Agency Service:**

A bank discharges agency services on behalf of its customers which are as follows:

(i) The bank collects payments of bills of exchange, cheques dividends etc. on behalf of his customers.

(ii) It buys and sells shares, securities, debentures etc. for its customers.

(iii) The bank remits money to different places by bank drafts on telegraphic transfer (T/T) on behalf of its customers.

(iv) It discharges the functions of marketing, work as a trustee, administrator or executor for its customers.

(v) It gives proper advice to the customers in the matter of correspondence and other matters of business.

6. **Miscellaneous Services**:

Besides the above mentioned services the commercial bank performs a number of other services the important of them are as follows:

(i) It provides lockers facility to the customers where the customers can keep the valuable documents and ornaments etc.

(ii) It underwrites the company debentures and shares.

(iii) It provides information's about the customers.

(iv) It issues travelers cheques, letter of credit etc. to the customers and it accepts bills on behalf of the customers.

Unit III-CONSORTIUM FINANCING

Under consortium financing, the banks formally join, by way of an inter- se agreement, to meet the credit needs of the borrowers, In case of project financing, the banks and term lending institutions come together. As per Oct 1996 credit policy, RBI allowed the individual consortium, to frame their own norms for consortium lending.

When a company or a firm is in need of huge finance it approaches more than one bank for providing the finance and when two or more banks join together and extend the loan facilities by sharing the loan amount between themselves, it is called as consortium financing.

Compulsory consortium formation: Banks have to ensure that their exposure does not exceed the prudent credit exposure ceiling (max 15 % of their capital fund for individual borrowers and 40 % for group borrowers).

No. of banks and new banks- There is no ceiling on the no. of banks to participate. Without the consent of the existing consortium members, no bank can extend any credit facility.

Disposal of loan application- 60 days (45 for export) for fresh loans or enhancements, 45 days (30) for renewal and 30 days (15) for ad hoc facilities.

Where the participating banks are unable to adhere to the time frame, borrowers are free to bring in new banks.

Appraisal- The lead bank is responsible for preparation of appraisal note, its circulation, arrangement for convening meeting etc. It receives fee from the borrower for this.

Documentation- The documents are obtained under the Single Window Scheme, i.e. for all banks, one set of documents is obtained.

Asset classification- Each bank is to classify the loan account, according to conduct of accounts with the bank concerned, irrespective of the classification with other banks.

Post sanction follow–up: Regular meeting of consortium members is a normal requirement where the banks share information about conduct of account & performance of the borrowing unit.

Interest Rate– Since Jan 1995, the banks can fix their own rates.

Charge on securities: The banks have charge over the securities which mean they share the charge in the ratio of their exposure approved by the consortium through a formal agreement.

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