DAFFODIL INSTITUTE OF IT (DIIT)
Bachelor of Business Administration (BBA)
First Year Second Semester
THEORY AND PRACTICE OF BANKING

Chapter-2
Commercial Banking

1. Define the terms Bank.

Bank: Bank is financial institution that collects society's surplus cash and gives a part of that as loan to investors for earning profit. Bank is an intermediary institution that makes relationship between the owner of surplus savings and investor of deficit capital.

According to John Herry, "Bank is an economic institution whose main aim is to earn profit through exchange of money and credit instruments."

According to Cairncross, "A bank is financial intermediary, a dealer in loans and debts."

Finally a bank is a financial institution which deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it.

2. Define the term Banking.

Banking: Banking is the business activity of a bank. Simply, any activity carried out by a bank for business purposes is called banking.

According to R. P. Kent, "Banking is the business of a banker, the keeping or management of a bank."

Banking means accepting savings, lending money, paying for cheques, providing mortgage facilities, providing safety locker, providing over draft facilities, issuing letter of credit, act as money changer, issuing travelercheques are some of the activities carried out by modern banks in the banking industry.

3. Who is a Banker?

Banker: A banker is defined as a person who carries on the business of banking. He engages in the business of a bank. He performs all functions of banking like collection of deposit, granting loans and advances, maintaining good relationship with customers etc.

4. What is commercial bank?

Commercial Bank:A commercial bank is a financial institution that is authorized to receive money from businesses and individuals and lend money to them.Commercial banks serve customers directly. Commercial banks offer a range of deposit products to individuals and businesses such as current accounts, savings accounts, fixed deposit, etc.

One of the major functions of commercial banks is lending commercial loans, trade finance, mortgage and housing loans, vehicle loans, personal loans, etc. Commercial banks also offer a number of services to their customers such as safe deposit facilities, letters of credit, and provision of foreign exchange.

5. Discuss the characteristics or features of a bank.

Characteristics / Features of a Bank:

1. **Dealing in Money:** Bank is a financial institution which deals with other people's money i.e. money given by depositors.
2. **Individual / Firm / Company:** A bank may be a person, firm or a company. A banking company means a company which is in the business of banking.
3. **Acceptance of Deposit:** A bank accepts money from the people in the form of deposits which are usually repayable on demand or after the expiry of a fixed period. It gives safety to the deposits of its customers. It also acts as a custodian of funds of its customers.
4. **Giving Advances:** A bank lends out money in the form of loans to those who require it for different purposes.
5. **Payment and Withdrawal:** A bank provides easy payment and withdrawal facility to its customers in the form of cheques and drafts. It also brings bank money in circulation. This money is in the form of cheques, drafts, etc.
6. **Agency and Utility Services:** A bank provides various banking facilities to its customers. They include general utility services and agency services.
7. **Profit and Service Orientation:** A bank is a profit seeking institution having service oriented approach.
8. **Ever increasing Functions:** Banking is an evolutionary concept. There is continuous expansion and diversification as regards the functions, services and activities of a bank.
9. **Connecting Link:** A bank acts as a connecting link between borrowers and lenders of money. Banks collect money from those who have surplus money and give the same to those who are in need of money.
10. **Banking Business:** A bank's main activity should be to do business of banking which should not be subsidiary to any other business.

11. **Name Identity:** A bank should always add the word "bank" to its name to enable people to know that it is a bank and that it is dealing in money.

6. **State the essential qualities of a successful banker.**

Essential qualities of a successful banker: In today's scenario, retail banking is a very dynamic space to work in. It's fast paced, highly competitive and extremely customer centric. The essential qualities of a successful bankerare:

1. **Customer-oriented Attitude:** The most important aspect in the service industry is customer satisfaction. Yes, you have to remember, 'customer first.' A successful banker has to always remember to put the customer interests first and commit to deliver superior customer service to him/her. To do this always, you need to be a problem solver, empathetic to the customer, and positively oriented. Remember, your customer is a human being with feelings and not just an account that you have to manage.

2. **Good Communication Skills:** First listen and then talk. Understanding the issue and adapting to the situation to give the right solution is the key to good communication skills.

3. **Good Negotiation Skills:** A successful banker is one who is able to engage and network with internal and external customers for the desired results. He/she is the one who has the negotiation skills to be able to comprehend and find solutions to difficult conflict situations and resolve all customer queries.

4. **Excellent Product Knowledge:** It is imperative to possess product knowledge, and be up-to-date with industry updates, competitors and in-house product innovations.

5. **Impeccable Time Management:** For an effective output, one needs to master time management skills. Planning the day would involve eliminating the unnecessary interruptions, setting priorities, multitasking and knowing when to multi-task. Ultimately, it's important to set a timeline to accomplish the assigned tasks in conjunction with the organisation's expectation. As they say, "the show must go on", in service industry delivering as promised and when promised is paramount to create a USP (Unique Selling Proposition).

6. **Being Responsible:** Since the bank is a financial institution based on trust, a successful banker should be extremely responsible and ethical. He/she should own the work and the customer he/she handles.

7. **Exhibiting Professionalism:** Banking is an exceptionally knowledge driven and competitive business. Customers come with all their savings and wealth to the bank. A successful banker must be professional in his/her approach to ensure that the customers build confidence in the bank and entrust them with all their finances.

8. **Being an Initiator/Pioneer:** "I am a staunch believer – Nothing ventured, nothing gained." A retail banker is like an entrepreneur who is responsible for generation of profit for his/her organization. The way one approaches a customer, builds a rapport, creates a brand image and ensures expansion and retention of the relationship requires spearheading.

9. **Sound Judgement:** A banker has to be vigilant to be able to avert frauds. The industry has become highly prone to fraudulent activities in spite of several processes in place. Even with Stringent Anywhere Banking facilities and advanced technology, the ever lurking fraudster can still breach the system. Therefore, you should be compliant, process driven, and totally dedicated to carrying the task to 100% completion.

10. **Risk Management:** Along with judgement, you need to be cautious while managing all the risks involved in the transactions you carry out on behalf of your customer. Also, you should be able to practice due diligence at all points of time.

Inculcating the aforementioned characteristics and skills does not take much time, but you need to have the zeal and the right training to imbibe them. In retail banking, banks provide training, but you too will have to make an arduous effort to master the necessary skills, knowledge and attitude.

7. What are the objectives of bank?

The objectives of bank can be classified from different viewpoints:

1. **Objectives from the viewpoints of bank owners:**

   a) **Earning profit:** Every bank owner lead a bank to earn profit. Without profit they cannot run their organization.
   b) **Rendering services:** Rendering services is the objective of bank.A bank creates not only for earning profit but also for giving services to the customers.
   c) **Investment of funds:** Investment of fund is another main object of a bank. The earn money by investment to the customers.
   d) **Earning good will:** Goodwill is the most important asset for any organization specially in banking .Without goodwill they cannot run properly.
   e) **Rising efficiency:** Rising efficiency is the most important for banking. If they do not try to affect then they will not be able to lead their organization very successfully.
2. **Objectives from the viewpoints of government:**
   a) Issuance of note and currency: Government issues note and currency to the market. They have only right to do this of any country.
   b) Formation of capital: Formation of capita is another object of government.
   c) Investment of capital and Industrialization: Government invest capital and help to growth of industry of their country. They give financial support to the organization to success.

d) Control of money market: Government is the controller of money market of every country. They try to improve the money market success. So they take many steps to control money market.
e) Creation of employee: Creation of employee is the main challenge of government. If any country's maximum people are being employee then this country will success.
f) Counseling in financial matter: In every financial matter of bank the government take decision of any matter.

3. **Objectives from the viewpoints of customers:**
   a) Safe custodian to the public money: Bank gives to the customer firstly safe their money. Many customers keep money to the bank to safe their money.
   b) Counselor of public money: This is another objective of bank to the point of customer.
   c) Representative credit facility: Bank creates representative and trusty to the customer. People trust bank and so the keep money in that bank and take lone from the bank.
   d) Providing credit facilities: Bank provides credit facilities to the customers.

8. What are the types of a bank? Or. Discuss about the classification of Banks.

The bank can be classified on the basis of flowing categories:

1. **On the basis of ownership:**
   - **a. Government bank:** The bank which is made by the government is called government bank. Government is the hade of the bank. It regulates banking activities & monetary policy of a country. Example, Sonali Bank
   - **b. Private bank:** The bank which is made by the public share is called private bank. It is controlled by the central bank. Example, BRAC Bank

2. **On the basis of functions:**
   - **a. Central bank:** A central bank is the apex controlling institution in the banking and financial system of a country. A central bank is usually controlled by the government. Example, Bangladesh Bank.
   - **b.** C**ommercial bank:** These banks collects money from people in various sectors and gives the same as a loan to business men and make profits in interests these business men pay.
   - **c. Industrial bank:** It is actually invest their money in various sectors for long term security share. Example, Investment Corporation of Bangladesh (ICB).

d. **Cooperative bank:** The main business of cooperative bank is to provide finance to agriculture sector. Actually, established from cooperation of helping their members for giving facilities .Example, Bangladesh cooperative bank.

e. **Saving bank:** These types of bank influence lower class or lower earning people, this bank can help lower people to increase their income. Example, Bangladesh postal saving bank.

f. **Mortgage bank:** This type of bank provides loans and advances its customer. Example, BHBFC

3. **On the basis of organizational structure:**

a. **Unit banking:** The banking system in which the bank has only a central office and has no brunches is called unit banking. In Bangladesh there is no unit bank.

b. **Brunch banking:** The banking system in which the banks are appeared in different countries and cities in one central bank is called brunch banking, Example, Sonali bank, Rupali bank etc.

c. **Group banking:** The banking system in which a bank purchases the ownership of small banks which are in some business and has the managing power to manage and operate the small bank is called group banking.

d. **Chain banking:** This banking system is established in systematically in chain system. There is no chain banking system in Bangladesh but now a day in USA this banking system is developed.

e. **Mixed banking:** The banking which performs the function of specialized bank and commercial bank is called mixed banking Example, BDBL

4. **On the basis of Registration:**

a. **Scheduled bank:** The banks which are enlisted or included in the scheme of the central bank are called schedule bank. All commercial bankslike DBBL, AIBL, EXIM etc. are called schedule bank.

b. **Non-Schedule bank:** Non-scheduled banks are banks which are not included in the scheduled of the central bank.Banks are not included in scheme of Bangladesh Bank are called non-scheduled bank. Example, Grameen bank is a non-scheduled bank.

9. **Mention the various utility services provide by commercial banks.**

General Utility Functions: The general utility functions of the commercial banks include

1. To provide safety locker facility to customers.
2. To provide money transfer facility.

3. To issue travelers'cheque.
4. To act as referees.
5. To accept various bills for payment e.g. phone bills, gas bills, water bills, etc.
6. To provide merchant banking facility.
7. To provide various cards such as credit cards, debit cards, Smartcards, etc.

10. Describe the various type of bank classified on the basis of functions.

There are various types of banks. The necessity for the variety among these banks is because each bank is specialized in their own field. Each bank has its own principles and policies. Different rates of interests are also noted among these banks. All these banks are listed as below:

1. **Savings Banks** –These banks are suited for employees with a monthly salary. Low waged people may open an account in the savings bank.

2. **Commercial Banks** – These banks collects money from people in various sectors and gives the same as a loan to business men and make profits in interests these business men pay. Since the loan is large the interest rates are also high.

3. **Industrial Development Bank** – these banks are committed towards enhancing the growth of industries by providing loans for a very long period of time. This is vital for the long term growth of the industries.

4. **Land Development's Bank** – These banks promote growth in the food sector, by giving loans to farmer at a relatively lower interest rate. The loan is usually given on the basis of land. If a farmer has lots of agricultural fields then the more will be the loan provided.

5. **Indigenous Banks** – native banks. They are normal moneylenders; only this time, handling huge amounts of money. They collect money from the community and provide loans to business men and industrialists for a short amount of time.

6. **Mortgage Banks** – these banks are specialized in providing mortgage loans alone. In order to sell loans they depend solely on the secondary market.

7. **Spare Bank** – these banks are present in Norway. They promote both savings and commercial facilities to the both people and organizations in Norway.

8. **Federal or National Banks** – these banks control the principles and policies of other banks across the country. These banks are managed and run by the government. This bank provides benchmarks which other banks should follow.Cooperative banks: cooperative banks as the name suggests gets money from the general community without any bias and provide loans to all sections of people in the neighborhood. Their motto is not profit alone, but service.

9. **Exchange Banks** – these banks will be available in more than a single country. They provide services for the buying and selling of gold and silver; transactions will be in foreign currencies.

10. **Consumer's Bank** – these are consumer friendly banks; they encourage the consumer in buying commercial products and provide options for easy repay of the loan amount.

11. **Community Development Banks** – These banks provide services to the community; where there has been nothing or very little development over the years.

12. **Credit Unions** – they act just like a cooperative bank except that they provide services to only one employee union in the community. Low interest rates and easy installment paybacks are features of this bankPostal savings bank: these banks are oriented with postal services. People save money for a defined period of time and are paid with standard interest rates.

13. **Private Banks** – these banks are not for the general public or community. They serve entirely for private personnel's assets and transactions alone.

14. **Offshore Banks** – they are also private banks except that they have little tax to pay for their transactions; there is very little regulation for this bank.

15. **Ethical Banks** – as the name implies ethical banks promote candid transactions; between various customers of the bank. Policies and rules are transparent in nature.

16. **Internet Bank** – provides banking facilities only via internet. There will be no physical contact with the bank. All transactions are permitted only through online.

17. **Investment Banks** – these banks are pertinent to large organization's investment ventures across the industry. They provide advice in the investments and promote corporate transactions.

18. **Merchant Banks** – these banks exist for a long time. They promote investing in organizations that reap huge benefits for a long time rather than brand new organizations.

19. **Universal Banks** – these banks have a wide spectrum of financial assistances to provide. Insurances to stocks, they promote everything across all countries around the globe.

20. **Islamic Banks** – these banks are based on the principles of the religion Islam. There are no interests for loans acquired from this bank. Service charges may apply.

The above are some of the types of banks around the globe. They may be further classified according to their role and designation.

11. What are the main sources of bank earnings?

Interest received on various loans and advances to industries, corporates and individuals is bank's main source of income. Another sources are:

A. **Interest on loans:**Banks provide various loans and advances to industries, corporates and individuals. The interest received on these loans is their main source of income.

B. **Interest on investments:**Banks invest in various government and rated securities, and earn interest and dividends from these investments.

C. **Fees income:**Banks charge fees for performing services like syndication of loans, accepting bills of exchange, providing safety vaults, etc. For their customers.

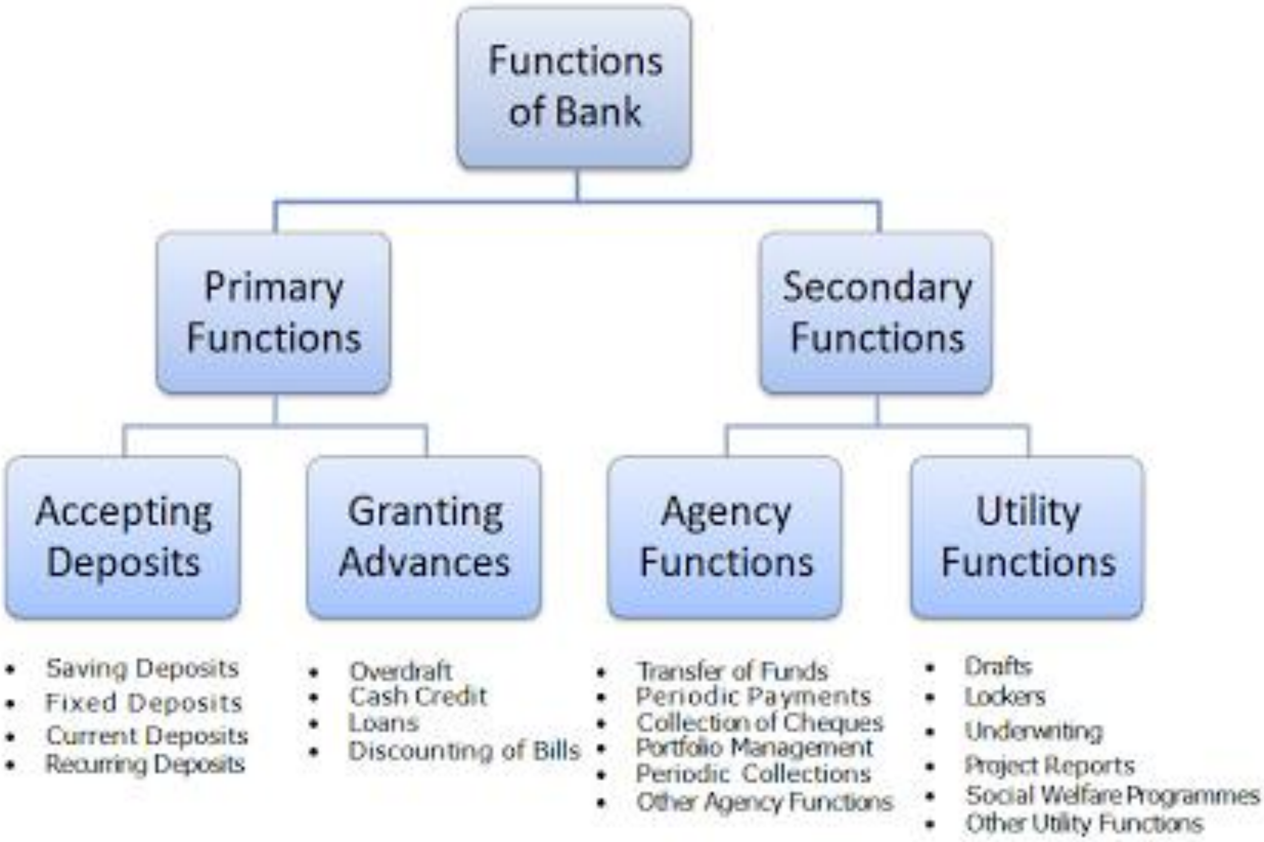
D. **Forex operations:**Banks also deal in foreign exchange and act as brokers for the same, earning an income from these operations.

E. **Commission on third party products:**Banks earn commission income by distributing insurance and mutual fund products to their customer base.

12. Discuss the functions of a modern bank.

Or. What are the services produced by the modern bank?

The functions of banks are briefly highlighted in the following chart:



A. Primary Functions of Banks: The primary functions of a bank are also known as banking functions. They are the main functions of a bank.

These primary functions of banks are explained below.

1. **Accepting Deposits**: The bank collects deposits from the public. These deposits can be of different types, such as:

   a. **Saving Deposits**: This type of deposits encourages saving habit among the public. The rate of interest is low. At present it is about 4% p.a. Withdrawals of deposits are allowed subject to certain restrictions. This account is suitable to salary and wage earners. This account can be opened in single name or in joint names.

   b. **Fixed Deposits**: Lump sum amount is deposited at one time for a specific period. Higher rate of interest is paid, which varies with the period of deposit. Withdrawals are not allowed before the expiry of the period. Those who have surplus funds go for fixed deposit.

   c. **Current Deposits**: This type of account is operated by businessmen. Withdrawals are freely allowed. No interest is paid. In fact, there are service charges. The account holders can get the benefit of overdraft facility.

d. **Recurring Deposits:** This type of account is operated by salaried persons and petty traders. A certain sum of money is periodically deposited into the bank. Withdrawals are permitted only after the expiry of certain period. A higher rate of interest is paid.

2. **Granting of Loans and Advances**: The bank advances loans to the business community and other members of the public. The rate charged is higher than what it pays on deposits. The difference in the interest rates (lending rate and the deposit rate) is its profit.The types of bank loans and advances are :

   a. **Overdraft**: These types of advances are given to current account holders. No separate account is maintained. All entries are made in the current account. A certain amount is sanctioned as overdrafts which can be withdrawn within a certain period of time say three months or so. Interest is charged on actual amount withdrawn. An overdraft facility is granted against a collateral security. It is sanctioned to businessman and firms.

   b. **Cash Credits:** The client is allowed cash credit up to a specific limit fixed in advance. It can be given to current account holders as well as to others who do not have an account with bank. Separate cash credit account is maintained. Interest is charged on the amount withdrawn in excess of limit. The cash credit is given against the security of tangible assets and / or guarantees. The advance is given for a longer period and a larger amount of loan is sanctioned than that of overdraft.

   c. **Loans**: It is normally for short term say a period of one year or medium term say a period of five years. Now-a-days, banks do lend money for long term. Repayment of money can be in the form of installments spread over a period of time or in a lump sum amount. Interest is charged on the actual amount sanctioned, whether withdrawn or not. The rate of interest may be slightly lower than what is charged on overdrafts and cash credits. Loans are normally secured against tangible assets of the company.

   d. **Discounting of Bill of Exchange:** The bank can advance money by discounting or by purchasing bills of exchange both domestic and foreign bills. The bank pays the bill amount to the drawer or the beneficiary of the bill by deducting usual discount charges. On maturity, the bill is presented to the drawee or acceptor of the bill and the amount is collected.

B. Secondary Functions of Banks: The bank performs a number of secondary functions, also called as non-banking functions.These important secondary functions of banks are explained below:

1. **Agency Functions**: The bank acts as an agent of its customers. The bank performs a number of agency functions which includes :

a. **Transfer of Funds**: The bank transfer funds from one branch to another or from one place to another.

b. **Collection of Cheques:** The bank collects the money of the cheques through clearing section of its customers. The bank also collects money of the bills of exchange.

c. **Periodic Payments:** On standing instructions of the client, the bank makes periodic payments in respect of electricity bills, rent, etc.

d. **Portfolio Management:** The bank also undertakes to purchase and sell the shares and debentures on behalf of the clients and accordingly debits or credits the account. This facility is called portfolio management.

e. **Periodic Collections:** The bank collects salary, pension, dividend and such other periodic collections on behalf of the client.

f. **Other Agency Functions:** They act as trustees, executors, advisers and administrators on behalf of its clients. They act as representatives of clients to deal with other banks and institutions.

2. **General Utility Functions:** The bank also performs general utility functions, such as

a. **Issue of Drafts and Letter of Credits:**Banks issue drafts for transferring money from one place to another. It also issues letter of credit, especially in case of, import trade. It also issues travelers' cheques.

b. **Locker Facility:** The bank provides a locker facility for the safe custody of valuable documents, gold ornaments and other valuables.

c. **Underwriting of Shares:** The bank underwrites shares and debentures through its merchant banking division.

d. **Dealing in Foreign Exchange:** The commercial banks are allowed by RBI to deal in foreign exchange.

e. **Project Reports**: The bank may also undertake to prepare project reports on behalf of its clients.

f. **Social Welfare Programs:** It undertakes social welfare programs, such as adult literacy programs, public welfare campaigns, etc.

g. **Other Utility Functions:** It acts as a referee to financial standing of customers. It collects creditworthiness information about clients of its customers. It provides market information to its customers, etc. It provides travelers' cheque facility.

13. Discuss the modern banking system.

The modern banking system can be classified into following types:

A. **On the basis of organizational structure**

   1. **Brunch banking:** The banking system in which the banks are appeared in different countries and cities in one central bank is called brunch banking, Example, Sonali bank, Rupali bank etc.

   2. **Unit banking:** The banking system in which the bank has only a central office and has no brunches is called unit banking. In Bangladesh there is no unit bank.

   3. **Group banking:** The banking system in which a bank purchases the ownership servable small banks which are in some business and has the managing power to manage and operate the small bank is called group banking.

   4. **Chain banking:** This banking system is established in systematically in chain system. There is no chain banking system in Bangladesh but now a day in USA this banking system is developed.

B. **On the basis of functions**

   1. **Saving bank:** These types of bank influence lower class or lower earning people, this bank can help lower people to increase their income. Example, Bangladesh postal saving bank.

   2. **Investment Banks**: These banks are pertinent to large organization's investment ventures across the industry. They provide advice in the investments and promote corporate transactions.

   3. **Merchant Banks**: These banks exist for a long time. They promote investing in organizations that reap huge benefits for a long time rather than brand new organizations.

   4. **Mixed banking:** The banking which performs the function of specialized bank and commercial bank is called mixed banking Example, BDBL.

14. What are the functions of commercial banking to the development of the economy of BD?

Following are the important functions of the commercial bank:
Functions of commercial bank:

1. **Accepting Deposits:**Some people have excess money and they want to deposits it to some honest man or an institution who can also give them some profit. So first function of the commercial bank is to receive deposits. There are three types of it.

   a) Demand Deposits or Current Account: These deposits can be drawn at any time, so bank is not ready to give interest on it.

b) Fixed Deposits: These deposits are fixed or particular period. Commercial banks also pay an interest on these accounts.

c) Saving Deposits: To create the habit of savings, bank accepts the savings deposits and pays an interest on these deposits. A depositor can draw a small amount at any time.

2. **Granting of Loans and Advances**: The bank advances loans to the business community and other members of the public. The rate charged is higher than what it pays on deposits. The difference in the interest rates (lending rate and the deposit rate) is its profit.The types of bank loans and advances are :

   a) Advancing Loans: Bank also advances the loan merchants and charges the interest. It is the major source of its income. It also issued the loan for short term, medium term and for long term.

   b) Over Draft Facility: It also provides the overdraft facility to its clients. The credit which a bank wants to issue, it is deposited in the account of a debtor. In this regard sometimes limit is fixed by the bank for customers. Up to that particular limit one person can draw an amount up to that limit.

   c) Discounting of Bill: Commercial banks also discount the bills and facilities the business. For example one businessman purchases anything from other person and promises to pay after one month. The seller will write a bill to the buyer and there will be an order that after a one month the buyer will pay an amount to the seller. Buyer will sign on the bill. In other words buyer will accept the responsibility of that amount. If seller is in need of money, he will take it to the bank and will receive the money by discount the bills. The commercial bank also may re discount it from the central bank.

3. **Cheap Medium of Exchange:**By issuing cheques and drafts bank provides cheap medium of exchange.

4. **Transfer of Money:**The commercial bank is very helpful in transferring the money from one place to another, by issuing the drafts.

5. **Custodian of Precious Articles:**Banks also provide locker for the safety of precious articles.

6. **Agency Services:**Bank also performs the duty of an agent. It collects and pays on the behalf of the customers.

7. **Investment:**Banks also make an investment in different companies and industries.

8. **Creation of Credit:**It also creates and extends the volume of credit.

9. **Facilities Foreign Trade:**It also provides the finance to the foreign trade. Letters of credits are issued by the commercial banks for the foreign payments.

10. **Purchase and Sale of Securities:**The commercial bank purchases and sells the securities, for him and sometimes on the behalf of the customers.

11. **Collection of Dividends:**Bank provides very useful services in the collection of dividends and it charges a very nominal fee.

12. **Executor of the Standing Orders:**The customer may order in writing to his bank to make a payment of regular installment to any one person or institution. The payment can be also stopped in writing.

13. **Acting as a Trustee:** If a client directs his bank to act as a trusty in the administration of a business, the bank performs this responsibility.

Alternative Answer

Functions:A commercial bank is authorized to serve the following functions:

1. Receive deposits - take money in from individuals and businesses (called depositors)
2. Disburse payments - make payments upon the direction of its depositors, such as honoring a check
3. Collections - a bank will act as your agent to collect funds from another bank payable to you, such as when someone pays you by check drawn on an account from a different bank
4. Invest funds in securities for a return
5. Safeguard money - banks are considered a safe place to store your wealth
6. Maintain and service savings and checking accounts of its depositors
7. Maintain custodial accounts - accounts controlled by one person but for the benefit of another person, such as a trust account
8. Lend money

Alternative Answer

Functions of Commercial Banks: Commercial bank being the financial institution performs diverse types of functions:

1. **Primary Functions**

2. **Secondary Functions**

Primary Functions: Commercial Banks performs various primary functions some of them are given below:

1. **Accepting deposits**: Commercial bank accepts various types of deposits from public especially from its clients. It includes saving account deposits, recurring account deposits, fixed deposits, etc. These deposits are payable after a certain time period.

2. **Making advances**: The commercial banks provide loans and advances of various forms. It includes an overdraft facility, cash credit, bill discounting, etc. They also give demand and demand and term loans to all types of clients against proper security.

3. **Credit creation**: It is most significant function of the commercial banks. While sanctioning a loan to a customer, a bank does not provide cash to the borrower Instead it opens a deposit account from where the borrower can withdraw. In other words while sanctioning a loan a bank automatically creates deposits. This is known as a credit creation from commercial bank.

Secondary Functions: Along with the primary functions each commercial bank has to perform several secondary functions too. It includes many agency functions or general utility functions. The secondary functions of commercial banks can be divided into agency functions and utility functions.

1. **Agency Functions** : Various agency functions of commercial banks are
   a) To collect and clear cheque, dividends and interest warrant.
   b) To make payment of rent, insurance premium, etc.
   c) To deal in foreign exchange transactions.
   d) To purchase and sell securities.
   e) To act as trusty, attorney, correspondent and executor.
   f) To accept tax proceeds and tax returns.
2. **General Utility Functions** : The general utility functions of the commercial banks include
   a) To provide safety locker facility to customers.
   b) To provide money transfer facility.
   c) To issue traveler'scheque.
   d) To act as referees.
   e) To accept various bills for payment e.g. phone bills, gas bills, water bills, etc.
   f) To provide merchant banking facility.
   g) To provide various cards such as credit cards, debit cards, Smart cards, etc.

15. Distinguish between the primary and secondary functions of bank?

primary functions: The primary functions of a bank includes the function of accepting deposits and granting advances i.e. Accepting deposits of money from the public for the purpose of lending or investment where the depositor can demand for repay through cheque, draft, order or otherwise. These are also known as quantitative functions of a bank.

Secondary functions: The secondary functions of a bank includes the agent function which refers to the banking function of transferring money, purchase and sale of securities, consultancy business etc. And general utility services which includes locker facility, letter of credit etc. These are also called qualitative services of a bank.

16. What are different types of account? Explain.

Although banks offer a wide variety of accounts, they can be broadly divided into five types: savings accounts, basic checking accounts, interest-bearing checking accounts, money market deposit accounts, and certificates of deposit.

- **Checking account:** A checking account offers easy access to your money for your daily transactional needs and helps keep your cash secure. Customers can use a debit card or checks to make purchases or pay bills. Accounts may have different options or packages to help waive certain monthly service fees. To determine the most economical choice, compare the benefits of different checking packages with the services you actually need.
- **Savings account:** A savings account allows you to accumulate interest on funds you've saved for future needs. Interest rates can be compounded on a daily, weekly, monthly, or annual basis. Savings accounts vary by monthly service fees, interest rates, method used to calculate interest, and minimum opening deposit. Understanding the account's terms and benefits will allow for a more informed decision on the account best suited for your needs.
- **Certificate of Deposit (CD):** Certificates of deposit, or CDs, allow you to invest your money at a set interest rate for a pre-set period of time. CDs often have higher interest rates than traditional savings accounts because the money you deposit is tied up for the life of the certificate – which can range from a few months to several years. Be sure you do not need to draw on those funds before you open a CD, as early withdrawals may have financial penalties.
- **Money market account:** Money market accounts are similar to savings accounts, but they require you to maintain a higher balance to avoid a monthly fee. Where savings accounts usually have a fixed interest rate, these accounts have rates that vary regularly based on money markets. Money market accounts can have tiered interest rates, providing more favorable rates based on higher balances. Some money market accounts also allow you to write checks against your funds, but on a more limited basis.
- **Individual Retirement Accounts (IRAs):** IRAs, or individual retirement accounts, allow you to save independently for your retirement. These plans are useful if your employer doesn't offer retirement benefits or you want to save more than your employer-sponsored plan allows. These accounts come in two types: the traditional IRA and Roth IRA. The Roth IRA is popular because the funds can be withdrawn tax-free in many situations. Others prefer traditional IRAs because these contributions are tax-deductible. Both accounts have contribution limits and other requirements you may need to discuss with your tax advisor before choosing your account.

17. What is unit banking? Discuss the features of unit banking.

Unit banking: The banking system operations are carried through a single office without any brunch is called unit banking.

According to M.N Mishra,"Unit banking system is that system in which banking operation are carried though a single office specials at one place."

The banking system in which the bank has only a central office and has no brunches is called unit banking. There is no unit bank in Bangladesh.

Features of unit banking: The important features of unit banking are given below:

1. **Unit office:** A unit bank has no brunch. It operate its activities in unit office.
2. **Particular area:** Unit bank are not in every area of any country. It has a particular area that areas they are operate their business activities.
3. **Owner ship:** As the unit banking has no another brunch and office so the ownership of the bank will be one person or partnership but their area will be small.
4. **Limited capital:** As the size of this bank is small and this is not a company organization so the capital of the bank is limited.
5. **Small size:** As the bank has no brunch and it operate with limited capital,so the size of the bank are small.
6. **Easy formation:** The formation of the bank is very easy because the bank has no brunch, not more capital, not so many areas are one so the formation of the bank is also very easy.
7. **Scale of operation:** The scale of operation of this bank is very easy and simple .Need not much money and has no many employee and brunch, so the scale of operation is easy.
8. **Efficient management:** As there is no brunch, not many employees, size is also small so the management can easily manage the bank.
9. **Method of functioning:** The method of functioning is very easy.
10. **Rapid decision:** As the size, branch,employee are under control of the bank so the bank manager can easily take rapid decision.
11. **Legal entity:** The bank has a legal entity to operate its business.

18. What are the advantages and disadvantages of unit bank?

Advantage of unit banking: The advantages of unit banking are given below:

1. **Easy management:** As the bank is small, the size of this bank is small and the employees are not so much so the management of the bank is easy.

2. **Less operational cost:** As the size is small of the bank, the employee are less, there have no brunch of this bank so the operational cost is less.

3. **Close management and workers relationship:** As a small, not many employee, no brunch so the relation between manager and employee are very close and friendly.

4. **Quick decision:** The bank manager can take quick decision of this bank.

5. **Little capital and stuff :** The bank is very small, it has no brunch, not so mane employee so the bank need not so much capital and stuff.

6. **Efficient management:** The bank manager can manage the bank efficiently.

7. **Local development:** The bank lands its business activities in one place. So it can create local development.

8. **Less fraud and irregularities:** As the bank has no other branch so the bank has less possibility to fraud ness and irregularities.

Disadvantage of unit banking: The disadvantages of unit banking are given below:

1. **Limited size:** The bank operates its business activities in one place and operates with less capital so the size is small of the bank.

2. **Limited financial resources:** It is a small size bank, so the financial resource is also limited.

3. **Investment of idle funds:** The bank can invest their funds in small area.

4. **No risk development:** the bank has any risk diversification.

5. **Trustworthiness:** The bank has less trustiness o the people.

19. What is branch banking? Explain the advantages and disadvantages branch banking.

Branch banking: The bank operates its banking activitiesunder a single name through a wide network is called branch banking.

According to P.S. Rose, “Banks that sell their service through multiple offices are called branch banking.”

The banking system in which the banks are appeared in different countries and cities in one name is called brunch banking. Example, Sonali bank, DBBL etc

Advantage of branch bank: The advantages of Branch banking are given below:

1. **Large scale of operations:** As the bank has many branch of the country and cites so the operation scale is very large of this bank.

2. **Huge capital:** This type of bank has large reserve.

3. **Less costly:** The bank has limited cost.

4. **Uniformed in the rate of interest: The** bank has uniformed in the rate of interest.
5. **Wise banking policy:** The bank has wise policy.
6. **Great efficiency:** As it is a branch bank .so it is more efficient.
7. **More safety:** This type of bank is more safe then unit bank.
8. **Remittance of funds:** This categories bank remittance of funds is large.

Disadvantage of branch bank:

1. **Lose control and management:** These types of bank is controlling is loose and management also loose.
2. **Delay of decision making:** These types of bank are cannot take decision easily.
3. **Chances of failure:** This type of bank has more chance to failure for their loose management.
4. **Monopolistic tendency:** This type of bank has always been monopolistic.
5. **Relation between manager and employee: The** relation between manager and employee are not good.
6. **Lack of flexibility:** This type of bank has lack of flexibility.

20. Distinguish between branch banking and unit banking.

Differences between Branch bank and unit bank are given below:

Particulars	Branch banking	Unit banking
Definition	Under branch banking system banking business is carried out thought a network of branches in the same town or country under the guidance and control of single banking.	The banking business is care out through a single office without any branch is called unit banking.
Rate of interest	Rate of interest is uniformed.	It is not uniformed.
Operational freedom	Less operational freedom.	More operational freedom.
Managemen t Quality	Efficient trained and supervised.	Less trained, skilled and supervised.
Financial resources	Large financial resources are available.	Large financial resources are not available.
Decision making	Delay in decision making process.	Quick decision can make.

Cost and Competition	Cost and coopetition is very high.	Less cost and coopetition.

21. Discuss the dissimilarity between industrial bank and commercial bank.

Dissimilarity between commercial and industrial bank are follows:

Key Points	Commercial Bank	Industrial Bank
Nature of banking	Commercial Bank provides financial facilities to commercial activities.	It is bank which primarily provides financial facilities to industrial or productive activities.
Loan	It generally provides short term loans for meeting working capital needs.	It generally provides long term loans for meeting fixed capital needs.
Financing period	It provides finance for a short duration.	It provides finance for a longer time period like 15 or 20 years.
Other services	Commercial Bank provides agency and general utility services to its clients.	Industrial bank provides under writing, promotional and consultancy services to its clients.

22. Difference between commercial bank and co-operative bank.

Differences between commercial and cooperative bank are:

Key Points	Commercial Bank	Cooperative Bank
Registration	In Bangladesh the commercial banks are required to be registered under banking regulation act.	In Bangladesh it required to be registered under the cooperative society's act.
Area of operation	It operates over a large area. Some of even have branches in foreign countries.	Its operational area is limited and mostly confined to local area.
Basis of operation	It operates on the basis of commercial principles to earn profit.	It operates on the basis of cooperative motives. e.g. service to its members and the society.
Rate of interest	It provides lower a rate of interest as compare to cooperative bank.	It provides a higher rate of interest as compare to commercial bank.
Objectives	The main objective of commercial bank is to accept deposits from public for the purpose of lending to industrial corporation.	The main objective of a cooperative bank is to accept deposit from the members for purpose of providing loans to firmer, small businessmen with a cooperative motive.

23. What are the differences between commercial and merchant bank?

Differentiating between commercial bank and merchant bank:

Serial	Commercial Bank	Merchant Bank
1.	A commercial bank can provide loans to individuals and small businesses.	Merchant bank serves mainly large companies and many wealthy individuals.
2.	Commercial bank raises funds by collecting deposits from general public and lends as loan to the individuals.	Merchant bank often focuses on investing a depositor's assets in financial portfolio and managing these investments.
3.	It is generally accessible to anyone for basic banking needs.	These are commonly called investment bank.
4.	It purchases bonds form government and corporate entities.	Apart from investing and managing the assets of wealthy clients it also counseling and advice to large corporation.

24. What is the expectation of the society and the nation from the nationalized banks?

The expectation of the society and the nation from the nationalized banks are given below:

1. **Banking facility to the unbanked location:** Opening of branches is essential to develop banking practice, mobilize savings of the people and implement projects for rural development.

2. **Provide credit to neglected section of the society:** The banks should provide credit to small scale industry and small farmers.

3. **Financing small scale industry:** Banks should provide finance to small scale units, village and cottage industries.

4. **Small business finance:** The nationalized banks have to contribute to increase opportunities for self-employment in the small sector by financing retail traders, transport operations, professionals and others.

5. **Assistance to women:** Financial assistance is to be made available for women entrepreneur for setting up their small business.

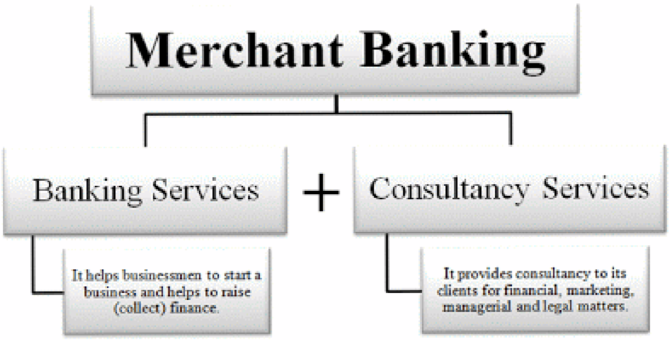
6. **Financing to agriculture:** The banks can extended credit facility to modernization of farm, minor irrigation and land development sectors.

7. **Welfare of minorities:** Nationalized banks should take special care to minorities for the development of socio economic condition.

8. **Assistance to students:** the interest of loan given to the student will be lower than the prevailing rate for pursuing higher education.

25. What is merchant banking? What are the functions carried out in merchant banking?

Merchant banking: Merchant Banking is a combination of Banking and consultancy services. It provides consultancy to its clients for financial, marketing, managerial and legal matters. Consultancy means to provide advice, guidance and service for a fee. It helps a businessman to start a business. It helps to raise (collect) finance. It helps to expand and modernize the business. It helps in restructuring of a business. It helps to revive sick business units. It also helps companies to register, buy and sell shares at the stock exchange.



Merchant Banking act as Financial Engineer for a Business.

In short, merchant banking provides a wide range of services for starting until running a business. It acts as Financial Engineer for a business.

Functions of Merchant Banking: The important functions of merchant banking are depicted below.

1. **Raising Finance for Clients:** Merchant Banking helps its clients to raise finance through issue of shares, debentures, bank loans, etc. It helps its clients to raise finance from the domestic and international market. This finance is used for starting a new business or project or for modernization or expansion of the business.

2. **Broker in Stock Exchange:** Merchant bankers act as brokers in the stock exchange. They buy and sell shares on behalf of their clients. They conduct research on equity shares. They also advise their clients about which shares to buy, when to buy, how much to buy and when to sell. Large brokers, Mutual Funds, Venture capital companies and Investment Banks offer merchant banking services.

3. **Project Management:** Merchant bankers help their clients in the many ways. For e.g. advising about location of a project, preparing a project report, conducting feasibility studies, making a plan for financing the project, finding out sources of finance, advising about concessions and incentives from the government.

4. **Advice on Expansion and Modernization:** Merchant bankers give advice for expansion and modernization of the business units. They give expert advice on mergers and

amalgamations, acquisition and takeovers, diversification of business, foreign collaborations and joint-ventures, technology up-gradation, etc.

5. **Managing Public Issue of Companies:** Merchant bank advice and manage the public issue of companies. They provide following services:

    i. Advise on the timing of the public issue.
    ii. Advise on the size and price of the issue.
    iii. Acting as manager to the issue, and helping in accepting applications and allotment of securities.
    iv. Help in appointing underwriters and brokers to the issue.
    v. Listing of shares on the stock exchange, etc.

6. **Handling Government Consent for Industrial Projects:** A businessman has to get government permission for starting of the project. Similarly, a company requires permission for expansion or modernization activities. For this, many formalities have to be completed. Merchant banks do all this work for their clients.
7. **Special Assistance to Small Companies and Entrepreneurs**: Merchant banks advise small companies about business opportunities, government policies, incentives and concessions available. It also helps them to take advantage of these opportunities, concessions, etc.

8. **Services to Public Sector Units:** Merchant banks offer many services to public sector units and public utilities. They help in raising long-term capital, marketing of securities, foreign collaborations and arranging long-term finance from term lending institutions.

9. **Revival of Sick Industrial Units:** Merchant banks help to revive (cure) sick industrial units. It negotiates with different agencies like banks, term lending institutions, and BIFR (Board for Industrial and Financial Reconstruction). It also plans and executes the full revival package.

10. **Portfolio Management:** A merchant bank manages the portfolios (investments) of its clients. This makes investments safe, liquid and profitable for the client. It offers expert guidance to its clients for taking investment decisions.

11. **Corporate Restructuring:** It includes mergers or acquisitions of existing business units, sale of existing unit or disinvestment. This requires proper negotiations, preparation of documents and completion of legal formalities. Merchant bankers offer all these services to their clients.

12. **Money Market Operation:** Merchant bankers deal with and underwrite short-term money market instruments, such as:

    i. Government Bonds.
    ii. Certificate of deposit issued by banks and financial institutions.
    iii. Commercial paper issued by large corporate firms.
    iv. Treasury bills issued by the Government (Here in India by CB).

13. **Leasing Services:** Merchant bankers also help in leasing services. Lease is a contract between the lessor and lessee, whereby the lessor allows the use of his specific asset such as equipment by the lessee for a certain period. The lessor charges a fee called rentals.
14. **Management of Interest and Dividend:** Merchant bankers help their clients in the management of interest on debentures / loans, and dividend on shares. They also advise their client about the timing (interim / yearly) and rate of dividend.

26. Discuss the role of private commercial bank to the development of the economy of Bangladesh.

Or. "Deposit is the blood of bank and bank is the blood of an economy of a country." - Justify the statement.

27. What is virtual banking?

Virtual banking: Providing the banking services through extensive use of information technology without direct recourse to the bank by the customer is called virtual banking. The origin of virtual banking can be traced to the 1970,s with the installation of ATM's. The principal types of virtual banking services include automated teller machines (ATM's), phone banking and most recently internet banking. With the increasing use of internet banking there is greater reliance now on information technology and the decrease of physical bank branches to deliver the banking services to the customer.

28. What is credit creation? Explain the mechanism of credit creation by commercial bank. Use an example.

Credit creation: Credit creation is the multiple expansions of banks demand deposits. It is an open secret now that banks advance a major portion of their deposits to the borrowers and keep smaller parts of deposits to the customers on demand. Even then the customers of the banks have full confidence that the depositor's lying in the banks are quite safe and can be withdrawn on demand. The banks exploit this trust of their clients and expand loans by much more time than the amount of demand deposits possessed by them. This tendency on the part of the commercial banks to expand their demand deposits as a multiple of their excess cash reserve is called creation of credit.

Mechanism of credit creation by commercial bank: The most common mechanism used to measure this increase in the money supply is typically called the money multiplier. It calculates the maximum amount of money that an initial deposit can be expanded to with a given reserve ratio.

Suppose a depositor deposits TK. 10000 in his savings account, which will become the demand deposit of the bank. Based on the assumption that not all customers will turn up at the same day to withdraw their deposits, bank maintain a minimum cash reserve of 10% of the demand deposits, i.e. tk. 1000. It lends the remaining amount of tk. 9000 in the form of credit to other customers. This further creates deposits for the bank. With the cash reserve of tk. 1000 the credit creation is worth tk. 10000.

So the credit multiplier is given by

Credit multiplier= 1/CRR= 1/10%=10 = 1000*10= 10000

The money supply in the economy will increase by the amount of credit multiplier.

29. Discuss the limitation of credit creation.

Theoretically, the banking system can create unlimited amount of credit through expansion of deposits. However, in reality, the powers of banks to create multiple credit or deposits are subject to a number of limitations as explained below:

1. **Amount of cash:**The credit creation power of banks depends upon the amount of cash they possess. The larger the cash, the larger the amount of credit that can be created by banks.The amount of cash that a bank has in its vaults cannot be determined by it. It depends upon the primary deposits with the bank. The bank's power of creating credit is thus limited by the cash it possesses.

2. **Proper securities:**An important factor that limits the power of a bank to create credit is the availability of adequate securities. A bank advances loans to its customers on the basis of a security, or a bill, or a share, or a stock or a building, or some other type of asset. It turns ill-liquid form of wealth into liquid wealth and thus creates credit. If proper securities are not available with the public, a bank cannot create credit. As pointed out by Crowder, "Thus the bank does not create money out of thin air it transmutes other forms of wealth into money."

3. **Banking habits of the people: The** banking habits of the people also govern the power of credit creation on the part of banks. If people are not in the habit of using cheques, the grant of loans will lead to the withdrawal of cash from the credit creation stream of the banking system. This reduces the power of banks to create credit to the desired level.

4. Minimum legal reserve ratio:The minimum legal reserve ratio of cash to deposits fixed by the central bank is an important factor which determines the power of banks of creates credit. The higher this ratio (RRr), the lower the power of banks to create credit; and the lower the ratio, the higher the power of banks to create credit.

5. **Excess reserves:** The process of credit creation is based on the assumption that banks stick to the required reserve ratio fixed by the central bank. If banks keep more cash in reserves than the legal reserve requirements, their power to create credit is limited to that extent. If Bank A of our example keeps 25 per cent of Rs 1000 instead of 20 per cent, it will lend Rs 750 instead of Rs 800. Consequently, the amount of credit creation will be reduced even if the other banks in the system stick to the legal reserve ratio of 20 per cent.

6. **Leakages:**If there are leakages in the credit creation stream of the banking system, credit expansion will not reach the required level, given the legal reserve ratio. It is possible that some persons who receive cheques do not deposit them in their bank accounts, but withdraw the money in cash for spending or for hoarding at home. The extent to which the amount of cash is withdrawn from the chain of credit expansion, the power of the banking system to create credit is limited.

7. **Cheque clearances:**The process of credit expansion is based on the assumption that cheques drawn by commercial banks are cleared immediately and reserves of commercial banks expand and contract uniformly by cheque transactions. But it is not possible for banks to receive and draw cheques of exactly equal amount. Often some banks have their reserves increased and others reduced through cheque clearances. This expands and contracts credit creation of the part of banks. Accordingly, the credit creation stream is disturbed.

8. **Behavior of other banks:** The power of credit creation is further limited by the behavior of other banks. If some of the banks do not advance loans to the extent required of the banking system, the chain of credit expansion will be broken. Consequently, the banking system will not be "loaned up".

9. **Economic climate:**Banks cannot continue to create credit limitlessly. Their power to create credit depends upon the economic climate in the country. If there are boom times there is optimism. Investment opportunities increase and businessmen take more loans from banks. So credit expands. But in depressed times when the business activity is at a low level, banks cannot force the business community to take loans from them. Thus the economic climate in a country determines the power of banks to create credit.

10. **Credit control policy of the central bank:**The power of commercial banks to create credit is also limited by the credit control policy of the central bank. The central bank influences the amount of cash reserves with banks by open market operations, discount rate policy and varying margin requirements. Accordingly, it affects the credit expansion or contraction by commercial banks.