Functions of Modern Commercial Banks

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It would be reasonable to say that the modern banking system is one of the bedrocks of society—something that ensures the proper functionality of social order. The system allows individuals having the means for purchasing tangible things as well as enabling nations to engage in trade deals using banks as instruments for financial transactions. There are different types of banking systems, and commercial banks focus on creating value for people, along with offering a positive contribution to the national economy in general. As a result, to understand the core functions of modern commercial banks, one should provide a definitive background by speaking of the aspects that constitute such financial institutions. The next phase is to show that commercial banks have various vital functions—ones affecting millions of people in the United States and all over the globe. In such regard, when exploring the key functions of modern commercial banks, it is crucial to appeal to elements like granting loans to populations, creating credit for shareholders, mobilizing savings, and national economic development as most notable ones.

Background

Speaking about the notion of a commercial bank, it is crucial to mention that such a financial institution operates as a subject that grants loans to shareholders along with issuing transaction deposits. The significance of commercial banks is based on the focus on off-balance sheet activities—something that allows making several transactions that other types of banks do not offer. However, the byproduct of such a capability is that the financial institution is often highly regulated by the government. Another crucial feature of a commercial bank is that such an
institution has access to a government safety net—meaning that a bank's large part of deposit funds are covered by government deposit insurance—for instance, the Federal Deposit Insurance Cooperation and the Federal Reserve in the United States (Berger & Bouwman, 2016). In terms of regulations, for instance, in the United States, commercial banks are supervised by several authorities. To ensure there are no disruptive activities held by a financial institution, the Federal Reserve along with state banking authorities impose policies, regulations, and monitoring activities on state-chartered banks (Berger & Bouwman, 2016). The system of regulation allows saving banks from engaging in disruptive financial activities, as well as aligns the objectives of the financial institution with those that benefit the national economy.

Functions of Commercial Banks

Loan Granting

Being financial intermediaries, modern commercial banks have a number of key functions they perform to create profit. Offering loans is among the fundamental functions where, on one side, the financial institution provides loans to the public, while on the other side, people who borrowed money from commercial banks pay back loans with a particular interest rate. This interest rate constitutes the profit for the financial institution. Importantly, while in the past commercial banks were allowed to provide loans for commerce only, in the modern system, such banks offer loans to all sectors of the economy. When speaking about types of loans, there are the following: cash credit, investment in company's shares, discounting of bills, and overdraft facilities often requiring a shareholder borrowing money to have realizable assets as a safety net (Muley, 2016). While offering loans, commercial banks cover a broad range of public financial activities, from providing finances for construction to providing consumers with the financial
means to purchase various goods. Before granting a loan, a commercial bank engages in reviewing a potential applicant to determine whether a person or a business is eligible for a short-term or medium-term loan. Such a process is crucial for maintaining a bank's long-term liquidity (Agarwal, 2019). Therefore, granting loans to various sectors of the economy is the function of commercial banks—something that allows starting a business or purchasing goods that a consumer needs.

Credit Creation

Another crucial function of commercial banks is associated with the process of the creation of credit. In the context of the loan granting, credit creation is the next step—one defined by the provision to the customer of a functional bank account. Through such an account, a shareholder can make various financial transactions. However, instead of offering a customer actual physical cash, the commercial bank increases the finances in circulation in the economy—the phenomenon that increases credit (Agarwal, 2019). While considered as one of the most significant functions of commercial banks, credit creation is about the multiplication of bank deposits—the approach that is done through loans and advances (Muley, 2016). In such regard, credit creation is crucial for the growth of the economic system, namely because it substitutes physical cash and allows a customer to create deposits that have a positive effect on a bank’s long-term liquidity. As a result, benefits from credit creation affect consumers, banks, and the national economy, making it possible to engage in the further economic growth of the financial system. Opening new deposits are the processes that ensure the growth of a commercial
bank—something that allows the financial institution to play a more significant positive role in the subsequent economic development of the nation's financial system.

Savings Mobilization

Going further, one should recognize the mobilization of savings as another crucial function of modern commercial banks—the instrument that provides shareholders with a degree of financial interest when they create a bank deposit. Specifically, individuals and businesses can open an account in a commercial bank and deposit money to the financial institution. In return, banks mobilize savings of people and companies offering interest on the deposits. There are three critical types of deposits: demand, time, and fixed deposits (Muley, 2016). Importantly, when opening an account and depositing money into a bank, both sides of the deal benefit. People who created a financial inflow will eventually receive their interest rate based on the type of deposit and amount deposited. As for the banks, they will have a steady inflow of finances that can be used for various financial operations a bank engages in—for instance, loan granting and credit creation as mentioned above (Muley, 2016). As a result, mobilizing savings is about creating a circular flow of finances, allowing shareholders to benefit from the process of depositing money into banks.

Economic Development

Finally, in a broader perspective, the function of commercial banks is about developing an economic system through various banking activities. By giving loans, creating credit, and mobilizing savings, commercial banks ensure a steady flow of finances within a nation's
economic system, thus making it functional (Muley, 2016). On the other hand, when it comes to national and international trade transactions, commercial banks are the ones taking a part of mediators of such transactions, creating proper conditions for deals. There were instances when commercial banks assisted governments in offering loans to particular economic sectors to help nations develop economically. Boosting specific segments of business can be done to have a positive impact on both social and economic progress (Muley, 2016). In such a context, one can see that commercial banks provide underdeveloped economic sectors with financial means that allow to develop the industry and make it profitable in the broader setting of a nation's economy. Creating an inflow of finances into particular economic segments is a process that can develop an entire community, fostering not only economic but social development as well.

Conclusion

Considering the previously mentioned concepts, one should say that modern commercial banks have a range of functions that affect various shareholders, from individual consumers to whole nations. In such regard, commercial banks play a vital role as a financial institution because of loan granting, credit creation, savings mobilization, and economic development. The evidence shows that the provision of financial loans creates benefits for particular economic segments that cannot receive the required finances otherwise. Even though loans should be returned with a particular interest rate, businesses and individuals can use such a function of a commercial bank to develop business outreach and start creating value. In terms of credit creation, opening deposits ensures the growth of banks as well as provides the growth of the financial system in general—namely because it does not require the utilization of physical cash.
When shareholders have a surplus of finances, they can deposit funds into banks and receive interest rates. In return, through the function of savings mobilization, banks receive investments they can operate with. Finally, the key features of commercial banks ensure the broader economic growth of a nation's financial system.
References


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