What is the need of the Narration? How involve by Job Vs. Research?

FORMS OF BANKING LENDING

It has been universally recognised that lending is one of the two principal functions of commercial banks,not only because of their social obligations of meeting the credit need of different sections of the community but also for the fact that lending is most profitable, the interest rates on loans have always been much above the interest rates on investments. Having sterilized a portion of deposits in cash reserves and highly liquid assets (which yield little or no earning) for the purpose of satisfying liquidity requirements, a banker has to deploy the residual funds in profitable outlets so that they might be able to pay interest on deposit,salary to the staff, meet other establishment expenses,built up reserves and share dividend to the shareholders.

The present system of commercial bank lending in India is partly governed by the historical goals of commercial banking and partly by the cummulative efforts of the regulatory authorities, viz.,the Reserve Bank of India and the Government of India. Commercial banks provide credit facilities to the society in different forms, viz., the cash credit, loans, discounting of bills etc. Each one of these forms ~~have~~ distinct features and relevance in meeting the financial needs of the borrowers as discussed below.

. Cash Credit System

Under the cash credit systems cash credit account of the borrower - firm is maintained by the banks and the credit limits are fixed. The customer is allowed to draw any amount within the credit limit sanctioned by the bank. The cash credit limits are ordinarily sanctioned against the pledge or hypothecation of goods and /or against personal security of the borrowers.

In the initial stages, when the banks were mainly financing trade and seasonal industries, their emphasis was mainly on security of the loan rather then on the purposes for which the facility was used and thus they found the cash credit system more convenient not only to them but also to the beneficiary customers.

The main advantage of this system is its flexibility. It enables the borrowers to recycle the funds efficiently as they may operate the account within the stipulated credit limit as and when required and thereby minimize interest cost by reducing the debit balances. The anxiety to minimize interest cost prompts the borrower to route all his cash accruals thought the account and keep the drawings at the minimum required level. This ensures lesser cost to the borrower and better turnover of funds to the bank. The flexibility of the system prevents undue delay, by not repeating documentation and changing securities.

Because of this, the banks and their customers, in India have been traditionally accustomed to this system. However, there are certain weaknesses in this, from the view point of banks and society. For instance, the system does not ensure efficient management of funds by both parties. The traditional practice of fixing borrowing limit to meet the peak level needs, under the cash credit system, has usually resulted in the fixation of larger limits than required for most part of the year. This system enables the borrowers to draw funds from the account even during the periods of credit restraint as the limits once sanctioned are not curtailed during credit squeeze. Also because of the importance attached to the nature and value of the security under the system it accentuates, to some extent atleast the inflationary pressures and also adversely affects the efficacy of banks in their credit planning efforts and the central banking authority.

The cash credit system is also not conducive to working capital management efficiency in the borrowing firms. An efficient manufacturer gets less finance because his inventory and receivables level will be lower than that of an inefficient producer. Similarly, a producer who withholds his output, holding larger stocks of raw materials to take advantage of the rising prices in the market is more favored under the system than the one who sells out his output and maintains his inventory at the minimum required levels.

The limits under the cash credit system are normally reviewed. This is a long period for review looking to the short term nature of the advances. often even the annual reviews are delayed.

Loan System

Under the loan system, entire amount is sanctioned and paid to the borrower, either in cash or by transfer to his current account. No subsequent debit is ordinarily allowed except by way of interest, incidental charges, insurance premium, expenses for security protection etc. Usually the repayment is made throughout mutually agreed instalments.

The essential advantage of the loan system is that it is for a fixed period. So the borrowers have to negotiate every time with the banker for renewing the loan under the system. The banker is in decisive position to renew it or not, depending upon his own resource position and credit policy. At the otherwise he may be saddled with surplus funds or may find it difficult to meet his requirements of funds during that time.. This system therefore, ensures a better financial discipline both among the borrowers and the bankers. As pointed out earlier,there is a built-in system of reviewing the loan proposal when the earlier loan is settled. There are a few other advantages also, mainly to the bankers, such as book keeping convenience, avoidance of leakage of income, etc. and the simplicity of the system as compare to determining limits and sub-limits.

The main weakness of the loan system is its infexibility. Each time it has to be negotiated. This leads to the tendency among the borrowers to borrow more than what they need in order to avoid the formalities of documentation, repeatedly.

Although loan is always given for specified purposes, banks usually have no control over the end use of the lonable funds. The individual transaction loans have to be usually combined with the revolving credit agreement and informal lines of credit which are virtually commitments to give loans, arranged in advance, as and when required by the borrower. The loans are also more often renewed than repaid. thus, it is argued that the loans system also would in effect be a 'roll over' credit. The loan system while simpler than cash credit system in general has certain operational difficulties in India due to legal, traditional and infra-structural factors. For instance, the documentation is more comprehensive in India than under the cash credit system and has many in-built complications under the existing legal provisions relating to registration charges, etc. further, in U.S.A. and other developed countries, there is a well-developed secondary level financial market to supplement bank finance. It could not so far develop in India. As a result, industrial borrowing have to entirely depend on the bank loans and credits. While single transaction loans are a form of finance in India its extensive use with large industrial borrowers has not developed as it does not confer any particular advantage over the cash credit system.

Bill System

Under this system bills are purchased and discount by banks mainly of approved customers in whose favour regular cash credit limits are sanctioned. In case of documentary bills of lading etc. for determining the bills' limit, bankers verify the credit-worthiness of borrowers and genuineness of the bills. The bills discounted by lead to the commitment of the bank funds for the period between the date of discounting the bill and the date of maturity. The usual maturity period time of bills is 90 days or so. The use of bills in meeting the working capital needs of industries in India was not popular due to legal factors, cost factor and in-built discipline factor. However, due to the genuineness of transactions and the financial discipline facilitating credit and fund planning in banks as well as in industries, several committees/Study Groups recommended, time and again, that the bill system be made more popular in India as the use of bills of exchange, as an instrument of credit, would enable the banks and others with surplus funds, to buy bills of various maturity and those who are in deficit, to discount such bills in the market to suit their requirements. Also due to definite date of repayment in the case of bill finance, credit planning in banks becomes relatively easy. However, inspite of many merits of bill finance, it cannot totally replace the other forms of bank lending especially the cash credit system. The process of evaluation of the genuineness of bills is time consuming and the provision of stamp duty and other administrative costs both at the banks and beneficiaries levels, make it a relative high cost source of finance. Inspite of all these weaknesses it is still felt desirable to encourage the bill system of financing in India.

The existing system of bank lending in the country is a combination of cash credit, loans and bills. Loan system is used where the borrower needs money in lump-sum for a definite purpose, viz. purchase of fixed assets or durable goods. These loans are repayable in time-bound installments. The cash credit system is used for financing working capital system requirements of manufacturing and trading firms, and the bill system is used to supplement the cash credit system to finance sales and receivables.

However, a review of the lending pattern by commercial banks and their portfolio analysis shows that of all the forms of bank advances, the cash credit system still occupies the most important place in terms of its share in the total bank credit. The reason for this situation may be found in greater emphasis of banks on deployment of their funds in short-term and medium-term avenues, under-developed state of the capital and the bill markets, and greater preference of borrowers for the cash credit form of advance over loan bills system.