Course: PGDFM

Paper II

Topic: Bank Finance

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Bank Finance in India

Most of the joint stock banks in India are modeled on the lines of the British banks, which are purely commercial bank. In other words, they provide only short-term finance to business firms.

They play an important role in financing the short-term requirements and they account for over four fifths of the total credit by all the financial institutions. However, in recent years commercial banks in India have ventured into new lines of activity of extending medium and long-term credits to industries. Thus, there is a visible change in the attitude of the commercial banks.

They provide loans and advances to village artisans and other weaker sections of the community. They are very liberal in advancing to educated unemployed to create self-employment opportunities. However, it should be noted that still 90% of the banks finance available to corporate sector today comprises of the working capital finance.

Here, we should also consider the practical difficulties of a banker. The lending capacity of the banker is limited by law as well as by financial considerations. In spite of these limitations, the banks share is by far the largest — at about 50% of the loaned fund of the industry.

Form of Bank Financing

1. Cash Credit

Cash credit is an arrangement by which a banker allows his customer to borrow money up to a certain limit against either a bond, promissory note of one or more sureties and or on the hypothecation of stock.

This is the most popular method of financing by commercial banks. The borrower should bring the account to credit at least once in a year. The interest will be charged for the amount actually utilized by the borrower and not for the amount sanctioned.

2. Overdraft

Under this arrangement, the banker allows his customer to overdraw his current account temporarily. The period of credit shall be generally one week to one month. This overdraft facility is provided only to overcome the occasional shortage of funds.

3. Loans

When a banker makes an advance in a lump sum, the whole of which is withdrawn in cash and is supposed to be repaid generally in one single installment, it is called a loan.

The borrower should pay interest on the whole amount. However, it is also allowed to repay the amount in installments. If so, the borrower should pay interest only on the reduced balance. Here the advance is kept as a separate loan account.

These are the traditional ways of providing advance to the customers by commercial banks. Besides, discounting of bills is also becoming popular in India.

4. Discounting of Bills

The most important form in which bankers give accommodation, without any collateral security is the discounting of clean bills. This form of financing is very popular in Western countries. Genuine trade bills are of much use to the traders, acceptors and also to the commercial banks. But the Bill Market has not developed sufficiently in India.

Other Methods of Bank Finance

The other methods of providing assistance are as follows:

1. Purchasing of shares and debentures issued by companies.

2. Providing medium and long-term loans.

3. Granting loans and advances on the collateral security of shares and debentures of the corporation.

4. Underwriting the issue of shares and debentures.

5. Provision of financial consultancy services.

Though commercial banks mainly provide short-term finance, the short-term facility provided by the banks is gradually being converted into medium finance by the renewal of the loan from time to time. Banks are also now providing long-term finance to deserving cases.

However, they have done very little in this direction. Certain efforts were made in the recent past to introduce industrial banking on the lines of German example in order to provide long-term finance to Indian Industries. However, the results are not satisfactory.