

2nd semester Bcom notes
Banking Operations and innovations

Unit 4

Bank Lending

Forms of Advances:

Banks offer different kinds of borrowing facilities to their customers. The credit facilities may be broadly classified into these different kinds:

1. Loans
2. Cash credit system
3. Overdraft
4. Discounting of bills
5. Hire Purchase Advances.

The explanation to the above is as under:

1. Loans- Under this system, the banker sanctions a specified lumpsum amount to a customer for a specified period at a certain rate of interest. A separate loan account is opened in the name of the customer and the customer can draw the amount at any time. The interest is charged on the full amount sanctioned, irrespective of the fact, whether it is used or not.

Types of Loans:

a. Short term loans- It is given for a period of not exceeding one year and it is given mainly for the working capital requirements of business.

b. Medium term loans- It is granted for a period not exceeding 5 years.

c. Long term loans- Loans given for a period of five years and above come under the category of long term loans.

2. Cash Credit- Under this system, a customer is permitted to borrow money up to a particular limit against sufficient securities. A separate account is opened for this purpose. The borrower can withdraw money from this account as and when he needs it. Interest on Cash credit is charged only on the actual amount utilised. However there is a minimum interest clause or a commitment charge.

3. Overdraft- It is an arrangement, whereby a customer is allowed to overdraw his current account up to a specified limit. It is sanctioned to current account holder. It is a temporary financial accommodation given to current account holder, where a holder is allowed to overdraw from his account. Withdrawals

and deposits can be made frequently. Interest is charged on the amount actually utilised. There is also a minimum interest clause, which will apply in case the overdraft is not made use of.

4. Discounting of Bills- Under this type, the banker lends money against the bill of exchange or a promissory note. A holder of a bill has to wait, till the maturity of the bill, say three months or so to realise the amount of the bill. But if he is in urgent need of money he can take the bill to his banker and discount it. It means the banker will credit the account of the customer, who brings the bill for discount, after deducting certain charges from the amount of the bill. These charges are called discount charges and they constitute an income to the banker.

5. Hire purchase advances- Under this system banks provide finance to business concerns engaged in hire purchase business. They don't give finance to ultimate buyers directly. The business houses engaged in hire purchase selling, obtain loan facilities on the security of hypothecation of goods sold out on hire purchase basis. They are very popular in the case of durable goods like TV, refrigerators, motor vehicles etc