

## Concept of Advances in Commercial Banks in India

**\*Dr. Ritu Toshniwal**

### **Abstract**

Advances constitute the most profitable as well as the most risky function performed by commercial banks. Therefore, it must be done efficiently and with a minimum loss. Advance operation is one of the important aspect of banking. A study of the balance sheets of public sector banks reveals that about 85 per cent of their revenue arises from interest and discount income derived from advances, including bills purchased and discounted. The strength of the banking system thus primarily depends on the soundness of the advances. It performs this function by advancing the money to the depositors' accounts by accepting the promise to pay from borrowers. Priority sector advances which are available in Indian Banking System are also discussed in the present study.

**Key Words:** Profitable, Operation, Strength, Borrowers, Priority Sector Advances.

### **Introduction**

A bank's health and profitability is mainly shaped by the quality, volume and yield on its advances portfolio. Its contribution to the national economy can also be judged by the quantum and nature of its advances in various spheres of national activity. This is so because while a bank has very little control over the amount and nature of deposits flowing into its books, the advances portfolio is largely of its own making in accordance with its policies.

The advances operation must be conducted in a profitable and safe manner. Safety is essential to commercial banking since banks hold thousands of crores of deposits of individuals, business and government. Profits are also necessary for the successful operation of a bank. Bank advance comprehends all kinds of promises to pay of banking institutions including demand deposits, time deposits, notes, bankers' acceptances, letters of credit and shares. The term bank advance is often used in restricted sense in banking parlance. There are two reasons for this restricted use. First the demand deposits are money by far the most voluminous kind of money found in modern monetary system and the deposit liabilities of the central bank are largely the reserves of the commercial banks and as such govern the capacity of the commercial banks to maintain demand deposits and second the advances of commercial and central banks represent the principal source of all other kinds of advances.

## Importance of Advances

Of all the functions of modern banking, the advance of funds with or without security, is by far the most important function. The shares of advances in the total assets of the banks is generally about 60 per cent and is the backbone of the banking structure. The strength of the banking system thus primarily depends on the soundness of the advances. Advances inspire confidence in the depositors and prospective customers of the banking sector. In fact, commercial banks bridge the gap between those who have money for which they have no use and those who have projects in which borrowed money can be used at once. Not only this, a step further may be traces in the operation of the commercial banks as these create new demand deposits in the process of granting loans and buying investment securities and truly it can be said that commercial banks monetize credit. In this capacity, the commercial bank substitute their generally acceptable promises to pay off their customers. The banking system performs its primary function by its ability to create money. It performs this function by advancing the money to the depositors accounts by accepting the promise to pay from borrowers. These deposits, created by the advancing process, result in an increase in the money supply, and the economy is stipulated.

Banks advancing is very important to the economy for it makes possible the financing of the agricultural, industrial and commercial activities of the country. Bank loans are called agents of indirect production. They also make possible production for inventory. In addition to the financing of agricultural, commercial and industrial activities banks through their consumer loans contribute to consumption activities creating constant demand for consumer goods like houses, furniture, appliances etc.

## Forms of Advances

Advances by commercial banks are made in different forms such as loans, cash credits, overdrafts, bills purchased, bills discounted etc. These are generally short-term advances. Commercial banks do not sanction advances on a long-term basis beyond a small proportion of their demand and time liabilities. They cannot afford to lock up their funds for long periods. The bank advances are made available in the following forms:

1. **Loans:** Loans are usually given in a lumpsum and are repayable after the term or installments. If one repay and desire a further amount, that will be a separate transaction. These loans are generally for fixed capital requirement. The loans may be clean or against security. In loan account, the entire amount is paid to the borrower either in cash or by transfer to his account. Sometimes, the repayment is provided for by installments without allowing the demand character of the loan to be affected in any way. Interest is charged on debit balances, usually with quarterly rates unless there is an arrangement to the contrary. As regards, security it has been justly remarked that the security may be personal or in the form of shares, debentures, government papers, immovable property, fixed deposit receipts, life insurance policy, goods etc.

2. **Cash Credit:** A cash credit account can be operated in the same way as a current account but within a stipulated limit. The limit is expected to be sanctioned by the bank on the basis of certain norms. It is a drawing account against credit granted by the bank and is operated in exactly the same way as a current account on which an overdraft can be sanctioned. In this system, the bank establishes a line of credit and one is allowed to draw according to their needs. Where a customer having a current account overdraws his account, the transaction amounts to a cash credit. The cash credit account may be clean, against stock, or even against book debts or other current assets. Separate limits are granted and depending on the number of limits, separate accounts are opened. The drawing power in each account is generally transferred to the operated account for the sake of convenience, even if there is no customary requirement to do so.
3. **Overdraft:** When a customer, who has a current account is allowed by the bank to draw more than his deposits in the account, such facility is called an 'overdraft' facility. In this facility, the customer is permitted to withdraw the amount as when he needs it and to repay it by means of deposits in his account as and when it is convenient to him. A banker sometimes grants unsecured overdrafts for small account to customers, having current accounts with them. Such drawings require strict control, except for isolated drawings which are promptly repaid and are not likely to resorted again. Sanction is necessary in all other cases, these are called temporary overdrafts. It may be permitted with safety, only where there is an apparently reliable source of funds available to a borrower for easily repayment.
4. **Bills Purchased:** It is one of the forms of granting advances to the customer. Bills purchases are the bills purchased from approved customers in whose favour regular limits are sanctioned. In the case of documentary bills, the drafts are accompanied by documents of title of goods such as railway receipts and bill of lading. Before granting a limit, the banker satisfies as to the credit worthiness of the drawer. Although, the term 'bills purchased' seems to imply that the bank becomes the owner of such bills. It will be observed that in almost all cases, the bank holds the bills only as security for the advances.
5. **Bills Discounted:** Usance bills, maturing within 90 days or so after date or sight, are discounted by banks for approved parties. In the case of discounting, the bills discounted are only accepted for payment by the drawee. These bills can be clean or documentary i.e. supported by documents of title or they can be demand (at sight) or time (after sight). They can be inland or foreign. The difference between the present worth and the amount of the bill represents earnings of the banker for the period for which the bill is to run. In banking terminology, this item of income is called 'discount'. When a bank discounts the bill in possession of an endorsed on the bill, the bank generally informs the drawer of the bill about such discounting of the bill. If the drawer of the bill himself gets the bills discounted there is

no necessity of such intimation. The bank treats the amount of the discounted bill as an advance until the maturity date.

6. Export Credit: Export credit facility is given to the exporter of goods for the development of business and to earn foreign exchange for the country in the form of Packing credit advances and Post shipment advances by the bank.
  - a) Packing Credit: It is also known as pre-shipment finance. This refers to the advances made available by banks to exporters at the pre-shipment stage for the purpose of procuring goods for exports, procuring raw materials and processing them into finished goods, packing and shipping them and paying export duty freight and other expenses connected with the exports. The advance is available at concessional rate of interest for a specific period. The advance is allowed till the consignment/ goods are ready for shipment.
  - b) Post-Shipment advances: It refers to any advance granted or any other credit provided to the exporter after the shipment of goods. This advance is allowed by negotiating the documents covering the goods shipped for exports. The advance is allowed from the moment goods are shipped to the time the proceeds are received. The advance is made at concessional rate of interest to boost export earnings.

### **Priority Sector Advances**

The evolution of priority sector concept may be traced back to 1967 when social control on the banks was imposed. The National Credit Council established in early 1968 as a part of social control schemes defined priority sectors to include agriculture, small-scale industries and exports. After the nationalization of 14 major banks in 1969 the list of priority sector was enlarged to include in addition to agriculture and small-scale industries and other sectors such as road and water transport operations, retail trade and small business, professional and self-employed and education.

In the Indian banking system, priority sector advances are made available through different programmes announced by the government, which are as under:

1. Agriculture: Individuals, firms, companies etc. having necessary resources, skills, capacity and willingness to undertake any productive activity in agriculture are eligible for loans. Loans are granted for financing any productive activity in agriculture except the purchase of land, working capital loans are granted for raising crops.
2. Transport: Scheme of financial assistance to road transport operators applies to small road transport operators playing vehicles such as taxis, tempos, trucks etc. and any other small vehicles used as public transport vehicle. Need based credit facilities depending upon the repayment capacity of the applicant out of business income generated are considered under the scheme.

3. Professional and Self- Employed: Scheme of financial assistance to professional and self-employed persons applies to individuals or firm engaged or intending to engage in providing services which call for special qualifications, skill and experience. The credit facility is granted for purchase of necessary tools/ equipment, furniture and fixtures directly related to the profession/business and for purchase of new or old car/motor cycle/scooter/van etc. The credit facility is granted by way of term loan or demand loan repayable in instalments.
4. Educational Loans: Educational loans are granted to individuals for educational purposes. Any Indian student in age group of 15-28 years and having consistently brilliant academic record may get financial assistance for any graduation or post-graduation course of a recognized university, research, vocational training courses, job oriented diploma courses recognized by government or university. Loans are also granted for undergoing higher studies abroad.
5. Retail Trade and small business: The scheme of financial assistance to retail traders applies to individuals, firms, fair price shops, consumer co-operative stores engaged/ intending to engage in retail trading of various commodities such as textiles, provisions and general stores, medicines, consumer items and perishable commodities. Advances under the scheme may be granted to meet the genuine working capital needs only of the trader to hold and sell goods. Advances under this scheme are granted by way of cash credit.

## Conclusion

Advance operation is one of the important aspect of banking. Bank advancing is very important to the economy for it makes possible the financing of the agricultural, industrial and commercial activities of the country. The bank advances are made available in form of loans, cash credit, overdraft, bills purchased, bills discounted and export credit. The leading commercial banks in India have adopted the policy of making advances as per statutory requirements promulgated by the government/ Reserve Bank of India from time to time.

*\*Assistant Professor  
Sri Balaji PG Mahavidyalaya, Jaipur*

## References

1. *L.V. Chandler, The Economic of Money and Banking, New York: Harper and Row, 1969*
2. *Bedi and Hardikar: Practical Banking Advances, Institute of Banking Studies, New Delhi, 1991*
3. *K.C. Nanda, Credit and Banking, Response Books, New Delhi, 1999, p-66*
4. *Bedi, Ayyar, Shenoy and Subramaniam: Theory and Practice of Banking, Jeevandeep Prakashan, Mumbai, 1978*
5. *Joint Publicity Committee of Public Sector Banks: Handbook for the Borrowers Priority Sector-Leading Schemes at a Glance*