

PRINCIPLES OF BANK LENDING

LENDING BANK

Lending of funds is the main business of a bank. The major portion of bank fund is employed by way of lending

Meaning of lending banker

The lending banker is the banker who lends funds to trade, commerce and industry etc to meet their financial requirements.

PRINCIPLES OF BANK LENDING or SOUND LENDING

- 1. Liquidity:** liquidity refers to convertibility into cash. The major portion of bank deposits is repayable on demand or at a short notice. Therefore the banks must see to it that advances are not locked up but comes back immediately.
- 2. Safety:** safety is the most important principles of lending. A banker has to see that the borrower should be able to repay the principle amount along with interest.

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- 3. Profitability :** in order to ensure sufficient profit a bank should employ its fund in genuine sources which gives not only fair returns but also steady returns.
- 4. Diversification :** Another important principle to be followed by the banker is to see that loans and advances are spread to different categories.
- 5. Purpose :** A banker should grant advance for productive purposes such as financing trade, commerce and industry. He should not grant advances for unproductive purposes.

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- 6. Security :** Another guiding factor in bank advance is security. When the banker advances without security he will run the risk of losing the money.
- 7. Income generating potentiality of the project:** The banker has to see whether the project for which money is lent will generate necessary funds to repay the loan.
- 8. Term of loan :** Generally a banker prefers to grant short term loans as it cannot lock up its funds by granting loans for a long period.

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9. Public interest : The banker should grant advances to those industries which require development in the countries planning program.

TYPES OF BANK LOAN

1. Clean loans/term loans

- It used to grant loans or advances in lump sum usually on the basis of some acceptable securities
- Under this system credit is given for a definite purpose and for a predetermined period at an agreed rate of interest

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- 2. Overdraft :** A customer is allowed to draw cheque up to an agreed limit over and above the credit balance in the account.
- It is a short term credit facility
 - The interest is calculated on the amount actually utilized by the customer at regular intervals.

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3. Cash Credit: Cash credit is a flexible system of lending under which the borrower has the option to withdraw the funds as and when required and to the extent of his needs. Under this arrangement, the banker specifies a limit of loan for the customer up to which the customer is allowed to draw.

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- 4. Discounting of bill:** It is an arrangement under which a banker takes a bill of exchange before its due date and pays to the customer. Then on the due date the banker receives the face value of the bill from the drawee.
- 5. Purchasing of bill:** It is a financial arrangement under which a banker takes a bill and pays to the credit of the customer(the face value of the bill minus the discount charges)

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6. Letter of credit: It is a guarantee by the bank to the suppliers of the goods that their bill will be honoured by the bank on behalf of the customer.

Types of Letter of Credit

- **Revocable letter of credit**
- **Irrevocable letter of credit**
- **Confirmed letter of credit:** Confirmed letter of credit is a special type of letter of credit in which another bank apart from the issuing bank has added its guarantee.


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- **Back to back letter of credit**
- **Transferable letter of credit**
- **Standby letter of credit**

Types of securities for bank leaning or methods of creating charge

Creating a charge on a security or charging a security refers to the procedure by which a banker establishes his right as a lender on the particular security offered by the borrower.

- 1. Lien :** A banker has a general lien. It refers to his right to retain any property of his customer for the debt due from the customer.



2. Pledge : A contract where by a borrower offers his tangible property to his lender as a security for the amount borrowed on the understanding that the property pledged will be returned when the debt is repaid