Borrowings constitute an important source of funds for banks. Banks often maintain, after meeting their CRR and SLR requirements, their Credit-Deposit Ratio at levels higher than what is possible for them, by borrowing from other banks, the Reserve Bank of India, IDBI and other Financial Institutions, the local inter-bank Call Money Market etc. The extent to which banks can thus meet their requirements depends upon the Credit Policy of the Reserve Bank of India and the ability of individual banks to generate funds.

**SOURCES OF BORROWINGS:**

Borrowings by banks may be divided, broadly, into two categories viz. entitlement borrowings and need based borrowings. Entitlement borrowings are those borrowings to which banks are entitled, from the Reserve Bank of India and other financial institutions such as the IDBI, NABARD, EXIM Bank etc. Need based borrowings refer to borrowings by banks from the Inter-Bank Call Money Market, re-discounting of Bills, under the New Bill Market Scheme, with financial institutions, borrowings from the Reserve Bank of India against Securities, Issue of Participation Certificates etc. In other words, while entitlement borrowings constitute a permanent source of funds and can be taken into consideration for the purpose of determining the ideal Credit-Deposit Ratio, need based borrowings cannot be taken into consideration to fix the optimal/ideal Credit-Deposit Ratio as they are resorted to beyond the optimal level of Credit-Deposit Ratio to meet liquidity crisis. However, in actual practice, Reserve Bank of India does not now re-discount Bills for Banks. Further, banks are also under advice from the Reserve Bank of India that while they may resort to re-discount
of Bills with the IDBI and other financial institutions, they may recourse to their entitlement refinance from the Reserve Bank of India and they can also borrow from the local Money Market only during times of temporary mismatches between their sources and uses of funds and not regularly for deployment of credit etc. Reserve Bank of India has also advised banks that they should plan, under their Credit Budget, for deployment of credit only within and from & out of their own resources.

Banks also get transit funds as float funds on account of various services they render to their customers such as issue of DDs, TTs, MTs, Gift/Travellers' Cheques, collection of cheques etc. Customers remit funds to banks for issue of such instruments or for transfer of funds. There is normally a time lag between the remittance of these funds and their actual payment. During this period, banks are free to use these funds, free of cost. Thus, for instance, if a DD is issued by a branch of a Bank for a customer in favour of a person payable at a branch operating in a far away place, it would take at least five to six days or even more for the DD to reach the concerned person and to get presented for payment. During this period of five to six days, the money would lie with/be available for the Bank free of cost (as no interest need be paid for it by the Bank) and as such it may be/would be used by the Bank for its own operations. Similarly, banks get funds also on account of other types of services they render to customers such as Collection of Bills etc. In this case, there is a time lag between actual collection of Bills and receipt of intimation, at the sending branch.
Thus, banks get fairly huge quantum of transit or float funds, almost free of cost, which are also used by them. Higher the proportion of these funds to the total funds of banks, higher would be their credit-deposit ratio and profit. Hence, banks strive hard to mobilise as much funds as possible through these means.

**Borrowings/Rediscounting from/with IDBI and NABARD:**

The IDBI and the NABARD are the apex institutions in the Country for financing industrial and rural development respectively. IDBI assists in the setting up of industries and also for improving infrastructural facilities, in the Country, for industrial development. Apart from extending direct assistance, in many ways, to set up industries, it assists industrial growth in the Country by providing refinance/rediscounting facility to banks against their advances to industries.

**Refinance:**

Any scheduled bank or State Co-operative Bank is eligible for refinance against term loans and other advances extended by them to industries which are repayable within periods not exceeding 15 years. Each eligible credit institution has to enter into a general Agreement with the IDBI for availing, under various Scheme, refinance from it. The limit upto which a credit institution can borrow from the IDBI by way of Refinance is fixed by the IDBI in the light of the business plan of the credit institution and its expected requirements for funds. Within this general framework, IDBI provides Refinance to banks under various Schemes as set out below.
a) Under the Normal Refinance Scheme, on banks applying to the IDBI for refinance, which they should within six months from the date on which they sanction the concerned loans, the IDBI would provide refinance to the eligible extent, on the merits of individual applications. The period for repayment of refinance availed by financial institutions would normally synchronise with the schedule of repayment relating to the concerned loan granted by the primary lending institution viz. the concerned Bank against which IDBI refinance is sought.

b) Automatic Refinance Scheme is another Scheme which covers term loans of Rs.5 lakhs or less/extended by commercial banks to Artisans, Village & Cottage Industries, Small Scale Sectors and Small Road Transport Operators. Under this Scheme, the eligible institutions need not forward their relative sanction notes along with their applications for refinance, as under Normal Refinance, but they should apply to the IDBI enclosing a Statement incorporating therein all the relevant particulars of loans given during a particular period of time to various Small Scale Industrial concerns and Small Road Transport Operators. Provision of Refinance on such loans is automatic.

c) IDBI provides refinance to banks under another Scheme as well called the 'Composite Loans Scheme'. Under this Scheme, IDBI provides refinance to banks against Composite Loans, extended by them to borrowers, consisting of equipment finance or working capital finance or both to meet credit requirements of artisans up to the extent of Rs.25,000 and to Small Scale Industrial Units in the Tiny Sectors. The procedure to be adopted for sanction and disbursement of refinance under this Scheme is the same as for the Automatic Refinance Scheme.
Apart from these Schemes, banks are also eligible for refinance against advances made by them to mini-steel industries.

Normally, credit extended by banks for (a) acquisition of fixed assets such as land, buildings and plant & machinery, (b) replacement or renovation of equipments including movable assets forming part of the capital and (c) in appropriate cases, margin money for working capital are eligible for refinance from the IDBI. IDBI also provides 100% refinance against loans granted by eligible credit institutions under the Composite Loan Scheme as also against those granted to persons belonging to Scheduled Castes and Scheduled Tribes and 75% refinance against loans granted to all other categories of borrowers.

The rates of interest chargeable by banks on loans granted by them against which IDBI refinance is sought/availed by them and the rates of interest payable by banks on the amounts of refinance availed by them are determined by the IDBI. Normally, the difference between the two rates is maintained at 4% p.a. Currently, the basic lending rate is 14% p.a. in the case of commercial banks and the IDBI's rate for refinance is 10% p.a. However, IDBI's rates vary according to the types of refinance provided by them to banks.

Rediscounting with the IDBI:

The objective of the Scheme is to facilitate the promotion of sales of machinery of various kinds/types in the Country, thereby accelerating the tempo of industrial growth in the Country. On delivery of machinery, the Bills/Promissory Notes are accepted/guaranteed on behalf of the purchaser/user and delivered to the manufacturer-seller who gets them discounted by his
own bank, thus realising quickly the cost of the machinery; the manufacturer-seller's bank, in turn, takes the discounted bills to the IDBI and gets them re-discounted and thus realises the amount paid/loan given by it to the manufacturer/seller. The discounting bank takes back the Bills from the IDBI against payment and obtains payments from the acceptors/guarantors of the Bills on due dates. Thus, the facility under the Scheme is available for sale of machinery to all concerns/companies manufacturing industrial and agricultural machinery and equipment and those engaged in printing and publication of newspapers.

The cushion/margin between the rates chargeable by banks for discounting bills and the rates chargeable by the IDBI for re-discounting bills is determined by the Reserve Bank of India. Normally, the cushion varies from 1.75% to 2%.

Refinance from NABARD:

NABARD was set up in July 1982 with a view to providing credit assistance for the promotion of agriculture, small scale industries, cottage and village industries, handicrafts, other rural crafts and other allied economic activities in rural areas with a view to promoting integrated rural development and thereby promoting rural prosperity. NABARD has a special responsibility of institution building in the field of rural credit.

NABARD extends short term credit repayable over periods not exceeding 18 months each for agricultural operations and other specific production/marketing activities. NABARD also provides long term refinance to financial institutions for promoting agriculture and rural development for granting loans to certain specified categories of borrowers.
NABARD charges between 6% and 10% p.a. on refinance provided by it to banks compared with rates varying between 9% and 13% p.a. being charged by banks to borrowers, the cushion being 3%.

Economics of availment of refinance/rediscount from the IDBI/NABARD - A COST-BENEFIT STUDY

The economics of Refinance from and rediscount with the IDBI and NABARD should be studied from two angles viz. as sources of funds to banks and as tools for promoting industrial development in the Country.

As sources of funds for banks, Refinance/Rediscount from the IDBI and the NABARD are undoubtedly beneficial to them in that, as mentioned earlier, the rates charged by them (the IDBI and the NABARD) on Refinance provided by them are far lower than the rates charged by banks to their borrowers. The 'spread' between the two rates is as follows:

a) Refinance from the IDBI - 4% p.a. lower than the rates charged by banks to their customers
b) Rediscount with the IDBI 2% ** **
c) Refinance from the NABARD 3% ** **

These rates do not include service charges of banks in this regard i.e. the charges incurred by banks in servicing the relevant advances. After making provision for service charges, the 'spread' would be as follows:
<table>
<thead>
<tr>
<th></th>
<th>Spread before service charges</th>
<th>Estimated service charges</th>
<th>Spread after making provisions for service charges</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Refinance from the IDBI</td>
<td>4.00</td>
<td>1.75</td>
<td>2.25</td>
</tr>
<tr>
<td>b) Rediscounts with the IDBI</td>
<td>2.00</td>
<td>1.75</td>
<td>0.25</td>
</tr>
<tr>
<td>c) Refinance from the NABARD</td>
<td>3.00</td>
<td>1.75</td>
<td>1.25</td>
</tr>
</tbody>
</table>

Based on the Report of the Sub-Committee to the PEB Committee which conducted a sample Study and computed the average costs of servicing individual transactions/average cost of servicing every Rs.100 of transaction in regard to Sb. Com. Banks.

Profit arising out of term lendings and purchase of Bills which are eligible for refinance/rediscounts from the IDBI, NABARD and EXIM Bank is low in view of concessional rates of interest being leviable by banks for such loans/purchase of Bills. Nevertheless, banks obtain refinance/rediscounts against such lendings and deploy the proceeds thereof at higher rates of interest which get them good income.

The following Cost-Benefit Analysis clearly indicates the economics of the borrowings by banks from the IDBI/NABARD. (on the basis of making results of the case Bank.)
<table>
<thead>
<tr>
<th></th>
<th>Primary Operation per Rs.100/-</th>
<th>Secondary Operation per Rs.100/-</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cost of Funds</td>
<td>Return on Funds</td>
</tr>
<tr>
<td>Refinance from IDBI</td>
<td>7.95%</td>
<td>12.25%</td>
</tr>
<tr>
<td>Rediscounts with IDBI</td>
<td>7.95%</td>
<td>10.25%</td>
</tr>
<tr>
<td>Refinance from NABARD</td>
<td>7.95%</td>
<td>11.25%</td>
</tr>
</tbody>
</table>

Average cost of mobilisation of deposits plus service charges @ Rs.1.00 per hundred.

Average return on funds less service charges @ Rs.1.25 per hundred.

**TOTAL/AVERAGE RETURN**

<table>
<thead>
<tr>
<th>Refinance from IDBI (Per Rs.100/-)</th>
<th>Rediscounts with IDBI</th>
<th>Refinance from NABARD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit on first Primary operation</td>
<td>4.30%</td>
<td>2.30%</td>
</tr>
<tr>
<td>Profit on Secondary Operation 75% of the funds for Secondary Operation</td>
<td>1.69%</td>
<td>1.69%</td>
</tr>
<tr>
<td>Total Profit (for Rs.135)</td>
<td>5.99%</td>
<td>3.99%</td>
</tr>
</tbody>
</table>

Average Return per Rs.100/-

|                        | 3.42%                 | 2.28%                 | 2.85%                 |

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It has been assumed, for the purpose of calculation, that, on an average, only 75% refinance is available to banks from these institutions. However, if the fund is mobilised from the local Call Money Market rather than by availing of refinance/rediscounting, banks would earn still higher profits but the question arises as to whether the liquidity of banks would be maintained. Refinance and rediscounts available to banks constitute a permanent source of finance for them and repayments and disbursements would compensate each other so that, at any point of time, a fixed quantum of funds would be available to banks from these sources. On the other hand, call borrowings are only temporary.

Further, banks are instruments of economic growth. Hence, they have the responsibility to extend as much credit assistance as possible to the productive sectors of the Economy. They should, therefore, function necessarily as a vital link between developmental financial institutions and the community by extending loans, at the lowest rates of interest possible, to the productive sectors of the Economy by availing Refinance against such loans extended by them and rediscounting Bills with them.

Thus, the twin facilities of refinance and rediscount are highly useful to banks from the points of view of cost, benefit and liquidity.

Quantum of refinance and rediscount available for banks:

The quantum of refinance and re-discount available for banks would depend on, inter alia,
a) the quantum of term loans extended by banks to industrial and agricultural sectors;
b) the aggregate sum for which banks hold eligible bills negotiated by them for being re-discounted with the IDBI and
c) availability of funds with these institutions (such as the IDBI, HABARD etc.)

Normally, there is no problem for these institutions in regard to availability of funds as they derive sufficient funds from several sources. The limit upto which each bank can have recourse to these institutions for refinance and rediscount facilities is fixed for each year on the basis of its projections in regard to disbursement of term loans as submitted by it to these institutions. The level upto which individual banks may go in for refinance/rediscount depends upon the following factors:

1. Banks are eligible to avail refinance/rediscounts from various financial institutions upto the limits fixed for the same. The limit fixed for individual banks for availment of refinance from the IDBI is three times their Capital and Reserves. The limits for individual banks for rediscounting of Bills are fixed, periodically, on the basis of Bills available with banks for rediscounting.

2. While the maximum limit for availment of refinance and rediscount is thus fixed for individual banks, the actual eligibility of each bank for refinance/rediscounting would depend upon the level of eligible advances made by it.

Hence, it should be the objective of individual banks to optimise the inflow of funds from these
sources by stepping up the levels of their relevant advances which are eligible for refinance and rediscount so that they would be able to earn higher profits by higher levels of borrowings and consequently higher levels of lendings etc.

To sum up, the optimal level for individual banks for availment of refinance/rediscounts from the IDBI/NABARD would be the limits which are granted by these institutions to individual banks on the basis of certain criteria and banks should, therefore, maintain their advances that would be eligible for refinance/rediscounting at the optimal levels.

**Borrowings from the Reserve Bank of India**

The Reserve Bank of India provides Refinance to banks against Food and Export Credit extended by them. Such Refinance is extended by the Reserve Bank of India with a view to encouraging banks to extend liberal credit support to certain essential activities designed for the promotion of public interest and welfare. Banks are, in fact, entitled for Refinance from the Reserve Bank of India in such areas of lending, but it is left to the discretion of banks to recourse to the Reserve Bank of India and avail such Refinance against their entitlement, whenever they find it necessary. Details relating to Refinance are set out in Page 87.
Currently, the Reserve Bank of India extends refinance to banks against their Food and Export Credit at a rate of interest of 10 per cent per annum which is also, incidentally, the ceiling rate in regard to the Call Money Market i.e. the maximum rate at which banks can lend or borrow in the local Money Market for very short periods. Banks are allowed to charge the Food Corporation of India interest at the rate of 1% per cent per annum for their Food Credit and 1.3 per cent per annum, on an average, on their Export Credit. Thus, the rate of interest at which the Reserve Bank of India extends refinance to banks in these cases is lower by few percentage points than the rates at which banks are allowed to lend for these purposes. Food Credit and a sizeable portion of Export Credit are seasonal in nature and the extent to which banks would be entitled for refinance (from the Reserve Bank of India) would depend upon the amounts lent by banks to the relevant activities. For instance, currently, Scheduled Commercial Banks are entitled to 100% refinance against Food Credit beyond the level of Rs.4300 crores and 100% of the excess of Export Credit extended by them over and above their weekly average export credit during 1983. Thus, the availability of refinance from the Reserve Bank of India would depend upon the extent to which banks lend to these activities.

Economics of Availment of Refinance from the Reserve Bank of India:

As in the case of refinance from the IDBI/NASAR and the cost/return on funds relating to refinance from the Reserve Bank of India have to be calculated by taking into consideration the secondary operations as well.
<table>
<thead>
<tr>
<th>Refinance against</th>
<th>Food Credit</th>
<th>Export Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Funds</td>
<td>7.95%</td>
<td>7.95%</td>
</tr>
<tr>
<td>Return on Funds</td>
<td>14.00%</td>
<td>12.00%</td>
</tr>
<tr>
<td>Profit on Funds</td>
<td>+5.05%</td>
<td>+4.05%</td>
</tr>
<tr>
<td>Profit on Primary Operation</td>
<td>+6.05%</td>
<td>+4.05%</td>
</tr>
<tr>
<td>Profit on Secondary Operation</td>
<td>+2.25%</td>
<td>+2.25%</td>
</tr>
<tr>
<td>Total (in Rs. 100)</td>
<td>8.30</td>
<td>6.30</td>
</tr>
<tr>
<td>Average Return per Rs. 100</td>
<td>8.15%</td>
<td>+3.15%</td>
</tr>
</tbody>
</table>

Average cost of mobilisation of deposits plus service charges @ Rs. 1.00 per hundred.

Average return on Food Credit @ 14% p.a. for which service charges would be negligible.

Average return on Export Credit @ 13% p.a. less service charges @ Rs. 1.25%.
It may be seen from the above calculations that there is a slight difference in the methodologies adopted for this purpose and for computing profit in regard to refinance/rediscounts with IDBI/NABARD. While in the case of IDBI/NABARD only 75% of the loan sanctioned is taken towards secondary operations, in the case of refinance against Food/Export Credit 100% is taken as refinance. Consequently, the average return would be higher in the case of refinance from the Reserve Bank of India.

Optimal level of borrowings from the Reserve Bank of India:

Refinance from the Reserve Bank of India against Food and Export Credit, being entitlement refinance, may be availed by banks at short notice without any delay. In view of the higher level of profit arising out of these borrowings, banks should resort to these borrowings to the maximum extent possible and thereby optimise their credit-deposit ratio. However, the optimum level of entitlement is quantified by the monetary policy of the Reserve Bank of India.

One important point to be noted in this context is the possibility of banks substituting to the extent possible borrowings from the Reserve Bank of India by borrowings from the inter-bank Call Money Market, subject, of course, to eligibility being there for availment of refinance (from the Reserve Bank of India) and rediscount (from other Financial Institutions) and funds being available in the Money Market. Both may be availed at short notice. However, normally, the cost of market borrowings is lower than that of rediscount/refinance from the Reserve Bank of India. Hence, it would be advantageous for banks to borrow from the Call Money Market whenever Call Money Market rates are low and to resort to borrowings from the Reserve Bank of India only when Call Money Market become stringent.
The Reserve Bank of India also grants to banks, in its capacity as the 'lender of the last resort', discretionary refinance against securities. Such discretionary refinance is not entitlement refinance and as such is granted to individual banks only occasionally, whenever it is really warranted. Banks also cannot hope to go in, as a matter of routine, for discretionary refinance from the Reserve Bank of India in view of the following factors:

1. Discretionary refinance is granted by the Reserve Bank of India in its capacity as the 'lender of the last resort' only when banks face the problem of acute illiquidity due to sudden and unexpected withdrawals of huge deposits by big depositors resulting in difficulty for banks to meet their day to day operations. In other words, discretionary refinance would not be available to banks to overcome illiquidity arising out of improper funds management.

2. Discretionary refinance is granted to banks against Government Securities held by them. If these securities are pledged to the Reserve Bank of India for availing discretionary refinance, they cannot and would not be counted for SLR. Hence, discretionary refinance may be availed by banks only when banks maintain excess security holdings over and above what is required for the maintenance of SLR.

3. Discretionary Refinance is granted only for short periods of one month or even less say for 15 days or so. Hence, they cannot and should not be construed by banks as regular source of funds.

4. The Reserve Bank of India charges a fairly high rate of interest of say 13% to 14% p.a. as discretionary refinance extended by it to banks. Hence, it is also prohibitive in nature.
Participation Certificates

The Participation Certificate Scheme was introduced during 1970-71 as an experimental measure and was placed on a permanent footing and made available to banks since July 1, 1977. These Certificates are instruments by which a bank can sell to a third party a part of or the entire loan granted by the Bank to any of its clients. The Scheme was introduced by the Reserve Bank of India with the main idea of providing for greater mobilisation of funds by banks and for helping to minimise their recourse to the Reserve Bank of India for funds. It was also intended to serve as an useful adjunct to the Bill Money Market. These Certificates carry handsome rates of interest and hence are normally attractive to investors.

Accordingly, till the middle of 1979, banks raised funds on a fairly large scale by issue of Participation Certificates (PCs).

However, in practice, the Scheme failed to achieve the basic objectives set for it. Banks began to mobilise huge funds by resorting heavily to issue of Participation Certificates, especially since the beginning of 1979 when the economy was suffering from excess liquidity. Consequently, the Reserve Bank of India could not contain expansion in money supply through the normal restrictive measures. Hence, the Reserve Bank of India set up a Working Group under the Chairmanship of Shri W S Tambe to study the situation. On the recommendations of the Group, the Reserve Bank of India advised all Scheduled Commercial Banks, in July 1979, that borrowings under...
the Participation Certificate Scheme be brought, in a phased manner, within the scope of CRR and SLR, by treating them as deposits and not as Contingent Liabilities. Hence, banks stopped, ever since July 1979, resorting to raising funds by issue of Participation Certificates as it became very costly and unprofitable.

In fact, the Reserve Bank of India has virtually restrained banks from raising funds by issuing Participation Certificates. A Cost-Benefit Analysis relating to raising funds by issue of Participation Certificates by banks, as set out hereunder, indicates as to how much banks would lose by raising funds through issue of Participation Certificates and deploying them as credit, etc.
Cost-Return on Participation Certificates issued by banks (Based on 1982 points pertaining to the Case Bank) (for Rs.100 of PCs)

Assuming that CRR is 9%

a) incremental CRR is 10% and
b) SLR is 35%

For every Rs.100 of PCs issued, 54% would be impounded by the Reserve Bank of India by way of CRR & SLR.

Then:

Rs.

a. Cost of Rs.100 of Participation Certificates @ 10% p.a.

b. Return on Participation Certificates:

i) Rs.3 kept with the Reserve Bank of towards basic CRR

ii) Rs.16 maintained with the Reserve Bank of India towards CRR (return @ 9% p.a.)

iii) Rs.3 kept in tills and as balances with other banks

iv) Rs.32 deployed as investments in Govt. Securities etc. (return @ 7% p.a.)

v) Remaining Rs.46 deployed in the form of advances (return @ 12.25% p.a. after deducting servicing costs)

Total Return (for Rs 100) 9.22

Net Loss 0.68

Thus, it may be seen that for every sum of Rs.100 raised by issue of Participation Certificates, banks would entail a loss of Rs.0.68. Naturally, banks do not and cannot raise funds by issue of Participation Certificates for deploying them for profit.
Other Rediscounting facilities:

Under the New Bill Market Scheme, banks are entitled to rediscount their commercial bills (Drawee Bills) with other financial institutions. The Drawee Bills Scheme which has, of late, gained momentum, provides a good source of funds for banks. However, the margin between the cost of funds obtained by banks by rediscounting Drawee Bills and the return on them when deployed is fairly low as shown below:

**Primary Operation (per Rs. 100/-)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Funds (inclusive of Servicing Cost)</td>
<td>7.95</td>
</tr>
<tr>
<td>Return on Funds (inclusive of Servicing Cost)</td>
<td>12.25</td>
</tr>
<tr>
<td>Profit</td>
<td>4.30</td>
</tr>
</tbody>
</table>

**Secondary Operation (per Rs. 100/-)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Funds (No Servicing Cost)</td>
<td>11.50</td>
</tr>
<tr>
<td>Return on Funds</td>
<td>12.25</td>
</tr>
<tr>
<td>Profit</td>
<td>0.75</td>
</tr>
</tbody>
</table>

Profit on Primary Operation: 4.30

Profit on Secondary Operation: 0.75

Average Profit (per Rs. 100 p.a.): 2.02

Even though the average profit on both Primary and Secondary Operations pertaining to borrowings under the Scheme is 2.02, yet we have to take into consideration the profit arising out of Secondary Operation only in this regard which is 0.75% only. While refinancing from the Reserve Bank of India, IDBI and NABARD is Entitlement Refinance granted for the...
promotion of public interests (such credit extended to the Food Corporation of India for its food procurement operations) including promotion of Exports etc. and as such account for a wider margin of profit. Whereas Trade Bills are only purely commercial Bills in nature and hence profit arising out of Primary business in this regard is only normal as in the nature of all other advances. Hence, whether Drawee Bills are rediscounted or not, banks' profitability would not be affected. In other words, rediscounting of Drawee Bills is only in the nature of funds mobilising efforts of banks and does not constitute part of social or developmental lending and hence profit arising out of primary operation cannot be taken into consideration. Thus, profit arising out of the rediscounting of Drawee Bills is around 0.75% p.a.

The use of this facility by banks is subject to certain important factors. The first is the availability with the bank of Drawee Bills with necessary maturity dates. Secondly, the willingness of borrowers to convert OLCC accounts into Bills Accounts which makes it necessary for them to commit to honour the Bills on specified dates. Thirdly, availability of institutions to rediscount these Bills.

On a study undertaken for the purpose of ascertaining the optimal level of use of this facility by banks in few selected banks, including the Case Bank, it is found that Drawee Bills account for around only 12% of the total amounts of Bills discounted by them. It is further empirically established that there is resistance on the part of traders to avail the Bills facility. Further, the cost of operations also is high in this regard. In the words of the Working Group to Review the System of Cash Credit set up by the Reserve Bank of India in 1979 under...
the Chairmanship of Shri K B Chore. "As the drawee are committed to a definite period of payment, they would be reluctant to accept the Bills drawn by suppliers. The process of evolution is, therefore, likely to take time. The cost of operation for borrowers and the cost of administering the system of banks would also be somewhat high on account of stamp duty and detailed book-keeping. Still the advantages of the Bill system of financing outweigh their disadvantages and there is a need for encouraging the Bill system of financing." Thus, there is a growing tendency in banks to go in, on an increasing scale, for the Drawee Bills Scheme. Accordingly, the Chore Committee has recommended, "It is necessary to give some directional changes to ensure that wherever possible the use of Cash Credit would be supplanted by loans and Bills."

Under the circumstances, it may not be possible or even proper to fix any ideal limit for rediscounting under the Drawee Bills Scheme. Though there may be some resistance for the speedy introduction/implementation of the Drawee Bills Scheme, yet it is likely to gather momentum in the coming years and Money Market borrowings may perhaps be replaced progressively by Bill Market borrowings.

Hence, we may assume, for the purpose of this Study, that the ideal level/limit for rediscounting Drawee Bills may be 12% of the total funds available under the head Bills Discounted for individual banks, which is based on the average level of such discounting facilities for the Banking System as a whole.
Borrowings from the Call Market

Though it is possible to borrow from the Call Money Market, utilise/deploy such funds borrowed presumably and thereby realise marginally higher levels of Credit-Deposit Ratio and profit, yet borrowings from the Inter-Bank Call Money Market cannot and should not be treated as a regular source of funds for banks, as they are purely short term in nature and at any time the market may rule stringent or even go virtually dry. Hence, they are to be resorted to by banks only as a last resort to meet temporary shortages in funds faced by them in their day to day operations.

In other words, if borrowings are made from the Call Money Market, banks should have alternate sources and out of which they would be able to repay them immediately. One important factor in the Call Money Market in India is the prevalence of a system of administered interest rates. The Indian Banks' Association, which is the apex Body for all banks in India has fixed a ceiling of 10% p.a. on the rates of interest payable in the Inter-Bank Call Money Market, which is also, incidentally, the prevalent Bank Rate in the Country. As mentioned earlier, it is possible to substitute Entitlement Borrowings from the Reserve Bank of India by Call Money Market borrowings when the prevalent rate of interest in the Market is less than 10% and switch over to borrowings from the Reserve Bank of India when the Call Money Market becomes tight. By this procedure, banks would be in a position to keep the cost of borrowings at a lower level and also ensure simultaneously, liquidity.
It is also possible for banks to take risk and keep the Call Market borrowings at a marginally higher level and step up the Credit-Deposit ratio to that extent. But such an operation is possible only to a marginal extent when banks expect return flow of funds in short periods to fill in gaps in their inflow of funds.

Thus, Call Market borrowings may be resorted to by banks only on occasions warranted by temporary mismatches between sources and uses of funds, through trading, with calculated risk, in the market would enable banks to earn higher profits, as spelt out earlier.

**SUM UP:**

Borrowings constitute a significant source of funds for banks. A judicious mix of these funds by keeping the cost at the lowest level possible and utilising them to the optimal point would enable banks to step up their profit/profitability.