Money and Banking
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Lecture - 37

Let me begin the kind of a reaching the final stage in this course and just two more weeks.

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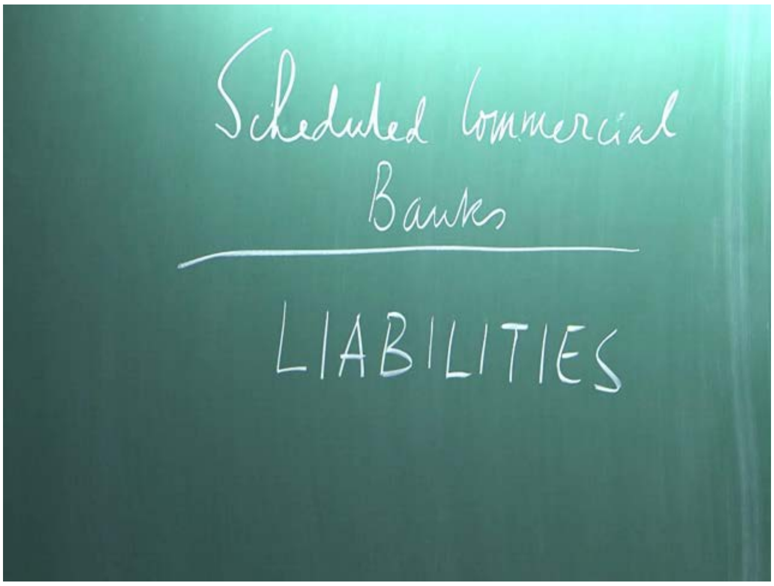

I am going to get into I am going to get into details of scheduled commercial banks, this topic is on banks and they are just not one kind of banks called commercial banks, there are the regular commercial banks, there are set of commercial banks created by the reserve bank of India, known as regional rural banks in the 70's they were created. Then of course, you have which people do not know many of you, something called co operative banks, they are group of institutions called co operative banks, so I will do that at the end.

Now, let us come to scheduled commercial banks, which include both the banks that we know, the public sector banks. And of course, there are famous private sector banks in India today, some are Indian owned, some are foreign private sector banks in India, Standard Charted, Hong Kong national bank, Hong Kong bank, Deutsche bank, city bank, etcetera. Now, these commercial banks the way they operate in India, there is a balance sheet that you can look at, and let us look at the liabilities.

Now, what do you notice here, in the liabilities this is very important, is that there are three groups of items in the liabilities, notice here there are three groups of items.

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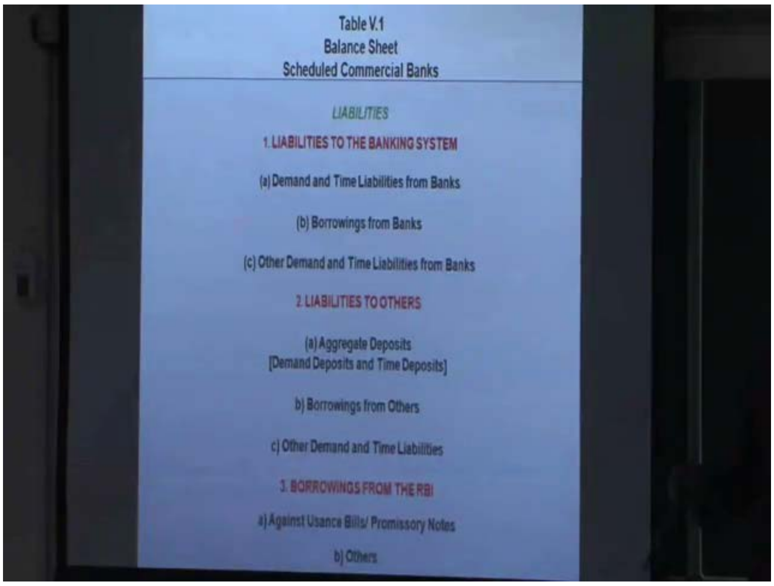

One, liabilities to the banking system which you know that banks keep other banks money. So, it creates a liability and the flip side of the liability will be the asset, so if I keep my state bank keeps some money with Punjab national bank, Punjab national bank it becomes liability because, it is state banks money. And state banks money is there money means it is state banks asset, so when I come to assets it will appear again.

Then you have liabilities to others, which is the big amount because, this is the deposits, ours deposit, etcetera that we keep. And then we have borrowings from the RBI. Now, how I would discuss this, is that it the first two items, red items the under that a is demand and time liabilities from banks, which is very easy to understand. The demand deposit accounts of other banks and the time deposit accounts of other banks, this is very interesting many people do not know that banks keep money in another bank.

Like, I keep money or we keep money, in a bank in a savings account, fixed deposit banks also do that with other banks, many people do not know that. Then, we have liability to others aggregate deposits demand and time deposits, which is our stuff our, money, our money, company money, etcetera alright, so this a a is very easy to understand. Now, what I would go into is, you see there is a borrowing from banks, borrowing from others, they are borrowings and there are borrowings is the red thing here is from the RBI.

So, let me explain the borrowings three borrowings, here is a borrowing, here is a borrowing and the big amount here borrowing from the RBI. So, banks do borrow money a lot, so that I need to explain compared to the deposits, deposits is very easy for you to understand. And then finally, I will talk about the c item, other demand and time liabilities, again there are other demand and time liabilities, what are they I need to talk about that.

So, let me explain the borrowings first because, demand and time liabilities basically means demand accounts and time accounts, fixed deposit account, saving account, current account money, no big deal everybody understands that. Borrowings, from other banks, when you have borrowings here, from other banks they borrow because, there are all kind of things, like a bank selling CD look how borrowing take place, one bank selling CD another bank purchases, it becomes this first banks borrowing also [FL] alright.

Then, you go to call market, huge amount banks borrow from other banks because, the call market what did I say the market call rate, what it is called interbank call rate it is called interbank call rate. So, one bank borrowing from other bank call market alright, so these items are there then, there can be also market repo which can be a borrowing, repo market repo not RBI’s repo, which you saw market repo. So, banks borrowing from another banks, through a repo transaction alright.

Then you have borrowings from others in this here, alright what are the others, how do they borrow well banks borrow from others in various ways. For instance there is this practice in India that Nabard which used to be a department of RBI now, has become a autonomous institution, they deal with rural credit. How do they deal with, they do not directly go to the farmers, the rural credit that the Nabard wishes to give, is handed over to the banks, banks lend that money.

So, banks are borrowing from Nabard alright, then you come to industrial development there is also some borrowing that goes on, a famous organization for industrial finance, the rural finance Nabard is very famous in India. For industrial finance the famous organization in India has been government of India organization, has been IDBI. So, often what IDBI would do, would land into industries not directly, will give the money to banks and then banks give that money.

Then I another example I gave you, how banks get money from other financial institution non banks and then finally, do the transaction is the housing loan business. National housing bank, does not have a state bank like counter, where you can go and get loan for your house, national housing bank loans are channeled through commercial banks. So, this creates another kind of liabilities, borrowings alright for commercial banks alright.

Then there are various things, like for funds that comes often from RBI like export promotion funds, various ways from RBI they borrow, not the regular banking activity for development purposes alright. So, that is also understandable borrowing from others, one is borrowing from banks which I told you by selling CD etcetera, you borrow. Another one is borrowing from others here, now this RBI borrowing you see under RBI borrowings, there are two, one it says against usance bills promissory notes, the other one this is others.

So, what happens banks it is a regular practice in almost all countries, that commercial banks can discount their bills either with a discount house, if it exists as in England in our country discounts house is just coming up, the discount and finance house of India becoming big. Usually they would used to go to the central bank RBI and borrow, against they will take government securities [FL] as security deposits or collateral al right and then borrow against it or they would ask RBI to rediscount bills.

So, there is a commercial bill of a well know company say Tata consultancy services something or Tesco, [FL] commercial banks wants money it can get rediscounted from RBI and RBI would be happily giving money against it. So, whenever RBI is lending, it can be lending against commercial bills, commercial papers, etcetera. As well as you know the famous borrowing against securities, which is government of India securities etcetera.

So, there are these two kinds of borrowing that goes on alright, one is against issuance bills or promissory notes in commercial paper etcetera, commercial bill. And again other ones, are the government securities etcetera they keep on using that to borrow like, you know I like I need cash at home, how do I go, I go about doing it this way. One is I take my jewelry to a fund funding agency, give my jewelry and get cash against, it another one would be I can go and rediscount or sell off securities bonds etcetera that I have.

Another one can be, you know various way I can borrow, similarly banks go to RBI and borrow against whatever valuables they may have, whatever RBI is willing to accept. So, that is where borrowings from the RBI takes place, we will look into the numbers how much are they that is the empirical part is coming, the conceptual part is this. Now, the most difficult item on the liabilities sheet, which I found is this c item, here it with respect to liabilities to the banking system here, with respect to liabilities to others.

Other demand and time liabilities, these this item is very small, but it took some time for me to understand what is this O which I called here, other detail what is other detail, what are the other I mean saving account [FL] time deposit, fixed deposit would be time time accounts, demand accounts [FL] you have taken all, with respect to bank transactions, interbank transactions with respect to the public transactions, alright. What is detail, detail is very funny, o detail is often say, there are some deposits on home, the interests have accrued alright.

They have to be paid that will come under other demand and liabilities interests that banks pay on deposits also. Then there are some bills that has to be paid, banks have not paid the bills, they will come under the other liabilities bank may have alright, then they may have, you know bank is a corporate company. So, a corporate company corporation will have share capital, so on share capital bank is supposed to announce dividends, there are some rules in announcing dividends, if they if it is an ordinary share then certain rules are there, you may skip sometimes, but you may pay later etcetera.

So, dividends which have not been paid would be noted as other t detail because, I owe this money to the other share holders and the share holders can be another bank alright whoever they are, who owned shares in my bank alright in my paid up capital alright. Then there is some item which comes, which is very interesting called suspense account balances. Suspense account balances are like, if I can explain this to you, they consist of various items which are not very clear.

For instance an account, where the account holder is untraceable, amount is lying and he is neither withdrawing it or nothing. So, they do not come here, they are separated then there is an account number which is not connected to the person, so there is some problem, they have been kept aside. Then mobile banking what is happening, somebody in the use send some money to me here and I he sends a message that, you can go and collect the money from such and such bank.

So, that money comes to such and such bank, until I go and collect that money there is no account, I may not have any account, but an identification is required I go and come mobile banking sometimes it is like that, which are not very clear to me because, I have never done mobile banking like that. So, the money in that bank till it lies there because, it has come from the US for me alright, will not go into my account because, I do not have an account.

Now, it goes into the suspense account of that bank, temporary money alright. So, this is like called I have found a language here, had called money in transit. Like money is supposed to come to me I have an account where he is not sending it to me, he has sent it to somebody where there is a mobile banking facility and that mobile bank in India has accepted it alright and this money is finally, going to come to me. So, it is in transit alright not a money order which I receive directly or a demand draft, I receive directly alright it is not like that.

It is just a electronic message that comes on my mobile that would be lovely, if I receive an electronic message someday I have not received, so far that you have you can go to such and such bank and withdraw this amount of money given to you, I wish that happens to me too, but it has not happened. So, there are all kinds of some frozen accounts, where it is lying idle for a long time the account has been frozen, but the money is still lying there.

So, they will not go into the bank regular aggregate deposit amounts, they are unclear amounts, sometimes there is a problem with the account number, sometimes there is a problem with the person, sometimes a person was alive, but no longer alive, but he did not make any nominee. So, the account money still is there, is that will be a may be a long process for and somebody to claim that, say may be his son or daughter or wife or whoever, would go and claim that money.

But, it had there has to be a long court procedure may be, if I have an account and I expire and I do not have somebody nominated, which is called a nominee you know either my son or wife or whoever, then the money would not that bank will eat up the money [FL] money would still lie there, but it would go into a suspense account, the account would be frozen and it will go there and lie there till somebody claims it. So, suspense account, money etcetera and then mobile banking kind of a money where, no one person does not require an account to be in that bank, to receive that money some other identification procedure is there.

They go into this other demand and time liabilities alright clear ok alright you can read up a little bit if you wish. Now, I come to the assets this is much more complicated, but I will come to the assets this part you know a lot. So, let us come to the commercial bank assets.

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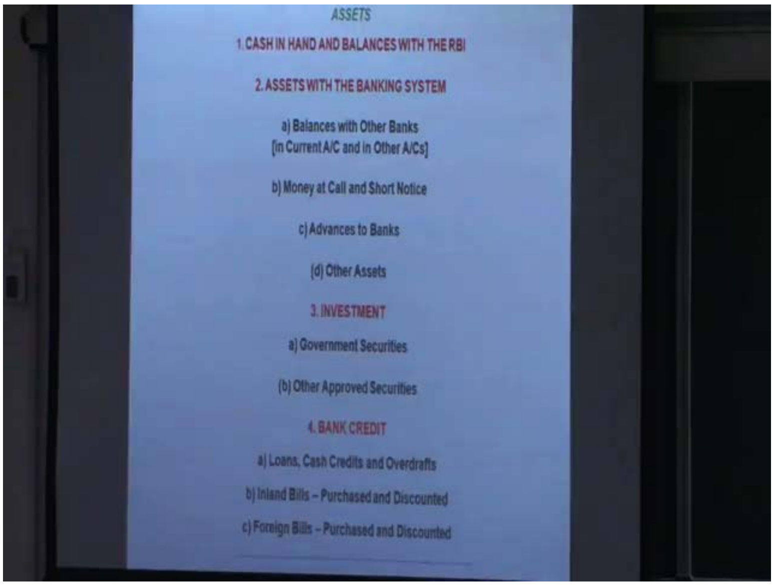

Now, here are four red lettered, red alphabets titles, four there were three here four. Now, you can look up this four, just read this slide a little bit and you would understand, some of them is very common sense thing what they are. Next is assets, I am going to talk about, assets of the scheduled commercial banks, it can be a regional rural bank, it can be any other commercial bank public or private it does not matter, this is a standard format in India and I think RBI has created this. So, they have to collect data and they keep data also, I have seen RBI site collecting has data on these heads.

Now, what you have in the top, cash in hand and balances with the RBI everybody knows that, [FL] cash and balances with the RBI because, of the CRR. Because, of centralized clearing facility, banks keep cash with RBI, which RBI can use. Suppose, one bank to another bank transaction going on and just debit cash here and credit it there, RBI need to have the cash. Now, which are number two is the most important assets with the banking system.

What are the assets a balances with other account just now, I told you other one had a thing like liability, the other side of liability is this in current account and other accounts bank having an account with another bank alright. Then money at call in short notice you know that call money basically, assets SBI creates a lot of assets here because, SBI has the largest pool of cash usually what I have heard among all commercial banks. So, they do lend in the call market heavily alright.

Then advances to banks it can give advances to banks, a bank borrows from another bank [FL] that borrowing part this is advances to banks alright alright. Then other assets include no, banks advances are not I am very sorry bank advances are not that c, d thing that is other assets, d c is banks give loan to other banks also alright, these are the things which we usually do not know and c d’s etcetera and then shares and debentures of other banks that I purchase, will be my asset alright.

So, state bank subscribes to the regional rural banks, then state bank subscription, share share subscription would be part of this other assets of state bank, then if state bank purchases c d’s of other public sector banks then they become state bank’s assets etcetera. So, these are the things they have, then investment this is a very big item, you know that SLR requires commercial banks to invest because, that how SLR is it is a basket, CRR is only cash by the way there were a monetary policy, very brief 2, 3 days back excuse me, there was a monetary policy announcement of RBI.

CRR was reduced marginally 25 basis points, nothing else and finance minister very unhappy I am glad finance minister unhappy because, I have been unhappy for a long time, now I told you about it. So, at last finance minister is also unhappy; that means, the central bank governor is not listening to what government wants to do, he is acting on his own just like, the fight we have in the US sometimes conflict federal reserve bank the federal government.

Federal Reserve [FL] chairman is a very powerful man always in the US. Now, it is Bernanke probably, Bernanke is the chair man federal reserve it is you have you do not know, she is reading Bernanke’s papers you are supposed to read some papers, written by him in the eighties very famous papers. I know Bernanke I heard of him I did not read much Bernanke monetary economics, macro Bernanke is the fed reserve chairman, famous academic economist also. Earlier it was Alan green span, he was there for a long time.

So, often there are conflicts in India it has we are becoming a western country like. So, the central government finance, policies or economic policies are at conflict, doctor Chidambaram is very unhappy, with the RBI governor's decision anyway. So, now, SLR requires investment, under captive market kind of a situation, where all banks are forced to invest in government securities and other approved securities, both a and b because, then you have to show the SLR.

Now, if you have more cash what do you do with it, you try to utilize. So, sometimes banks a particular commercial bank may not find a number of outlets, like giving a loan to some other bank, lending in a call market, subscribe to the shares no such activity very lucrative may be, it may find investing in government securities or other securities more lucrative. So, banks keep on investing more than what SLR requires and it has become look at the data what I found is more interesting, is that this investment number three item number three for commercial banks is huge.

And that told me as a percentage of total assets, that told me banks just not invest in government securities or other approved securities because, of the captive market requirements that the RBI wants SLR to be maintained, it is doing much more meaning banks do not find many other alternative outlets to invest or use their money alright. But, you will say sir banks huge amount of loans creation, credit creation is there well you know credit goes up and down with economy.

But, banks want to keep on making money, like a like any company wants to keep on selling products and earn something, they may be make a profit. So, banks do not want and they have to pay the deposits, so banks cannot have once the deposits come, the liabilities they cannot just sit idle because, the deposit interest payments have to be made.

So, naturally and they have overhead costs [FL] huge amount of overhead costs alright. So, banks want to earn keep on earning, so sometimes it looks like in India, investment component is quite large, despite banks of course, make money by creating loans, but the problem with loans number four item bank credit, problem with credit is in a country like India, recession or no recession who borrows money and who would return god knows. They have a problem of NPA all the time nonperforming assets, when a loan is created it is an asset, you can see it is under here asset, heading is asset.

So, non performing asset essentially means, I have given a loan and maybe after a first few installments the loan installment returns never happened, the company went bankrupt because, the loan was given not with very detailed inspection and careful evaluation of the borrower, financial standing.

Now, later they realized my goodness, we have given this loan it will never come back. Right now, they have a problem with the loans that they have given and what will happen, if they are not returned recently there was a case. India government case where, banks have invested heavily and now supreme court is cancelling their contract, I think with respect to telecom it happened, banks invest kingfisher airlines, telecom, supreme court is telecom I think telecom supreme court, but kingfisher airlines is different story.

Now, you can imagine how much money they have borrowed, an airlines when they borrow money my goodness, it is consortium funding probably, not one bank 2, 3 banks are involved [FL] what I am saying is, quite a substantial amount of NPA that it creates, loans are not returned, interest payments are not made any more, they all stopped the inflow of cash are all stopped. So, bank credit is an outlet is a normal that, went that what we learn, when we hear about banks how they make money, we learn that they give loans and on loans they earn interest income.

But, if you look at the data, it is very interesting how banks in India earn money as a whole, not individual banks if you go to individual bank studies, if somebody wants to do some day you will see there is a lot of variation. But, I aggregate data I have all scheduled banks I will show you and then you have loans, what are the three kinds of lending have bank credit there, is one is called loans, one is called cash credits and overdrafts and I am coming to that I am going to explain them.

And of course, you have inland bills, foreign bills which you have already seen commercial bills. And that business in banks you remember the data, very little as a percentage of bank credit I give that to you the line is continuously coming down, you remember that data, percentage of bank credit, previous money market I discussed that commercial bills, volume as percentage of bank credit what banks are involved with a miniscule. So, the large amount here of course is a, and not b and c last item not b and c large amount is a.

So, now, I need to pay some attention this will be my task today and this will be my task also on Monday, to tell you a little bit more about the main operation of the banks traditional operation of the banks, not the investment money wise they may be a large number. But, traditionally when we studied commercial banks, even when I studied them as a student I came to know of two things, the RBI regulation CRR etcetera. And other thing I came to know was, is banks loan creation business.

A simple credit multiplier, I discussed right in the beginning, this has to do with this bank credit, a in a very simple form that was for the prescriptive of monetary policy, like if there is an open market operation and a bank receives extra 100 rupees, how will it utilize it or 1000 rupees, how will it utilize it. Alright, it creates a multiplier effect on the credit system, the entire banking system, the total credit increases through a multiplier. And in that simple formula I had probably the credit multiplier is one of the CRR or something, it worked out to be, they are all connected to.

So, my next task is to talk about this item, which is the most important item, loans cash credit and overdrafts. Well overdrafts you know, I do not have to discuss, it essentially means if I have a good relationship with the bank and I am short of cash and I do not have it in my account there, I can take a temporary loan again, which I would return quickly an overdraft. Even a customer like me, who has not who does not take a loan I am not a company, but I have my deposits in your bank, but my money has gone down a lot and if say, state bank of India knows me they can give me an over draft facility, temporary advance they can give.

So, I need not talk about that, but I need to talk about loans, so I want you to pay some 5, 10 minutes a little bit today 10, 15 minutes and then on Monday I will complete this. Here, is some complications, loans, now I have consulted a few books to prepare the notes and the notes still may not be very clear to you, I will supply the notes to you. Let me come to that, so the first point why I am going to focus is, if you look at the data, this is 99 percent or 98 percent of bank credit.

So, I am going to talk about that, why the importance is there alright. There are two kinds of loans that banks in India create, which is also true probably of any bank in the world, one is called demand loan, another one is called term term loan, just like the deposits when bank receives money it goes either into a demand account or into a term account deposits. Similarly, when banks give loan to somebody, it can be either a demand loan or a term loan alright.

A demand loan is one which is very short term loan, which can be demanded by the bank and usually it is announced also like within 24 hours or 1 month or half a year or something you have to return the money, very short term loan. Usually we call a short term, something which is less than equal to 1 year, so anything which goes beyond 1 year becomes a medium term and anything which goes beyond 3 years or something becomes a long term, in India roughly what I have seen.

So, demand loan usually are very short term loan alright, even an overdraft can be a loan can be called a demand loan alright. And often in the case of a demand loan, it is given to a party, where no mortgages are asked, no collateral is asked because, I know he does transaction with me I know he is stuck today and he will get money tomorrow, coming in and his accounts are all with me. So, I have enough confidence, so I can just give him money, advance it sanction it without asking for a security, collateral what is called like something security can be all kinds of things alright.

In the case of a individual the security is often like I get a loan to by a flat, the flat becomes the mortgage amount. So, till I repay the loan the flat owner ship remains with the, papers remain with the bank once I have repaid the entire amount, then the ownership gets handed over to me. So, the flat itself is a tangible object which they can keep as security I do not have to extra property jewelry and other valuables bonds, shares, etcetera I do not have to.

So, demand loan usually a short term loan, carries no security with it and it is usually I think companies have these demand loans borrowed from banks because, of working capital requirement. What is working capital requirement, it is not to construct a new house or buy a new machine, which is capital loan, which is capital, working capital is I have to pay some bills, I have to pay the wages, I have to pay the raw material supplier I expected the money to come I sold some goods, but the somehow it got stuck.

So, it is going to be 15 days, 1 month more or 2 months more before the money arrives, but I have to pay wage to my employees, I have to pay the raw material supplier, I have to pay the rent, I have to pay the electricity bill, I have to pay the water bill. So, I go to the bank with whom I have an understanding and I get a demand loan and bank will not ask for that nominal amount, usually will not ask a lot when I am going a big business with it.

But, an unknown company goes for a demand loan with a bank, [FL] it is usually on the basis of trust and understanding and confidence that I do business with this company. So, I know and I know his financial situation, so I can advance a demand loan that is also associated with it because, I am not asking for any security. And usually the loan is given as a lump sum to him like the [FL] in case of a demand loan and it will be returned there is an agreement off course.

And as soon as the loan is given the interest rate starts counting, like I gave a loan on first of November. So, interest rate starts counting every month, as soon as the loan is given and the amount in it is entity is given to you, [FL] and this is what they do and because, of this simplicity of the demand loan, securities involved and the interest is counted immediately, administratively keeping it is books, accounts is very easy. Such and such party on such and such day the loan has been sanctioned and the interest starts counting from that day.

And the money is immediately put in his account usually, not the cash handed over. [FL] Now, it is up to you how you use it, I am not bothered I have given you this demand loan and interest starts counting right away, whether you use only one tenth of it, sit for 2 months and then use again rest use that is up to you alright. Now, come to term loan, in case of a term loan it can be either with respect to agriculture credit, buying heavy machineries like tractors etcetera, it can be industrial term loan of course, very long term loan it can be, sometimes it is 10 years or more a term loan term, term loan’s maturity sometimes 10 years or more.

And you know in case of term loans we get housing etcetera also we get term loans, 15 years EMI I have to pay, 10 years EMI I have to pay that is also there alright. But, like demand loan a term loan immediately the total amount is given to you, except an interest starts getting charged, chargeable on it active [FL] as soon as it is sanctioned and they say the account has been put into your account the amount has been put in your account credited in your account.

So, the only difference coming is demand loan is very short term and term loan is a long term alright. The repayment schedule of term loan, can be either in one installment at time of maturity or few installment as agreed upon by the bank and the party, in case of very large amounts banks usually, in case of very large amounts when it comes to term loans to industry etcetera, bank usually go for like kingfisher airlines, more than 1 crore large amount is counted as more than 1 crore and kingfisher had 1000 of crores, 100 of crores borrowed.

So, it is a consortium banking they start operating it is very interesting that exists [FL] the company will have to negotiate that loan, not from one bank I have to negotiate that loan with a few bank. So, they have meetings all together etcetera and then it is goes consortium banking and then, it can be an EMI return schedule like fix payment loan, you learnt that fixed payment loan, fix term loan first topic it can be like that, it can be onetime payment I can be few installments that you have to pay etcetera.

The loan business is very simple, when the loan is given the entire money is given to the borrower and the interest is chargeable, the repayment schedule is usually worked out, by the bank and has to be agreed upon by the borrower, life is simple [FL] and highly complex. Now, I am coming to that which I will take today and Monday, which you many people do not know, introit I did not know I had to learn about it called this middle term called cash credits. [FL]

What is a cash credit system and banks operate a cash credits a lot. Now, what is cash credit, commercial banks give cash credit which is you can called that loosely a money, lend money to entities commercial entities usually and this cash credit system works under, a system you can call that there is a formal name called cash reserve system.

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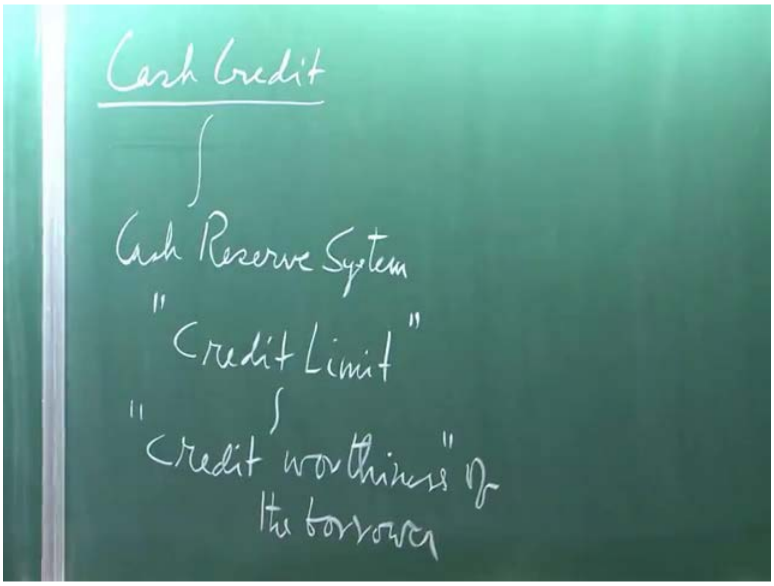

So, why I said is that this cash credit as opposed to loan is different from loan, cash credit is different from loan. And they operate under a system called cash reserve system called a cash reserve system, under this system what happens, when somebody comes to borrow from a bank, the lender usually looks at the financial details, health of the company, what securities they are bringing in I am coming to that they will check all that and then say sanctions 50 lakhs.

When they sanction 50 lakhs, this is where the credit system works, essentially credit multiplier works. They do not allow the borrower to take the money, as case of demand loan and term loan as a full amount, they will not bank will not credit 50 lakhs,in his account right away. They will create a credit limit something called a credit limit, for the borrower that is how much, it can borrow from the bank at any given point of time against that 50 lakh loan.

So, they may create a system like every 2 months you can borrow, 5 lakhs not more than that, the total sanctioned loan will be given to you, but not as a lump sum amount, every 2 months you can came to us and borrow 5 lakhs. Because, we have checked this is how you need to do the spending, so it is controlling the borrower how it is spends, that money that I am giving to you, he is controlling his spending basically, he is not saying. [FL]

This credit limit becomes that, how that credit limit is set against the sanctioned loan of 50 lakhs, becomes the judgmental issue of an how good a bank is to judge a particular borrower, how he would you use the money. Therefore, how much should be given, how you judge his business, how much he requires all kinds of parameters come, there where the bank managers role become very important.

This credit limit is again decided by, how much money you can borrow towards, that sanctioned loan of 50 lakhs every 2 months or every 3 months is decided by something called this is a very interesting expression, called credit worthiness of the borrower credit worthiness of the borrower worthiness of the borrower. So, you as a student you want my help, so I judge the worthiness of this student credit worthiness, this credit worthiness is something the bank manager will have to judge, decide the credit limit and I think they would also, at the same time judge therefore, how much loan if will give it to him.

Everything and how much loan also takes into consideration the collateral and I am coming to that. Now, the credit worthiness of the borrower is assessed by the bank and here, there are various things that banks take into consideration, bank take banks take into consideration something called current assets, it is in the balance sheet of a company. Current assets of the company and it looks at the current assets, what are the current assets usually, the current assets are usually say the finished goods that the company already has in it is inventory, semi finished goods which can be finished and then sold again.

Of course, the market value of good has also been already considered because, the company is doing an odd business, it will not consider that, will not give any money probably at all or give may be very little, it has just that market, marketability the salability of the product of the company, that it is selling. Judge it will also take stock of the raw materials, these are all values if you look at a balance sheet of a company is there, in the current assets column or group, it will take all that into account and the create a credit worthiness of the company.

How much therefore, money it would require and set the credit limit. And when the current assets are taken, there is a margin requirement, you remember the margin requirement word. The total value of assets are not exactly matched by the amount lend to the person, a part of that 20 percent, 30 percent, 35 percent would be deducted whatever remains out of the current asset value then the bank [FL].

So, suppose I have a market value of a property which is lying there, 1 crore and I mortgage that as a collateral go to the bank and try to borrow, the bank will not take the 1 crore market value equal to the loan that bank can give it. Bank would take that as an assets or collateral deduct a chunk of value, from that which is called margin requirement get an 80 percent, 75 percent of that current market price of that. Whatever that number comes to be 1 crore 75 percent, 75 lakh then they will say we will sanction a 60 lakh loan to you. [FL]

So, in case of current assets when I am judging the credit worthiness of the borrower how his business is running, [FL] stock of inventories raw materials [FL] finished good, [FL] semi-finished good, general financial of the company I made the asset valuation, but I do not take that asset valuation, as a determinant factor of the credit worthiness. I did not take a margin requirement, deduct some numbers which ever my bank policies.

Then I come to a number in rupee terms, initially in percentage terms then the rupee, term and that rupee term is used to [FL] alright. Then comes very interesting, once the credit limit has been set, the party knows the borrower that in his account that amount of money would been put periodically, whatever that agreement is. Now, banks keep an eye how is that money utilized, some borrower's utilize the entire amount, [FL] conservative in spending, though I have got the loan, I have a sanctioned amount towards the sanctioned loan some amount, put in my account from that loan. But, I do not use the entire amount.

So, this usage of this is very interesting alright. I there is one more word here I am not going to use that, this margin requirement of assets, current assets as told you, this which creates the, the credit worthiness judge the credit worthiness of that party, is often called the primary security also alright. So, I did not going into the primary security now, these requirement require the borrower to partly finance their current assets from their own funds, what they do usually banks. [FL] Now, I will give you a loan not exactly the amount you need, I will give a loan which is say 75 percent of the amount.

That I have estimated that you need 25 percent, you fund it from your own money. They usually banks do not give the entire amount, even in case of consumption loan I have heard, that you are buying going to by a car, a bank will give you 90 percent of money, not 100 percent often and 10 percent you have to shell out from your pocket, I have heard they do that alright. So, there is a margin also they keep there, in terms of the requirement.

So, this primary security that they calculate, after taking the margin etcetera, this becomes very important. And I will come to a few more issues, but it is nearly 49 I need not go, have you understood a little bit these terms you should write them, credit limit the whole system is called cash reserve system, for cash credit. Then credit limit, credit worthiness of the borrower then the current assets I said which creates the primary security and money is slowly sanctioned.

So, bank is very cautious in giving money, but still it creates a lot of NPA means miss judges, and sometimes it is corruption, bank manager is dealing with a working in a public bank, [FL] government bank owner, public deposit and he goes up things, he does not take responsibility as he as you should have done with his own business, he is a paid employee also. If they do not do their job properly, then the NPA goes up, if they do the job properly a bank manager and his supporting staff, then the NPA cannot go up because, you can see, so much of caution is there, how they operate. I came to this, I am not going to rush it is going be too complex for you. So, I will start again talking about it and complete it and compare it, with the loan system.