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Class 11 commerce Sub. BST. Date 23.01.2021

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Commercial Banks

Commercial banks occupy a vital position as they provide funds for different purposes as well as for different time periods. Banks extend loans to firms of all sizes and in many ways, like, cash credits, overdrafts, term loans, purchase/discounting of bills, and issue of letter of credit. The rate of interest charged by banks depends on various factors such as the characteristics of the firm and the level of interest rates in the economy. The loan is repaid either in lump sum or in installments. Bank credit is not a permanent source of funds. Though banks have started extending loans for longer periods, generally such loans are used for medium to short periods. The borrower is required to provide some security or create a charge on the assets of the firm before a loan is sanctioned by a commercial bank.

Merits

The merits of raising funds from a commercial bank are as follows:

- (i) Banks provide timely assistance to business by providing funds as and when needed by it.
- (ii) Secrecy of business can be maintained as the information supplied to the bank by the borrowers is kept confidential;
- (iii) Formalities such as issue of prospectus and underwriting are not required for raising loans from a bank. This, therefore, is an easier source of funds;
- (iv) Loan from a bank is a flexible source of finance as the loan amount can be increased according to business needs and can be repaid in advance when funds are not needed.

Limitations

The major limitations of commercial banks as a source of finance are as follows:

- (i) Funds are generally available for short periods and its extension or renewal is uncertain and difficult;
- (ii) Banks make detailed investigation of the company's affairs, financial structure etc., and may also ask for security of assets and personal sureties. This makes the procedure of obtaining funds slightly difficult;

(iii) In some cases, difficult terms and conditions are imposed by banks. for the grant of loan. For example, restrictions may be imposed on the sale of mortgaged goods, thus making normal business working difficult.