

Bill market assignment



ASSIGNMENT Recent developments in Commercial Bill Market NOVEMBER 30, 2009 University School of Management Studies Guru Gobind Singh Indraprastha University Delhi Submitted By: SACHIN GOEL (68) MANAV MUDGAL (69) GH Batch MBA (IIIrd SEMESTER) Commercial bill A non-bank bill of exchange (loan) generated by merchant or investment banks and companies. The bill is evidence of the borrower's debt and commitment to repay at the due date. These bills are covered by the Bills of Exchange Act 1909 – 73, as are bank bills, but they are called 'commercial' to indicate they are issued by institutions other than banks.

Types of Commercial Bills: Commercial bill is an important tool finance credit sales. It may be a demand bill or a usance bill. A demand bill is payable on demand, that is immediately at sight or on presentation by the drawee. A usance bill is payable after a specified time. If the seller wishes to give sometime for payment, the bill would be payable at a future date. These bills can either be clean bills or documentary bills. In a clean bill, documents are enclosed and delivered against acceptance by drawee, after which it becomes clear.

In the case of a documentary bill, documents are delivered against payment accepted by the drawee and documents of bill are filed by bankers till the bill is paid. Commercial bills can be inland bills or foreign bills. Inland bills must (1) be drawn or made in India and must be payable in India: or (2) drawn upon any person resident in India. Foreign bills, on the other hand, are (1) drawn outside India and may be payable and by a party outside India, or may be payable in India or drawn on a party in India or (2) it may be drawn

in India and made payable outside India. A related classification of bills is export bills and import bills.

While export bills are drawn by exporters in any country outside India, import bills are drawn on importers in India by exporters abroad. The indigenous variety of bill of exchange for financing the movement of agricultural produce, called a ' hundi' has a long tradition of use in India. It is vogue among indigenous bankers for raising money or remitting funds or to finance inland trade. A hundi is an important instrument in India; so indigenous bankers dominate the bill market. However, with reforms in the financial system and lack of availability of funds from private sources, the role of indigenous bankers is declining.

The market for commercial bills is an important segment of the financial market in many developed countries. Unfortunately in India, the market is virtually a non-starter given the cash-credit system of credit delivery of banks for very short-term working capital requirements of corporate. In an effort to develop the bills market, the interest rate ceiling of 12. 50% on rediscounting of commercial bills was removed in May 1, 1989. However, after the securities “ scam” of 1992, RBI curbed the market by imposing control on the banks to discount bills to the extent of assessed working capital requirements and credit norms.

Till date the bills discounting scheme has yet to find enthusiastic takers in the banking industry. The development of bills discounting as a financial service depends upon the existence of a fully fledged bill market. The Reserve Bank of India (RBI) has constantly endeavored to develop the

commercial bills market. Several committees set up to examine the system of bank financing, and the money market had strongly recommended a gradual shift to bills finance and phase out of the cash credit system. The most notable of these were: (1) Dehejia Committee, 1969, (2) Tandon Committee, 1974, (3) Chore Committee, 1980 and (4) Vaghul Committee, 1985.

This section briefly outlines the efforts made by the RBI in the direction of the development of a full fledged bill market. Bill Market Scheme, 1952: The salient features of the scheme were as follows: 1) The schemes was announced under section 17(4)(c) of RBI Act enables it to make advances to scheduled banks against the security of issuance of promissory notes or bills drawn on and payable in India and arising out of bonafide commercial or trade transaction bearing two or more good signatures one of which should be that of scheduled bank and maturing within 90 days from the date of advances. 2) The scheduled banks were required to convert a portion of the demand promissory notes obtained by them, from their constituents in respect of loans/overdrafts and cash credits granted to them into usance promissory notes maturing within 90 days, to be able to avail of refinance under the scheme; (3) The existing loan, cash credit or overdraft accounts were, therefore, required to be split up into two parts viz. , (A) one part was to remain covered by the demand promissory notes, in this account further withdrawals or repayments were as usual being permitted. B) the other part, which would represent the minimum requirement of the borrower during the next three months would be converted into usance promissory notes maturing within ninety days. (4) This procedure did not bring any change in

offering the same facilities as offered before by the banks to their constituents. Banks could lodge the usance promissory notes with the RBI for advances as eligible security for borrowing so as to replenish their loanable funds. (5) The amount advanced by the RBI was not to exceed the amount lent by the scheduled banks to the respective borrowers. 6) The scheduled bank applying for accommodation had to certify that the paper presented by it as collateral arose out of bona fide commercial transactions and that the party was creditworthy. Bill Market Scheme, 1970: In pursuance of the recommendations of the Dehejia Committee, the RBI constituted a working group to evolve a scheme to enlarge the use of bills. Based on the scheme suggested by the study group, the RBI introduced, with effect from November 1, 1970 the new bill market scheme in order to facilitate the re-discounting of eligible bills of exchange by banks with it.

To popularize the use of bills, the scope of the scheme was enlarged, the number of participants was increased, and the procedure was simplified over the years. The salient features of the scheme are as follows: Eligible Institutions: All licensed scheduled banks and those which do not require a license (i. e. the State Bank of India, its associate banks and nationalized banks) are eligible to offer bills of exchange to the RBI for rediscount. There is no objection to a bill, accepted by such banks, being purchased by others banks and financial institutions but the RBI rediscounts only those bills as are offered to it by an eligible bank.

Eligibility of Bills: The eligibility of bills offered under the scheme to the RBI is determined by the statutory provisions embodied in section 17(2)(a) of the Reserve Bank of India Act, which authorize the purchase, sale and rediscount

of bills of exchange and promissory notes, drawn on and payable in India and arising out of bona fide commercial or trade transactions, bearing two or more good signatures one of the which should be that of a scheduled bank or a state cooperative bank and maturing: 1) In the case of bills of exchange and promissory notes arising out of any such transaction relating to the export of goods from India, within one hundred and eighty days (2) In any other case, within ninety days from the date of purchase or rediscount exclusive of days of grace; (3) The scheme is confined to genuine trade bills arising out of genuine sale of goods. The bill should normally have a maturity of not more than 90 days. A bill having a maturity of 90 to 120 days is also eligible for rediscount, provided at the time of offering to the RBI for rediscount it has a usance not exceeding 90 days. The bills presented for rediscount should bear at least two good signatures. The signature of a licensed scheduled bank is treated as a good signature; 4) Bill of exchange arising out of the sale of commodities covered by the selective credit control directives of the RBI has been excluded from the scope of the scheme, to facilitate the selective credit controls and to keep a watch on the level of outstanding credit against the affected commodities. Commercial bills can be traded by offering the bills for rediscounting. Banks provide credit to their customers by discounting commercial bills. This credit is repayable on maturity of the bill. In case of need for funds, and can rediscount the bills in the money market and get ready money. Commercial bills ensure improved quality of lending, liquidity and efficiency in money management. It is fully secured for investment since it is transferable by endorsement and delivery and it has high degree of liquidity. The bills market is highly developed in industrial countries but it is very limited in India.

Commercial bills rediscounted by commercial banks with financial institutions amount to less than Rs 1, 000 crore. In India, the bill market did not develop due to (1) the cash credit system of credit delivery where the onus of cash management rest with banks and (2) an absence of an active secondary market. Measures to Develop the Bills Market: One of the objectives of the Reserve Bank in setting up the Discount and finance House of India was to develop commercial bills market. The bank sanctioned a refinance limit for the DFHI against collateral of treasury bills and against the holdings of eligible commercial bills. With a view to developing the bills market, the interest rate ceiling of 12. per cent on rediscounting of commercial bills was withdrawn from May 1, 1989. To develop the bills market, the Securities and Exchange Board of India (SEBI) allowed, in 1995-96, 14 mutual funds to participate as lenders in the bills rediscounting market. During 1996-97, seven more mutual funds were permitted to participate in this market as lenders while another four primary dealers were allowed to participate as both lenders and borrowers. In order to encourage the ' bills' culture, the Reserve Bank advised banks in October 1997 to ensure that at least 25 percent of inland credit purchases of borrowers be through bills. Size of the Commercial Bills market:

The size of the commercial market is reflected in the outstanding amount of commercial bills discounted by banks with various financial institutions. The share of bill finance in the total bank credit increased from 1993-94 to 1995-96 but declined subsequently. This reflects the underdevelopment state of the bills market. The reasons for the underdevelopment are as follows: The Reserve Bank made an attempt to promote the development of the bill

market by rediscounting facilities with it self till 1974. Then, in the beginning of the 1980s, the availability of funds from the Reserve Bank under the bill rediscounting scheme was put on a discretionary basis. It was altogether stopped in 1981.

The popularity of the bill of exchange as a credit instrument depends upon the availability of acceptance sources of the central bank as it is the ultimate source of cash in times of a shortage of funds. However, it is not so in India. The Reserve Bank set up the DFHI to deal in this instrument and extends refinance facility to it. Even then, the business in commercial bills has declined drastically as DFHI concentrates more on other money market instruments such as call money and treasury bills. It is mostly foreign trade that is financed through the bills market. The size of this market is small because the share of foreign trade in national income is small.

Moreover, export and import bills are still drawn in foreign currency which has restricted their scope of negotiation. A large part of the bills discounted by banks are not genuine. They are bills created by converting the cash-credit/overdraft accounts of their customers. The system of cash-credit and overdraft from banks is cheaper and more convenient than bill financing as the procedures for discounting and rediscounting are complex and time consuming. This market was highly misused in the early 1990s by banks and finance companies which refinanced it at times when it could to be refinanced. This led to channeling of money into undesirable uses.