# 19BAE711-WORKING CAPITAL MANAGEMENT

## Types of Bank Credit

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Bank credit refers to the various forms of financial assistance provided by banks to individuals, businesses, and other entities. This credit can be in the form of loans, advances, or other credit facilities, and it plays a crucial role in meeting the short-term and long-term financial needs of borrowers.

### *Types of Bank Credit*

1. **Term Loans**
   - **Short-Term Loans**: Loans with a repayment period of less than one year. Used for working capital needs, inventory purchases, or other short-term requirements.
   - **Medium-Term Loans**: Loans with a repayment period ranging from one to five years. Used for equipment purchase, renovation, or other medium-term needs.
   - **Long-Term Loans**: Loans with a repayment period exceeding five years. Used for major capital expenditures like real estate, infrastructure, or significant business expansions.
2. **Working Capital Loans**
   - **Cash Credit (CC)**: A short-term loan provided to businesses to finance their day-to-day operations. It is typically secured against inventory, receivables, or other current assets.
   - **Overdraft (OD)**: A facility that allows businesses or individuals to withdraw more money than what is available in their current account, up to a pre-approved limit. Interest is charged only on the amount overdrawn.
   - **Working Capital Demand Loan (WCDL)**: A short-term loan to meet the fluctuating working capital needs of a business. It is repayable on demand and secured against inventory, receivables, or other current assets.
3. **Project Financing**
   - **Project Loans**: Long-term loans provided for the financing of specific projects, such as infrastructure development, industrial projects, or large-scale commercial ventures. The repayment is typically based on the cash flow generated by the project.
4. **Letters of Credit (LC)**
   - **Commercial LC**: A commitment by a bank to pay a seller on behalf of the buyer, provided that the seller meets the terms and conditions specified in the LC. Commonly used in international trade.
   - **Standby LC**: A guarantee by a bank to pay a beneficiary in case the applicant fails to fulfill their contractual obligations. Used as a backup payment method.
5. **Bank Guarantees**
   - **Performance Guarantee**: A bank promises to pay a beneficiary if the applicant fails to perform their contractual obligations.
   - **Financial Guarantee**: A bank guarantees the payment of a financial obligation, such as a loan or lease.
   - **Bid Bond**: A guarantee that compensates the beneficiary if the bidder withdraws or fails to sign the contract after winning the bid.

6. **Consumer Credit**
    - **Personal Loans**: Unsecured loans provided to individuals for personal expenses such as medical bills, education, or home renovations.
    - **Credit Cards**: A revolving credit facility allowing individuals to make purchases or withdraw cash up to a pre-approved limit. Interest is charged on the outstanding balance.
    - **Home Loans**: Long-term loans provided for the purchase, construction, or renovation of residential property. They are typically secured against the property.
    - **Auto Loans**: Loans provided for the purchase of vehicles. They are typically secured against the vehicle being financed.
7. **Trade Credit**
    - **Supplier Credit**: Credit extended by suppliers to businesses for the purchase of goods and services. The repayment terms are usually short-term.
    - **Buyer's Credit**: Credit provided by banks to importers for making payments to overseas suppliers. It allows importers to defer payment for goods and services.
8. **Commercial Loans**
    - **Business Loans**: Loans provided to businesses for various purposes, including expansion, capital expenditures, and operational needs. They can be secured or unsecured.
    - **Equipment Financing**: Loans or leases provided for the purchase of machinery and equipment. The equipment itself often serves as collateral.
    - **Inventory Financing**: Loans provided to purchase inventory. The inventory acts as collateral for the loan.
9. **Revolving Credit Facilities**
    - **Line of Credit (LOC)**: A flexible loan arrangement allowing businesses or individuals to borrow up to a pre-approved limit, repay, and borrow again as needed. Interest is charged only on the amount used.
    - **Revolving Credit Accounts**: Similar to a line of credit, but often used for specific purposes such as credit card accounts or home equity lines of credit (HELOC).
10. **Invoice Financing**
    - **Invoice Discounting**: A facility where businesses can sell their invoices to a bank at a discount to get immediate cash flow.
    - **Factoring**: Similar to invoice discounting, but the bank also takes over the collection of payments from the debtors.

### *Control Aspects of Bank Credit*

1. **Credit Appraisal**: Thorough assessment of the borrower's creditworthiness, including financial statements analysis, credit history, and business performance.
2. **Collateral Management**: Evaluation and monitoring of collateral provided by the borrower to secure the loan.
3. **Loan Documentation**: Proper documentation of loan agreements, terms and conditions, collateral details, and repayment schedules.
4. **Monitoring and Review**: Regular monitoring of the borrower's financial health and loan utilization to ensure timely repayment and detect any early signs of distress.
5. **Risk Management**: Implementation of risk management strategies to mitigate credit risk, including diversification of the loan portfolio and setting appropriate credit limits.

### *Advantages of Bank Credit*

1. **Access to Funds**: Provides access to necessary funds for businesses and individuals to meet their financial needs.

2. **Flexible Terms**: Offers a variety of credit facilities with flexible terms and repayment options.
3. **Builds Credit History**: Helps borrowers build and improve their credit history, which can be beneficial for future borrowing.
4. **Supports Growth**: Enables businesses to invest in growth opportunities and expand their operations.

### *Disadvantages of Bank Credit*

1. **Interest Costs**: Borrowers must pay interest on the borrowed funds, which can be significant over time.
2. **Credit Risk**: The risk of default if the borrower is unable to meet repayment obligations.
3. **Collateral Requirements**: Many credit facilities require collateral, which can be a burden for some borrowers.
4. **Stringent Approval Process**: The approval process for bank credit can be stringent and time-consuming.

## Conclusion

Bank credit is a versatile financial tool that caters to the diverse needs of businesses and individuals. By offering various types of credit facilities, banks play a crucial role in supporting economic growth and development. However, effective management and prudent use of bank credit are essential to mitigate risks and ensure financial stability.