CHAPTER

13 BILLS MARKET

INTRODUCTION

The bill market or discount market refers to the market where short dated bills and other papers are bought and sold. The treasury bills are the most important instruments used in the bill market.

The bill market is an important sub-market of the money market. The co-ordinated and developed bill market accelerated resources for rapid development.

The practice of re-discounting bills by Discount Houses with the Bank of England to relieve the stringency of liquid funds in the market imparted to the central bank the power to influence the cost of money and the rediscount rate or bank rate slowly emerged as a major weapon of monetary control. It is noteworthy in the context of the monetary history of Britain, that the bill market developed in the country autonomously and the central bank sought to influence the cost of credit in the economy through its medium subsequently and not *vice versa*, as is being attempted in other parts of the world.

All developed and organised money markets have a developed commercial bills of exchange market in which funds are borrowed by the government for 3 months (a Treasury Bills Market), a market for foreign exchange dealings, etc.[1] In an underdeveloped country, wherein unorganised money market predominates, the bill market acts as a governor of the unorganised money market within the fold of the central bank control and also links the unorganised money market with that of the organised. Among the bill markets functioning in the world, the London Bill Market, commonly known as the 'London Discount Market', is looked upon as the leading bill market in the world. Discount Houses have a unique place in the Houses, alone, that the Bank of England operates as lender of resort.

1. Messrs Madan and Nadler have mentioned the possible existences of six different sub-markets in their book, *International Money Markets.*

It is through Discount Houses that the Bank of England used to channel the marginal amounts of the cash with which it sees fit to provide the economy.[2] Although the importance of the discount market has been delegated to a secondary place in the short-term market in the post-war period, it still continues to play a very crucial role in the money market. The Committee on the Working of the Monetary System in England observed: "*It is no service to claim that the discount market is indispensable to the functioning of the monetary system; but the fact remains that the discount market, by smoothening out irregularities in the ebb and flow of funds among the commercial banks and others, does simplify the functioning of the banks and enables them, free from the embarrassment of temporary disturbances in their liquidity, to concentrate on their major task of providing credit for the production of goods and services. It would be beyond human ingenuity to replace the work of the discount houses; but they are doing the work effectively, and they are doing it at a trifling cost in terms of labour and other real resources.*"[3] Although the importance of the discount market in the post-war period in England is on decline, they are still considered as the direct and effective link between the Central Bank and the money market.

THE RESERVE BANK OF INDIA AND THE BILL MARKET SCHEME

A well organised bill market is essential for the smooth working of the credit system, the progress of commercial banking as well as linking up the various credit agencies effectively to the central bank of a country. A bill market is the market for short-term bills generally of three months duration. Three types of bills of exchange or trade bills, finance bill or promissory notes and treasury bills are dealt within the bill market. The commercial banks can keep their liquid cash profitably in these bills for short periods. In times of necessity, the banks can dispose of the bills easily or rediscount them with the central bank. So the bill market plays a significant part in the money market.

The Central Banking Enquiry Committee emphasised the need for developing a bill market in India as early as 1931. But it did not develop even after the establishment of the Reserve Bank due to several reasons.

In January 1952, for the first time, the Reserve Bank introduced a Bill Market Scheme.

Under Section 17 (4) of the Reserve Bank of India Act, the apex bank undertook to make advances to scheduled banks against the security of usance promissory notes or trade bills having a maturity of 90 days and bearing two signatures, of which one would be that of a scheduled bank.

The salient features of the Scheme, as originally formulated by the Reserve Bank, were as follows:

(*i*) The Reserve Bank undertook to make demand loans at its banking offices in India to scheduled banks against their promissory notes supported by usance bills or promissory notes of their constituents. Section 17(4)(c) of the Reserve Bank of India Act permits

2. Radcliffe Committee Report (1959), p. 58.
3. *Ibid.*, p. 64.

the Reserve Bank to make advances against bills of exchange and promissory notes drawn on and payable in India and arising out of bonafide commercial or trade transactions bearing two or more good signatures (one of which shall be that of a scheduled bank) and maturing within ninety days. As banks normally finance business through loans, cash-credits and overdrafts, they were permitted to convert a part of the borrowings (representing the minimum requirements of the borrower during the next three months) into usance promissory notes of ninety days which they could lodge with the Reserve Bank as collateral securities for advances.

(*ii*) As an inducement to banks to popularise the bill as an instrument of credit, the Reserve Bank offered to make advances against bills at half per cent below the Bank Rate, *i.e.,* at 93 per cent per annum. (The Indian Central Banking Enquiry Committee had recommended that the rate on loans against authorised securities should be higher than the rate on bills and that it would be useful to have a larger margin between these rates at the outset.)

(*iii*) As a further incentive, the Bank agreed to bear the cost of the stamp duty incurred in converting demand bills into time bills. [The Indian Central Banking Enquiry Committee (1931) had recommended the abolition of the stamp duty on bills. The State Governments did not, however, accept the suggestion, though in 1940 it was reduced to two annas per thousand Rupees.]

(*iv*) The minimum value of individual bills tendered to the bank was fixed at ` 1 lakh each, while the maximum limit for a single advance which a bank might take at any time was fixed at ` 25 lakh.

The scheme, however, has one very important limitation. It makes no provision for the indigenous banker's *hundi*, which is the most important credit instrument in the market sector of the economy. The present hundi market constitutes the nucleus of a real bill market. The Reserve Bank has, therefore, failed to integrate the two sectors of the market. The progress achieved under this scheme is quite limited. Despite its name, there is no market for these bills. It is primarily a bill accommodation scheme, for which purpose banks create bills by converting a portion of their cash credit overdraft accounts into bills so as to conform to the requirements of Section 17(4)(c) and 17(2)(a) of the Reserve Bank of India Act, 1934. The borrower executes a promissory note in favour of the bank, which adds its own signature (to conform to the "two good signatures" requirement for eligibility for borrowing from the Reserve Bank) and submits this as collateral security to the Reserve Bank. Though a market may not have been created for genuine trade and industrial bills, the Bill Market Scheme has served well as a device to ensure the elasticity of funds during the busy season and has permitted a degree of qualitative control in terms of retaining to the Reserve Bank the right to check any particular packet of bills.

This Bill Market Scheme undoubtedly had some achievements to its credit. It, no doubt, *'served well as a device to ensure the elasticity of funds during the busy season and has also permitted a degree of qualitative control in terms of reserving to the Reserve Bank the right to check any particular packet or bills.... It has sought to fit into the framework of the existing eligibility criteria the requirements for seasonal finance without too much disturbance of banking practices.'*

In retrospect, one could say that considering the popularity of the cash credit system with the industry and trade as a facile source of finance and the predominance of these interests in the ownership and management of commercial banks in India at that time, any attempt on the part of the banks to force them to switch over to bill finance in lieu of cash credit would have been effectively thwarted by them.

In 1957, on the recommendations of the Export Promotion Committee, the Reserve Bank of India, extended the scheme to include export bills in order to enable scheduled banks to provide finance to exports on a liberal scale. The extension of the bill market scheme to export bills has been continued further year after year.

CLASSIFICATION OF BILL MARKET

There were two distinct bill markets till April 1997. *First,* the Treasury Bill Market-the market which deals with treasury bills. In India, treasury bills are short-term (91 days to 364 days) liability of the Central Government. RBI is a major passive player. Since April, 1997, *ad hoc* treasury bills have been replaced by ways and means for financing Central Government's temporary deficits.

Second, the Commercial Bill Market-commercial bills as instruments of credit are useful to business firms and banks.

THE NEW BILL MARKET SCHEME 1970

The 1952 Bill Market Scheme remained a partial success. It was criticised that it did not develop the good bill market in India. The scheme appears to be a device for extending credit for banks during busy season. It is not based on genuine trade bills but on the conversion of loans and advances by scheduled banks into usance bills.

The Deheja Committee set in motion the introduction of a new bill market. The report brought out the abuses of cash credit system and suggested the use of bill financing and for the supervision of the end use of funds lent by commercial banks.

A study group was appointed by the Reserve Bank in February 1970, under the chairmanship of Shri M. Narasimham to go into the question of enlarging the use of the bill of exchange as an instrument for providing credit and creation of a bill market in India. The group submitted the report in June 1970. Following its recommendations, the Reserve Bank announced a new bill market scheme under Section 17(2)(a) of the Reserve Bank of India Act in November 1970.

(*i*) All eligible scheduled banks are eligible to offer bills of exchange for rediscount.

(*ii*) The bills of exchange should be a genuine trade bills and should have arisen out of the sale of goods. Accommodation bills are not eligible for this purpose.

(*iii*) The bill should not have a maturity time of more than 120 days and when it is offered to the Reserve Bank for rediscount, its maturity should not exceed 90 days.

(*iv*) The bill should have at least two good signatures, one of which should be that of a licensed scheduled bank.

(*v*) The minimum amount of bill should be ` 5,000 and on one occasion, the value of bill offered for rediscount should not be less than ` 50,000.

In 1971, the Reserve Bank simplified the procedure for rediscounting the bills. To avoid delays and reduce the work involved in physically delivering and redelivering the bills to and from the Bank, it was decided to dispense with the actual lodgement of bills, each of the face value of ` 2 lakh and below.

The minimum amount of a bill eligible for rediscount with the Bank was reduced to ` 1,000. The facility which was available only in Mumbai, Kolkata (Calcutta), Chennai (Madras) and New Delhi, was extended to Kanpur and (Bangaluru).

In April 1972, the bills drawn on and accepted by the Industrial Credit and Investment Corporation of India Limited on behalf of the purchasers were covered by the scheme provided they are presented to the Reserve Bank by an eligible scheduled bank.

The New Bill Market Scheme has opened vistas of development of full fledged bill market in India. Certain criticisms were levelled against the working of the scheme. The unorganised money market has not been drawn within its fold. Most of the bills presented for rediscount related to trade and not agriculture. The period of the bill admitted under the scheme was also inadequate. The procedure followed for determining the eligibility of the bank for the purpose of rediscounting is far from satisfactory.

The two note worthy features of the new scheme are:

(i) The bills covered under the scheme are genuine trade bills; and

(ii) The scheme provides for their rediscounting.

The Reserve Bank has been making constant efforts for the orderly development of a bill market. However, it will take a long time to have a bill market of the type found in advanced countries.

A Bill of Exchange is an instrument in writing containing an unconditional order by the maker directing a specified person to pay a sum of money to the order or to the bearer of the bill. Such bills augment the instruments of financial transaction, supplementing the available resources in times of seasonal stringencies for the purpose of refinance from the Reserve Bank.

TYPES OF BILLS

Bill of Exchange are broadly classified as follows:

1. Demandand Usance bills
2. Clean bills
3. Documentary bills
4. Inland & foreign bills

5. Export & Import bills
6. Indigenous bills
7. Accommodation bills
8. Supply bills.

CLASSIFICATION OF THE BILL MARKET

From the operational point of view, the bill market is classified into two distinct markets.

1. *Discount market* refers to the market where short-term genuine trade bills are discounted by financial intermediaries.
2. *Acceptance market* refers to the market where short-term genuine trade bills are accepted by financial intermediaries.

ADVANTAGES

Commercial bill market is an important source of short-term funds for trade and industry. The main advantages are:

1. Liquidity
2. Self-liquidating and Negotiable asset
3. Certainty of payment
4. Ideal investment
5. Simple regal remedy
6. High and quick yield, and
7. Easy Central bank control.

DRAWBACKS

The New Bill market Scheme has, however, the following drawbacks:

(*i*) Really speaking, it is not based on genuine trade bills. It is still based on conversion of bank loans into bills of usance.

(*ii*) The scheme has not been confined to regular finance.

(*iii*) Hundis are not acceptable under this scheme, hence indigenous bankers remain out of the circle. To enlarge the scope of the bill market in India, it is very essential to recognise *Multani Hundis* under the scheme.

(*iv*) The Reserve Bank has been exercising its discretionary power to the fullest in implementing this scheme. It would have been better if the scheme had been made an obligatory function of the Reserve Bank.

(*v*) Agricultural finance is also outside the purview of this scheme.

Other drawbacks of the bill market are:

(i) Absence of bill culture

(ii) Absence of rediscounting among banks

(iii) Absence of secondary market

(iv) Absence of acceptance services.

To encourage the generation of bills and the development of a bill culture, the Working Group of Money Market (1987) had recommended that the Credit Authorisation Scheme (CAS) should be modified over a three year period by providing limits for bill transactions. There should be:

(*a*) A phased increase in the proportion of bill acceptances to total credit purchases to a level of 75 per cent; the phasing should be done in such a manner that a proportion of at least 25 per cent reached by April 1, 1988 and 50 per cent by April 1, 1989;

(*b*) The banking system should move gradually away from receivable financing to bill financing. Commencing from April 1, 1988, a gradual phasing out of receivable financing was proposed to be undertaken. From April 1, 1988, for calculating the drawing power on cash credit/overdraft limits against receivables, only 75 per cent of the eligible receivables was to be taken into account. This should be reduced to 50 per cent from April 1, 1989 and 25 per cent from April 1, 1990. In other words, regressively credit sales should be effected by drawing usance bills, since such bills could be discounted with banks.

Based on the recommendations of the committee to review the working of the monetary system and the Working Group on the Money Market, the following important measures were taken:

(*i*) Non-bank institutions were permitted to participate in the money market;

(*ii*) A number of instruments were developed to provide breadth and depth to the money market;

(*iii*) A Discount and Finance House of India (DFHI) was set up in 1988 as a Reserve bank subsidiary with participation from other money market institutions to facilitate smoothening of short-term liquidity imbalances and to impart greater flexibility to the money market;

(*iv*) A 364-day treasury bill on an auction basis was introduced in April 1992;

(*v*) A 91-day auction treasury bill was introduced in January 1993; and

(*vi*) A new treasury culture has been developed among banks and institutions.

The bills market has not yet developed, mainly because of easy availability of other instruments. The outstanding of commercial bills rediscounted by commercial banks with various financial institutions rose from ` 374 crore at the end of March 1996 to ` 515 crore at end March 2004 and fell to ` 355 at end March 2005.

AN INNOVATION

In a broad sense, the Bill Market Scheme has emerged as an interesting innovation in the sense that it is a compromise between the convenience of banks and their borrowers on the one hand and that of the Reserve Bank and the banking system on the other. It has sought to fit into the framework of the existing eligibility criteria the requirements for seasonal finance without too much disturbance in banking practices. The question, however, remains of enlarging the supply of bills representing genuine trade transactions. Inland D.A. bills, for instance, are reportedly very much in vogue and point to the possibilities in this direction. To emphasise the seasonal character of the bill market facility, the limits sanctioned in respect of the accommodation under the scheme are said to be now confined to a period of 8 months, namely, November to June (inclusive). The Bill Market Scheme needed to, therefore, be viewed not as an instrument of enhancing central bank control on the Lombard Street model, but rather as a device to which a selective bias could be imparted in regulating central bank accommodation to the banking system.

Bill financing in preference to cash credit lending would further result into better turnover of funds and ensure maximum utilisation of bank's resources. At present, to encourage the bill market, the Reserve Bank has agreed to rediscount bills offered by commercial banks at bank rate and such refinancing would not affect the Net Liquidity Ratio of the concerned bank. It is not known as to how long the re-discounting facilities would continue in this form but with the differential of 3 to 4 per cent between the Reserve Bank's re-discounting rate and the discounting rates of commercial banks, the bill business appeared to be an attractive proposition. However, one aspect of bill business which is often ignored by most of the supporters of the bill market from the commercial banking sector relates to its effect on the profitability of banks. As the discount rates are generally lower than the interest rates on similar advances, with the gradual replacement of cash credits by bill financing, the banks' earnings are bound to suffer unless discount rates are brought on par with interest rates.

FINANCE COMPANIES' ENTRY

The finance companies have been attracted to enter bill business. Some of them have reportedly transacted large volumes of business. While their capital base is not large, they have been required to even apportion it among their various activities, such as leasing, bill discounting and hire purchase. Thus, they are said to be dependent on bank finance for their bill discounting activity.

To a large extent, finance companies adopt any one of the following methods of bill financing. They may co-accept the bills to facilitate discounting; they may discount the bills and the banks may rediscount them, especially where a letter of credit has been opened by the buyer who is a reputed party; they may get the bills discounted by banks and render only broking service to their clients.

The "*agency*" approach seems to have been given encouragement in the name of expansion of the banks' bill business and improvement in profitability, especially since such finance is provided on the usual cash credit terms. The question that would arise is, bill discounting through

the "*agency*" approach a short-term or a long-term strategy? Be that as it may, there emerged a need for fresh thinking for evolving a long-term corporate strategy, as bill financing has been referred to as the backbone of the banking business the world over.

LONG-TERM CORPORATE STRATEGY

The bank credit delivery system has vastly improved in India with the setting up of numerous bank branches. Bill financing has emerged as a strategy to enable parties to deal with customers at distant centres. Branches at different centres can serve one another well and conditions favourable for developing bill business exist by way of handling documents, remitting proceeds and other facilities. The branch network enables banks to produce customer profits and obtain credit reports quickly.

The bill culture can ensure that it benefits everyone engaged in business, especially those in small businesses supplying goods and services to large potential customers. Large customers on the other hand would derive benefit by supporting small business by way of assured and continuous supplies, quality products and lower prices. The mutuality of interest should prompt all business to shift to bill financing in preference to the cash credit and overdraft system of financing trade.

Both borrowers and banks at present seem to overlook certain long-term advantages of bill financing. Trade and industry have to consciously use bill financing as a more predictable means of cash budgeting than the cash credit system, under which cash flows cannot be forecast with any high degree of certainty. Bill financing facilitates efficient working capital management. The quicker re-cycling of limited funds would ensure and promote efficiency and productivity which is the need of the hour. From the banking system's viewpoint, a large portfolio of bills in a reasonably secured mode of finance, is important since it improves liquidity and facilitates better fund management.

The central banking authority is best suited to take a fresh look at the present state of affairs in the bill market and evolve a long-term strategy in consultation with the premier trade bodies and the banks.

CONCLUSION

The Reserve Bank's new Bill Market Scheme is a big step towards the development of a bill market in India. In fact, it is the first serious attempt at developing a bill market which would bring about an integration of the credit structure in the country and make monetary control more effective. The Study Group on 'Enlarging the Use of the Bill of Exchange' has pointed out that the evolution of the bill market will also make the Bank Rate variations by the Reserve Bank a more effective weapon of monetary control as the impact of any such change could be transmitted through this sensitive market to the rest of the banking system.

Once the bill market develops in the country and covers a large part of trade credit, apart from influencing the cost of credit in the economy, it would also be possible for the monetary authorities to vary the duration of the trade credit available to industry and trade by varying the usance of the bills eligible for discount. When it is felt that it is necessary to lighten trade credit

in the economy, the usance of the bills eligible for discount can be reduced; but when it is felt necessary to relax credit, the usance of the bills eligible for discount can be enhanced. In this manner, the monetary authorities can influence the cost as well as the volume of trade credit available in the economy.

A properly developed bill market will act as a link between the organised and unorganised money markets in the country. Moreover, where the unorganised money market occupies a more important place in relation to the total resources of the country, the growth of discounting facilities acts in the same way as a subsidy; but it has the additional advantage of developing contacts between the various parts of the banking system and making it easier for the central bank to enforce its policy.[4] Thus, a link may be established between the two markets, which may also enable the Reserve Bank to implement its monetary policy more effectively in the future market developments.

SELF ASSESSMENT QUESTIONS

(1) Discuss the role of bills market in the economy.

(2) Analyse the advantage dis-advantages of a bill market.

(3) Corporate strategy for bill market.

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4. *Ibid.*