17. Money and Financial Institutions

Very Short Answer

1. Question

What is currency?

Answer

According to RBI, the currency consists of two things paper notes and coins. RBI is the sole authority that issues the notes and coins. Since it is issued by the RBI, it accepted as a medium of exchange in the country.

2. Question

Explain the meaning of money.

Answer

Money is the widely used medium of exchange. Money is any item which is generally accepted as payment against any goods or services and repayment of debts, such as taxes. Money is originated from the Latin word Monets.

3. Question

What does the Check mean?

Answer

A check is the document that orders a bank pay a specific amount of money from the persons account to another person or any other whose name the check is being issued.

4. Question

What is the name of the Indian currency?

Answer

The Indian currency is known as the Indian rupee. The issuer of the Indian currency that is Rupee is the central bank of India. Reserve bank of India has the sole authority to monetize the currency.

5. Question

Which is the central bank of India?

Answer

Reserve bank of India is the central bank of India. The RBI was established in 1st April 1935 under the Reserve Bank of India act, 1934. The main function of RBI is to control the entire financial institutions and commercial banks in the economy. RBI was nationalized on 1st January 1949.

6. Question

What do you think of saving?

Answer

Savings is the portion of income which is not spent by the consumer. Saving is the method used for using the money or financial assets for future use. Banks are the institutions which promote the saving habit for the consumers.

7. Question

What is the symbol of Indian currency?

Answer

The sign of the Indian rupee is '₹' and the code used is 'INR.' The sign is designed by the Uday Kumar and presented to the public by the government of India on 15th July 2010. Before the adoption most commonly used symbol was 'Re' or 'Rs.'

8. Question

Which notes are monetized by the Governments of India in 2016?

Answer

The government of India monetized the new 500 and 2000 rupee notes and demonetized the old 500 and 1000 rupee notes. This was done mainly to curb out the black money in the economy. The demonetization was done on 8th November 2016.

9. Question

Who is the financial intermediary?

Answer

A financial intermediary is an entity which stands between two parties who indulge in the financial transactions. The banks and financial institutions act a financial intermediary for the parties who involve in the financial transaction.

10. Question

What are the requirements for loans?

Answer

Collateral security, interest rate, income certificate of the party, and many other documents as specified by the bank are the requirements for enhancing loan. Collateral is an important requirement for the loan. Collateral is an asset that borrower owns. The collateral can be anything that has monetary value in it. The lender uses that collateral as a guarantee for that which borrower will repay the amount in future.

11. Question

What is the control of institutional financial resources?

Answer

The control of the institutional financial resources is the Reserve Bank of India. It the central bank of India which controls the entire financial institution in the economy.

Short Answer

1. Question

What is called a barter system?

Answer

The barter system is the traditional form of transferring the goods and services for other goods and services. A barter system is an old method of exchange. This system has been used for centuries and long before money was invented. People exchanged services and goods for other services and goods in return. In a barter system, the goods are exchanged for another good. When goods are exchanged with each other, it lacks with many difficulties.

• Double coincidence of wants: One of the most difficult of barter system is the double coincidence of wants in which the buyer and seller should agree to sell each other's commodity in exchange even if they are not interested

• Difficulty in finding buyer and seller: It is very difficult to find the buyer who is need of commodity which the seller wants to sell.

• Store of value: the Barter system lacks the function of store of value because the sold commodities cannot be saved for future use whereas money can be easily saved as a deposit.

2. Question

What were the difficulties in the barter system?

Answer

• <u>Double coincidence of wants:</u> One of the most difficult of barter system is the double coincidence of wants in which the buyer and seller should agree to sell each other's commodity in exchange even if they are not interested. This will also lead to not an equal valuation of the goods. There will be no existence of costly good or cheaper goods; All the goods will equal.

• <u>Difficulty in finding buyer and seller:</u> It is very difficult to find the buyer who is need of commodity which the seller wants to sell. Finding a person who is in need of the commodity that we are intended to sell is very difficult.

• <u>Store of value</u>: the Barter system lacks the function of store of value because the sold commodities cannot be saved for future use whereas money can be easily saved as a deposit. The goods do not possess the quality to use for future requirements.

3. Question

Explain the work of money in the form of a measure of value.

Answer

Money is anything that is widely accepted for a transaction and which has a monetary value. A modern form of money includes paper notes and coins. Other than these two there are many types of money there are e-money, mobile wallet are some types which are as money currently in our economy. Best fit example of new forms of money that is e-money is Paytm which is widely accepted nowadays. New forms of e-money are not accepted in rural areas by the person who has lack of knowledge on the internet. Paper notes and coins accepted everywhere in India because of it the promissory note issued by the RBI. All the modern money will have the function of the store of value.

Money has the function of a measure of value. Money acts as a measure of exchange value. This means that money is a sort of general denominator, through which the exchange value of all goods and services can be articulated without any difficulty. Innumerable exchange rates under the barter system earlier caused massive trouble in the transactions of all kinds. Money has removed this difficulty by portion as a common measure of value. The value of all goods and services is expressed in terms of price and prices are expressed in terms of money. As money acts as a unit of account, it has significantly reduced the number of exchange rates.

4. Question

What are the credentials?

Answer

A credential is an attestation of qualification, competence, or authority issued to an individual by a third party with relevant or de facto authority or assumed competence to do so. It is the document which is given to an individual for representing his individuality. It can be proof of academic certificate, security clearance, identification documents, keys, power of attorney and so on.

It can be used as collateral for acquiring a loan from any institution or banks. For education loan for studying higher studies, the academic certificate is submitted as collateral for acquiring the loan. Collateral is an asset that borrower owns. The collateral can be anything that has monetary value in it.

The bank demands the collateral for the guarantee against their repayment for the credit. Collateral can be land, building, gold, vehicle…etc.

5. Question

What are the limitations of metal currency?

Answer

In this system, metals such as copper, bronze, gold, and others were considered money. It offered the users a lot of advantages in terms of ease of handling and certainty in the amount of transaction. It provided a standard unit of measuring value. With the passage of time, precious metals like gold, silver, and others began to be considered as money. Many kings started minting coins in their names that were circulated among the public to be used as money.

Limitations

• Necessary to carry in bulk in case of large transactions

Whenever there is a large number of transactions, there is a need for carrying more amount of metallic currency. Therefore it will be heavier to carry.

• Difficult to access the value of metallic money

When the metallic currency is of the same weight, it will be difficult to assess the value of the currency.

6. Question

What is the financial institution? Explain with examples.

Answer

A financial institution is a mediator between consumers and the capital or the debt markets providing banking and investment services. The most common types of financial institutions comprise commercial banks, investment banks, brokerage firms, insurance companies, and asset management funds. Other types consist of credit unions and finance firms. Financial institutions are synchronized to control the supply of money in the market and protect consumers.

A central bank is a financial institution accountable for the oversight and administration of all other banks. Reserve Bank of India is the central bank of India. The RBI was established in 1st April 1935 under the Reserve Bank of India Act, 1934. The main function of RBI is to control the financial institutions and commercial banks in the economy.

7. Question

What are the institutional financial sources? Explain with examples.

Answer

Financial institutions, otherwise known as banking institutions, are corporations which supply services as intermediaries of financial markets. Broadly, there are three major types of financial institutions. Financial institutions in most countries operate in a heavily synchronized environment because they are critical parts of countries' economies, due to economies' confidence in them to grow the money supply via fractional reserve lending. Regulatory structures differ in each country, but typically involve prudential regulation as well as consumer protection and market stability.

One of the major sources of the financial institution is commercial banks. It is one of the formal sources of credit. Commercial banks make up a significant role for the source of credit. The banks accept deposit from the households who have excess money advance loans to the households who are in need of it. It is one of the easiest ways of getting a loan for the households.

8. Question

Describe the properties and defects of non-institutional financial sources.

Answer

The credit from the noninstitutional financial sources is the getting loans from the money lenders, relatives and many other therefore it does not have any code of conduct, and they charge any rate of interest which leads to the huge cost to the borrowers to repay, and lenders can easily exploit the borrowers. Rural poor always depend on the noninstitutional financial source of credit due to lack of awareness and ease of availability. When the credit is available for the emergency purpose, he will borrow from the noninstitutional financial sources.

9. Question

Who is the country banker? Explain three key features.

Answer

The country banker is the central bank of the country. RBI is the central authority that can authorize and issue the currency note and coins which are widely accepted as the medium of exchange. They act on behalf of the central government in most of the financial perspective of the country. RBI is the central government institution that controls all formal sector loans. All the commercial banks and many other financial institutions are supervised under RBI. RBI is the central bank of India, and it is the apex bank in the country. One of the main function of the central bank is to supervise all the commercial banks.

Features

• <u>Monetize the currency</u>

The central bank is the sole authority to print the currency in the economy. No other financial institution in the country has the authority to do that.

• <u>Controller of credit</u>

To control the credit, the central bank will increase or decrease the cash reserve ratio (CRR) which is kept as a reserve by all commercial banks in the central bank. When the economy is in inflation (continuous rise in the price level), then the central bank will increase the CRR which will reduce the lending capacity of the commercial bank and the process is reversed when there is deflation.

• The controller of the commercial bank

The central bank controls all the commercial banks in the economy. Any expansion in the commercial bank is taking place; it should be from the prior permission of the central bank.

10. Question

Explain the moneylenders as a source of credit.

Answer

Money lender has a significant role in the non-institutional source of credit. They have a significant role in the rural areas because they lend their money to people with minimum time for the collateral and with high interest. Rural poor are not aware of the banking system because of the lack of education. Therefore they are forced to acquire a loan from the money lenders. Most of the people in the rural areas don’t have access to the native bankers and other financial institution; this increases the significance of the money lenders.

Even though they advance the loan, they do not accept the deposit form the people.

Long Answer

1. Question

Explain the different phases of currency development

Answer

Anything that is acceptable as a medium of exchange and even the means of payment for the settlement of debts can be considered as money. In today's world, money consists of currency notes and coins. The money as we see today has been the result of a long evolution process. The main steps through which money progressed are:

Barter system

It involves the exchange of commodities. In the system, commodities were exchanged for commodities. But such a system required the fulfillment of double coincidence of want. Every person had to find a buyer who was ready to buy their commodity and in exchange sell the particular commodity that they needed. It was the greatest difficulty of the barter system. Also in a barter system, there was no measuring rod for measuring the value of money. This money could not be used as a store of value or for future payments.

These serious inconveniences of barter led to the introduction of commodity money.

Commodity money

It is the next stage of the barter system. In the financial system, commodities were exchanged as money. Some standard commodities like shells, fur, utensils, weapons, and grains were considered money. The commodities that acted like money was decided upon the mutual consent of the parties involved in the transaction. Thus the system of exchange where defied commodities began to be exchanged as money was known as the commodity system. But it also had many inconveniences like problems in deciding the commodities that acted as money and their uses. Here also money failed to provide a standard for measuring value. These problems paved the way for the development of metallic money.

Metallic money

In this system, metals such as copper, bronze, gold, and others were considered money. It offered the users a lot of advantages in terms of ease of handling and certainty in the amount of transaction. It provided a standard unit of measuring value. With the passage of time, precious metals like gold, silver, and others began to be considered as money. Many kings started minting coins in their names that were circulated among the public to be used as money.

Paper money

This is the modern form of money that is being used across the world. The precious metals and coins were inconvenient to be carried in large quantities. In place of this paper currency was introduced that gave the convenience of the transaction to the users. They could carry large amounts in the form of currency notes. In the modern currency system, the notes are issued by the central bank that is the apex monetary authority of the country. No one has the authority to reject the money that is being circulated by the central bank. Thus this became the most convenient method of conducting transactions and exchanges.

Plastic money and e-money

This developed with the development of internet facilities. Plastic money consists of debit cards, credit cards, and other facilities. The users can carry them instead of carrying currency. A debit card allows the user to withdraw money from the account while credit card allows the user to overdraw beyond the account holder's balances. The expansion of the internet has also paved the way for the development of e-wallets like PayTm, Google Pay and other services through which transactions can be carried out.

Thus the evolution of money has different stages from the past till now. Still, money is in the process of evolution with the changes in the needs and requirements of the people.

2. Question

Explain the main functions of the currency.

Answer

Money is often defined in terms of the three functions or services that it provides. Money serves as a medium of exchange, as a store of value, and as a unit of account**.**

Money is a most significant function is as a medium of exchange to make easy transactions. Without money, all transactions would have to be conducted by barter, which involves direct exchange of one good or service for another. The difficulty with a barter system is that in order to obtain a particular good or service from a supplier, one has to possess a good or service of equal value, which the supplier also desires. In other words, in a barter system, the exchange can take place *only* if there is a double coincidence of wants between two transacting parties. The likelihood of a double coincidence of wants, however, is small and makes the exchange of goods and services rather difficult. Money effectively eliminates the double coincidence of wants problem by serving as a medium of exchange that is accepted in all transactions, by all parties, regardless of whether they desire each others' goods and services.

Store of value

In order to be a medium of exchange, money must hold its value over time; that is, it must be a store of value. If money could not be stored for some period of time and still remain valuable in exchange, it would not solve the double coincidence of wants problem and therefore would not be adopted as a medium of exchange. As a store of value, money is not unique; many other stores of value exist, such as land, works of art, and even baseball cards and stamps. Money may not even be the best store of value because it depreciates with inflation. However, money is more liquid than most other stores of value because as a medium of exchange, it is readily accepted everywhere. Furthermore, money is an easily transported store of value that is available in a number of convenient denominations.

Unit of account

Money also functions as a unit of account, providing a *common measure of the value* of goods and services being exchanged. Knowing the value or price of a good, in terms of money, enables both the supplier and the purchaser of the good to make decisions about how much of the good to supply and how much of the good to purchase.

3. Question

Extend the functions of commercial banks in details.

Answer

Commercial banks make up a significant role for the source of credit. The banks accept deposit from the households who have excess money advance loans to the households who are in need of it. It is one of the easiest ways of getting a loan for the households.

Functions of commercial banks

• Accepting deposit

The commercial bank accepts various types of deposits from the public, especially from its clients. It includes saving account deposits, recurring account deposits, fixed deposits, etc. These deposits are payable after a certain time period. There are different types of deposits that are accepted by the commercial banks; they are namely: savings deposit, current account deposit, permanent deposit.

Savings deposit is the deposit accepted by the commercial banks for inculcating the savings habit among the individuals. They provide interest rate against the deposit, but the interest rate will be lower compared to permanent account deposit.

Current account deposit is the deposit advanced to the people who withdraw the deposit frequently for the business purposes. The interest rate for this deposit is lower than the savings deposit.

Permanent deposit is also known as fixed deposit. The deposit which is deposited in a bank cannot be withdrawn by the account holder frequently without passage of fixed time period. The interest rate is very much higher and cannot be withdrawn within the maturity date.

• Advancing loan

They advance loan to the people who are in need of the money. The commercial banks provide loans and advances of various forms. It includes an overdraft facility, cash credit, bill discounting, etc. They also give demand and demand and term loans to all types of clients against proper security. This is the most important function because this is the function which channelizes the fund into very much ideal way. This contributes to the capital formation in the society.

• Other functions

Credit creation is the other function which is carried in by the commercial banks. One of the main functions of the commercial bank is credit creation. It is the banks that create credit for the producers to invest in the economy. The banks make the credit available by accepting the deposit from the people. The investment of the investors makes the economy better off and investment is made available by the bank.

4. Question

What is the role of currency in the economy? Explain.

Answer

Money is most significant function is as a medium of exchange to make easy transactions. Without money, all transactions would have to be conducted by barter, which involves direct exchange of one good or service for another.

Role of money in the economy

• Promotes economic growth

Barter system was full of difficulties of exchanging goods and services between individuals. In the absence of easy exchange of goods and services, the barter system worked as an obstacle to the division of labour and specialisation among individuals which is an important factor for increasing productivity and economic growth. Further, the process of economic growth leads to the expansion of production of goods and services and consequential rise in incomes of the people.

• Promotes investment

From the viewpoint of development, another important role of money lies in making the magnitude of investment independent of the current level of savings. In a barter system, the goods not consumed constitute the savings as well as investment. That is, invest �ment is not different from current savings. The greater the current savings, the greater the investment. However, in a modern economy, this is not so. Whereas it is households which save in the form of money, it is the firms which invest money in capital goods.

• Money involves in the credit creation process

Credit creation is the other function which is carried on by the commercial banks. One of the main functions of the commercial bank is credit creation. It is the banks that create credit for the producers to invest in the economy. The banks make the credit available by accepting the deposit from the people. The investment of the investors makes the economy better off, and investment is made available by the bank.

5. Question

Explains the difference between institutional and non-institutional financial resources.

Answer

Basis	Institutional	Non institutional
Meaning	This includes those financial institutions which work under RBI with specified guidelines such as commercial banks	This does not categorize under any authority. They are independent. These sources include money lenders.
Examples	Commercial banks, mutual savings bank and another union such as SHGs	Money lenders, friends, and relatives
Mode	The mode of acquiring a loan is very difficult since it involves many terms of credit and needs many documents	The mode of acquiring a loan is very easy since it acquired from the relatives and friends. Does not need any complicated documents for advancing loans.
Interest rates	In case of interest rate, this institution will have less interest rate because they are more secure.	Since it is not authenticated any authority, they charge a higher interest rate. Most of the poor people in India acquire a loan from the money lenders and other informal sources.

6. Question

What are self- help groups? How are they different from conventional ways of providing loans?

Answer

Self Help Groups is a voluntary organization formed by the women to enhance the microcredit for the members in it and the women members get to indulge in the entrepreneurial activities such as run a canteen, small shops…etc. This self-help group was established to empower the women, and the empowerment of women will not only improve her, but it also improves the family as a whole which also contributes to the economic development of the country.

They are different from other organized banking institution. Currently, in India, the banking system has emerged to a lot more than development. The main motive of the bank is to accept the deposit and lend that deposit as a loan to investors. In a country like India, an ordinary person will not do not have any excess money to save as a deposit in the bank especially in rural areas. Nowadays, the bank is charging fines for our deposits when they go below a certain limit; they state that there should be a minimum balance of 1000 to 2000 RS in their bank account which is a big deal for the poor person in India whether in rural or urban areas. Self Help Groups helps to overcome the problem of saving for the ordinary person. Self Help Group is a voluntary organization formed by the women or men to enhance the microcredit for the members in it. The members of the organization save their money by fixing an amount to be deposited weekly, the amount will be such everyone can afford that. That deposited money can be advanced as a loan to any of the member in the group who is actually in need of it, but the loan will be advanced by the consent the group members. There will be transparency in the working of the organization because all the group members will be from the same village and all of them will be neighbors.

7. Question

Write an article on the native banker system.

Answer

Indigenous bankers are firms and associations that perform the normal functions of a banking system. They accept deposits and issue loans to the public. They are also associated with the discounting of bills of exchange or Hundis. The indigenous bankers have been an important part of the banking system in the country from the ancient times.

Until the mid-nineteenth century, the native bankers have been an important source of finance, not just for the business houses and firms but also for the local governments. With the advent of the British rule and the establishment of many nationalised banks, their role was highly diminished in the financial sector. After independence, with the growth of co-operative and commercial banks, their role further shrunk. Still, in many areas, the presence of native bankers can be seen, especially in the western and the southern part of the country.

The native bankers can perform their functions in three different ways- dealing only in the banking business, combining banking business with trade and dealing mainly in a trade with limited banking business. They are differentiated from the money lenders as they perform all the functions that a bank performs- accepting deposits, lending loans and discounting bills of exchange, unlike the moneylenders who concentrate only on lending loans.

The main functions of native bankers are:

<u>Accepting deposits</u>- The native bankers accept various kinds of deposits just like the modern banking institutions. They provide the investors with a nominal rate of return.

<u>Lending loans</u>- Another important function of native bankers is to provide loans to the public by accepting the property and other collateral. The bankers also provide them loans without any collateral or conditions based on the credentials and knowledge about the people.

<u>Transfer funds</u>- The bankers are also involved in the transfer of funds to people. They are involved in the discounting of bills of exchange.

Thus the native and indigenous bankers were the backbones of the economy. Still, they are an important segment in different parts where people have no access to proper banking services.