

## Lesson-17

### Money and financial Institutions

Money is one of the biggest inventions made by man. Like fire and wheel invention of money has made great contribution in the development of human life. Whatever is paid for goods and services is called money. Generally money is used as means of exchange. General acceptance as means of exchange or payment is the special quality of money. Everybody has faith that shall be accepted in economy everywhere. This faith makes money as 'money'. Thus money is accepted for goods and services.

**Exchange:** Taking and giving of goods and services for money of any another goods services is called exchange.

We purchase many things from the market. you must have also purchased things from market. If you buy a pen or biscuits worth ten ` the shopkeeper accepts it without any protest. In the same way we or any member of our family purchases things from market, we pay the price and the shopkeeper accepts money gladly. It makes it clear that Indian rupee is currency.

**Think:-**  
Can purchasing made in England and America be paid in Indian rupee?  
What is the mode of payment there in the market means What is the currency of America and England?

There are many forms of money which are used as means of payment. Money for common man is currency (bank note) or coins because payment system in India is related to currency notes and coins. Indian currency is known as 'Indian National Rupee. One rupee is equal to 100 paise. The symbol of Indian rupee is ` .This design is like devnagri

letter **R** and capital R of latin and their are two horizontal lines on it. This symbol was prepared by D. Udaikumar. In the same way \$ is the symbol of American currency \$ dollar. £ is the symbol of British sterling pound. € is the symbol European union currency Euro and ¥ is the symbol of Japanese currency yen.

#### Origin of Money and Development:-

##### 17.1.1 Origin of money:-

The English word 'money' has been derived from the latin word Moneta First mint in Rome was established in the temple of goddess Moneta and the coins from this mint were named money after the name of goddess Moneta.

Gradually the word money was used for currency. It is believed that India was the first to release coins along with china in the world history of Indian coins starts before Christ.

Silver coins of Mauryan period found in excavation prove that coins were in circulation In India even before Christ. The first 'rupee' in India was released by Shershah Suri (1540-1545).

At present coins of 50 paise, 1 rupee, two ` , 5 ` and 10 ` are being released in India. Reserve Bank of India is also releasing bank notes of 10,20,50, 100,500 and 2000 ` Bank notes of ` 1, ` 2 and ` 5 have been stopped but they are in circulation. Hon'ble Prime Minister Shri Narendra Modi has declared demonetization of 500 and 1000 ` notes. Ceasing legal tender of currency notes in circulation is demonetization.

The Reserve Bank of India has started Project Financial Literacy to impart financial education. Its objective is to provide information regarding

Central Bank and general banking conception to all. If we want to know about financial system it is possible through: [https://rbi.org.in/financial\\_education/home.aspx](https://rbi.org.in/financial_education/home.aspx). It is very effective and attractive step in imparting financial literacy by **Reserve Bank of India**. There are many interesting films games and comics available on this website regarding Indian financial network. The information and knowledge available here is reliable.

**17.1.2 Development of Money-** Regarding the origin and development of money. Some people say that nobody invented money. It is a coincidence. First of all, Barter System started then came money. Some scholars think that to remove problems of Barter System, money came into circulation. Whatever be the reason; everybody agrees that Barter System was at prevalent initially then came money in present form.

**(A) Barter System** In this system goods and services were exchanged directly for goods and services. Barter System is a matter of history now. There were problems in Barter System regarding requirement of both parties. It means a person who wants to sell a thing; the buyer must also need it. In Barter System both purchaser and seller must have needs and it was difficult. There was lack of standard measure in Barter System. There was great problem in transfer of value or deposit of money. It was risky to transfer money or value in form of goods, then there was also problem of indivisible goods. If a person wants to buy a horse for a sheep, he can neither exchange the whole horse nor divide it for a sheep. If they are divided, because of these problems Barter System was stopped. It was replaced by money exchange.

**(B) Metallic Currency-** Money in the form of goods was replaced by metal money In the beginning metal pieces were used as money. Then they were stamped and value was marked on them. Use of metal coins started in China, India and Egypt but transfer of metal money was not convenient. It cost more and the increasing demand was impossible to fulfill with metal money.

### **(C) Paper money-**

Due to limitations of metal money, Paper money was developed paper money was free from faults found in metal money. Paper money costs less and its transfer is very convenient Increasing demand of paper money can easily be fulfilled. In sequence of development of paper money, credit money and virtual money is also working as money. we shall study them in higher classes.

**17.2 Functions of money and role of money in economy-** Functions of money can also be seen as role of money in economy. Money mainly works as medium of exchange, measure of value, a standard for delayed payments and store of value. It also plays an important role in completing many actions.

### **Different Functions of Money**

**(A) Medium of Exchan -** Money has the basic role of medium of exchange or as mode of payment in economy. This function of money ends the problem of double needs. This money works as medium of exchange. This quality of money differentiates it from other properties. Money makes exchange convenient.

**(B) Measure of value** It means that money works as measure of value. It shows exchange value as money in all goods and services, An account statement is prepared showing similar unit in money of exchange value of goods and services on different measures. The problem in measure as money is that its value keeps on changing.

**© Standard of payment** Money is a unit by which all future payments can easily be made. The payments which are not made immediately and avoided are deferred payments. So loans are easy to be paid in money. Value of money is stable in comparison to other properties. It is generally accepted. So money is the best standard of such payments.

**(D) Store of Value-** It means that people can keep wealth and property in the form of money. Money works as storage of value. Value of money means purchasing power of money. Money is not

only store of value, other goods and property are also stores of value and compete with money. As store of value money is special because it is a liquid asset.

In this way money is generally used as medium of exchange, measure of value, and standard of payments. According to Wakers and Hartley Withers. “Money is that which works as money” According to Crowther money can be defined as a thing which is generally accepted as “medium of exchange” and also works as measure and store of value.

**(E) Other functions of money and its role in Economy-** With the help of money the value can be transferred easily. It provides a base for credit. People deposit some portion of their income in banks as money. This deposited money creates credit of bank. Money has also played an important role in economy by money circulation. Transfer of capital from one industry to another and from one place to another has been possible due to money.

Saving have been used as investment made possible due to money. There are two classes in economy-savers and investors. Savers deposit their savings as money in banks and other financial institutions. These institutions lend money to businessmen for investment. Firms and businessmen invest money in some productive investment. It increases the production capacity of economy and economy makes progress in economic development.

**Investment-** Investment means that expenditure which increases the actual assets of production in economy.

A consumer can get maximum satisfaction or welfare only by money. Money is easily divisible so the consumer spends his money on goods and services in such a way that he gets maximum satisfaction. Money also gives freedom and leverage to consumers in selection of things.

Money also plays an important role in production. Production on a large scale has been possible by adopting division of labor and specialization with

money. Specialization is possible when an economic resource produces special goods or services. When production is subdivided into different types of labor and every unit does special work in production of goods and service, it is called division of labour. Division of labour and specialization increase the efficiency in production and achieve higher standard in production. In the absence of money it was not possible to distribute the production in various units Through money the distribution of production in all units engaged in production is possible. It is not always possible to divide goods and total production but its value in money and be distributed in all production units following economic laws. Rapid increase in national and international trade has been possible due to money. In Barter System the area of trade was limited and trade on large scale was not possible. Much emphasis has been given to the welfare of the state in the present time. In running many schemes for the welfare of the public, govt. has to spend a lot. It is obtained through public loans and taxes which can be obtained through money. In present time the development level of human has been possible due to invention of money. There is no field of life where there is no role of money. Money is a means not an end.

### 17.3 Saving and credit

It is necessary to understand the concept of saving and credit to comprehend financial institutions properly. For the concept of saving and credit, we need to understand the following three situations:

#### Situations-1

Pankaj lives at Katrathal village in Sikar district with his parents, two brothers and a sister. He is an educated and energetic young man. He got his vocational education from a good institution and he wants to establish his own business. He has many options and good knowledge of the market. He also knows the techniques of business perfectly well. Yet he is not in a position to set up his business for lack of money. His father is a simple farmer and can fulfill only the needs of the family. In this situation Pankaj has only one option that is to borrow the requisite capital.

### Situations-2

Sanjay lives at Rajpura village in Jhunjhunu district. His parents are old. He is the eldest of three brothers and sisters and the only earning member in the family. He has a small field of 2 hectare. He earns for his family from the income of agriculture on his field. He has the liability to fulfill the needs of his family members. Income from agriculture is insufficient for his family. It is necessary for Sanjay to borrow money from a person or an institution to fulfill the basic needs of the family.

### Situations-3

Nitesh and his wife Chandani live in Jaipur. Nitesh is a bank employee and his wife is also in government job. Both are economical in nature. They have also inherited good economic base. Both fulfill their basic needs with a small portion of their income. So they have surplus amount from their income as saving.

In situation 1 Pankaj needs to take loan to set up his business and in situation 2 Sanjay has to take loan for consumption. Giving loan or lending money is called credit in Economics. Generally credit shows the reputation of financial credibility. On that basis a person or institution can take loan on a promise to pay in future, or get goods or services without paying in cash. It is clear that the word 'credit' in economics is used for providing finance for loans. In exchange one party purchases goods and the other sells it. Purchase and sale are two sides of the same merchandise. In the same way in financial transactions one party borrows or takes loan and the other party provides credit (lending or loaning) thus in financial transactions the amount loan will be same as amount given on credit.

Think over situation 3. We see that Nitesh and Chandani have large unused portion of income. The portion of income which was not consumed is called 'saving'. So surplus of income over consumption is income.

Many questions arise here. From where Sanjay will get loan to fulfill the needs of his family? Where will Nitesh and Chandani keep their savings safe? Can Nitesh and Chandani directly lend their

savings to Pankaj and Sanjay? But there are many possible practical problems in it first Nitesh and Chandani do not know the financial behavior of Pankaj and Sanjay, they will always have the fear of losing their hard earned money. Second In case they have sudden need of money somehow and Pankaj and Sanjay may or may not be able to return money at short notice. Third it is also possible that Nitesh and Chandani do not know Pankaj and Sanjay. Actually there are two separate parties one who takes loan and one who lends money. We need a mediator between them who can connect both the parties. Financial mediators play this role.

### Financial mediators-

Financial mediators are those institutions or persons who work as link between lender and borrower in the market. These institutions get money from those who spend less than their income and thus save money and provide credit to those persons and institutions who need money for consumption or production. When the investors deposit their saving with them, they get due interest and there is little risk of losing money. Deposit or can take back their deposits at short notice. In the same way borrowers and institutions also get much benefits from these financial mediators. Financial mediators have also availability of money. They lend money at normal rate of interest and on easy terms. Bank is an important mediator.

### 17.4 Traditional and non-Traditional source of credit-

There are many people whose expenses are more than their income. They need to take loans to meet out this extra expense. In the same way people who are engaged in production work or business, need more money to increase their business. For this they take loans. People can borrow money from different financial sources. On the other hand there are people, whose expenses are less than their income. They want to earn interest on their savings. For this they deposit their saving in those financial institutions. Financial institutions borrow and lend money. (Like deposits, loans, investments etc). Bank, cooperative societies, money Lenders and local bankers are financial institutions. They



can be classified as traditional and non-traditional sources. Traditional money lending institutions are registered under government and Reserve Bank. They are governed, controlled and guided by Reserve Bank of India and the government. They inform about all activities to their controlling institutions. They do not work only for benefits. They have to afford many social liabilities. They also lend money to the poor and weaker sections. They have an important role in establishing economic equality by financial investment to economically weaker sections.

### Financial Inclusion-

Financial inclusion means to provide financial services to poor, weak backward and low income group sections at different affordable rates and join them with financial services.

**17.5 Commercial Bank-** We have seen that Nitesh and Chandani spend less than their income. They would like to manage their savings in such a way that there would be no risk of losing money and they also get normal interest on their deposited capital. Those who have small savings invest in the institutions where their money is safe and can get it back easily whenever they need. Banks are important financial mediators to do this work. Banks accept deposits from consumers and lend it to those who need money for production and consumption. Bank works as a link between consumer and creditor. Consumers can withdraw money from banks whenever they need. So this deposit is known as demand deposit. It is an

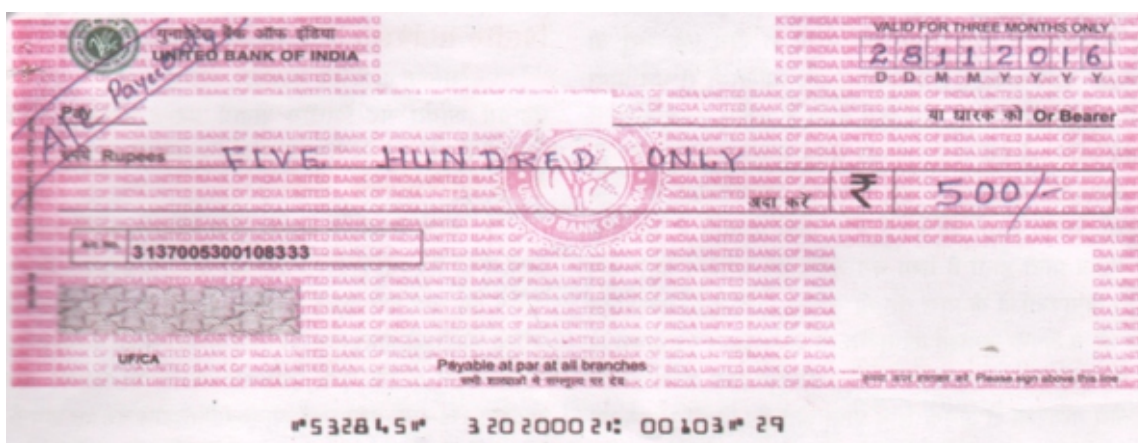
important quality of money as a medium of exchange. You might have heard about payments by cheque instead of cash. For payment made by cheque, Payee who has an account in bank, issues a cheque. Cheque is a kind of order which order banks to make payment to the person, the amount mentioned in it.

Tagore Education Institute has issued a crossed cheque worth ₹500 to Rajendra Prasad for payment. It has been made by two parallel slanting bars. This crossed cheque indicates that the payment shall be deposited in the account of the account holder. There are seven entries in the crossed cheque

1. Two parallel slanting bars.
2. Date of issue
3. Name of the receiver
4. Amount of payment in figures
5. Amount of payment in words
6. Account number of cheque issuer
7. Signature of cheque issuer

Non crossed cheques are also in circulation. Any representative of receiver can go to a bank and receive payment. Such types of cheques are risky.

Thus we see essential features of money in demand deposit. Through cheque, payment is directly deposited in the account as demanded. Now the question arises, What do the banks do with the amount deposited in accounts? Banks keep a small



portion of deposited money as cash. It is because the depositors can withdraw money at any time. Only a few depositors withdraw money on a particular day so banks do away with this amount in cash. Bank's major portion of deposit money goes in giving loan. Thus banks accept deposits from public and pay them by cash or by cheque on demand and they also give loans. Banks have special separate work of accepting deposits withdrawn by cheques. A commercial bank provides the services of accepting deposits and giving commercial loans.

### 17.5.1 Role Of Commercial Banks-

In present time commercial banks play a very important role in the development of economy. Their importance in economic development is as follows:-

1. It is necessary to have high rate of saving for economic development. Commercial Banks keep the public saving safe and give them due interest.
2. Banks circulate the money from public saving to the different producers and investors. If there are no banks, there is no use of saving the money and cannot be used in production.
3. Bank makes favourable allotment of resources. Bank lends money from saving to that sectors where there is maximum profit. Bank also allots resources which are essential for social welfare.

### 1.5.2 Functions of commercial banks-

#### (A) Accepting deposits

The most important service of the bank is to accept deposits. Bank receives deposits from persons, firms and other societies, Broadly these deposits are of three kinds-

- (a) Deposits from current accounts.
  - (b) Deposits from saving accounts.
  - (c) Fixed deposits.
- Businessmen deposit money in current

accounts. They can make frequent transactions in these accounts. Banks pay very low or zero interest on these accounts. Generally people deposit their money in savings accounts. There are some restrictions on transaction in these accounts. Banks pay due interest on these deposits. The deposit of current and saving accounts are jointly called demand deposits. Banks pay maximum interest on fixed deposits.

#### (B) Loaning-

Commercial banks provide loaning facilities to all the sectors of economy, like agriculture, industry, business etc. This loan is provided in the form of cash, credit and overdraft.

Over draft allotting to an account holder to withdraw more than his deposit as loan.

The rate of interest is different according to the purpose for persons and societies by banks. Banks charge more interest on loans than paying on deposits. The main source of bank income is the difference of interest from debtors and depositors.

#### (c) Other functions-

Banks also provides other facilities to their customers in addition to accepting deposit and loaning. Banks make collection of cheques and bills. They make regular payment of insurance installments. They provide locker facilities for the safety of valuable things. They also provide statistical information to different agencies. They provide facilities of money transfer. In short banks play important role in economic development in financial adjustment.

Banks pay interest on traditional sources deposits. Its rate of interest is lower than non-traditional sources. Traditional source keeps record of all their transactions in writing. Their working days and working hours are fixed. So they are not available everyday and every time for financial transactions and their credit procedure is slow and complicated. But they are never involved in exploiting activities. Banks and cooperative societies are institutional financial sources. Non institutional sources are those financial societies which are not registered under government and Reserve Bank of India for

financial transactions and do not follow their instructions. They are beyond the control and regulatory control of monetary authority. There is no regulatory authority or centre which controls the activities of sources of those non-institutional societies.

Generally non-traditional sources charge very high rate of interest from debtors. Non-traditional financial sources include local bankers, money lender, landlords and relatives. Their activities are not time bound. They are very flexible. Their loaning process is very easy and direct. They have very little paper formalities. They do not maintain elaborate record of transactions. and have serious allegations of forgery.

Non-traditional financial sources are mostly local. They are well known to the culture, traditions and customs of that area. So they are very flexible in loaning and recovery. They are well known to the economic conditions, economic behavior, capacity of repayment and other activities of the debtor. So the money paid is mostly recovered. They also use many unfair means to recover their money.

#### **17.6 Local bankers-**

They are also doing banking business in India. They are individual firms or persons who work as banks. The whole banking was done by them before the development of modern commercial banks in India. They have been important source of non-traditional credit. Local bankers do following works-

1. Accepting deposits from public.
2. Providing loans to its customers by mortgaging their property and also provide loan to customers on the basis of their credit without mortgaging their property.
3. To transfer funds from one place to another.
4. To run their business along with banking work.
5. Transaction with small businessmen and entrepreneurs.
6. To provide loan to debtor on the basis of his

financial status and personal knowledge about his business.

7. To work not only as friend but also as advisor

#### **17.7 Money lenders-**

Money lenders also have important role in non-traditional sources of money lending (credit).

Money lenders lend their own capital. They do not accept deposit from public. They generally give small personal loans. They charge high rate of interest from their borrowers. Those who can't approach banking system, generally take loans from these money lenders. Generally money lenders mortgage property and give loans to customers, but they also lend money without mortgaging property according to their credit.

They are also called exploiters for charging high rate of interest from debtors. Now-a-days the importance of money lenders and local bankers reduced due to expansion of financial services and financial institutions. Besides money lenders and local bankers landlords, friends and relatives are also important non-traditional sources of lending money.

#### **17.8 Self Help Groups:-**

Poor families still depend on non-traditional sources. Why is it so? There are still no banks in rural areas of India. Taking loan from bank is more difficult than non-traditional sources. One needs security or guarantee for loan and many documents. In the absence of proper papers for loan the poor cannot obtain loans from banks. On the other hand non-traditional lender like money lenders personally know the debtors. So they are often ready to loans when needed without repaying the old loans them without any bases. Debtors go to money lenders for new loans but money lenders charge high rate of interest, do not complete paper formalities and harass the poor debtors. In recent years people have tried to accept new methods to loan the poor. One if the idea is to join them in small self help groups and collect their savings specially women in rural areas. There are 15-20 members in



one self help group, who meet regularly and make savings. It can be from 25 ` to 100 ` or more per member. It depends on the saving capacity of the families. Members can take small loans from the group. The group charges interest on these loans and it is less than the interest charge by money lenders. If the group makes savings regularly, it take loans from banks after one or two years. Loan is given in the name of the group and its aim is to create self employment opportunities for its members. For example member are given small loans to get their mortgaged land released, fulfill the needs of working capital (to buy seeds, fertilizer, bamboos and clothes) build houses, buy sewing machines, handloom and cattle.

Members of the group take important decisions regarding savings and loan activities. Groups also takes decisions on loans, their purpose, amount, rate of interest and the time limit for returning loans. Group is responsible for receiving loans. If a member does not repay the loan, the other members of the group take it seriously. Thus when poor women unite themselves in self help group, banks are ready to pay them loan. Though they have no security or guarantee for loans.

In this way self help groups help the debtors in solving their problems regarding security of the loans. They get loans on normal rate of interest for their needs from time to time. Besides these groups also help in uniting poor people of rural areas. With their help women not only become independent but also get a common platform through regular meetings. In these meetings they discuss social topics like health, nutrition and domestic violence.

### **Chit Fund-**

Chit fund companies have important role in motivating people for saving and providing them loans. Company that operates guides and manages chit plan is called Chit Fund company. Chit Fund is a special saving and loaning plan running in India. It is a plan of mutual benefit. Under this plan all the members of the plan work under a contract and deposit their share. Total deposited amount is paid to one member by auction or tender. All the members participate in tender or auction. The

member who is ready to accept amount with maximum rebate is called prized buyer. If a member does not participate in tender or auction for loan, then the name of the winner is declared through lottery.

Every month one member gets amount of reward as winner. The man who becomes winner once is not included again in tender and auction. Only non-rewarded members can participate in subsequent tender or auction. The amount of rebate is divided and it is distributed equally among all members. By deducting the dividend the next installment is fixed. Chit fund company gets commission under contract from members for management, operation and guidance. The winner also has to continue paying his installment every month in the chit fund plan. Chitfund companies are also run by organized financial institutions, friends, relatives and unorganized groups.

### **Important Points**

1. Money is that which is accepted by all in exchange.
2. Money works as the currency of India is Rupaiya, a medium of exchange, measure of value, store of value and base of deferred payments.
3. The central bank of India is the Reserve Bank of India.
4. Barter system was prevalent before the invention of money. In this system, goods and services were directly exchanged for goods and services.
5. The portion of income which has not been consumed is called saving.
6. Credit means lending of money by one party to another.
7. Financial mediators are those persons, societies and firms who work as mediator between depositors and borrowers in the market.



8. Traditional financial sources are regulated, controlled and guided by Govt. of India and Reserve Bank of India.
9. Non-Traditional financial sources are out of control the control and regulations of govt. of India and Reserve bank of India.
10. Self help Groups are new trends for small loans.
11. Reserve Bank of India is propagating financial information in many ways to provide financial awareness.

### **EXERCISE**

#### **Very short Answer Type Questions-**

1. What is money?
2. Explain exchange.
3. What is meant by a cheque ?
4. What is the name of the Indian currency?
5. What do you mean by saving?
6. Which is the Central bank of India?
7. What is the symbol of the Indian currency?
8. Which currency was demonetized by govt. of India in 2016?
9. What are financial mediators?
10. For which work do we need loan?
11. Who controls the traditional financial sources?

#### **Short Answer Type Questions**

1. What is Barter System?
2. What were the problems in Barter system?
3. Explain the functions of money as a measure of value.
4. What is credit?
5. What are the limits of metallic money?

6. What are traditional financial sources? Explain with examples.
7. What is financial society? Explain with example.
8. Mention the merits and demerits of non-traditional financial sources?
9. What are local bankers? Mention their three characteristics.
10. Explain money lender as a source of credit.

#### **Essay Type Questions:-**

1. Explain the different stages of development of money.
2. Describe the main functions of money in detail.
3. Describe the functions of commercial banks in detail.
4. What is the role of money in economy? Explain
5. What is the difference between traditional and non-traditional Financial sources?
6. What are Self Help Groups? How are they different from traditional Methods of providing loaning?
7. Write an article on the system of local bankers