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FACT FILES

INDIAN ECONOMY

FINANCIAL MARKET, MONETARY POLICY & INDIAN BANKING SYSTEM

for Civil Services Examination

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CONTENTS

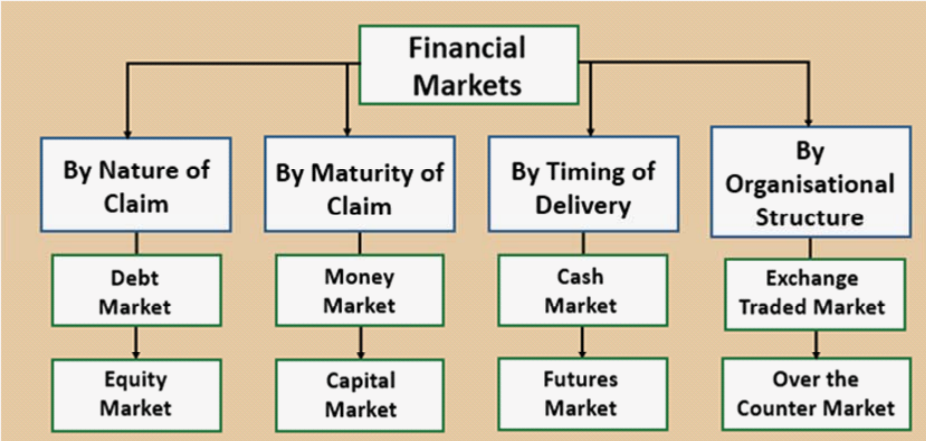
FINANCIAL MARKET

Financial markets refer broadly to any marketplace where the trading of securities occurs, including the stock market, bond market, forex market, and derivatives market, among others. Financial markets are vital to the smooth operation of capitalist economies. Financial markets play a crucial role in facilitating the smooth operation of capitalist economies by allocating resources and creating liquidity for businesses and entrepreneurs. The markets make it easy for buyers and sellers to trade their financial holdings. Financial markets create securities products that provide a return for those who have excess funds (Investors/lenders) and make these funds available to those who need additional money (borrowers).

Major Functions of Financial Markets

- **Price Determination:** Demand and supply of an asset in a financial market help to determine their price. Investors are the supplier of the funds, while the industries are in need of the funds. Thus, the interaction between these two participants and other market forces helps to determine the price.
- **Mobilization of savings**: For an economy to be successful it is crucial that the money does not sit idle. Thus, a financial market helps in connecting those with money with those who require money.
- **Ensures liquidity**: Assets that buyers and sellers' trade in the financial market have high liquidity. It means that investors can easily sell those assets and convert them into cash whenever they want. Liquidity is an important reason for investors to participate in trade.
- **Saves time and money**: Financial markets serve as a platform where buyers and sellers can easily find each other without making too much efforts or wasting time. Also, since these markets handle so many transactions it helps them to achieve economies of scale. This results in lower transaction cost and fees for the investors.

Classification of Financial Market



Money Market

- As money became a commodity, the money market became a component of the financial market for assets involved in short-term borrowing, lending, buying and selling with original maturities of one year or less. Money markets, which provide liquidity for the global financial system including for capital markets, are part of the broader system of financial markets.
- At the wholesale level, it involves large-volume trades between institutions and traders. At the retail level, it includes money market mutual funds bought by individual investors and money market accounts opened by bank customers. In any case, the money market is characterized by a high degree of safety and a relatively low return in interest.

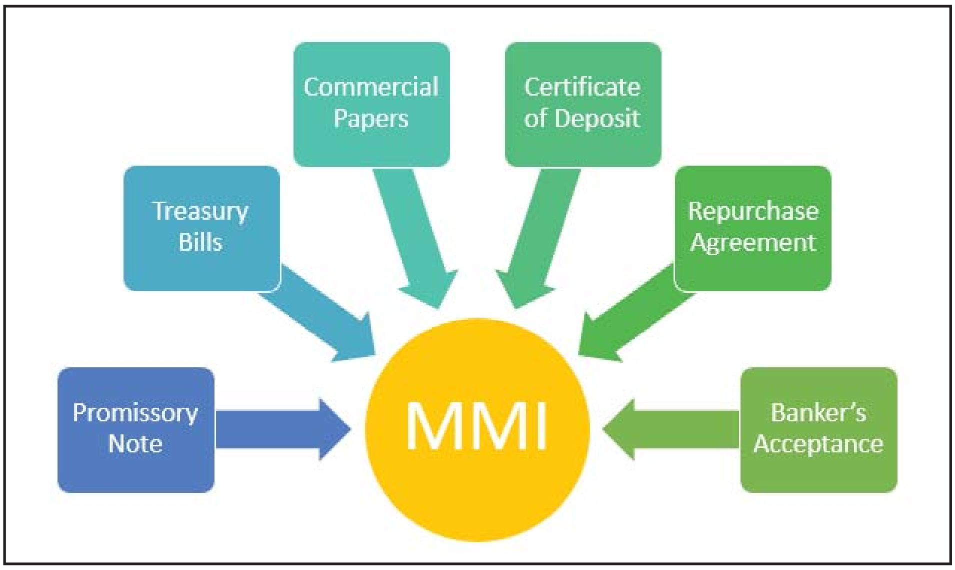
Point of Distinction	Money Market	Capital Market
1. Time Period/Term	Deals in short-term funds.	Long term funds.
2. Instrument Dealt in	Deals in securities like treasury bills, commercial paper, bils of exchange, certificate of deposits etc.	Deals in securities like Shares, debentures, bonds and government securities.
3. Participants	Commercial banks, NBFS, chit funds etc.	Stock Brokers, Under writers, mutual funds, individual investors, financial institutions
4. Regulatory body	RBI	SEBI
References: NOS and CBSE		

Structure of money market in India

Organized money market

- The organized segments of the Indian money market is composed of the Reserve Bank of India (RBI), the State Bank of India, Commercial banks, Co-operative banks, foreign banks, finance corporations and the Discount or Finance House of India Limited. The influence of the Reserve Bank of India's power over the Indian money market is confined almost exclusively to the organized banking structure.

Organized Money market instruments (MMI):



Treasury Bills (T-Bills):

- Issued by the Central Government, Treasury Bills are known to be one of the safest money market instruments available. However, treasury bills carry zero risk. I.e. are zero risk instruments. Therefore, the returns one gets on them are not attractive. Treasury bills come with different maturity periods like 3-month, 6-month and 1 year and are circulated by primary and secondary markets. Treasury bills are issued by the Central government at a lesser price than their face value. The interest earned by the buyer will be the difference of the maturity value of the instrument and the buying price of the bill, which is decided with the help of bidding done via auctions. Currently, there are 3 types of treasury bills issued by the Government of India via auctions, which are 91-day, 182-day and 364-day treasury bills.

Certificate of Deposits (CDs):

- A Certificate of Deposit or CD, functions as a deposit receipt for money which is deposited with a financial organization or bank. However, a Certificate of Deposit is different from a Fixed Deposit Receipt in two aspects. The first aspect of difference is that a CD is only issued for a larger sum of money. Secondly, a Certificate of Deposit is freely negotiable.
- First announced in 1989 by RBI, Certificate of Deposits have become a preferred investment choice for organizations in terms of short-term surplus investment as they carry low risk while providing interest rates which are higher than those provided by Treasury bills and term deposits.
- Certificate of Deposits are also relatively liquid, which is an added advantage, especially for issuing banks. Like treasury bills, CDs are also issued at a discounted price and their tenor ranges between a span of 7 days up to 1 year. However, banks issue Certificates of Deposits for durations ranging from 3 months, 6 months and 12 months.
- They can be issued to individuals (except minors), trusts, companies, corporations, associations, funds, non-resident Indians, etc.

Commercial Papers (CPs)

- Commercial Papers are can be compared to an unsecured short-term promissory note which is issued by highly rated companies with the purpose of raising capital to meet requirements directly from the market.

- CPs usually feature a fixed maturity period which can range anywhere from 1 day up to 270 days. Highly popular in countries like Japan, UK, USA, Australia and many others, Commercial Papers promise higher returns as compared to treasury bills and are automatically not as secure in comparison. Commercial papers are actively traded in secondary market.

Repurchase Agreements (Repo)

- Repurchase Agreements, also known as Reverse Repo or simply as Repo, loans of a short duration which are agreed upon by buyers and sellers for the purpose of selling and repurchasing.
- These transactions can only be carried out between RBI approved parties Repo / Reverse Repo transactions can be done only between the parties approved by RBI. Transactions are only permitted between securities approved by the RBI like treasury bills, central or state government securities, corporate bonds and PSU bonds.

Bankers Acceptance (BA)

- Bankers Acceptance or BA is basically a document promising future payment which is guaranteed by a commercial bank.
- Similar to a treasury bill, Banker's Acceptance is often used in money market funds and specifies the details of the repayment like the amount to be repaid, date of repayment and the details of the individual to which the repayment is due.
- Bankers Acceptance features maturity periods ranging between 30 days up to 180 days.

Repo rate

- Repo rate can be defined as an amount of interest that is charged by the Reserve Bank of India while lending funds to the commercial banks. The word 'Repo' technically stands for 'Repurchasing Option' or 'Repurchase Agreement'. Both the parties are required to sign an agreement of repurchasing which will state the repurchasing of the securities on a specific date at a predetermined price. The repo rate in India is controlled by the Reserve Bank of India.
- On 4 th October 2019, the Reserve Bank of India (RBI) revised its repo rate to 5.15% from the previous repo rate of 5.40% with a decrease of 25 basis points whereas, the present reverse repo rate is 4.90%.
- Any changes in the repo rates can directly impact the economy. A decrease in the repo rates helps in improving the growth and economic development of the country. A decline in the repo rate can lead to the banks bringing down their lending rate which is beneficial for retail loan borrowers.

Reverse Repo Rate

- Reverse repo rate is the rate of interest that is provided by the Reserve bank of India while borrowing money from the commercial banks. In other words, we can say that the reverse repo is the rate charged by the commercial banks in India to park their excess money with RBI for a short-term period.
- The current reverse repo rate in India as of October 2019 is 4.90%. Reverse repo rate is an important instrument of the monetary policy which control the money supply in the country.

Promissory Note

- A promissory note is a legal, financial tool declared by a party, promising another party to pay the debt on a particular day. It is a written agreement signed by drawer with a promise to pay the money on a specific date or whenever demanded.

- This note is a short-term credit tool which is not related to any currency note or banknote.

Money market mutual funds

- Money market mutual funds invest money in specifically, high-quality and very short maturity-based money market instruments. The RBI has approved the establishment of very few such funds in India. In 1997, only one MMMF was in operation, and that too with very small amount of capital.

The unorganized money market

- The unorganized sector of the money market is largely made up of indigenous bankers, money lenders, traders, commission agents etc., some of whom combine money lending with trade and other activities.
- Indigenous Bankers (IBs): Indigenous bankers are individuals or private firms who receive deposits and give loans and thereby operate as banks. IBs accept deposits as well as lend money. They mostly operate in urban areas, especially in western and southern regions of the country. The volume of their credit operations is however not known. Further their lending operations are completely unsupervised and unregulated. Over the years, the significance of IBs has declined due to growing organized banking sector.
- Money Lenders (MLs): They are those whose primary business is money lending. Money lending in India is very popular both in urban and rural areas. Interest rates are generally high. Large amount of loans are given for unproductive purposes. The operations of money lenders are prompt, informal and flexible. The borrowers are mostly poor farmers, artisans, petty traders and manual workers. Over the years the role of money lenders has declined due to the growing importance of organized banking sector.

Capital market

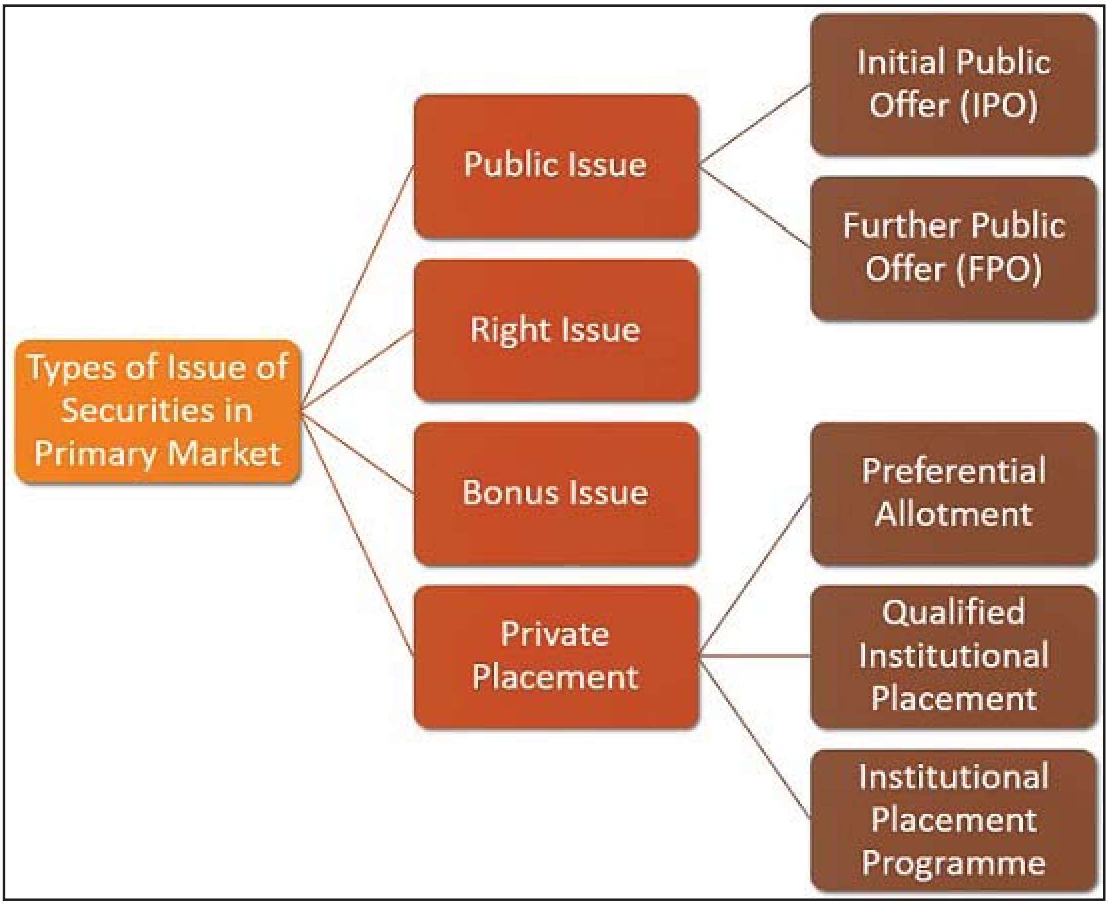
- Capital markets are venues where savings and investments are channeled between the suppliers who have capital and those who are in need of capital. The entities that have capital include retail and institutional investors while those who seek capital are businesses, governments, and people.
- Capital markets are composed of primary and secondary markets. The most common capital markets are the stock market and the bond market.
- Capital markets seek to improve transactional efficiencies. These markets bring those who hold capital and those seeking capital together and provide a place where entities can exchange securities.
- Capital markets are composed of the suppliers and users of funds. Suppliers include households and the institutions serving them—pension funds, life insurance companies, charitable foundations, and non-financial companies—that generate cash beyond their needs for investment. Users of funds include home and motor vehicle purchasers, non-financial companies, and governments financing infrastructure investment and operating expenses.

Classification of Capital Market

Primary market

- The primary market is the part of the capital market that deals with the issuance and sale of equity-backed securities to investors directly by the issuer. Investors buy securities that were never traded before. Primary markets create long term instruments through which corporate entities raise funds from the capital market. It is also known as the New Issue Market (NIM).

- In a primary market, companies, governments or public sector institutions can raise funds through bond issues and corporations can raise capital through the sale of new stock through an initial public offering (IPO). This is often done through an investment bank or finance syndicate of securities dealers. The process of selling new shares to investors is called underwriting. Dealers earn a commission that is built into the price of the security offering, though it can be found in the prospectus.
- Instead of going through underwriters, corporations can make a primary issue or right issue of its debt or stock, which involves the issue by a corporation of its own debt or new stock directly to institutional investors or the public or it can seek additional capital from existing shareholders.
- Since the securities are issued directly by the company to its investors, the company receives the money and issues new security certificates to the investors. The primary market plays the crucial function of facilitating the capital formation within the economy. The securities issued at the primary market can be issued in face value, premium value, and at par value.
- Once issued, the securities typically trade on a secondary market such as a stock exchange, bond market or derivatives exchange.



Public Issue:

- It is the most common method of raising the funds from the public at large. It is defined as Issue of stock on a public market rather than being privately funded by the companies own promoter's, which may not be enough capital for the business to start up, produce, or continue running. By issuing stock publically, this allows the public to own a part of the company, though not be a controlling factor.
- **An initial public offering (IPO**) refers to the process of offering shares of a private corporation to the public in a new stock issuance. Public share issuance allows a company to raise capital from public investors. The transition from a private to a public company can be an important time

for private investors to fully realize gains from their investment as it typically includes share premiums for current private investors. Meanwhile, it also allows public investors to participate in the offering.

- **A follow-on public offering (FPO)** is the issuance of shares to investors by a company listed on a stock exchange. A follow-on offering is an issuance of additional shares made by a company after an initial public offering (IPO). However, follow-on offerings are different than secondary offerings.

Rights issue

- A rights issue is an issue of rights to buy additional securities in a company made to the company's existing security holders. When the rights are for equity securities, such as shares, in a public company, it is a way to raise capital under a seasoned equity offering. Rights issues are sometimes carried out as a shelf offering.
- With the issued rights, existing security-holders have the privilege to buy a specified number of new securities from the firm at a specified price within a specified time. In a public company, a rights issue is a form of public offering (different from most other types of public offering, where shares are issued to the general public).

Bonus Issue

- A bonus issue, also known as a scrip issue or a capitalization issue, is an offer of free additional shares to existing shareholders. A company may decide to distribute further shares as an alternative to increasing the dividend payout. For example, a company may give one bonus share for every five shares held.
- Bonus issues are given to shareholders when companies are short of cash and shareholders expect a regular income. Shareholders may sell the bonus shares and meet their liquidity needs. Bonus shares may also be issued to restructure company reserves. Issuing bonus shares does not involve cash flow. It increases the company's share capital but not its net assets.
- Bonus shares are issued according to each shareholder's stake in the company. For example, a three-for-two bonus issue entitles each shareholder three shares for every two they hold before the issue. A shareholder with 1,000 shares receives 1,500 bonus shares (1000 x 3 / 2 = 1500).

Private Placement:

- Private placement (or non-public offering) is a funding round of securities which are sold not through a public offering, but rather through a private offering, mostly to a small number of chosen investors. "Private placement" usually refers to non-public offering of shares in a public company (since, of course, any offering of shares in a private company is and can only be a private offering).
- Private placements may typically consist of offers of common stock or preferred stock or other forms of membership interests, warrants or promissory notes (including convertible promissory notes), bonds, and purchasers are often institutional investors such as banks, insurance companies or pension funds.

Secondary market

- The secondary market, also called the aftermarket and follow on public offering is the financial market in which previously issued financial instruments such as stock, bonds, options, and futures are bought and sold. Another frequent usage of "secondary market" is to refer to loans which are sold by a mortgage bank to investors such as Fannie Mae and Freddie Mac.

- The term "secondary market" is also used to refer to the market for any used goods or assets, or an alternative use for an existing product or asset where the customer base is the second market (for example, corn has been traditionally used primarily for food production and feedstock, but a "second" or "third" market has developed for use in ethanol production).
- With primary issuances of securities or financial instruments, or the primary market, investors purchase these securities directly from issuers such as corporations issuing shares in an IPO or private placement, or directly from the federal government in the case of the government issuing treasuries. After the initial issuance, investors can purchase from other investors in the secondary market.
- The secondary market for a variety of assets can vary from loans to stocks, from fragmented to centralized, and from illiquid to very liquid. The major stock exchanges are the most visible example of liquid secondary markets - in this case, for stocks of publicly traded companies. Exchanges such as the New York Stock Exchange, London Stock Exchange, NSE, BSE and NASDAQ provide a centralized, liquid secondary market for investors who own stocks that trade on those exchanges. Most bonds and structured products trade "over the counter", or by phoning the bond desk of one's broker-dealer. Loans sometimes trade online using a Loan Exchange.

Stock exchange

- A stock exchange, securities exchange or bourse is a facility where stockbrokers and traders can buy and sell securities, such as shares of stock and bonds and other financial instruments. Stock exchanges may also provide facilities for the issue and redemption of such securities and instruments and capital events including the payment of income and dividends.
- Securities traded on a stock exchange include stock issued by listed companies, unit trusts, derivatives, pooled investment products and bonds. Stock exchanges often function as "continuous auction" markets with buyers and sellers consummating transactions via open outcry at a central location such as the floor of the exchange or by using an electronic trading platform.
- To be able to trade a security on a certain stock exchange, the security must be listed there. Usually, there is a central location at least for record keeping, but trade is increasingly less linked to a physical place, as modern markets use electronic communication networks, which give them advantages of increased speed and reduced cost of transactions. Trade on an exchange is restricted to brokers who are members of the exchange. In recent years, various other trading venues, such as electronic communication networks, alternative trading systems and "dark pools" have taken much of the trading activity away from traditional stock exchanges.
- Initial public offerings of stocks and bonds to investors is done in the primary market and subsequent trading is done in the secondary market. A stock exchange is often the most important component of a stock market. Supply and demand in stock markets are driven by various factors that, as in all free markets, affect the price of stocks.
- There is usually no obligation for stock to be issued through the stock exchange itself, nor must stock be subsequently traded on an exchange. Such trading may be off exchange or over-the-counter. This is the usual way that derivatives and bonds are traded. Increasingly, stock exchanges are part of a global securities market. Stock exchanges also serve an economic function in providing liquidity to shareholders in providing an efficient means of disposing of shares.

Major Stock Exchanges in India

National Stock Exchange

- The National Stock Exchange was founded in 1992. It was recognized as a stock exchange by SEBI under the Securities Contracts (Regulation) Act, 1956 and the operation commenced in 1994. Vikram Limaye is the Managing Director & Chief Executive Officer of National Stock Exchange of India Ltd (NSE).

- It was the first exchange in India to provide fully computerized electronic trading. NSE is one of the pioneers in technology and innovation which ensured the high-end performance of its systems. The exchange supports more than 3,000 VSAT terminals, making the NSE the largest private wide-area network in the country.
- Its automated system makes it's more reliable and efficient in comparison to the Bombay Stock Exchange (BSE).

Bombay Stock Exchange

- The Bombay Stock Exchange was founded on July 9, 1875. It is Asia's first stock exchange.
- In 1875, eminent businessman Premchand Roychand officially founded the Native Share and Stock Brokers Association which was later renamed the Bombay Stock Exchange.
- It is also the world's fastest exchange with a median trade speed of six microseconds.
- The Indian government recognized it officially as per the Securities Contracts Regulation Act in August 1957.
- The BSE joined the United Nations Sustainable Stock Exchange initiative in 2012.
- Approximately 5000 companies are listed in BSE.

Sensex

- Sensex or Sensitive Index is a value-weighted index composed of 30 companies with the base 1978-1979 = 100. It consists of the 30 largest and most actively traded blue chip stocks, representative of various sectors, on the Bombay Stock Exchange.

Nifty

- Nifty, also called NIFTY 50, is the market index consisting of 50 well-established and financially sound companies listed on National Stock Exchange of India (NSE). The base year is taken as 1995 and the base value is set to 1000.

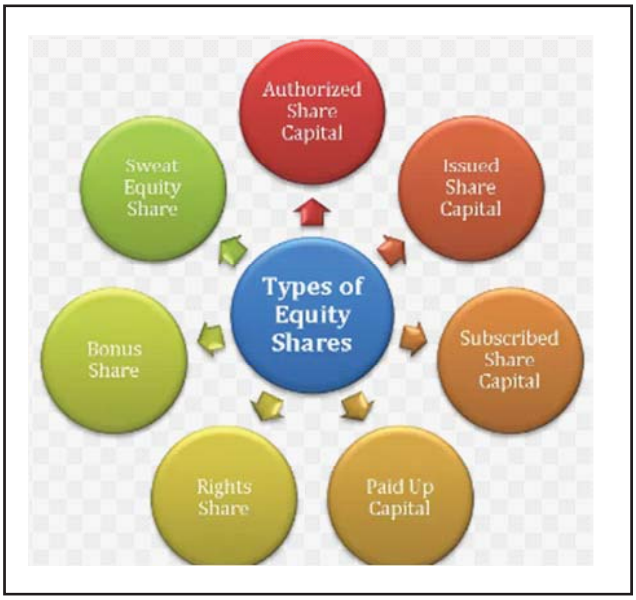
Instruments of Secondary Market

Shares

- In financial markets, a share is a unit used as mutual funds, limited partnerships, and real estate investment trusts. The owner of shares in the company is a shareholder (or stockholder) of the corporation. A share is an indivisible unit of capital, expressing the ownership relationship between the company and the shareholder. The denominated value of a share is its face value, and the total of the face value of issued shares represent the capital of a company, which may not reflect the market value of those shares.
- The income received from the ownership of shares is a dividend. The process of purchasing and selling shares often involves going through a stockbroker as a middle man. There are different types of shares such as equity shares, preference shares, bonus shares, right shares, and employees stock option plan shares.

Equity share

- Equity shares are also known as ordinary shares. They are the form of fractional or part ownership in which the shareholder, as a fractional owner, takes the maximum business risk. The holders of Equity shares are members of the company and have voting rights. Equity shares are the vital source for raising long-term capital.
- Equity shares represent the ownership of a company and capital raised by the issue of such shares is known as ownership capital or owner's funds. They are the foundation for the creation of a company.
- Equity shareholders are paid on the basis of earnings of the company and do not get a fixed dividend. They are referred to as 'residual owners'. They receive what is left after all other claims on the company's income and assets have been settled. Through their **right to vote**, these shareholders have a right to participate in the management of the company.



Preference share

- These are shares which are preferred over equity shares in payment of dividend, the preference shareholders are the first to get dividends if the company decides to distribute or pay dividends.
- Preference shares are shares having preferential rights to claim dividends during the lifetime of the company and to claim repayment of capital on wind up. In case of preference shares, the percentage of dividend is fixed i.e. the holders get the fixed dividend before any dividend is paid to other classes of shareholders.
- Preference shares are one important source of hybrid financing because it has some features of equity shares and some features of debentures. The preference shareholders enjoy preferential rights with regard to receiving dividends and getting back capital in case the company winds-up.
- In finance, a bond is an instrument of indebtedness of the bond issuer to the holders. The most common types of bonds include municipal bonds and corporate bonds.

Bond

- The bond is a debt security, under which the issuer owes the holders a debt and (depending on the terms of the bond) is obliged to pay them interest (the coupon) or to repay the principal at a later date, termed the maturity date.

- Interest is usually payable at fixed intervals (semiannual, annual, sometimes monthly). Very often the bond is negotiable, that is, the ownership of the instrument can be transferred in the secondary market. This means that once the transfer agents at the bank medallion stamp the bond, it is highly liquid on the secondary market.
- Thus a bond is a form of loan or IOU: the holder of the bond is the lender (creditor), the issuer of the bond is the borrower (debtor), and the coupon is the interest. Bonds provide the borrower with external funds to finance long-term investments, or, in the case of government bonds, to finance current expenditure. Certificates of deposit (CDs) or short-term commercial paper are considered to be money market instruments and not bonds: the main difference is the length of the term of the instrument.

Derivative Instruments

- Derivatives are products whose value is derived from the value of one or more basic variables, which are called Underlying Assets. The underlying asset can be equity, index, foreign exchange (Forex), commodity or any other asset. This means that any instrument that derives its value on its underlying equity, index, foreign exchange (Forex), commodity or any other asset, is a Derivative Instrument.
- Derivative products initially emerged as hedging devices against fluctuations in commodity prices and commodity-linked derivatives remained the sole form of such products for almost three hundred years. But after 1970s, the financial derivatives came into spotlight thanks to the growing instability in the financial markets. However, since their emergence, these products have become very popular and by 1990s, they accounted for about two thirds of total transactions in derivative products.
- The derivatives can be Forwards or Futures or Options or Warrants.

Other financial instruments/participants:

Mutual fund

- A mutual fund is an open-end professionally managed investment fund that pools money from many investors to purchase securities. These investors may be retail or institutional in nature.
- Mutual funds have advantages and disadvantages compared to direct investing in individual securities. Advantages of mutual funds include economies of scale, diversification, liquidity, and professional management. However, these come with mutual fund fees and expenses.
- Mutual funds are also classified by their principal investments as money market funds, bond or fixed income funds, stock or equity funds, hybrid funds or other.

Non-Banking Financial Company (NBFC)

- A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.
- A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

Venture Capital

Venture capital is a form of private equity financing that is provided by venture capital firms or funds to startups, early-stage, and emerging companies that have been deemed to have high growth potential or which have demonstrated high growth.

Hedge Fund

A hedge fund is an investment fund that trades in relatively liquid assets and is able to make extensive use of more complex trading, portfolio-construction and risk management techniques to improve performance, such as short selling, leverage and derivatives.

Angel Investor

An angel investor is an individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity. Angel investors usually give support to start-ups at the initial moments and when most investors are not prepared to back them.

Basic Stock Market Terms

- **Bid:** It is the highest price that the buyer of a stock is ready to pay for a particular stock.
- **Ask/Offer**: It refers to the lowest price at which the owner of the equity shares is ready to sell the shares in the stock market.
- **Bear Market**: It refers to a period in which the prices of equity shares fall consistently. One may look at it like beginning of a downward trend in the stock market.
- **Bull Market:** An opposite of bear market, a bull market situation in which the prices of the stocks are increasing over a prolonged period of time. A single stock and a sector can be bullish at one time and bearish at another time.
- **Beta:** It measures the association between price of one equity share and the overall movement of stock market.
- **Blue Chip Stock:** These are equity shares of companies which are well-established and financially stable. These generally have a relatively huge market capitalization.
- **Convertible Securities**: It is a security like preferred stocks, bonds, debentures which are issued by an issuer capable of being converted into other securities of that issuer.
- **Debentures:** It is a form of fixed-income instrument which is not backed by security of any physical assets or collateral of the issuer.
- **Delta:** A delta relates to the ratio of change in the price of a derivative in response to change in the price of the underlying asset. A higher delta suggests higher sensitivity of the delta to the price changes in the underlying asset.
- **Spread:** It refers to the difference between the bid and the ask prices of an equity share.
- **Volatility:** It refers to the fluctuations in the price of an equity share. Highly volatile stocks witness severe ups and downs during trading sessions.
- **Yield:** One may use the yield to calculate the return on an investment which he/she gets after receiving dividend on a share.
- **Arbitrage:** Arbitrage refers to buying and selling the same security on different markets and at different price points.

- **Dividend:** A portion of a company's earnings that is paid to shareholders, or people that own that company's stock, on a quarterly or annual basis.
- **Short-selling: in** the context of the stock **market**, is the practice where an investor sells **shares** that he does not own at the time of **selling** them. He sells them in the hope that the price of those **shares** will decline, and he will profit by buying back those **shares** at a lower price.
- **Insider trading:** the illegal practice of trading on the stock exchange to one's own advantage through having access to confidential information.

Regulatory Bodies

The Indian financial system is regulated by five major regulatory bodies, they are:

RBI

Established in April, 1935 in Calcutta, the Reserve Bank of India (RBI) later moved to Mumbai in 1937. After its nationalization in 1949, RBI is presently owned by the Govt. of India. It has 19 regional offices, majorly in state capitals, and 9 sub-offices. It is the issuer of the Indian Rupee. RBI regulates the banking and financial system of the country by issuing broad guidelines and instructions.

Securities Exchange Board of India (SEBI)

Securities Exchange Board of India (SEBI) was established in 1988 but got legal status in 1992 to regulate the functions of securities market to keep a check on malpractices and protect the investors. Headquartered in Mumbai, SEBI has its regional offices in New Delhi, Kolkata, Chennai and Ahmadabad.

Insurance Regulatory and Development Authority of India (IRDAI)

IRDAI is an autonomous apex statutory body for regulating and developing the insurance industry in India. It was established in 1999 through an act passed by the Indian Parliament. Headquartered in Hyderabad, Telangana, IRDA regulates and promotes insurance business in India.

Forward Market Commission of India (FMC)

Headquartered in Mumbai, FMC is a regulatory authority governed by the Ministry of Finance, Govt. of India. It is a statutory body, established in 1953 under the Forward Contracts (Regulation) Act, 1952. The commission allows commodity trading in 22 exchanges in India. The FMC is now merged with SEBI.

Pension Fund Regulatory and Development Authority (PFRDA)

Established in October 2003 by the Government of India, PFRDA develops and regulates the pension sector in India. The National Pension System (NPS) was launched in January 2004 with an aim to provide retirement income to all the citizens. The objective of NPS is to set up pension reforms and inculcate the habit of saving for retirement amongst the citizens.

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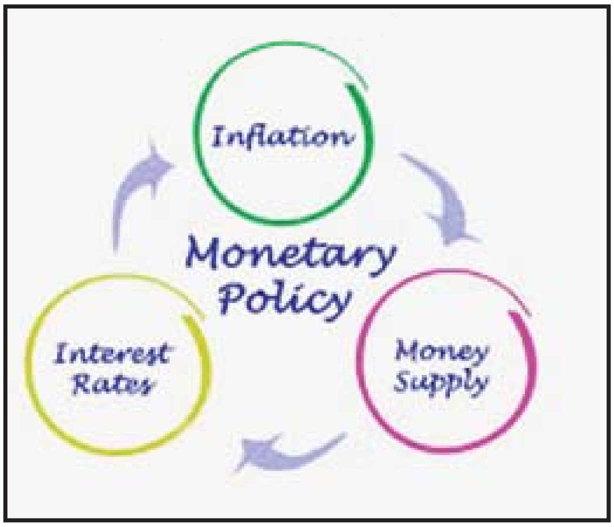
Monetary Policy and Indian Banking System

Monetary Policy



- It is the policy adopted by the monetary authority of a country that controls either the interest rate payable on very short-term borrowing or the money supply, often targeting inflation or the interest rate to ensure price stability and general trust in the currency.
- Unlike fiscal policy, which relies on taxation, government spending, and government borrowing, as tools for a government to manage cyclic financial swings such as recessions, **monetary policy aims to manipulate the money supply**, i.e. 'printing' more money or decreasing the money supply by changing interest rates or removing excess reserves.
- Further goals of a monetary policy are usually to **contribute to the stability of gross domestic product, to achieve and maintain low unemployment, and to maintain predictable exchange rates with other currencies**. Monetary economics can provide insight into crafting optimal monetary policy.

Monetary policy is referred to as being either Expansionary or Contractionary Policy

Expansionary Policy

- It occurs when a monetary authority uses its tools to stimulate the economy. An expansionary policy **maintains short-term interest rates at a lower than usual rate or increases the total supply of money in the economy more rapidly than usual.**
- It is traditionally used to try to combat unemployment in a recession by lowering interest rates in the hope that less expensive credit will entice businesses into expanding. This increases aggregate demand (the overall demand for all goods and services in an economy), which boosts short-term growth as measured by gross domestic product (GDP) growth.
- Expansionary monetary policy usually diminishes the value of the currency relative to other currencies (the exchange rate).

Contractionary Policy

- It maintains **short-term interest rates higher than usual**, **slows the rate of growth in the money supply, or even shrinks it to slow short-term economic growth and lessen inflation**.
- Contractionary monetary policy can lead to increased unemployment and depressed borrowing and spending by consumers and businesses, which can eventually result in an economic recession if implemented too vigorously.

Difference between Monetary and Fiscal policy

	Monetary Policy	Fiscal Policy
Tool	Interest rates	Tax and government spending
Effect	Cost of borrowing/mortgages	Budget deficit
Distribution	Higher interest rates hit homeowners but benefit savers	Depends which taxes you raise.
Exchange rate	Higher interest rates cause appreciation	No effect on exchange rate
Supply-side	Limited impact	Higher taxes may affect incentives to work
Politics	Monetary policy set by independent Central Bank	Changing tax and government spending highly political.
Liquidity trap	Cuts in interest rates may not work in liquidity trap	Fiscal policy advised in very deep recessions

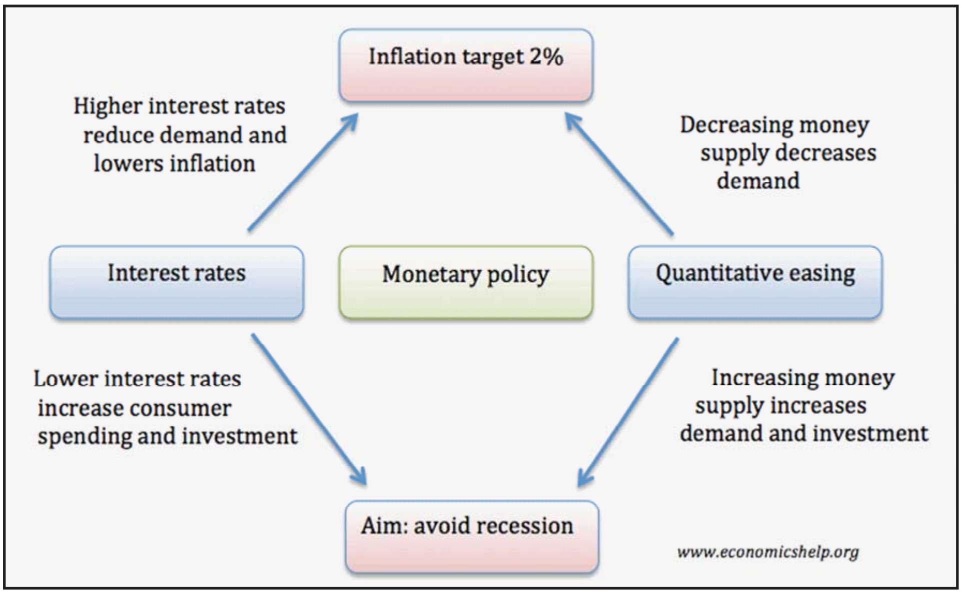
Objectives of Monetary Policy

- The **primary objective** of monetary policy is to **maintain price stability while keeping in mind the objective of growth**. Price stability is a necessary precondition to sustainable growth.

- In May 2016, the Reserve Bank of India (RBI) Act, 1934 was amended to provide a statutory basis for the implementation of the flexible **inflation targeting framework.**
  - **Flexible inflation targeting framework**
    - The amended RBI Act also provides for the inflation target to be set by the Government of India, in consultation with the Reserve Bank, **once in every five years**.
    - Accordingly, the Central Government has notified in the Official Gazette **4 percent Consumer Price Index (CPI) inflation** as the target for the period from August 5, 2016 to March 31, 2021 with the upper tolerance limit of 6 percent and the lower tolerance limit of **2 percent.**
  - The Central Government notified the following as factors that constitute failure to achieve the inflation target:
    - The average inflation is more than the upper tolerance level of the inflation target for any three consecutive quarters; or
    - The average inflation is less than the lower tolerance level for any three consecutive quarters.
- Prior to the amendment in the RBI Act in May 2016, the flexible inflation targeting framework was governed by an Agreement on Monetary Policy Framework between the Government and the Reserve Bank of India of February 20, 2015.

OBJECTIVES OF MONETARY POLICY

1. Rapid Economic Growth
2. Price Stability
3. Exchange Rate Stability
4. Balance of Payments (BOP) Equilibrium
5. Full Employment
6. Neutrality of Money
7. Equal Income Distribution
8. Control business cycle
9. Promote export and substitute imports
10. Improvement in Standard of Living
11. Control of Inflation and Deflation



Monetary Policy Committee (MPC)

- Now in India, the policy interest rate required to achieve the inflation target is decided by the Monetary Policy Committee (MPC). MPC is a six-member committee constituted by the Central Government **(Section 45ZB of the amended RBI Act, 1934).**

- The MPC is required to **meet at least four times a year**. The **quorum** for the meeting of the MPC is **four members. Each member of the MPC has one vote,** and in the event of an equality of votes, the **Governor has a second or casting vote.**
- The resolution adopted by the MPC is published after the conclusion of every meeting of the MPC. Once in **every six months, the Reserve Bank** is required to publish a document called the **Monetary Policy Report** to explain: (1) the sources of inflation and (2) the forecast of inflation for 6-18 months ahead.

The present Monetary Policy Committee (MPC)

- Governor of the RBI – Chairperson, ex officio.
- Deputy Governor of the RBI, in charge of Monetary Policy – Member, ex officio.
- One officer of the RBI to be nominated by the Central Board – Member, ex officio.
- Shri Chetan Ghate, Professor, Indian Statistical Institute (ISI) – Member;
- Professor Pami Dua, Director, Delhi School of Economics – Member; and
- Dr. Ravindra H. Dholakia, Professor, Indian Institute of Management, Ahmedabad (IIMA) – Member.

The Monetary Policy Process (MPP)

- The Monetary Policy Committee (MPC) determines the policy interest rate required to achieve the inflation target.
- The Reserve Bank's Monetary Policy Department (MPD) assists the MPC in formulating the monetary policy. Views of key stakeholders in the economy and analytical work of the Reserve Bank contribute to the process of arriving at the decision on the policy repo rate.
- The Financial Markets Operations Department (FMOD) operationalises the monetary policy, mainly through day-to-day liquidity management operations.
- The Financial Market Committee (FMC) meets daily to review the liquidity conditions so as to ensure that the operating target of monetary policy (weighted average lending rate) is kept close to the policy repo rate. This parameter is also known as the weighted average call money rate (WACR).

Monetary Policy Methods

Quantitative measures

- The methods used by the central bank to influence the total volume of credit in the banking system, without any regard for the use to which it is put, are called quantitative or general methods of credit control.
- These methods regulate the lending ability of the financial sector of the whole economy and do not discriminate among the various sectors of the economy. These are as follow:
  - **Repo Rate:** The (fixed) interest rate at which the Reserve Bank provides overnight liquidity to banks against the collateral of government and other approved securities under the liquidity adjustment facility (LAF).
  - **Reverse Repo Rate:** The (fixed) interest rate at which the Reserve Bank absorbs liquidity, on an overnight basis, from banks against the collateral of eligible government securities under the LAF.
  - **Liquidity Adjustment Facility (LAF):** The LAF consists of overnight as well as term repo auctions. Progressively, the Reserve Bank has increased the proportion of liquidity injected under fine-tuning variable rate repo auctions of range of tenors. The aim of term repo is to help develop the inter-

bank term money market, which in turn can set market based benchmarks for pricing of loans and deposits, and hence improve transmission of monetary policy. The Reserve Bank also conducts variable interest rate reverse repo auctions, as necessitated under the market conditions.

- **Marginal Standing Facility (MSF):** A facility under which scheduled commercial banks can borrow additional amount of overnight money from the Reserve Bank by dipping into their Statutory Liquidity Ratio (SLR) portfolio up to a limit at a penal rate of interest. This provides a safety valve against unanticipated liquidity shocks to the banking system.
- **Corridor:** The MSF rate and reverse repo rate determine the corridor for the daily movement in the weighted average call money rate.
- **Bank Rate:** It is the rate at which the Reserve Bank is ready to buy or rediscount bills of exchange or other commercial papers. The Bank Rate is published under Section 49 of the Reserve Bank of India Act, 1934. This rate has been aligned to the MSF rate and, therefore, changes automatically as and when the MSF rate changes alongside policy repo rate changes.
- **Cash Reserve Ratio (CRR):** The average daily balance that a bank is required to maintain with the Reserve Bank as a share of such per cent of its Net demand and time liabilities (NDTL) that the Reserve Bank may notify from time to time in the Gazette of India.
- **Statutory Liquidity Ratio (SLR):** The share of NDTL that a bank is required to maintain in safe and liquid assets, such as, unencumbered government securities, cash and gold. Changes in SLR often influence the availability of resources in the banking system for lending to the private sector.
- **Open Market Operations (OMOs):** These include both, outright purchase and sale of government securities, for injection and absorption of durable liquidity, respectively.
- **Market Stabilisation Scheme (MSS):** This instrument for monetary management was introduced in 2004. Surplus liquidity of a more enduring nature arising from large capital inflows is absorbed through sale of short-dated government securities and treasury bills. The cash so mobilised is held in a separate government account with the Reserve Bank.

Qualitative Measures:

- The methods used by the central bank to regulate the flows of credit into particular directions of the economy are called qualitative or selective methods of credit control. Unlike the quantitative methods, which affect the total volume of credit, the qualitative methods affect the types of credit, extended by the commercial banks; they affect the composition rather than the size of credit in the economy.
- The important qualitative or selective methods of credit control are:
  - **Marginal requirements**: This refers to difference between the securities offered and amount borrowed by the banks.
  - **Consumer Credit Regulation**: This refers to issuing rules regarding down payments and maximum maturities of installment credit for purchase of goods.
  - **Guidelines:** RBI issues oral, written statements, appeals, guidelines, and warnings etc. to the banks.
  - **Rationing of credit**: The RBI controls the Credit granted / allocated by commercial banks.
  - **Moral Suasion:** Psychological means and informal means of selective credit control.
  - **Publicity:** The central banks also use publicity as a method of credit control. Through publicity, the central bank seeks to:

- Influence the credit policies of the commercial banks
- Educate people regarding the economic and monetary condition of the country
- Influence the public opinion in favour of its monetary policy.

➤ **Direct Action**: This step is taken by the RBI against banks that don't fulfill conditions and requirements. RBI may refuse to rediscount their papers or may give excess credits or charge a penal rate of interest over and above the Bank rate, for credit demanded beyond a limit.

Banking System in India

- Modern banking in India originated in the last decade of the 18th century. Among the first banks were the Bank of Hindustan, which was established in 1770 and liquidated in 1829–32; and the General Bank of India, established in 1786 but failed in 1791.
- The largest and the oldest bank which is still in existence is the State Bank of India (S.B.I). It originated and started working as the Bank of Calcutta in mid-June 1806. In 1809, it was renamed as the **Bank of Bengal.** This was one of the three banks founded by a presidency government; the other two were the **Bank of Bombay in 1840** and the **Bank of Madras in 1843**.
- The three banks were merged in 1921 to form the **Imperial Bank of India**, which upon India's independence, became the **State Bank of India in 1955**. For many years the **presidency banks** had acted as quasi-central banks, as did their successors, until the **Reserve Bank of India was established in 1935, under the Reserve Bank of India Act, 1934**.

Nationalisation of Indian Banks

- Despite the provisions, control and regulations of the Reserve Bank of India, banks in India except the State Bank of India (SBI), remain owned and operated by private persons.
- By the 1960s, the Indian banking industry had become an important tool to facilitate the development of the Indian economy. At the same time, it had emerged as a large employer, and a debate had ensued about the nationalization of the banking industry.
- The Government of India issued the **Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969** and nationalized the 14 largest commercial banks with effect from the midnight of 19 July 1969. **The following banks were nationalized in 1969:**
  - Allahabad Bank (Now Indian Bank)
  - Bank of Baroda
  - Bank of India
  - Bank of Maharashtra
  - Central Bank of India
  - Canara Bank
  - Dena Bank (Now Bank of Baroda)
  - Indian Bank
  - Indian Overseas Bank
  - Punjab National Bank
  - Syndicate Bank (Now Canara Bank)

- UCO Bank
- Union Bank of India
- United Bank of India (Now Punjab National Bank)

A second round of nationalizations of six more commercial banks followed in 1980. The stated reason for the nationalization was to give the government more control of credit delivery. With the second round of nationalizations, the Government of India controlled around 91% of the banking business of India. The following banks were nationalized in 1980:

- Punjab and Sind Bank
- Vijaya Bank (Now Bank of Baroda)
- Oriental Bank of India (Now Punjab National Bank)
- Corporation Bank (Now Union Bank of India)
- Andhra Bank (Now Union Bank of India)

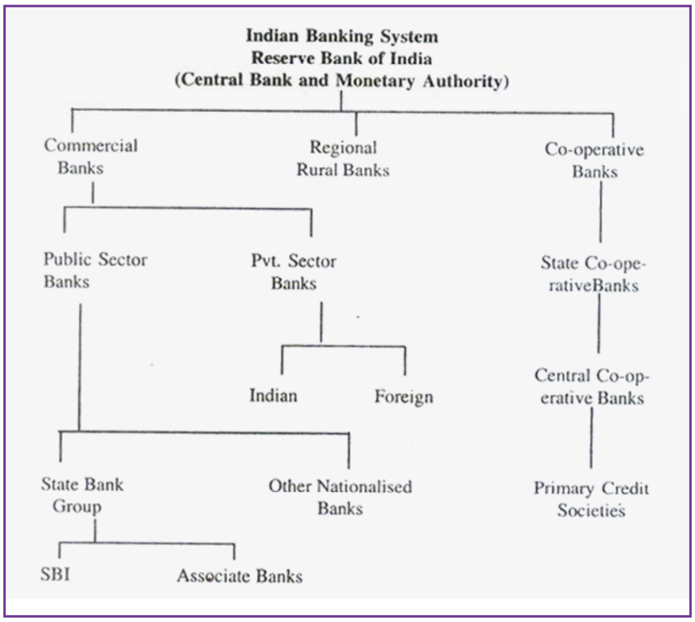
Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank. It was the only merger between nationalised banks and resulted in the reduction of the number of nationalised banks from 20 to 19. Until the 1990s, the nationalized banks grew at a pace of around 4%, closer to the average growth rate of the Indian economy.

Indian banking system after Liberalisation in the 1990s:

- In the early 1990s, the then government embarked on a policy of liberalisation, licensing a small number of private banks. These came to be known as **New Generation tech-savvy banks**, and included **Global Trust Bank** (the first of such new generation banks to be set up), which later amalgamated with Oriental Bank of Commerce, IndusInd Bank, UTI Bank (since renamed Axis Bank), ICICI Bank and HDFC Bank.
- This move, along with the rapid growth in the economy of India, revitalised the banking sector in India, which has seen rapid growth with strong contribution from all the three sectors of banks, namely, government banks, private banks and foreign banks.

Classification of Indian Banking System

- The Indian banking sector is broadly classified into **scheduled and non-scheduled banks.** The scheduled banks are those included under the **2nd Schedule of the Reserve Bank of India Act, 1934.**
- The scheduled banks are further classified into: nationalised banks; State Bank of India and its associates; Regional Rural Banks (RRBs); foreign banks; and other Indian private sector banks.
- The term commercial banks refer to both scheduled and non-scheduled commercial banks regulated under the Banking Regulation Act, 1949.



Reserve Bank of India (RBI)

- The RBI is India's central bank, which controls the issue and supply of the Indian rupee. RBI is the regulator of entire Banking in India. RBI plays an important part in the Development Strategy of the Government of India.
- RBI regulates commercial banks and non-banking finance companies working in India. It serves as the leader of the banking system and the money market. **RBI was set up in 1935 under the Reserve Bank of India Act, 1934.**
- Until the Monetary Policy Committee was established in 2016, it also controlled monetary policy in India. It commenced its operations on 1st April 1935 in accordance with the Reserve Bank of India Act, 1934. Following India's independence on 15 August 1947, the RBI was nationalised on **1 January 1949.**
- It is a member bank of the Asian Clearing Union. The general superintendence and direction of the RBI is entrusted with the **21-member** central board of directors: the governor; **four deputy governors**; two finance ministry representatives (usually the Economic Affairs Secretary and the Financial Services Secretary); ten government-nominated directors to represent important elements of India's economy; and four directors to represent local boards headquartered at Bombay, Calcutta, Madras and the capital New Delhi.
- The bank is also active in promoting financial inclusion policy and is a leading member of the **Alliance for Financial Inclusion (AFI).** The bank is often referred to by the name 'Mint Street'. RBI is also known **as banker's bank.**

Functions of RBI

- **Issue of Notes**: The Reserve Bank has a monopoly for printing the currency notes in the country. It has the sole right to issue currency notes of various denominations **except one rupee note (which is issued by the Ministry of Finance).**
  - The Reserve Bank has adopted the **Minimum Reserve System** for issuing/printing the currency notes. Since 1957, it maintains gold and foreign exchange reserves of Rs. 200 Cr. of which at least Rs. 115 cr. should be in gold and remaining in the foreign currencies.
- **Banker to the Government**: It performs all the banking functions of the State and Central Government and it also tenders useful advice to the government on matters related to economic and monetary policy. It also manages the public debt of the government.
- **Banker's Bank:** The Reserve Bank performs the same functions for the other commercial banks as the other banks ordinarily perform for their customers. RBI lends money to all the commercial banks of the country.
- **Controller of the Credit**: RBI uses two methods to control the extra flow of money in the economy. These methods are quantitative and qualitative techniques to control and regulate the credit flow in the country. When RBI observes that the economy has sufficient money supply and it may cause an inflationary situation in the country then it squeezes the money supply through its tight monetary policy and vice versa.
- **Custodian of Foreign Reserves**: For the purpose of keeping the foreign exchange rates stable, the Reserve Bank buys and sells foreign currencies and also protects the country's foreign exchange funds. RBI sells the foreign currency in the foreign exchange market when its supply decreases in the economy and vice-versa..
- **Other Functions**: The Reserve Bank performs a number of other developmental works. These works include the function of clearinghouse arranging credit for agriculture (which has been transferred to NABARD) collecting and publishing the economic data, buying and selling of Government securities

(gilt edge, treasury bills, etc) and trade bills, giving loans to the Government buying and selling of valuable commodities etc. It also acts as the representative of the Government in the International Monetary Fund (IMF) and represents the membership of India.

Commercial Banks

- The main function of these types of banks is to give financial services to the entrepreneurs and businesses.
- Commercial Banks finance businessmen like providing them with debit cards, banks accounts, short term deposits, etc. with the money deposited by people in such banks.
- Commercial banks lend money to these businessmen in the form of secured loans, unsecured loans, credit cards, overdrafts & mortgage loans.
- It got the tag of a nationalized bank in the year 1969 & hence the various policies regarding the loans, rates of interest, etc. are controlled by the RBI.
- Further classifications of the commercial banks include private sector banks, public sector banks, regional banks and foreign banks.

Public Sector Banks

- Public Sector Banks (PSBs) are a major type of bank in India, where a majority stake (i.e. more than 50%) is held by a government. The shares of these banks are listed on stock exchanges. There are a total of 12 Public Sector Banks alongside 1 state-owned Payments Bank in India.
- **Recent merger of public sector banks**
  - The consolidation of SBI associated banks started first by merging State Bank of Saurashtra to it. The merger happened on 13 August 2008. Then after State Bank of Indore was acquired by State Bank of India on August 27, 2010.
  - The remaining 27 nationalised banks were merged into **12 banks** from 2017–19. The State Bank of Bikaner & Jaipur, State Bank of Hyderabad, State Bank of Mysore, State Bank of Patiala and State Bank of Travancore, and Bharatiya Mahila Bank were merged with State Bank of India with effect from 1 April 2017.
  - Vijaya Bank and Dena Bank were merged into Bank of Baroda in 2018. IDBI Bank was categorised as a private bank with effect from January 2019.

Public Sector Banks (Government Shareholding %, as of 1st April, 2020)

- State Bank of India (61.00%)
- Bank of Baroda (63.74%)
- Union Bank of India (67.43%)
- Punjab National Bank (70.22%)
- Canara Bank (72.55%)
- Punjab & Sind Bank (79.62%)
- Indian Bank (81.73%)
- Bank of Maharashtra (87.01%)
- Bank of India (87.0535%)
- Central Bank of India (88.02%)
- Indian Overseas Bank (91%)
- UCO Bank (93.29%)

- On 30 August 2019, Finance Minister announced the government's plan for further consolidation of public sector banks: Indian Bank is to be merged with Allahabad Bank (anchor bank - Indian Bank); PNB, OBC and United Bank are to be merged (anchor bank - PNB); Union Bank of India, Andhra Bank and Corporation Bank are to be merged (anchor bank - Union Bank of India); and Canara Bank and Syndicate Bank are to be merged (anchor bank - Canara Bank).

Private Sector Banks

- Owned and operated by private institutes; free to operate and are controlled by market forces.
- A greater share is held by private players, not by the government.
- For example, Axis Bank, Kotak Mahindra Bank, ICICI Bank, HDFC Bank etc.

Foreign Banks

- Foreign country banks having several branches in India.
- Some examples of these banks include HSBC, City Bank, Standard Chartered Bank etc.

Regional Rural Banks (RRBs)

- The Regional Rural Banks (RRBs) were established in 1975 under the provisions of the Ordinance promulgated on 26th September, 1975 and Regional Rural Banks Act, 1976.
- The objective is to develop the rural economy by providing, for the purpose of development of agriculture, trade, commerce, industry and other productive activities in the rural areas, credit and other facilities, particularly to small and marginal farmers, agricultural labourers, artisans and small entrepreneurs, and for matters connected therewith and incidental thereto.
- As per RBI guidelines, the RRBs have to provide 75% of their total credit under **PSL (Priority Sector Lending).**

In News:

The Cabinet Committee on Economic Affairs has given its approval for continuation of the process of recapitalization of Regional Rural Banks (RRBs) by providing minimum regulatory capital to RRBs for another year beyond 2019-20, that is, up to 2020-21 for those RRBs which are unable to maintain minimum Capital to Risk weighted Assets Ratio (CRAR) of 9%, as per the regulatory norms prescribed by the Reserve Bank of India.

Payments Banks

- A Payments bank is an Indian new model of banks conceptualised by the Reserve Bank of India (RBI**). These banks can accept a restricted deposit,** which is currently limited to □100,000 per customer and may be increased further.
- These banks **cannot issue loans and credit cards**. Both current account and savings accounts can be operated by such banks.
- Payments banks **can issue ATM cards or debit cards and provide online or mobile banking**.
- Payments banks **cannot accept deposits from the Non-Resident Indians (NRIs).** It means; the people of Indian origin who have settled abroad cannot deposit their money in the payment banks.
- Payments banks cannot open subsidiaries to undertake Non-Banking Financial Services activities.

- **Bharti Airtel set up India's first live payments bank.**

6 Payments Banks of India:

- Airtel Payments Bank Limited.
- India Post Payments Bank Limited.
- Fino Payments Bank Limited.
- Paytm Payments Bank Limited.
- NSDL Payments Bank Limited.
- Jio Payments Bank Limited.

Feature	Payments banks	Traditional Banks	Wallets
Making Deposits	✓	✓	✓
Interest on deposits	✓	✓	×
Withdrawal facility	✓	✓	×
Availing of loans	×	✓	×
Credit Cards	×	✓	×
Buying investment products	✓	✓	×
Deposit limit	` 1 lakh	No limit	

Small Finance Banks

- To further the objective of financial inclusion, the RBI granted approval in 2016 to ten entities to set up small finance banks. Since then, all ten have received the necessary licenses.
- **A small finance bank is a niche type of bank** to cater to the needs of people who traditionally have not used scheduled banks.
- Each of these banks is to open at least 25% of its branches in areas that do not have any other bank branches (unbanked regions).
- A small finance bank should hold 75% of its net credits in loans to firms in priority sector lending, and 50% of the loans in its portfolio must be less than □25 lakh (US$38,000).
- **There are ten small finance banks:**
  - AU Small Finance Bank Ltd.
  - Capital Small Finance Bank Ltd.
  - Equitas Small Finance Bank Ltd.
  - ESAF Small Finance Bank Ltd.
  - Fincare Small Finance Bank Ltd.
  - Jana Small Finance Bank Ltd.
  - North East Small Finance Bank Ltd.

- Suryoday Small Finance Bank Ltd.
- Ujjivan Small Finance Bank Ltd.
- Utkarsh Small Finance Bank Ltd.

Cooperative Banking

- A Co-operative bank is a financial entity which belongs to its members, who are at the same time the owners and the customers of their bank.
- Co-operative banks in India are registered under **the States Cooperative Societies Act.** The Co-operative banks are also regulated by the Reserve Bank of India (RBI) and governed by the:
  - Banking Regulations Act 1949
  - Banking Laws (Co-operative Societies) Act, 1955.

Features of Cooperative Banks:

- **Customer Owned Entities**: Co-operative bank members are both customer and owner of the bank.
- **Democratic Member Control**: Co-operative banks are owned and controlled by the members, who democratically elect a board of directors. Members usually have equal voting rights, according to the cooperative principle of "one person, one vote".
- **Profit Allocation**: A significant part of the yearly profit, benefits or surplus is usually allocated to constitute reserves and a part of this profit can also be distributed to the co-operative members, with legal and statutory limitations in maximum cases.
- **Financial Inclusion**: They have played a significant role in the financial inclusion of unbanked rural masses.

Cooperative Banks	Commercial Banks
Co-operatives banks are co-operative organisations.	Commercial banks are joint-stock banks
Governed by the Co-operative Societies Act as well as Banking Regulation Act	Governed by the Banking Regulation Act
Subject to the rules laid down by the Registrar of Co-operative Societies	Subject to the control of the Reserve Bank of India directly
Borrowers are member shareholders, so they have some influence on the lending policy of the banks, on account of their voting power	Borrowers of commercial banks are only account- holders and have no voting power as such → Voting power as per shareholding
Have not much scope of flexibility on account of the rigidities of the bye-laws of the Co-operative Societies	Free from such rigidities
PSL does not applies	PSL Applies
Do not pursue the goal of profit maximization	Works for profit maximization

National Bank for Agriculture and Rural Development (NABARD)

- NABARD came into existence on 12 July 1982 by transferring the agricultural credit functions of RBI and refinance functions of the then **Agricultural Refinance and Development Corporation (ARDC).** It was dedicated to the service of the nation by the late Prime Minister Smt. Indira Gandhi on 05 November 1982.

- **The main objectives of NABARD are as follows:**
  - NABARD provides refinance assistance for agriculture, promoting rural development activities. It also provides all necessary finance and assistance to small scale industries.
  - NABARD in coordination with the State Governments provides agriculture.
  - It improves small and minor irrigation by way of promoting agricultural activities.
  - It undertakes R&D in agriculture, rural industries.
  - NABARD promotes various organizations involved in agricultural production by contributing to their capital.
- **In discharging its role as a facilitator for rural prosperity, NABARD is entrusted with:**
  - Providing refinance to lending institutions in rural areas
  - Bringing about or promoting institutional development
  - Evaluating, monitoring and inspecting the client banks
- Besides this pivotal role, NABARD also:
  - Acts as a coordinator in the operations of rural credit institutions
  - Extends assistance to the government, the RBI and other organizations in matters relating to rural development
  - Offers training and research facilities for banks, cooperatives and organizations working in the field of rural development.
  - Helps the state governments in reaching their targets of providing assistance to eligible institutions in agriculture and rural development.
  - Acts as regulator for cooperative banks and RRBs
- Recently the National Bank for Agriculture and Rural Development (Amendment) Bill, 2017 was passed.
  - Under the 1981 Act, NABARD may have a capital of Rs 100 crore. This capital can be further increased to Rs 5,000 crore by the central government in consultation with the RBI.
  - The Bill allows the central government to increase this capital to Rs 30,000 crore. The capital may be increased to more than Rs 30,000 crore by the central government in consultation with the RBI, if necessary.
  - Under the 1981 Act, the central government and the RBI together must hold at least 51% of the share capital of NABARD. The Bill provides that the central government alone must hold at least 51% of the share capital of NABARD. The Bill transfers the share capital held by the RBI and valued at Rs 20 crore to the central government. The central government will give an equal amount to the RBI.

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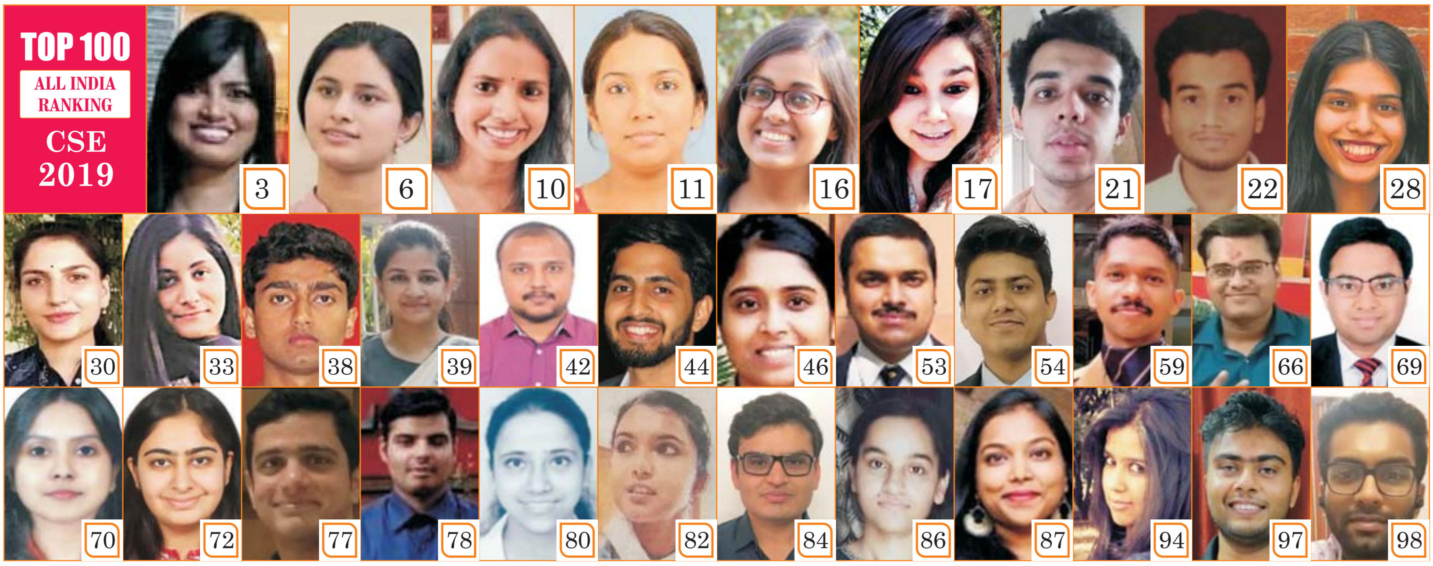

SUCCESS IS A PRACTICE WE DO!