Chapter 6
Banking

Part – A
Multiple Choice Questions.

Question 1.
A Bank is a ……………………….
(a) Financial institution
(b) Corporate
(c) An Industry
(d) Service institutions
Answer:
(a) Financial institution

Question 2.
A Commercial Bank is an institution that provides services ……………………….
(a) Accepting deposits
(b) Providing loans
(c) Both a and b
(d) None of the above
Answer:
(c) Both a and b

Question 3.
The Functions of commercial banks are broadly classified into ……………………….
(a) Primary Functions
(b) Secondary functions
(c) Other functions
(d) a, b, and c
Answer:
(d) a, b, and c

Question 4.
Bank credit refers to ……………………….
(a) Bank Loans
(b) Advances
(c) Bank loans and advances
(d) Borrowings
Answer:
(c) Bank loans and advances

Question 5.
Credit creation means ………………………..
(a) Multiplication of loans and advances
(b) Revenue
(c) Expenditure
(d) Debt
Answer:
(a) Multiplication of loans and advances

Question 6.
NBFI does not have ………………………..
(a) Banking license
(b) Government approval
(c) Money ministry approval
Answer:
(a) Banking license

Question 7.
Central bank is ………………………….. authority of any country.
(a) Monetary
(b) Fiscal
(c) Wage
(d) National Income
Answer:
(a) Monetary

Question 8.
Who will act as the banker to the Government of India?
(a) SBI
(b) NABARD
(c) ICICI
(d) RBI
Answer:
(d) RBI

Question 9.
Lender of the last resort is one of the functions of ………………………..
(a) Central Bank
(b) Commercial banks
(c) Land Development Banks
(d) Co – operative banks
Answer:
(a) Central Bank

Question 10.
Bank Rate means ……………………….
(a) Re – discounting the first class securities
(b) Interest rate
(c) Exchange rate
(d) Growth rate
Answer:
(a) Re – discounting the first class securities

Question 11.
Repo Rate means ……………………….
(a) Rate at which the Commercial Banks are willing to lend to RBI
(b) Rate at which the RBI is willing to lend to commercial banks
(c) Exchange rate of the foreign bank
(d) Growth rate of the economy
Answer:
(b) Rate at which the RBI is willing to lend to commercial banks

Question 12.
Moral suasion refers ……………………….
(a) Optimization
(b) Maximization
(c) Persuasion
(d) Minimization
Answer:
(c) Persuasion

Question 13.
ARDC started functioning from ……………………….
(a) June 3, 1963
(b) July 3, 1963
(c) June 1, 1963
(d) July 1, 1963
Answer:
(d) July 1, 1963

Question 14.
NABARD was set up in ……………………….
(a) July 1962
(b) July 1972
(c) July 1982
(d) July 1992
Answer:
(c) July 1982

Question 15.
EXIM bank was established in ………………………..
(a) June 1982
(b) April 1982
(c) May 1982
(d) March 1982
Answer:
(d) March 1982

Question 16.
The State Financial Corporation Act was passed by ………………………..
(a) Government of India
(b) Government of Tamilnadu
(c) Government of Union Territories
(d) Local Government.
Answer:
(a) Government of India

Question 17.
Monetary policy is formulated by ………………………..
(a) Co – operative banks
(b) Commercial banks
(c) Central Bank
(d) Foreign banks
Answer:
(c) Central Bank

Question 18.
Online Banking is also known as ………………………..
(a) E – Banking
(b) Internet Banking
(c) RTGS
(d) NEFT
Answer:
(b) Internet Banking

Question 19.
Expansions of ATM.
(a) Automated Teller Machine
(b) Adjustment Teller Machine
(c) Automatic Teller mechanism
(d) Any Time Money
Answer:
(a) Automated Teller Machine

Question 20.
2016 Demonetization of currency includes denominations of ……………………….
(a) ₹ 500 and ₹ 1000
(b) ₹ 1000 and ₹ 2000
(c) ₹ 200 and ₹ 500
(d) All the above
Answer:
(a) ₹ 500 and ₹ 1000

Part – B
Answer The Following Questions In One or Two Sentences.

Question 21.
Define Commercial banks?
Answer:
Commercial bank refers to a bank, or a division of a large bank, which more specifically deals with deposit and loan services provided to corporations or large/middle-sized business – as opposed to individual members of the public/small business.

Question 22.
What is credit creation?
Answer:

1. Credit Creation means the multiplication of loans and advances.
2. Commercial banks receive deposits from the public and use these deposits to give loans.
3. However, loans offered are many times more than the deposits received by banks.
4. This function of banks is known as 'Credit Creation'.

Question 23.
Define Central bank?
Answer:

1. A central bank, reserve bank, or monetary authority is an institution that manages a state's currency, money supply, and interest rates.
2. Central banks also usually oversee the commercial banking system of their respective countries.

Question 24.
Distinguish between CRR and SLR?
Answer:
CRR:

1. The Central Bank controls credit by changing the Cash Reserves Ratio.
2. Commercial Banks have excessive cash reserves on the basis of which they are creating too much of credit, this will be harmful for the larger interest of the economy.
3. So it will raise the cash reserve ratio which the Commercial Banks are required to maintain with the Central Bank.

SLR:

1. Statutory Liquidity Ratio (SLR) is the amount which a bank has to maintain in the form of cash, gold or approved securities.
2. The quantum is specified as some percentage of the total demand and time liabilities.
3. The liabilities of the bank which are payable on demand anytime, and those liabilities which are accruing in one month's time due to maturity.

Question 25.
Write the meaning of Open market operations?
Answer:

1. In narrow sense, the Central Bank starts the purchase and sale of Government securities in the money market.
2. In Broad Sense, the Central Bank purchases and sells not only Government securities but also other proper eligible securities like bills and securities of private concerns.
3. When the banks and the private individuals purchase these securities they have to make payments for these securities to the Central Bank.

Question 26.
What is rationing of credit?
Answer:

1. This is the oldest method of credit control. Rationing of credit as an instrument of credit control was first used by the Bank of England by the end of the 18th Century.
2. It aims to control and regulate the purposes for which credit is granted by commercial banks.
3. It is generally of two types.

Question 27.
Mention the functions of agriculture credit department?
Answer:
Functions of Agriculture Credit Department:

1. To maintain an expert staff to study all **Question**s on agricultural credit;
2. To provide expert advice to Central and State Government, State Co – operative Banks and other banking activities.
3. To finance the rural sector through eligible institutions engaged in the business of agricultural credit and to co-ordinate their activities.

Part – C
Answer The Following Questions In One Paragraph.

Question 28.
Write the mechanism of credit creation by commercial banks?
Answer:
Mechanism / Technique of Credit Creation by Commercial Banks:

1. Bank credit refers to bank loans and advances.
2. Money is said to be created when the banks, through their lending activities, make a net addition to the total supply of money in the economy.
3. Money is said to be destroyed when the loans are repaid by the borrowers to the banks and consequently the credit already created by the banks is wiped out in the process.
4. Banks have the power to expand or contract demand deposits and they exercise this power through granting more or less loans and advances and acquiring other assets.
5. This power of commercial bank to create deposits through expanding their loans and advances is known as credit creation.

Question 29.
Give a brief note on NBFI?
Answer:
Non – Banking Financial Institution (NBFI):

1. A non – banking financial institution (NBFI) or non-bank financial company (NBFC) is a financial institution that does not have a full banking license or is not supervised by the central bank.

2. The NBFIs do not carry on pure banking business, but they will carry on other financial transactions. They receive deposits and give loans. They mobilize people's savings and use the funds to finance expenditure on investment activities. In short, they are institutions which undertake borrowing and lending. They operate in both the money and the capital markets.

3. NBFIs can be broadly classified into two categories. Viz.., (1) Stock Exchange; and (2) Other Financial institutions. Under the latter category comes Finance Companies, Finance Corporations, ChitFunds, Building Societies, Issue Houses, Investment Trusts and Unit Trusts and Insurance Companies.

Question 30.
Bring out the methods of credit control?
Answer:
Methods of Credit Control:
I. Quantitative or General Methods:

1. Bank Rate Policy:
The bank rate is the rate at which the Central Bank of a country is prepared to re – discount the first class securities.

2. Open Market Operations:

1. In narrow sense, the Central Bank starts the purchase and sale of Government securities in the money market.
2. In Broad Sense, the Central Bank purchases and sells not only Government securities but also other proper eligible securities like bills and securities of private concerns.

3. Variable Reserve Ratio:
(I) Cash Reserves Ratio:

1. Under this system the Central Bank controls credit by changing the Cash Reserves Ratio.
2. For example, if the Commercial Banks have excessive cash reserves on the basis of which they are creating too much of credit,this will be harmful for the larger interest of the economy.
3. So it will raise the cash reserve ratio which the Commercial Banks are required to maintain with the Central Bank.

(II) Statutory Liquidity Ratio:

1. Statutory Liquidity Ratio (SLR) is the amount which a bank has to maintain securities.
2. The quantum is specified as some percentage of the total demand and time liabilities (i.ethe liabilities of the bank which are payable on demand anytime, and those liabilities which are accruing in one month’s time due to maturity) of a bank.

Question 31.
What are the functions of NABARD?

Answer:
Functions of NABARD:
NABARD has inherited its apex role from RBI i.e, it is performing all the functions performed
by RBI with regard to agricultural credit.

1. NABARD acts as a refinancing institution for all kinds of production and investment credit to agriculture, small-scale industries, cottage and village industries, handicrafts and rural crafts and real artisans and other allied economic activities with a view to promoting integrated rural development.

2. NABARD gives long-term loans (upto 20 Years) to State Government to enable them to subscribe to the share capital of co – operative credit societies.

3. NABARD gives long-term loans to any institution approved by the Central Government or contribute to the share capital or invests in securities of any institution concerned with agriculture and rural development.

4. NABARD has the responsibility of co – ordinating the activities of Central and State Governments, the Planning Commission (now NITI Aayog) and other all India and State level institutions entrusted with the development of small scale industries, village and cottage industries, rural crafts, industries in the tiny and decentralized sectors, etc.

5. It maintains a Research and Development Fund to promote research in agriculture and rural development

Question 32.
Specify the functions of IFCI?
Answer:

1. Long – term loans; both in rupees and foreign currencies.
2. Underwriting of equity, preference and debenture issues.
3. Subscribing to equity, preference and debenture issues.
4. Guaranteeing the deferred payments in respect of machinery imported from abroad or purchased in India; and
5. Guaranteeing of loans raised in foreign currency from foreign financial institutions.

Question 33.
Distinguish between money market and capital market?
Answer:
Money Market:

1. Money market is the mechanism through which short term funds are loaned and. borrowed. It designates financial institutions which handle the purchase, sale and transfer of short term credit instruments.
2. Commercial banks, acceptance houses, Non Banking Financial Institutions and the Central Bank are the institutions catering to the requirements of short term funds in the money Market.

Capital Market:

1. Capital Market is a part of financial system which is concerned with raising capital by dealing in shares, bonds and other long term investments.
2. The market where investment instruments like bonds, equities and mortgages are traded is known as the capital market.

Question 33.
Mention the objectives of demonetizations?
Answer:
Objectives of Demonetisation:

1. Removing Black Money from the country.
2. Stopping of Corruption.
3. Stopping Terror Funds.
4. Curbing Fake Notes.

Demonitisation is the act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency. The current form or forms of money is pulled from circulation, often to bereplaced with new coins or notes.

Part – D
Answer The Following Questions In About A Page.

Question 34.
Explain the role of Commercial Banks in economic development?
Answer:
Role of Commercial Banks in Economic Development of a Country Role of Commercial Banks:

1. Capital Formation
2. Creation of Credit
3. Channelizing the funds
4. Encouraging Rights Type of Industries
5. Banks Monetize Debt
6. Finance to Government
7. Employment Generation

8. Bank Promote Entrepreneurship

1. Capital Formation:

1. Banks play an important role in capital formation, which is essential for the economic development of a country.
2. They mobilize the small savings of the people scattered over a wide area through their network of branches all over the country and make it available for productive purposes.

2. Creation of Credit:

1. Banks create credit for the purpose of providing more funds for development projects.
2. Credit creation leads to increased production, employment, sales and prices and thereby they bring about faster economic development.

3. Channelizing the Funds towards Productive Investment:

1. Banks invest the savings mobilized by them for productive purposes.
2. Capital formation is not the only function of commercial banks.

4. Encouraging Right Type of Industries:

1. Many banks help in the development of the right type of industries by extending loan to right type of persons.
2. In this way, they help not only for industrialization of the country but also for the economic development of the country.
3. They grant loans and advances to manufacturers whose products are in great demand.

5. Banks Monetize Debt:

1. Commercial banks transform the loan to be repaid after a certain period into cash, which can be immediately used for business activities.
2. Manufacturers and wholesale traders cannot increase their sales without selling goods on credit basis.

6. Finance to Government:

1. Government is acting as the promoter of industries in underdeveloped countries for which finance is needed for it.

2. Banks provide long – term credit to Government by investing their funds in Government securities and short-term finance by purchasing Treasury Bills.

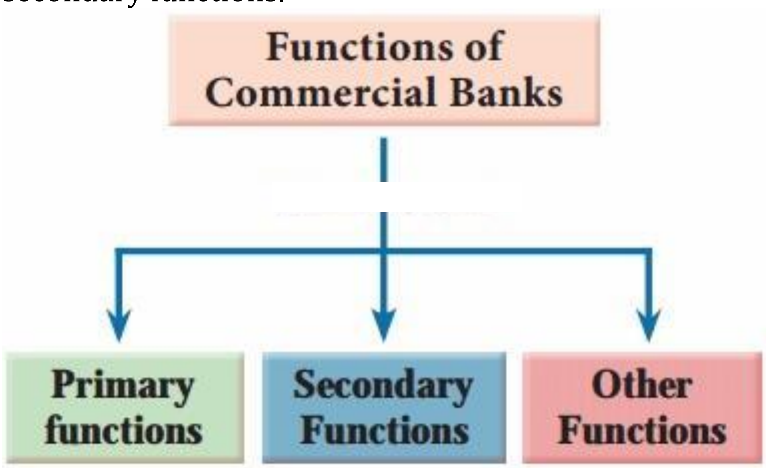
7. Employment Generation:

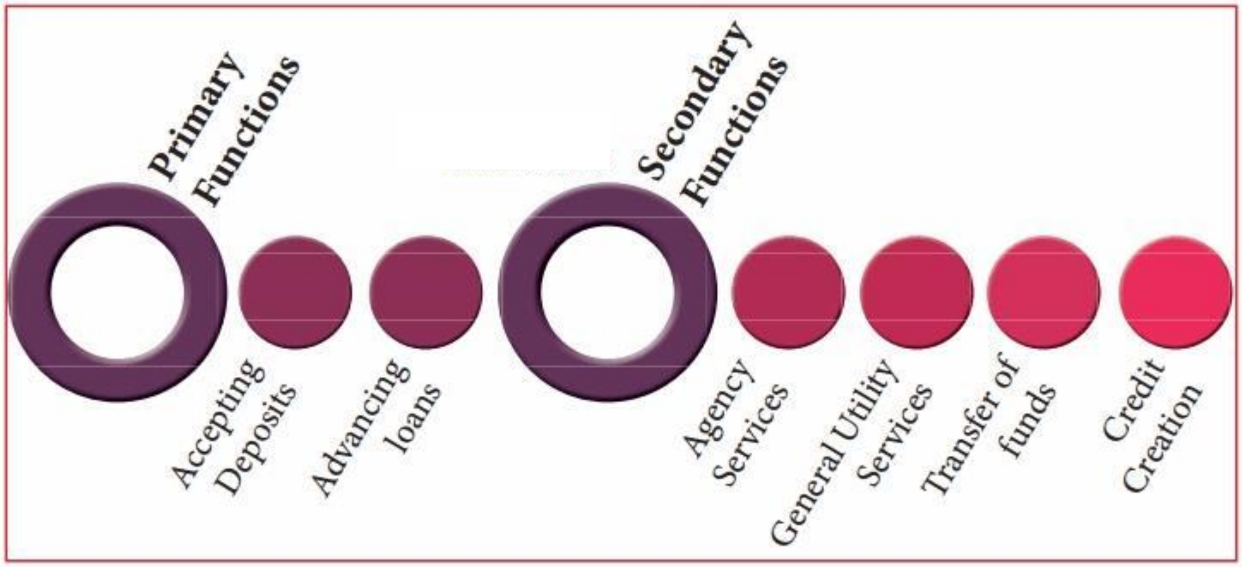
1. After the nationalization of big banks, banking industry has grown to a great extent.
2. Bank's branches are opened frequently, which leads to the creation of new employment opportunities.

8. Banks Promote Entrepreneurship:

- In recent days, banks have assumed the role of developing entrepreneurship particularly in developing countries like India by inducing new entrepreneurs to take up the well- formulated projects and provision of counseling services like technical and managerial guidance.

Question 36.
Elucidate the functions of Commercial Banks?
Answer:
The functions of commercial banks are broadly classified into primary functions and secondary functions.





Functions of Commercial Banks

(a) Primary Functions:
1. Accepting Deposits:
It implies that commercial banks are mainly dependent on public deposits.
There are two types of deposits

(I) Demand Deposits:
It refers to deposits that can be withdrawn by individuals without any prior notice to the bank. In other words, the owners of these deposits are allowed to withdraw money anytime by writing a withdrawal slip or a cheque at the bank counter or from ATM centres using debit card.

(II) Time Deposits:
It refers to deposits that are made for certain committed period of time. Banks pay higher interest on time deposits. These deposits can be withdrawn only after a specific time period by providing a written notice to the?bank.

2. Advancing Loans:

(a) It refers to granting loans to individuals and businesses. Commercial banks grant loans in the form of overdraft, cash credit, and discounting bills of exchange.

(b) Secondary Functions:
The secondary functions can be classified under three heads, namely, agency functions, general utility functions, and other functions.

1. Agency Functions:
It implies that commercial banks act as agents of customers by performing various functions.

(I) Collecting Cheques:
Banks collect cheques and bills of exchange on the behalf of their customers through clearing house facilities provided by the central bank.

(II) Collecting Income:
Commercial banks collect dividends, pension, salaries, rents, and interests on investments on behalf of their customers. A credit voucher is sent to customers for information when any income is collected by the bank.

(III) Paying Expenses:
Commercial banks make the payments of various obligations of customers, such as telephone bills, insurance premium, school fees, and rents.

2. General Utility Functions:
It implies that commercial banks provide some utility services to customers by performing various functions.

(I) Providing Locker Facilities:
Commercial banks provide locker facilities to its customers for safe custody of jewellery, shares, debentures, and other valuable items. This minimizes the risk of loss due to theft at homes. Banks are not responsible for the items in the lockers.

(II) Issuing Traveler's Cheques:
Banks issue traveler's cheques to individuals for traveling outside the country. Traveler's cheques are the safe and easy way to protect money while traveling.

(III) Dealing in Foreign Exchange:
Commercial banks help in providing foreign exchange to businessmen dealing in exports and imports. However, commercial banks need to take the permission of the Central Bank for dealing in foreign exchange.

3. Transferring Funds:
It refers to transferring of funds from one bank to another. Funds are transferred by means of draft, telephonic transfer, and electronic transfer.

4. Letter of Credit:
Commercial banks issue letters of credit to their customers to certify their creditworthiness.

(I) Underwriting Securities:
Commercial banks also undertake the task of underwriting securities. As public has full faith in the credit worthiness of banks, public do not hesitate in buying the securities underwritten by banks.

(II) Electronic Banking:
It includes services, such as debit cards, credit cards, and Internet banking.

(c) Other Functions:

(I) Money Supply:
It refers to one of the important functions of commercial banks that help in increasing money supply.

(II) Credit Creation:
Credit Creation means the multiplication of loans and advances. Commercial banks receive deposits from the public and use these deposits to give loans.

Question 37.
Describe the functions of Reserve Bank of India?
Answer:
Functions of Central Bank (Reserve Bank of India):
The Reserve Bank of India (RBI) is India's central banking institution, which controls the monetary policy of the Indian rupee.

1. Monetary Authority:
It controls the supply of money in the economy to stabilize exchange rate, maintain healthy balance of payment, attain financial stability, control inflation, strengthen banking system.

2. The issuer of currency:
The objective is to maintain the currency and credit system of the country. It is the sole authority to issue currency. It also takes action to control the circulation of fake currency.

3. The issuer of Banking License:
As per Sec 22 of Banking Regulation Act, every bank has to obtain a banking license from RBI to conduct banking business in India.

4. Banker to the Government:
It acts as banker both to the central and the state governments. It provides short-term credit. It manages all new issues of government loans, servicing the government debt outstanding and nurturing the market for government securities. It advises the government on banking and financial subjects.

5. Banker's Bank:
RBI is the bank of all banks in India as it provides loan to banks, accept the deposit of banks, and rediscount the bills of banks.

6. Lender of last resort:
The banks can borrow from the RBI by keeping eligible securities as collateral at the time of need or crisis, when there is no other source.

7. Act as clearing house:
For settlement of banking transactions, RBI manages 14 clearing houses. It facilitates the exchange of instruments and processing of payment instructions.

8. Custodian of foreign exchange reserves:
It acts as a custodian of FOREX. It administers and enforces the provision of Foreign Exchange Management Act (FEMA), 1999. RBI buys and sells foreign currency to maintain the exchange rate of Indian rupee v/s foreign currencies.

9. Regulator of Economy:
It controls the money supply in the system, monitors different key indicators like GDP, Inflation, etc.

10. Managing Government securities:
RBI administers investments in institutions when they invest specified minimum proportions of their total assets/liabilities in government securities.

11. Regulator and Supervisor of Payment and Settlement Systems:
The Payment and Settlement Systems Act of 2007 (PSS Act) gives RBI oversight authority for the payment and settlement systems in the country. RBI focuses on the development and functioning of safe, secure and efficient payment and settlement mechanisms.

12. Developmental Role:
This role includes the development of the quality banking system in India and ensuring that credit is available to the productive sectors of the economy. It provides a wide range of promotional functions to support national objectives.

It also includes establishing institutions designed to build the country's financial infrastructure. It also helps in expanding access to affordable financial services and promoting financial education and literacy.

13. Publisher of monetary data and other data:
RBI maintains and provides all essential banking and other economic data, formulating and

critically evaluating the economic policies in India. RBI collects, collates and publishes data regularly.

14. Exchange manager and controller:
RBI represents India as a member of the International Monetary Fund [IMF], Most of the commercial banks are authorized dealers of RBI.

15. Banking Ombudsman Scheme:
RBI introduced the Banking Ombudsman Scheme in 1995. Under this scheme, the complainants can file their complaints in any form, including online and can also appeal to the Ombudsman against the awards and the other decisions of the Banks.

16. Banking Codes and Standards Board of India:
To measure the performance of banks against Codes and standards based on established global practices, the RBI has set up the Banking Codes and Standards Board of India (BCSBI).

Question 38.
What are the objectives of Monetary Policy? Explain?
The specific objectives of monetary policy are Objectives of monetary policy:

1. Neutrality of Money
2. Stability of Exchange Rates
3. Price Stability
4. Full Employment
5. Economic Growth
6. Equilibrium in the Balance of Payments

1. Neutrality of Money:

1. Economists like Wicksteed, Hayek and Robertson are the chief exponents of neutral money.
2. They hold the view that monetary authority should aim at neutrality of money in the economy.
3. Monetary changes could be the root cause of all economic fluctuations.
4. According to neutralists, the monetary change causes distortion and disturbances in the proper operation of the economic system of the country.

2. Exchange Rate Stability:

1. Exchange rate stability was the traditional objective of monetary authority.
2. This was the main objective under Gold Standard among different countries.

3. When there was disequilibrium in the balance of payments of the country, it was automatically corrected by movements.

3. Price Stability:

1. Economists like Crustave Cassel and Keynes suggested price stabilization as a main objective of monetary policy.
2. Price stability is considered the most genuine objective of monetary policy.
3. Stable prices repose public confidence.
4. It promotes business activity and ensures equitable distribution of income and wealth.

4. Full Employment:

1. During world depression, the problem of unemployment had increased rapidly.
2. It was regarded as socially dangerous, economically wasteful and morally deplorable.
3. Thus, full employment was considered as the main goal of monetary policy.

5. Economic Growth:

1. Economic growth is the process whereby the real per capita income of a country increases over a long period of time.
2. It implies an increase in the total physical or real output, production of goods for the satisfaction of human wants.
3. Monetary policy should promote sustained and continuous economic growth by maintaining equilibrium between the total demand for money and total production capacity and further creating favourable conditions for saving and investment.

6. Equilibrium in the Balance of Payments:

- Equilibrium in the balance of payments is another objective of monetary policy which emerged significant in the post war years.