

# UNIT III SERVICE BUSINESS - I

## CHAPTER

# 10

## RESERVE BANK OF INDIA



### Learning Objectives

To enable the students to

- i. understand the meaning of central bank
- ii. gain knowledge about the origin of the Reserve Bank of India
- iii. describe the functions of the RBI

### 10.01 Need for the Study on Service Business

Educational, medical, hospitality and the like service business existed for centuries. Its prominence in the global trade is of recent origin i.e., after 1970. “The services sector has emerged as the most dynamic sector of the world economy, contributing almost one-third of world gross value added, half of world employment, one-fifth of global trade and more than half of the world foreign direct investment flows. It remains the key driver of India’s economic growth, contributing almost 66.1 per cent of its gross value added growth in 2015-16” - quotes the Indian Budget Estimate for 2015-16.

### 10.02 Banking Service

Banking service is the nerve center of industry and commerce in a country. It plays a vital role by providing the money required for their regular functioning and development. The word Bank, normally refers to commercial bank. There are many types of banks rendering different types of services. Central Bank is the most important one among them.

Every nation has one central bank. It is owned by the Government of the country. The control over the entire banking system of a country is vested with this apex bank. Central banks are known by different names in different countries. Their functions also vary from country to country. A Central bank is set up as an autonomous or quasi-autonomous body. Stability and growth of the country’s economy are the main goals of a Central bank. In India the Reserve Bank of India (RBI) is the central bank.

### 10.03 The Historical Development of Banks in India

- i. Bank of Hindustan was the first bank in India established in 1770 and was closed in 1932.

### Banking in ancient India

Rudimentary banking activities were carried out in India 3500 years ago (1500 CE). Interest earning and usury (unreasonable interest) were prevalent during the Vedic period. 1200 years before (8th century CE) the following concepts were in practice in Tamil Nadu: Patru-debit, Varavu-credit, Selavu-expenditure, Laabam-profit, Nashtam-loss, which all collectively known as 'Iynthogai'-trial balance-. 'Peredu' referred to Ledger



Bronze coins used during Raja Raja Chola Period 985-1014 CE

- ii. The General Bank of India was established in 1786 and was also liquidated in 1791.
  - iii. Bank of Calcutta was the first joint stock bank established in 1806. It was renamed as the Bank of Bengal in 1809.
  - iv. Bank of Bombay in 1840 and Bank of Madras in 1843 were established. "These banks are called Presidential Banks" (Bengal, Bombay and Madras only)
- 1881 witnessed the birth of 'Audh Bank', which was later renamed into Punjab National Bank in 1894 (19-05-1894).

These Presidential Banks were amalgamated into the Imperial Bank of India on 27 January 1921. It confined its operations to the urban sector and rural sector was completely neglected in those days. Therefore, after Independence, an Act was passed in Parliament to take over the Imperial Bank of India by the Government and State Bank of India came into being on July 1, 1955.

### Stamp of Imperial Bank of India



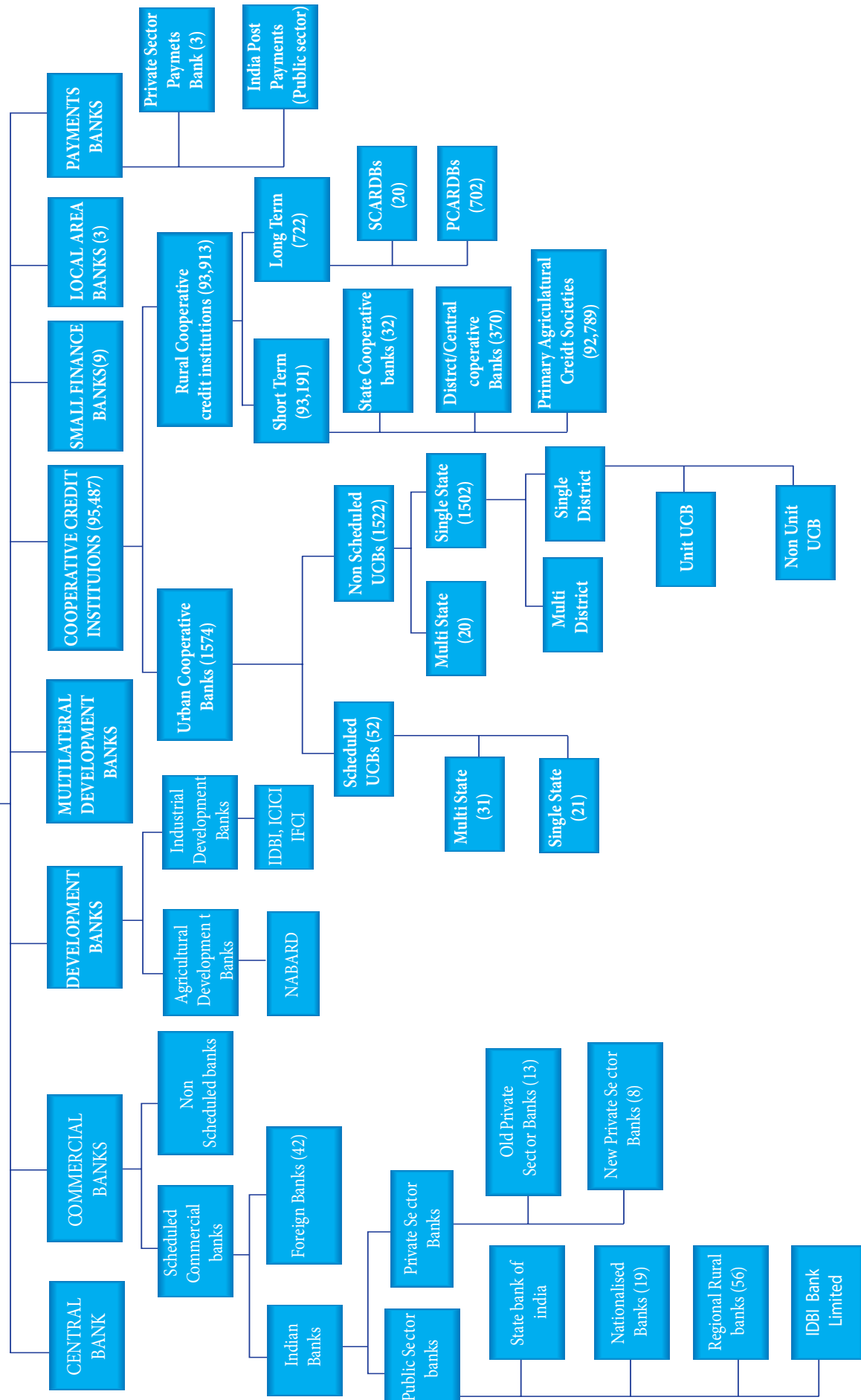
## 10.4 Bank Definition

According to Banking Regulation Act 1949, "Banking means the accepting for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, pay order or otherwise".



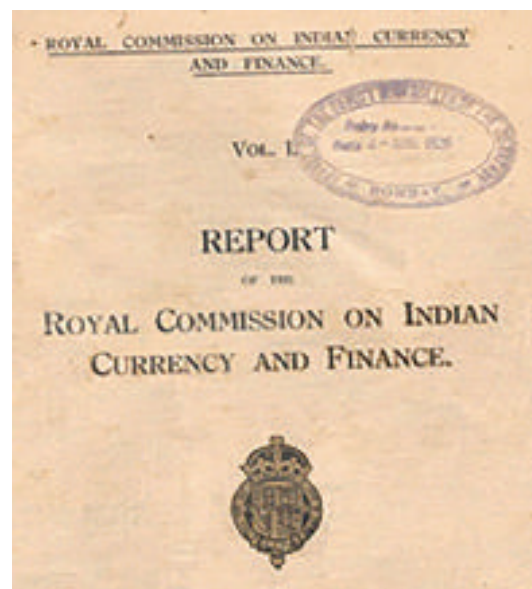
14 Banks were nationalised in India in the year 1969  
6 Banks were subsequently nationalised in India in the year 1980  
NABARD stands for .....

## TYPES OF BANKS



### 10.05 Definition of Central Bank

1. "A central bank being generally recognized as a bank which constitutes the apex of the monetary and banking structure of its country and which performs as best as it can, in the national economic interest."  
- De Kock. He gave a list of seven functions of central bank which are accepted by majority of economists.
2. "It may be defined as an institution charged with the responsibility of managing the expansion and contraction of the volume of money in the interest of the general public welfare." - Kent.
3. "A Central Bank is the bank in any country to which has been entrusted the duty of regulating the volume of currency and credit in that country."  
- Bank of International Settlement (BIS).



After independence, the Government of India passed Reserve Bank (Transfer to Public Ownership) Act, 1948 and took over RBI after paying appropriate compensation to the private shareholders. From January 1, 1949, RBI started functioning as a government owned central bank of India. It had three departments. The RBI was the central bank of Burma until 1947, and the central bank of Pakistan until June 1948.

### 10.06 Origin of RBI

The Imperial Bank of India carried out the note issue and other functions of the central bank. In 1926 the Hilton-Young Commission or the Royal Commission on Indian Currency and Finance (J. M. Keynes and Sir Ernest Cable were its members) made recommendation to create a central bank. As a result, the RBI Act 1934 was passed and RBI launched in operations from April 1, 1935. RBI was established with a share capital of ₹5 crores divided into shares of ₹100 each fully paid up. The entire share capital was owned by private shareholders. Its head office was in Calcutta and moved to Mumbai in 1937.

#### Emblem of RBI





## 10.07 Organisational Structure of RBI

The head office of the RBI is situated in Mumbai. This central office has 33 departments in 2017. It has four zonal offices in Mumbai, Delhi, Calcutta and Chennai functioning under local boards with deputy governors as their heads. It also has 19 regional offices and 11 sub-offices (2017). The RBI is governed by a Central Board of Directors. The 21 member board is appointed by the Government of India. It consists of;

- a. one governor and four deputy governors appointed for a period of four years,
- b. ten directors from various fields
- c. two Government officials
- d. four directors - one each from local boards.

## 10.08 Functions of RBI

The functions of the RBI can be grouped under three heads.

- A. Leadership and Supervisory Functions
- B. Traditional Functions and
- C. Promotional Functions.

### A. Leadership and Supervisory Functions

India being the fastest growing economy in the world, India is expected to play a major role in the world affairs by many countries. RBI being the banking institutional head of India has to be a part of global institutions. It has to transform the quality and size of banks in India to the level of banks in developed countries. Such functions get prominence in current scenario.

## 1. India's Representative in World Financial Institutions

In order to maintain consistency and harmony with international banking standards the RBI is associated with Basel Committee on Banking Supervision (BCBS, Switzerland) since 1997. RBI represents Government of India in International Bank for Reconstruction and Development (IBRD i.e. World Bank) and International Monetary Fund (IMF) in which India is a member since December 27, 1945.

## 2. Regulator and Supervisor of Indian Banking System

The broad guidelines for all banking operations in the country are formulated by the RBI. The RBI has power to issue licenses, control and supervise commercial banks under the RBI Act, 1934 and the Banking Regulation Act, 1949. It conducts inspection of the commercial banks and calls for returns and other necessary information from them.

## 3. Monetary Authority

The RBI formulates, implements and monitors the monetary policy of the country in order to maintain price stability, controlling inflationary trends and economic growth. It provides advices to the Government concerning agricultural finance, resource mobilization for implementing plans and legislation affecting banking and credit and international finance.

## 4. Closely Monitoring Economic Parameters

Broad economic parameters such as employment level, price levels and



production levels, trade cycles, foreign investment flows, balance of payments, financial markets, etc., are closely monitored by the RBI in order to achieve economic stability and growth. The Board of Financial Supervision (a committee of the Central Board of Directors) of the RBI meets at least once in a month (at times every day) to closely monitor all these current developments in the country.

## **5. Promptly Responding to New Challenges**

Whenever challenges arose before Indian Banking System, RBI promptly attend them by issuing Master Circulars and by organising committees to analyse, review and strengthen Indian Banking. A wealth of information can be found in every Master Circular or committee report. Example: Gopalakrishnan Committee on “Information security, Electronic Banking”, April, 2010

### **B. Traditional Functions**

#### **1. Banker and Financial Advisor to the Government**

The RBI accepts money into the Central and State Governments’ accounts and make payments on their behalf. It manages Government debt and is responsible for issue of new loans. It advises the government on the quantum, timing and terms of new loans. It provides ‘ways and means advances’ to the Governments to tide over temporary financial needs. It takes up the responsibility of investment of the surplus Government funds. Inter Government and inter departmental account adjustments are carried out by the RBI.

#### **2. Monopoly of Note Issue**

The RBI is the sole authority for the printing and issue of all currency notes in India except one rupee note. It is the duty of the RBI to ensure that sufficient number of good quality currency notes is available to the public. It exchanges currency and coins not fit for circulation. One rupee note and all coins are issued by the Ministry of Finance. Currency notes are printed at Nasik, Dewas, Salboni, Mysore and Hoshangabad. (Currency notes are never printed outside India).

#### **3. Banker’s Bank**

The relationship between RBI and other banks in the country is just like the relationship of a commercial bank with its customers. The RBI maintains the current accounts of all commercial banks in the country. All scheduled banks should deposit a percentage of cash reserve with RBI. All banks can receive loans from RBI by rediscounting of bills and against approved securities.

#### **4. Controller of Credit and Liquidity**

Controlling the credit money in circulation and the interest rate in the country is a major function of RBI. For this purpose, the RBI uses quantitative and qualitative methods of credit control. Ensuring the availability of sufficient cash and credit (liquidity) for business transactions and investment purposes in the economy is the responsibility of RBI.

##### **(a) Quantitative Methods of Credit Control**

The methods which influence the total volume of credit in Indian economy are called quantitative or general methods. An





increase in the first three measures will reduce the volume of money in circulation in India and vice versa.

- i. **Bank Rate Policy:** Bank rate refers to the rate at which the RBI rediscounts the bills given by the Scheduled banks.

Repo rate is the repurchase rate at which the RBI repurchases the Government securities (other securities also) from the Scheduled banks and gives loans. Reverse repo rate is the rate at which the RBI borrows money from Commercial banks by giving back those Government securities.

- ii. **Cash Reserve Ratio (CRR):** It is the ratio of Cash reserves with the RBI kept by Scheduled banks in proportion to the total Time and Demand Liabilities with them.
- iii. **Statutory Liquidity Ratio (SLR):** It is the ratio of money and money equivalents kept within the bank in proportion to the total Time and Demand Liabilities with them.
- iv. **Open Market Operations:** The RBI directly buys or sells the securities and bills in the money market either to decrease or to increase the total volume of money.

### **(b) Qualitative Credit Control Measures:**

These methods influence the volume of money in selected or particular sectors of the economy.

- i. **Rationing of credit:** Maximum limit is fixed for lending to certain sectors or specific purposes.

- ii. **Marginal Requirement:** It refers to the percentage of the value of securities submitted before issue of loans.

- iii. **Direct Action:** The RBI takes corrective actions on any bank or banks that does not follow its guidelines. It is called direct action.

- iv. **Moral Suasion:** The RBI puts pressure on the banks towards liberal or restricted lending during certain periods.

## **5. Lender of the Last Resort**

In times of emergency any bank in India can approach RBI for financial assistance. RBI provides them credit. When other sources of getting credit are exhausted, all banks can obtain loan from RBI and hence it is called lender of last resort.

## **6. Clearing House Services**

RBI acts as clearing house and maintains a clearing system for all commercial banks in India. The aggregate amount of cheques presented by a bank on other banks represents the claim by that bank on other banks. Similar claims are made by all the banks on every other bank in the clearing. A net settlement is arrived at the clearing house and accordingly the debit or credit entry is made in their current accounts. The cash reserves kept by the banks with RBI is utilised for this purpose. Clearing system saves time and eliminates paperwork and other difficult (otherwise tasks) tasks involved in inter-bank settlement. Though the RBI maintains the clearing house system only 14 clearing houses are owned by the RBI, 840 are managed by SBI and 6 by nationalised banks (total 860).



## 7. Custodian of Foreign Exchange Reserves

The RBI maintains a reserve of gold and foreign currencies. When foreign exchange reserves are inadequate for meeting balance of payments problem, it borrows from the International Monetary Fund (IMF). It also administers exchange control of the country and enforces the provisions of Foreign Exchange Management Act, 1999. Development and maintenance of foreign exchange market in India is also the function of RBI.

## 8. Maintenance of Foreign Exchange Rate

The RBI manages the exchange value of the rupee in order to facilitate India's foreign trade and payments. It ensures that normal short-term fluctuations in trade do not affect the exchange rate.

## 9. Collection and Publication of Authentic Data

It has also been entrusted with the task of collection and compilation of statistical information relating to banking and other financial sectors of the economy. RBI monthly bulletin, annual report and various committee reports contain treasures of authentic data.

### (C) Promotional Functions

The RBI performs a wide range of promotional functions to support national objectives.

### 1. Nurturing Banking Habits among the Public

It is the responsibility of RBI to maintain the public confidence in the banking system. It

protects the depositors' interest and aim at providing cost-effective banking services in order to include more people to avail banking services. It has also taken up the task of extending the banking system territorially and functionally to the unbanked areas.

### 2. Grievance Settlement Measures

RBI has appointed 20 (up to 2017) Banking Ombudsman in 20 state capitals. Banking Ombudsman Scheme is a speedy and inexpensive forum for resolution of customer complaints relating to certain services rendered by banks in India.

### 3. Agricultural Development

Agriculture industry is specified as priority sector by the RBI. The loans of all scheduled banks should consist of a percentage of loans to priority sector. It works in close association with NABARD to develop agriculture in India.

### 4. Promotion of Small Scale Industries

Micro Small and Medium Enterprises are included in the priority sector. All scheduled banks are required to open separate branches to specialise the financing of these industries.

### 5. Facilitates Foreign Trade

The RBI has simplified the rules for credit to exporters, through which they can now get long term advance from banks.

### 6. Supports Cooperative Sector

It helps cooperative banks by relaxing rules and providing indirect financing.

The rupee symbol was changed from Rs. to "₹" by the Government of India on July 15, 2010. This became necessary since other countries Indonesia, Mauritius, Nepal,



### Achievements of the RBI

1. RBI is one of the best central banks in the world. RBI took proactive measures during global economic slowdown in 2008-09 to save Indian economy.
2. National Bank for Agriculture and Rural Development (NABARD) was once a subsidiary of RBI. It is the first of its kind in the entire world.
3. The demonetisation in 2016-17 was a grand success because of the leadership role of the RBI.

Pakistan and the Seychelles also called their currencies rupee. Among global currencies Indian rupee is given the code INR (Indian Rupee) by the International Organisation for Standardisation.



### Demonetisation and Remonetisation

Government of India on the recommendation of the RBI carried out demonetization on November 8, 2016 in order to; a) to crack a whip against black money, b) drive out counterfeit currency in circulation, c) formalization of cash dependent business, and d) dismantling the financial strength of terrorism and naxalism. There were ₹ 17,118 billion value of ₹ 500 and ₹ 1000 currency notes in circulation before demonetisation. They consisted of around 2,203 crore pieces of notes. Of these 98.96% notes were returned to the banks. Subsequently remonetisation was carried out by issuing new ₹ 2000 and ₹ 500 currency notes.

### Key Terms

Amalgamation  
Lender of last resort  
Clearing house  
Banking ombudsman.



### For Own Thinking

A Debate on demonetisation and remonetisation



### For Future Learning

1. Know the Central Banks of Some other Countries  
The Central Bank of Russia is the Bank of Russia  
The Central Bank of Sri Lanka is the Central Bank of Sri Lanka
  - The Central Bank of the USA is \_\_\_\_\_
  - The Central Bank of Pakistan is \_\_\_\_\_
2. Mention the names of Central Banks in three other countries
  - i. ....
  - ii. ....
  - iii. ....
3. Understand the concepts monetary authority, banking system, financial system
4. Collection of names of RBI Governors
5. Collection of photo copy of currencies and coins in India.



### Case Study

1. Take up a recent newspaper clipping about RBI such as the measures taken to reduce NPA. etc.
2. Arrange for a group discussion on customer grievances and the cases settled by Banking Ombudsman offices.
3. Visit the RBI website [www.rbi.org.in](http://www.rbi.org.in) to read and have a discussion on any annual report, etc.



### Exercise



#### I. Choose the Correct Answer

1. Which bank has the power to issue bank notes?

- (a) Central bank
- (b) Commercial bank
- (c) Co-operative banks
- (d) Foreign banks

2. The Central bank of India is

- (a) PNB
- (b) SBI
- (c) ICICI
- (d) RBI

3. The Reserve Bank of India commenced its operations from April 1,

- (a) 1936
- (b) 1935
- (c) 1934
- (d) 1933

4. Bankers are not only dealers of money but also leaders in

- (a) Economic development
- (b) Trade development
- (c) Industry development
- (d) Service development

5. Which of the following is not a function of a central bank?

- (a) Guiding and regulating the banking system of a country
- (b) Deal with the general public
- (c) Acts essentially as Government banker
- (d) Maintains deposit accounts of all other banks

#### Answers

1. (a) 2. (d) 3. (b) 4. (a) 5. (b)

#### II. Very Short Answer Questions

1. What are the services included in Service businesses?
2. Write the meaning of 'Bank'.
3. Briefly explain about Central Bank.



### III. Short Answer Questions

1. What are the functions of RBI? (any 3)
2. Explain the origin of RBI.
3. Who are the persons involved in RBI administration?

### IV. Long Answer Questions

1. Classify the various functions of Reserve Bank of India. (any 5)

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