



Introduction

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Chapter 3: Money and Credit

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Introduction

Money as a Medium of Exchange

An intermediary instrument is used to facilitate the sale or purchase of goods between the buyer and the seller. In the olden days, both parties agreed to sell and buy each others' goods. This is known as the barter system. Here, the double coincidence of wants is an important feature because the goods are directly exchanged without the use of currency.

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Introduction

Later, metallic coins of gold, silver and copper were used as a medium of exchange in transaction. In modern economies, money functions as a medium of exchange. A person holding money can exchange it for any desired good and service in the market.

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Modern Forms of Money:

Modern forms of money are currencies and coins which are authorised by the Government of the country. The Reserve Bank of India (RBI) issues currency notes on behalf of the Government. The law legalises the use of currency notes as a medium of payment which everyone has to accept in all the transactions in India.



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Deposits with Banks:

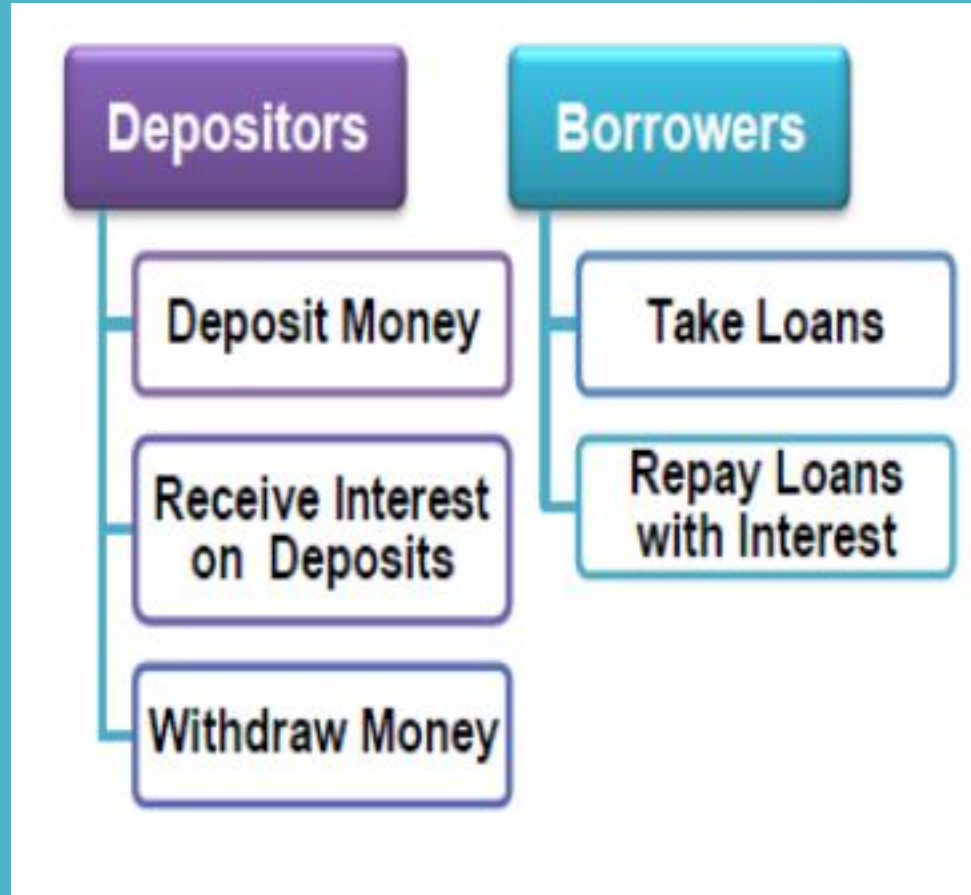
- **Cash Deposit:** Some people may hold certain amount of money with banks as deposits after meeting the day-to-day expenses. The banker accepts the person's deposit and pays an amount of interest on the deposits. The deposits in the bank account can be withdrawn on demand, and these deposits are called demand deposits.

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Deposits with Banks:

- **Cheques:** A bank account holder can make payment through a cheque for a specific amount instead of cash. A cheque is a paper with the instruction to the banker to pay the specified amount from the person's account to the person in whose name the cheque has been issued.

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Bank Loans:

The bank maintains only a certain portion of deposits as cash with them and most deposits are used to extend loans. People may require loans for their economic activities. Thus, banks make use of these deposits to meet the loan requirement of people. Banks charge a higher rate of interest on loans than the interest they pay on deposits. The difference between the amount of interest received and paid is their main source of income.

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Credits:

Credit refers to an agreement in which the lender supplies the borrower with money, goods or services in return for the promise of future payment. Generally, farmers take crop loans at the beginning of the season and repay the loan after harvest. If the income from the harvest is not sufficient to repay the credit, then a part of the land is sold to repay the credit. This is a situation called debt-trap.

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Terms of Credit:

- The loan agreement specifies that the borrower needs to pay interest to the lender along with the principal amount, and the lender may demand collateral against loans.
- Collateral is an asset which the borrower owns (such as land, livestock and bank deposits) and uses as a guarantee to a lender until the loan is repaid.
- Thus, the terms of credit comprise interest rate, collateral, documentation and the mode of repayment.

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Loans from Cooperatives:

Cooperative societies are the other major source of cheap credit in rural areas. It accepts deposits from farmers and uses it as collateral for obtaining loans from banks. Further, these funds are used to provide loans to members.

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Types of Credit in India:

Types of loan/credit can be grouped into formal and informal sector loans.

- Loans provided by banks and cooperatives are formal sector loans. The functions of formal sector loans are supervised by RBI. They are
 - o To maintain minimum cash balance as reserve in the bank.

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Types of Credit in India:

- o To provide loans not only to the profit-making business but also to the small-scale industries, small cultivators and borrowers.
- o To submit the periodical report to RBI regarding the total amount extended as credit and the rate of interest charged on credit.

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Types of Credit in India:

- Loans provided by moneylenders, traders, employers, relatives and friends are informal sector loans. There is no organisation to supervise the activities of the informal sector. These lenders charge a higher rate of interest than banks and cooperatives. Because of the higher interest rate, the amount to be repaid is greater than the income of the borrower. Thus, banks and cooperatives need to lend cheap and affordable credit for the country's development.

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Types of Credit in India:

Importance of formal and informal sources of credit for people in rural areas:

- o Only 50% of the total credit is provided by the formal sector and the remaining by the informal sector.**
- o The formal sector has to increase the credits in rural areas to reduce the dependence on credits from the informal sector.**
- o The formal sector loan has to expand and it is equally distributed to everyone.**

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Self-help Groups for Poor:

As the bank requires clear documentation and collateral to avail loans, the poor people depend on informal sources for loans. They are bound to pay high rates of interest for the absence of collateral. Therefore, self-help groups (SHGs) with 15–20 members (particularly women) are formed to pool their savings. A member's savings may vary from Rs 25 to Rs 100 or above based on their ability to save. Members of the group can take small loans at a reasonable rate of interest. This development of a group helps to obtain loans from banks.

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Self-help Groups for Poor:

Thus, SHGs help borrowers to receive loans without collateral at times of necessity such as for releasing mortgaged land, for meeting working capital needs and for acquiring assets (e.g. sewing machine, handloom and cattle).

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Advantages of Self Help Group (SHG):

- It assists borrowers in overcoming the lack of collateral issues.
- SHGs are the foundations of the rural poor's organisation.
- People can receive loans on schedule and at a fair interest rate for a number of objectives.
- It assists women in becoming financially self-sufficient.
- The group's frequent meetings give a forum for discussing and taking action on a variety of social concerns such as health, nutrition, domestic violence, and so on.

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