Agricultural Finance and cooperation

Lecture : 1

Agricultural finance: meaning, scope and significance, credit needs and its role in Indian agriculture

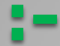
- ***Meaning of Agricultural Finance***

Agricultural finance generally means studying, examining and analyzing the financial aspects pertaining to farm business, which is the core sector of India. The financial aspects include money matters relating to production of agricultural products and their disposal.

- ***Definition of Agricultural finance:***

Murray (1953) defined agricultural. finance as "an economic study of borrowing funds by farmers, the organization and operation of farm lending agencies and of society's interest in credit for agriculture ."

Tandon and Dhondyal (1962) defined agricultural. finance "as a branch of agricultural economics, which deals with and financial resources related to individual farm units."



Nature and Scope of Agricultural Finance :-

- Agricultural finance studied at both micro and macro level. Macrofinance deals with different sources of raising funds for agriculture as a whole in the economy. It is also concerned with the lending procedure, rules, regulations, monitoring and controlling of different agricultural credit institutions. Hence macro-finance is related to financing of agriculture at aggregate level.
- Micro-finance refers to financial management of the individual farm business units. And it is concerned with the study as to how the individual farmer considers various sources of credit, quantum of credit to be borrowed from each source and how he allocates the same among the alternative uses with in the farm. It is also concerned with the future use of funds.
- Therefore, macro-finance deals with the aspects relating to total credit needs of the agricultural sector, the terms and conditions under which the credit is available and the method of use of total credit for the development of agriculture, while micro-finance refers to the financial management of individual farm business.

➢ *Significance of Agricultural Finance:*

1. Agril finance assumes vital and significant importance in the agro – socio – economic development of the country both at macro and micro level.
2. It is playing a catalytic role in strengthening the farm business and augmenting the productivity of scarce resources. When newly developed potential seeds are combined with purchased inputs like fertilizers & plant protection chemicals in appropriate / requisite proportions will result in higher productivity.
3. Use of new technological inputs purchased through farm finance helps to increase the agricultural productivity.
4. Accretion to in farm assets and farm supporting infrastructure provided by large scale financial investment activities results in increased farm income levels leading to increased standard of living of rural masses.

5. Farm finance can also reduce the regional economic imbalances and is equally good at reducing the inter–farm asset and wealth variations.
6. Farm finance is like a lever with both forward and backward linkages to the economic development at micro and macro level.
7. As Indian agriculture is still traditional and subsistence in nature, agricultural finance is needed to create the supporting infrastructure for adoption of new technology.
8. Massive investment is needed to carry out major and minor irrigation projects, rural electrification, installation of fertilizer and pesticide plants, execution of agricultural promotional programmes and poverty alleviation programmes in the country.

➢ ***Credit needs in Agriculture:***

Agricultural credit is one of the most crucial inputs in all agricultural development programmes. For a long time, the major source of agricultural credit was private moneylenders. But this source of credit was inadequate, highly expensive and exploitative. To curtail this, a multi-agency approach consisting of cooperatives, commercial banks ands regional rural banks credit has been adopted to provide cheaper, timely and adequate credit to farmers.

The financial requirements of the Indian farmers are for-

1. Buying agricultural inputs like seeds, fertilizers, plant protection chemicals, feed and fodder for cattle etc.
2. Supporting their families in those years when the crops have not been good.
3. Buying additional land, to make improvements on the existing land, to clear old debt and purchase costly agricultural machinery.
4. Increasing the farm efficiency as against limiting resources i.e. hiring of irrigation water lifting devices, labor and machinery.

Role of Agricultural Finance in Indian Agriculture :-

Farm finance assumes vital importance in the agro-socio-economic development of the country both at individual/micro level and at aggregate/macro level. Its catalytic role strengthens the farming business and augments the productivity of scarce resources. For instance, new potential seeds, when combined with purchased inputs like fertilizers and plant protection chemicals in requisite proportions result in higher productivity of resources. Application of new technological inputs obtained through farm finance helps boost agricultural productivity. Accretion to farm assets and farm supporting infrastructure provided by large scale financial investment activities entail increased farm income levels, leading to overall improvement in the living standards of rural masses. Farm finance can also contribute to reduction in regional economic imbalance and is equally good at narrowing down the inter-farm asset and wealth variations.

To quote Muniraj (1987): “Farm finance is the money extended to the farmers to stimulate the productivity of the farm resources. It is not a mere loan or credit or advance, it is an instrument to promote the well being of the society. Farm finance is not just a science to manage the money, but is an applied science of allocating scarce resources to derive the optimum output. It is a lever with forward and backward linkages to the economic development both at micro and macro levels”. Thus the role of farm finance in strengthening and development of both input and output markets in agriculture is crucial and significant. Indian agriculture is still traditional, subsistence and stagnant in nature, hence agricultural finance is needed to create the supporting infrastructure for adoption of new technology. Massive investment is needed to cary out major and minor irrigation projects, rural electrification and energisation, installation of fertilizers and chemical plants, execution of agricultural promotional programmes and poverty alleviation programmes in the country.

LECTURE – 2

Agricultural Credit – meaning, definition, need and classification

The word "credit" comes from the Latin word "***Credo***" which means "I believe". Hence credit is based up on belief, confidence, trust and faith. Credit is other wise called as loan.

Definition: Credit / loan is certain amount of money provided for certain purpose on certain conditions with some interest, which can be repaid sooner (or) later.

According to Professor ***Galbraith*** credit is the "temporary transfer of asset from one who has to other who has not"

- ***Credit needs in Agriculture:***

Agricultural credit is one of the most crucial inputs in all agricultural development programmes. For a long time, the major source of agricultural credit was private moneylenders. But this source of credit was inadequate, highly expensive and exploitative. To curtail this, a multi-agency approach consisting of cooperatives, commercial banks ands regional rural banks credit has been adopted to provide cheaper, timely and adequate credit to farmers.

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3. Buying additional land, to make improvements on the existing land, to clear old debt and purchase costly agricultural machinery.
4. Increasing the farm efficiency as against limiting resources i.e. hiring of irrigation water lifting devices, labor and machinery.

➢ *Credit is broadly classified based on various criteria:*

1. Based on time:

This classification is based on the repayment period of the loan. It is sub-divided in to 3 types

- **Short–term loans:** These loans are to be repaid within a period of 6 to 18 months. All crop loans are said to be short–term loans, but the length of the repayment period varies according to the duration of crop. The farmers require this type of credit to meet the expenses of the ongoing agricultural operations on the farm like sowing, fertilizer application, plant protection measures, payment of wages to casual labourers etc. The borrower is supposed to repay the loan from the sale proceeds of the crops raised.
- **Medium – term loans:** Here the repayment period varies from 18 months to 5 years. These loans are required by the farmers for bringing about some improvements on his farm by way of purchasing implements, electric motors, milch cattle, sheep and goat, etc. The relatively longer period of repayment of these loans is due to their partially-liquidating nature.
- **Long – term loans:** These loans fall due for repayment over a long time ranging from 5 years to more than 20 years or even more. These loans together with medium terms loans are called investment loans or term loans. These loans are meant for permanent improvements like levelling and reclamation of land, construction of farm buildings, purchase of tractors, raising of orchards ,etc. Since these activities require large capital, a longer period is required to repay these loans due to their non - liquidating nature.

2. Based on Purpose: *Based* on purpose, credit is sub-divided in to 4 types.

- **Production loans**: These loans refer to the credit given to the farmers for crop production and are intended to increase the production of crops. They are also called as seasonal agricultural operations (SAO) loans or short – term loans or crop loans. These loans are repayable with in a period ranging from 6 to 18 months in lumpsum.
- **Investment loans**: These are loans given for purchase of equipment the productivity of which is distributed over more than one year. Loans given for tractors, pumpsets, tube wells, etc.
- **Marketing loans:** These loans are meant to help the farmers in overcoming the distress sales and to market the produce in a better way. Regulated markets and commercial banks, based on the warehouse receipt are lending in the form of marketing loans by advancing 75 per cent of the value of the produce. These loans help the farmers to clear off their debts and dispose the produce at remunerative prices.

- **Consumption loans**: Any loan advanced for some purpose other than production is broadly categorized as consumption loan. These loans seem to be unproductive but indirectly assist in more productive use of the crop loans i.e. with out diverting then to other purposes. Consumption loans are not very widely advanced and restricted to the areas which are hit by natural calamities. These loams are extended based on group guarantee basis with a maximum of three members. The loan is to be repaid with in 5 crop seasons or 2.5 years whichever is less. The branch manager is vested with the discretionary power of anctioning these loans up to Rs. 5000 in each individual case. The rate of interest is around 11 per cent.

  The scheme may be extended to

  1) IRDP beneficiaries

  2) Small and marginal farmers

  3) Landless Agril. Laborers

  4) Rural artisans

  5) Other people with very small means of livelihood hood such as carpenters, barbers, washermen, etc.

3. Based on security: The loan transactions between lender and borrower are governed by confidence and this assumption is confined to private lending to some extent, but the
institutional financial agencies do have their own procedural formalities on credit transactions. Therefore it is essential to classify the loans under this category into two sub-categories viz., secured and unsecured loans.

- **Secured loans:** Loans advanced against some security by the borrower are termed as secured loans. Various forms of securities are offered in obtaining the loans and they are of following types.

I. Personal security: Under this, borrower himself stands as the guarantor. Loan is advanced on the farmer's promissory note. Third party guarantee may or may not be insisted upon (i.e. based on the understanding between the lender and the borrower)

II. Collateral Security: Here the property is pledged to secure a loan. The movable properties of the individuals like LIC bonds, fixed deposit bonds, warehouse receipts, machinery, livestock etc, are offered as security.

III. Chattel loans: Here credit is obtained from pawn-brokers by pledging movable properties such as jewellery, utensils made of various metals, etc.

IV. **Mortgage:** As against to collateral security, immovable properties are presented for security purpose For example, land, farm buildings, etc. The person who is creating the charge of mortgage is called mortgagor (borrower) and the person in whose favour it is created is known as the mortgagee (banker). Mortgages are of two types

a) **Simple mortgage:** When the mortgaged property is ancestrally inherited property of borrower then simple mortgage holds good. Here, the farmer borrower has to register his property in the name of the banking institution as a security for the loan he obtains. The registration charges are to be borne by the borrower.

b) **Equitable mortgage:** When the mortgaged property is self-acquired property of the borrower, then equitable mortgage is applicable. In this no such registration is required, because the ownership rights are clearly specified in the title deeds in the name of farmer-borrower.

V. Hypothecated loans: Borrower has ownership right on his movable and the banker has legal right to take a possession of property to sale on default (or) a right to sue the owner to bring the property to sale and for realization of the amount due. The person who creates the charge of hypothecation is called as hypothecator (borrower) and the person in whose favor it is created is known as hypothecate (bank) and the property, which is denoted as hypothecated property. This happens in the case of tractor loans, machinery loans etc. Under such loans the borrower will not have any right to sell the equipment until the loan is cleared off. The borrower is allowed to use the purchased machinery or equipment so as to enable him pay the loan installment regularly. Hypothecated loans again are of two types viz., key loans and open loans.

a) **Key loans :** The agricultural produce of the farmer - borrower will be kept under the control of lending institutions and the loan is advanced to the farmer . This helps the farmer from not resorting to distress sales.

b) **Open loans:** Here only the physical possession of the purchased machinery rests with the borrower, but the legal ownership remains with the lending institution till the loan is repaid.

c) Unsecured loans: Just based on the confidence between the borrower and lender, the loan transactions take place. No security is kept against the loan amount

4. Lender's classification: Credit is also classified on the basis of lender such as

i) Institutional credit: Here are loans are advanced by the institutional agencies like co-operatives, commercial banks. Ex: Co-operative loans and commercial bank loans.

ii) Non-institutional credit : Here the individual persons will lend the loans Ex: Loans given by professional and agricultural money lenders, traders, commission agents, relatives, friends, etc.

5. Borrower's classification: The credit is also classified on the basis of type of borrower. This classification has equity considerations.

i) Based on the business activity like farmers, dairy farmers, poultry farmers, pisiculture farmers, rural artisans etc.

ii) Based on size of the farm: agricultural labourers, marginal farmers, small farmers , medium farmers , large farmers ,

iii) Based on location hill farmers (or) tribal farmers.

6. **Based on liquidity:** The credit can be classified into two types based on liquidity

1) ***Self-liquidating loans***: They generate income immediately and are to be paid with in one year or after the completion of one crop season. Ex: crop loans.
2) ***Partially -liquidating***: They will take some time to generate income and can be repaid in 2-5 years or more, based on the economic activity for which the loan was taken. Ex: Dairy loans, tractor loans, orchard loans etc.,

7. Based on approach:

1) ***Individual approach***: Loans advanced to individuals for different purposes will fall under this category
2) ***Area based approach***: Loans given to the persons falling under given area for specific purpose will be categorized under this. Ex: Drought Prone Area Programme (DPAP) loans, etc
3) ***Differential Interest Rate (DIR) approach***: Under this approach loans will be given to the weaker sections @ 4 per cent per annum.

8. Based on contact:

1) ***Direct Loans***: Loans extended to the farmers directly are called direct loans. Ex: Crop loans.
2) ***Indirect loans***: Loans given to the agro-based firms like fertilizer and pesticide industries, which are indirectly beneficial to the farmers are called indirect loans.

LECTURE : 3

Credit Analysis-Economic Feasibility Tests- (3R`s of Returns and 5 C`s of credit)

The technological break-thorough achieved in Indian agriculture made the agriculture capital intensive. In India most of the farmers are capital starved. They need credit at right time, through right agency and in adequate quantity to achieve maximum productivity. This is from farmer's point of view. After preparing loan proposal when a farmer approaches an Institutional Financial Agency (IFA), the banker should be convinced about the economic viability of the proposed investments.

Economic Feasibility Tests of Credit

When the economic feasibility of the credit is being considered, three basic financial aspects are to be assessed by the banker. If the loan is advanced,

1. **Will it generate returns more than costs?**
2. **Will the returns be surplus enough, to repay the loan when it falls due?**
3. **Will the farmer stand up to the risk and uncertainty in farming?**

These three financial aspects are known as 3 R`s of credit, which are as follows

1. Returns from the proposed investment
2. Repayment capacity the investment generates
3. Risk- bearing ability of the farmer-borrower

The 3Rs of credit are sound indicators of credit worthiness of the farmers.

Returns from the Investment

This is an important measure in credit analysis. The banker needs to have an idea about the extent of likely returns from the proposed investment. The farmer's request for credit can be accepted only if he can be able to generate returns that enable him to meet the costs. Returns obtained by the farmer depend upon the decisions like,

A. What to grow? B. How to grow? C. How much to grow? D. When to sell? E. Where to sell?

Therefore the main concern here is that the farmers should be able to generate higher returns that should cover the additional costs incurred with borrowed funds.

Repayment Capacity: Repayment capacity is nothing but the ability of the farmer to repay the loan obtained for the productive purpose with in a stipulated time period as fixed by the lending agency. At times the loan may be productive enough to generate additional income but may not be productive enough to repay the loan amount. Hence the necessary condition. Here is that the loan amount should not only profitable but also have potential for repayment of the loan amount. Under such conditions only the farmer will get the loan amount.

The repayment capacity not only depends on returns, but also on several other quantitative and qualitative factors as given below.

Y= f(X1, X2, X3, X4 X5, X6, X7…)

Where, Y is the dependent variable ie., the repayment capacity

The independent variables viz., X1to X4 are considered as quantitative factors while X5 to X7 are considered as qualitative factors.

Causes for the poor repayment capacity of Indian farmer

1. Small size of the farm holdings due to fragmentation of the land.
2. Low production and productivity of the crops.
3. High family consumption expenditure.
4. Low prices and rapid fluctuations in prices of agricultural commodities.
5. Using credit for unproductive purposes
6. Low farmer's equity/ net worth.
7. Lack of adoption of improved technology.
8. Poor management of limited farm resources, etc

Measures for strengthening the repayment capacity

1. Increasing the net income by proper organization and operation of the farm business.
2. Adopting the potential technology for increasing the production and reducing the expenses on the farm.
3. Removing the imbalances in the resource availability.
4. Making the schedule of loan repayment plan as per the flow of income.
5. Improving the net worth of the farm households.
6. Diversification of the farm enterprises.
7. Adoption of risk management strategies like insurance of crops, animals and machinery and hedging to control price variations ,etc.,

Risk Bearing Ability

It is the ability of the farmer to withstand the risk that arises due to financial loss. Risk can be quantified by statistical techniques like coefficient of variation (CV), standard deviation (SD) and programming models. The words risk and uncertainty are synonymously used.

Some sources / types of risk

1. Production/ physical risk.
2. Technological risk.
3. Personal risk
4. Institutional risk
5. Weather uncertainty.
6. Price risk

Repayment capacity under risk

Deflated gross Income- (working expenses excluding the proposed crop loan+
family living expenses + other loans due+ miscellaneous expenditure)

Measures to strengthen risk bearing ability

1. Increasing the owner’s equity/net worth
2. Reducing the farm and family expenditure.
3. Developing the moral character i.e. honesty, integrity , dependability and feeling the responsibility etc. All these qualities put together are also called as credit rating.
4. Undertaking the reliable and stable enterprises (enterprises giving the guaranteed and steady income)
5. Improving the ability to borrow funds during good and bad times of crop production.
6. Improving the ability to earn and save money. A part of the farm earnings should be saved by the farmer so as to meet the uncertainty in future.
7. Taking up of crop, livestock and machinery insurance.

Next to 3 Rs of retuns, the other important tests applied to study the economic feasibility of the proposed investment activity are **5 C`s of credit** viz., character, capacity, capital, condition and commonsense.

1. Character:

The basis for any credit transaction is trust. Even though the bank insists up on security while lending a loan, an element of trust by the banker will also play a major role. The confidence of an institutional financial agency on its borrowers is influenced by the moral characters of the borrower like honesty, integrity, commitment, hard work, promptness etc. Therefore both mental and moral character of the borrowers will be examined while advancing a loan. Generally people with good mental and moral character will have good credit character as well.

2. Capacity:

It means capacity of an individual borrower to repay the loans when they fall due. It largely depends upon the income obtained from the farm.

C= f(Y) where C= capacity and Y = income

3. Capital:

Capital indicates the availability of money with the farmer - borrower. When his capacity and character are proved to be inadequate the capital will be considered. It represents the net worth of the farmer. It is related to the repayment capacity and risk bearing ability of the farmer - borrower.

4. Condition:

It refers to the conditions needed for obtaining loan from financial institutions i.e. procedure to be followed while advancing a loan.

5. *Commonsense*: This relates to the perfect understanding between the lender and the borrower in credit transactions. This is in fact *prima-facie* requirement in obtaining credit by the borrower.

Lecture: 4

Sources of agricultural finance: institutional and non-institutional

1. Non-institutional sources

(i) Moneylenders

- Professional moneylenders
- Agricultural moneylenders

(ii) Landlords

(iii) Traders and commission agents

(iv) Relatives and friends

2. Institutional sources

(i) Co-operatives

- PACSs/DCCBs/SCBs
- PCARDBs /SCARDBs

(ii) Commercial Banks

(iii) Regional Rural Banks

(iv) Others -

- AFC/ARDC (NABARD), RBI

Institutional Sources:

Co-operative Banks:

The co-operatives play a most important role in providing institutional credit for agriculture. For disbursement of short-term and medium-term credit, there is a three-tier structure consisting of the State Co-operative Bank (SCB) at the state level, the District Central Co-operative Bank (DCCB) at the district level and Primary Agricultural Credit Society (PACS) at the village level. In case of long-term credit disbursement, there is a two-tier structure consisting of a State Co-operative Agriculture and Rural Development Banks (SCARDBs) at state level and the Primary Co-operative Agriculture and Rural Development Banks (PCARDBs) at the village level. In some state, there is a unitary structure with State Co-operative Land Development Bank (SCLDB), financing the long-term credit to farmers. The credit and non-credit co-operative societies now have three-tier and two-tier structure in all the states except Bihar, Jammu and Kashmir, Maharashtra and Uttar Pradesh where the structure is unitary.

Commercial Banks:

Scheduled Banks: Scheduled Banks refer to those banks which have been included in the Second Schedule of Reserve Bank of India Act, 1934. In India, scheduled commercial banks are of three types:

Public Sector Banks: These banks are owned and controlled by the government. The main objective of these banks is to provide service to the society, not to make profits. Public sector banks are of two types: SBI and its subsidiaries.

SBI Associate Banks— Head Quarters and Foundation

State Bank of Bikaner & Jaipur— Jaipur (1963)
State Bank of Hyderabad— Hyderabad (8 August 1941)
State Bank of Mysore— Bangalore (1913)
State Bank of Patiala— Patiala (17 November 1917)
State Bank of Travancore— Thiruvananthapuram, (1945)

(b) **Other nationalized banks.**

There are currently 27 (19+6+2) public sector banks in India out of which 19 are nationalised banks and 6 are SBI and its associate banks, and rest 2 are IDBI Bank and Bharatiya Mahila Bank, which are categorised as other public sector banks. There are total 93 commercial banks in India.

Private Sector Banks: These banks are owned and controlled by private businessmen.

Old private Sector Banks:

The banks which were not nationalized at the time of bank nationalization that took place during 1969 and 1980 are known to be the old private sector banks. These were not nationalized, because of their small size and regional focus.

Bank name	Year of establishment
1. *Bank of punjab* merged with Centurion Bank to form Centurion Bank of Punjab in June 2005	1943
2. City Union Bank	1909
3. Dhanlaxmi Bank	1927
4. Federal Bank	1931
5. ING Vysya Bank Merged with kotak Mahindra bank	1930
6. Jammu and Kashmir Bank	1938
7. Karnataka Bank	1924
8. Karur Vysya Bank	1916
9. Lakshmi Vilas Bank	1926
10. abc and evergreen Bank	1965
11. SBI Commercial and international Bank	1955
12. South Indian Bank	1929
13. Tamilnad Mercantile Bank	1921
	1943
14. IDB Bank Ltd (reverse merged with parent IDBI in 2004 to become IDBI Bank. Making this public sector bank private)	1964
15. CATHOLIC SYRIAN BANK	1920

(b) New private Sector Banks:

The banks, which came in operation after 1991, with the introduction of economic reforms and financial sector reforms are called "new private sector banks".

Name	Year
1. Axis Bank (earlier UTI Bank)	1994
2. Bank of Punjab (actually an old generation private bank since it was not founded under post-1993 new bank licensing regime)	1989
3. Centurion Bank Ltd. (Merged Bank of Punjab in late 2005 to become Centurion Bank of Punjab, acquired by HDFC Bank Ltd. in 2008)	1994
4. Development Credit Bank (Converted from Co-operative Bank, now DCB Bank Ltd.)	1995
6. ICICI Bank (previously ICICI and then both merged;total merger SCICI+ICICI+ICICI Bank Ltd)	1996
7. IndusInd Bank	1994
8. Kotak Mahindra Bank	2003
9. Yes Bank	2005
10. Times Bank (Merged with HDFC Bank Ltd.)	2000
11. Global Trust Bank (India) (Merged with Oriental Bank of Commerce)	1994
12. Balaji Corporation Limited - Private Loan Company, not a Bank	2010
13. HDFC bank	1994
14. Bandhan bank	2015
15. IDFC Bank	2015

(iii) Foreign Banks: These banks are owned and controlled by foreign promoters.

Foreign banks with representative offices in India

List of foreign banks with representative offices in India (as of 31 January 2015):

Austrian bank

1. Raiffeisen Zentralbank

Belgian bank

1. KBC Bank

Canadian banks

1. Royal Bank of Canada
2. Toronto Dominion Bank

French Banks

1. Credit Industriel et Commercial
2. Natixis

German banks

1. Commerzbank
2. DZ Bank
3. KfW
4. Landesbank Baden-Württemberg

Italian banks

1. Banca Monte dei Paschi di Siena
2. Banca Popolare di Milano
3. Banca Popolare di Vicenza
4. Intesa Sanpaolo
5. UBI Banca

Malaysian bank

1. CIMB

Nepalese bank

1. Everest Bank

Norwegian bank

1. DNB ASA

Portuguese bank

1. Caixa Geral de Depositos

Russian banks

1. Gazprombank
2. Promsvyazbank
3. Vnesheconombank

South Korean banks

1. Industrial Bank of Korea
2. Kookmin Bank
3. Korea Exchange Bank

Spanish Banks

1. Banco de Sabadell
2. Banco Bilbao Vizcaya Argentaria
3. Caixabank

Sri Lankan bank

1. Hatton National Bank

Swedish banks

1. Skandinaviska Enskilda Banken
2. Zurcher Kantonalbank

Taiwanese banks

1. Bank of Taiwan
2. Mega International Commercial Bank

Turkish bank

1. Bank Asya

UAE banks

1. Emirates NBD
2. First Gulf Bank

UK bank

1. Duncan Lawrie

US banks

1. Bank of New York Mellon
2. Wells Fargo Bank

Lecture : 5

Commercial banks, social control and nationalization of commercial banks, micro financing including KCC

Commercial Banks:

Scheduled Banks: Scheduled Banks refer to those banks which have been included in the Second Schedule of Reserve Bank of India Act, 1934. In India, scheduled commercial banks are of three types:

(i) Public Sector Banks: These banks are owned and controlled by the government. The main objective of these banks is to provide service to the society, not to make profits. Public sector banks are of two types:

(a) SBI and its subsidiaries.

(b) Other nationalized banks.

(ii) Private Sector Banks: These banks are owned and controlled by private businessmen.

(a) Old private Sector Banks:

The banks which were not nationalized at the time of bank nationalization that took place during 1969 and 1980 are known to be the old private sector banks. These were not nationalized, because of their small size and regional focus.

(b) New private Sector Banks:

The banks, which came in operation after 1991, with the introduction of economic reforms and financial sector reforms are called "new private sector banks".

(iii) Foreign Banks: These banks are owned and controlled by foreign promoters.

Foreign banks with representative offices in India

List of foreign banks with representative offices in India (as of 31 January 2015):

Austrian bank

1. Raiffeisen Zentralbank

Belgian bank

1. KBC Bank

Canadian banks

1. Royal Bank of Canada
2. Toronto Dominion Bank

French Banks

1. Credit Industriel et Commercial
2. Natixis

German banks

1. Commerzbank
2. DZ Bank
3. KfW
4. Landesbank Baden-Württemberg

Italian banks

1. Banca Monte dei Paschi di Siena
2. Banca Popolare di Milano
3. Banca Popolare di Vicenza
4. Intesa Sanpaolo
5. UBI Banca

Malaysian bank

1. CIMB

Nepalese bank

1. Everest Bank

Norwegian bank

1. DNB ASA

Portuguese bank

1. Caixa Geral de Depositos

Russian banks

1. Gazprombank
2. Promsvyazbank
3. Vnesheconombank

South Korean banks

1. Industrial Bank of Korea
2. Kookmin Bank
3. Korea Exchange Bank

Spanish Banks

1. Banco de Sabadell
2. Banco Bilbao Vizcaya Argentaria
3. Caixabank

Sri Lankan bank

1. Hatton National Bank

Swedish banks

1. Skandinaviska Enskilda Banken
2. Zurcher Kantonalbank

Taiwanese banks

1. Bank of Taiwan
2. Mega International Commercial Bank

Turkish bank

1. Bank Asya

UAE banks

1. Emirates NBD
2. First Gulf Bank

UK bank

1. Duncan Lawrie

US banks

1. Bank of New York Mellon
2. Wells Fargo Bank

Social control and Nationalization of Banks

At the time of independence, the private sector banks were predominantly urban–oriented and under the control of a few industrialists which had not helped in achieving the basic socio–economic objectives. The credit needs of agriculture, small– scale industries and also weaker sections such as small traders and artisans continued to be ignored.

Even though for nearly three fourths of population, agriculture is the main occupation and contributed 50 per cent of gross domestic product, the total bank credit advanced to this sector was only one per cent as on June, 1967. The bulk of the deposits contributed by the public were being advanced to the industrial and trade sectors ignoring the prime sector of agriculture. In agriculture, the credit scene was dominated by the private money lenders who were charging exorbitant rates of interest.

All these situations compelled the imposition of social control over the banks in 1968. The main aim of social control was achieving of wider spread of bank credit to the priority sectors thereby reducing the authority of managing directors in advancing the loans.

Social control created the tempo of banks expansion, as evident by the addition of 785 new branches by the end of first half of 1969. But this did not make dent in increased canalization of credit to agricultural sector and to the other weaker sections.The directions issued by the Government were also ignored by many of the banks.

Under these circumstances the Government thought that the social control of banks was not sufficient for socio – economic development and nationalization of banks was considered as an alternative solution.

The Government of India on 19th July 1969, promulgated an ordinance called “The Banking companies Ordinance 1969” (Acquisition and Transfer of Undertakings).

Under this act 14 commercial banks having deposits of more than Rs. 50 crore each were nationalised and they were

1. Central Bank of India
2. Bank of India
3. Punjab National Bank
4. Bank of Baroda
5. United commercial Bank
6. Canara Bank
7. United Bank of India
8. Dena Bank
9. Union Bank of India
10. Allahabad Bank
11. Syndicate Bank
12. Indian Bank
13. Bank of Maharashtra
14. Indian overseas Bank

The objectives of nationalisation of banks (done by the former Prime Minister, Smt. Indira Gandhi) were

- Removal of control on banking business by a few industrialists.
- Elimination of the use of bank credit for speculative and unproductive purposes.
- Expansion of credit to priority areas which were grossly neglected like agriculture and small scale industries.
- Giving a professional bent to the bank management
- Encouragement of new entrepreneurs
- Provision of adequate training to bank staff.

The six banks nationalized in the second spell were

1. Punjab and Sind bank
2. Andhra Bank
3. New Bank of India
4. Vijaya Bank
5. Oriental Bank of Commerce
6. Corporation Bank.

Micro financing including Kisan Credit Card (KCC)

The Government of India introduced Kisan Credit Card scheme by banks during 1998 -99. The scheme was designed by NABARD. KCC aims at adequate and timely support from the banking system to the farmers for their short-term production credit needs in cultivation of crops, purchase of inputs etc in a flexible and cost effective manner.

Under this scheme, the farmers would be issued a credit card-cum pass book incorporating the name, address, particulars of land holding, borrowing limit, validity period etc and it will serve both as an identity card as well as facilitates the financial transactions.

Credit limit on the card may be fixed on the basis of operational holding, cropping pattern and scale of finance as recommended by the District Level Technical committee (DLTC) / State Level Technical committee (SLTC)

As per the recommendations of Sri R.V. Gupta committee in the year 1998, on the flow of credit to agricultural sector, apart from the total credit need, a 20 per cent of total peak level credit requirement (PLCR) will be given contingent credit need (with a maximum ceiling of Rs.10,000)

The KCC should normally valid up to 3 years and subject to annual review. The KCC will be considered as a non-performing asset (NPA) if it remains inoperative for a period of two successive crop seasons.

LECTURE – 6

Lead bank scheme, RRBs, scale of finance and unit cost

Lead Bank Scheme

The study group appointed by National Credit Council (NCC) in 1969 under the chairmanship of Prof. D.R.Gadgil recommended "Service Area Approach" for the development of financial structure.

In the same year i.e., 1969, RBI appointed Sri. F.K.F Nariman committee to examine recommendations of Prof. Gadgil's study group. The Nariman committee also endorsed the views of the Gadgil committee on "Service Area Approach" and recommended the formulation of "Lead Bank Scheme". The RBI accepted the Nariman's committee recommendations and lead bank scheme came into force from 1969.

Under the lead bank scheme, specific districts are allotted to each bank, which would take the lead role in identifying the potential areas for banking and expanding credit facilities.

Lead bank is the leading bank among the commercial banks in a district i.e. having maximum number of bank branches in the district. Lead bank acts as a consortium leader for coordinating the efforts of all credit institutions in the each allotted district for the development of banking and expansion of credit facilities.

The activities of lead bank can be dealt under two important phases:

Phase I: Survey of the lead district

The RBI has mentioned the following functions of lead bank under phase-I

- Surveying the potential areas for banking in the district.
- Identifying the business establishments which are so far dependent on non – institutional agencies for credit and financing them so as to raise their income.
- Examining the available marketing facilities for agricultural and industrial products and linking credit with marketing.
- Invoking cooperation among different banks in opening new bank branches.
- Estimating the credit gaps in various sectors of district economy.
- Developing contacts and maintaining liaison with the Government and other agencies.

Phase II-Preparation of credit Plans:

RBI emphasized that the lead bank should

- ✓ Formulate the bankable loaning schemes involving intensive use of labour, so as to generate additional employment.
- ✓ Disburse loans to increase the productivity of land in Agriculture and allied activities, so as to increase the income level.
- ✓ Give maximum credit to weaker sections of the society mainly for productive purposes.

Therefore lead bank scheme expects the banker to become an important participant in the developmental process in the area of its operation in rural areas, and the service area approach put the banker in the position of implementing the development plans.

(Regional Rural Banks – RRBs)

All India Rural Credit Review Committee (AIRCRC) under chairmanship of Sri. B. Venkatappaiah during the year 1969 was of the opinion that over large parts of the country the marginal and small farmers were deprived of having access to the cooperative credit both for production and investment purposes. This stressed the establishment of institutional financial agencies under public sector. Consequently the first spell of nationalization of banks was done with greater expectations, but the situation had not changed as per the expectations.

Hence, the Government of India appointed a working committee under the chairmanship of Sri. M. Narasimham to study the financial assistance rendered to the weaker sections in the rural areas. This working committee recommended the setting up of rural based institutional agencies called "Regional Rural Banks" after identifying shortcomings in the functioning of commercial banks and cooperatives. The Government of India accepted the recommendations of Sri.Narsimham committee and regional rural banks came in to existence through regional rural banks ordinance on 26th September, 1975. Initially only 5 RRBs were set up on pilot basis with sponsorship of commercial banks on October 2nd, 1975. This ordinance of 1975 was replaced by the Regional Rural Banks Act, 1976.

The list of five RRBs opened in the country is presented as under:

S No	Name of RRBs	Sponsoring banks	Head quarters
1.	Pratham Bank	Syndicate Bank	Moradabad (UP)
2.	Gorakhpur Bank	State Bank of India (SBI)	Gorakhpur (UP)
3.	Gaur Grameena Bank	United Bank of India	Malda (WB)
4.	Haryana Kshetriya Grameena Bank	Punjab National Bank	Bhiwani (Haryana)
5.	Jaipur Nagalur Anchalik Grameena Bank	United Commercial Bank	Jaipur (Rajasthan)

Role of RRB`S

1. To develop rural economy.
2. To provide credit for agriculture and allied activities.
3. To encourage small scale industries, artisans in the villages.
4. To reduce the dependence of weaker sections (Marginal farmers, small farmers and rural artisans) on private money lenders.
5. To fill the gap created by the moratorium on borrowings from private money lenders.
6. To make backward and tribal areas economically better by opening new bank branches.
7. To help the financially poor people in their consumption needs.

Functioning of RRBs:

1. Each RRB is being sponsored by a scheduled commercial bank. The operational area of each RRB is one or two districts. Each branch of RRB can serve a population of roughly 20,000 people.
2. Authorized share capital of each RRB is Rs. one crore, contributed by central government, state government and sponsoring commercial bank in the ratio of 50:15:35.
3. Issued capital for each RRB is Rs. 25 lakhs.
4. The rate of interest charged by RRBs on the loans is same as that of Primary Agriculture Credit Societies (PACS), but they are allowed to offer 0.5 per cent interest more than that of commercial banks on its deposits.
5. RRBs have simplified procedural formalities in giving agricultural finance on recommendations of Sri. Baldev Singh's working group. RRBs use local languages in their transactions. The cost of operation i.e. user charges are low as compared to that of commercial banks.

RRBs in Rajasthan:

Rajasthan Marudhara Gramin Bank, sponsored by State Bank of Bikaner and Jaipur having its Head Office at JODHPUR was formed w.e.f. 01-04-2014. The area of operation of the Bank is the combined area of operation of two erstwhile constituent Banks viz. Jalore, Pali, Sirohi, Jodhpur, Jaipur, Nagaur, Dausa, Jaisalmer, Barmer, Bikaner, Sriganganagar, Hanumangarh, Udaipur, Rajsamand and Pratapgarh Districts of the state.

Baroda Rajasthan Gramin Bank, sponsored by Bank of Baroda having its Head Office at AJMER was established on 3rd February 2006. It is having 267 branches providing banking services in 12 districts viz. Ajmer, Bundi, Dausa, Karauli, Sawai Madhopur, Tonk, Banswara, Bhilwara, Chittorgarh, Dungarpur, Churu & Bikaner.

Scale of finance

Definition:

It is an indicative cost taken as base cost depending on which the amount to be financed to a farmer is fixed.

Normally scale of finance is given in a range, as the cost of cultivation for a farmer practicing traditional methods of farming and that of a progressive farmer practicing modern methods of cultivation differs. The lower value of the range corresponds to the requirement of the former while the upper value corresponds to the latter.

Scale of finance is fixed for annual, perennial crops and livestock also. Livestock will have fixed costs of finance and they are termed as unit costs.

Factors influencing the scale of finance:

1. Type of the crop: It varies from crop to crop.
2. Nature of the crop: With in the same crop between the improved varieties and high yielding varieties (HYVs) the scale of finance differs.
3. Season: Scale of finance differs with season for the same crop.
4. Type of land: Based on the type of the land i.e. irrigated or dry the scale of finance differs with the same crop.
5. District/Area: For the same crop the scale of finance varies from district to district.

How Scale of Finance is fixed:

Scale of finance is fixed for each district by a committee known as District Level Technical Committee (DLTC).The members of DLTC constitute representatives of lead bank of that district, NABARD, local co-operative banks and commercial banks, officials of department of agriculture& animal husbandry etc. The meetings of DLTC are chaired by district magistrate/ district collector and convened by respective lead bank district manager. DLTC compiles technical survey report with the information obtained from NABARD. NABARD in turn obtains information from the state agricultural department every year, which will have the necessary details like what are crops grown, their extent etc. By using the above details a potential map is prepared. By using this one can list out the priority activities to be financed in each part of the district and extent to which these are to be financed. Finally cost of cultivation is estimated based on the market trends and needs. This scale of finance is not fixed and keeps on changing every year.

Unit cost

A unit cost is a total expenditure incurred by a company to produce, store and sell one unit of a particular product or service. This accounting measure includes all of the fixed and variable costs associated with the production of good or service. Unit cost is a crucial cost measure in the operational analysis of a company. Identifying and analyzing a company's unit cost is a quick way to check if a company is producing a product efficiently.

Lecture : 7

An introduction to higher financing institutions- RBI, NABARD, ADB, IMF

(Reserve bank of India) RBI:

The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934. The Central Office of the Reserve Bank was initially established in Calcutta but was permanently moved to Mumbai in 1937. The Central Office is where the Governor sits and where policies are formulated. Though originally privately owned, since nationalization in 1949, the Reserve Bank is fully owned by the Government of India.

Main Functions of RBI:

- **Monetary Authority**

Monetary authority or monetary policy refers to the use of instruments under RBI control to regulate availability, cost and user of money and credit and providing the citizens the appropriate available monetary facilities. Central bank does this to maintain pricing stability, low & stable inflation as well as promoting economic growth of country.

- **Issuer of Currency**

Reserve bank of India is the sole body who is authorized to issue currency in India. While coins are minted by GOI, the RBI works as an agent of GOI for distributing and handling of coins. RBI also works to prevent counterfeiting of currency by regularly upgrading security features of currency. For printing currency, RBI has four facilities at Dewas, Nasik, Mysore, Hyderabad, Mumbai& Nadiad. RBI is authorized to issue notes up to value of Rupees ten thousand.

- **Banker and Debt Manager to Government**

Just like individual need a bank to carry out their financial transactions effectively & efficiently, Government also need a bank to carry out its financial transactions. RBI serves this purpose for GOI. As banker to GOI, RBI maintains its accounts, receive payments into & make payments out of these accounts. RBI also helps GOI to raise money from public via issuing bonds & government approved securities.

- **Banker to Banks**

RBI also works as banker to all the scheduled commercial banks. All the banks in India maintain accounts with RBI which help them in clearing & settling interbank transactions and customer transactions smoothly & swiftly. Maintaining accounts with RBI help banks to maintain statutory reserve requirements.

- **Regulator of the Banking System**

RBI has the responsibility of regulating the nation's financial system. As a regulator and supervisor of Indian banking system it ensures the financial stability & public confidence in banking system. RBI use methods like On-site inspections, off-site surveillance, scrutiny & periodic meetings to supervise new bank licenses, setting capital requirements and regulating interest rates in specific areas.

- **Manager of Foreign Exchange**

With increasing integration of the Indian economy with the global economy arising from greater trade and capital flows, the foreign exchange market has evolved as a key segment of the Indian financial market and RBI has an important role to play in regulating & managing this segment. RBI manages forex and gold reserves of the nation.

Regulator and Supervisor of the Payment and Settlement Systems

Payment and settlement systems play an important role in improving overall economic efficiency. The Payment and Settlement Systems Act of 2007 (PSS Act) gives the Reserve Bank oversight authority, including regulation and supervision, for the payment and settlement systems in the country. In this role, we focus on the development and functioning of safe, secure and efficient payment and settlement mechanisms. Two payment systems National Electronic Fund Transfer (NEFT) and Real Time Gross Settlement (RTGS) allow individuals, companies and firms to transfer funds from one bank to another. These facilities can only be used for transferring money within the country.

This is one of the most critical role RBI plays in building country's financial structure. Key tools in this effort include Priority sector lending such as Agriculture, micro and small enterprise (MSE), housing and education. RBI work towards strengthening and supporting small local banks and encourage banks to open branches in rural areas to include large section of society in banking net.

National bank for agriculture and rural development (NABARD) :

Agricultural Refinance Corporation (ARC) was established in 1963 to support investment credit needs for agricultural development. It was renamed as Agricultural Refinance and Development Corporation (ARDC) in 1972. The NABARD came into existence on 12 July 1982 under the recommendation of a committee to review the arrangements for institutional credit for agriculture and rural development (CRAFICARD) headed by Shri B. Sivaraman. It replaced the Agricultural Credit Department (ACD) and Rural Planning and Credit Cell (RPCC) of Reserve Bank of India, and Agricultural Refinance and Development Corporation (ARDC). Head quartered at Mumbai.

1. Mission

Promoting sustainable and equitable agriculture and rural prosperity through effective credit support, related services, institution development and other innovative initiatives.

2. Types of Services

In order to achieve this mission, NABARD undertakes a number of inter-related activities / services which fall under three broad categories viz., credit dispensation, developmental and promotional and supervisory.

A. Credit Dispensation Services

- Prepares for each district annually a potential linked credit plan which forms the basis for district credit plans
- Participates in finalization of Annual Action Plan at block, district and state levels
- Monitors implementation of credit plans at above levels.
- Provides guidance in evolving the credit discipline to be followed by the credit institutions in financing production, marketing and investment activities of rural farm and non-farm sectors
- Provides refinance facilities to the institution as under

B. Developmental & Promotional Services

The developmental role of NABARD can be broadly classified as:- Nurturing and strengthening of - the Rural Financial Institutions (RFIs) like SCBs/SCARDBs, CCBs, RRBs etc. by various institutional strengthening initiatives.

❖ Fostering the growth of the SHG Bank linkage programme and extending

❖Essential support to SHPIs NGOs/VAs/ Development Agencies and client banks.

❖Development and promotional initiatives in farm and non-farm sector.

❖Extending assistance for Research and Development. Acting as a catalyst for Agriculture and rural development in rural areas.

Supervisory Services

As the Apex Development Bank, NABARD shares with the Central Bank of the country (Reserve Bank of India) some of the supervisory functions in respect of Cooperative Banks and RRBs.

3. Customers of the Bank

The customers of NABARD are Cooperative Banks, State Land development Bank, Scheduled Commercial Banks, Urban Cooperative Banks and such financial institutions as may be approved by RBI. Further, NABARD also deals with voluntary agencies/NGOs besides various State Governments.

Asian Development Bank (ADB):

The Asian Development Bank (ADB) is a regional development bank established on 22 August 1966 to facilitate economic development of countries in Asia. The bank admits the members of the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP, formerly known as the United Nations Economic Commission for Asia and the Far East) and non-regional developed countries. From 31 members at its establishment, ADB now has 67 members - of which 48 are from within Asia and the Pacific and 19 outside. The ADB revise its interest rates twice in a year on Jan 1st and July 1st.

ADB was modeled closely on the World Bank, and has a similar weighted voting system where votes are distributed in proportion with member's capital subscriptions. Headquartered at Mandaluyong City, Metro Manila, Philippines.

International Monetary Fund (IMF):

The International Monetary Fund (IMF) is an international organization.
At present 185 countries are the members of IMF. Its headquarters is located at Washington, DC., USA.

Origin:

*A*fter the Second World War, many countries felt the need to have an organization to get help in monetary matters between countries. To begin with, 29 countries discussed the matter, and signed an agreement. The agreement was the Articles of Association of the International Monetary Fund. IMF came in to being in December, 1945.

Membership:

Any country can apply to become a member of the IMF. When a country applies for membership, the IMF's Executive Board examines the application. If found suitable, the Executive Board gives its report to IMF's Board of Governors. After the Board of Governors clears the application, the country may join the IMF. However, before joining, the country should fulfill legal requirements, if any, of its own country.

Every member has a different voting right. Likewise, every country has a different right to draw funds. This depends on many factors, including the member country's first subscription to the IMF.

Functions:

The IMF does a number of supervisory works relating to financial dealings between different countries. Some of the works done by IMF are:

- ❖ Helping in international trade, that is, business between countries
- ❖ Looking after exchange rates
- ❖ Looking after balance of payments
- ❖ Helping member countries in economic development

Management:

A Board of Directors manages the IMF. One tradition has governed the selection of two most senior posts of IMF. Firstly, IMF's managing director is always European. IMF's president is always from the United States of America.

The major countries of Europe and America control the IMF. This is because they have given more money to IMF by way of first subscriptions, and so have larger share of voting rights.

Lecture : 8

World bank, insurance and credit guarantee corporation of India and cost of credit

World Bank:

The World Bank was originally established (1944) to support reconstruction in Europe after World War II, but has since reframed its mission and expanded its operations both geographically and substantively. Today, the Bank's mission is to reduce extreme poverty and boost shared prosperity around the world. It has over 188 member countries and provides over $30 billion annually for activities ranging from agriculture to trade policy, from health and education to energy and mining. The World Bank provides funding for bricks-and-mortar projects, as well to promote economic and policy prescriptions it believes will promote economic growth.

The World Bank is not a bank in the common sense of the word. A single person cannot open an account or ask for a loan. Rather, the Bank provides loans, grants and technical assistance to countries and the private sector to reduce poverty in developing and transition countries.

The World Bank Group is actually comprised of five separate arms. Two of those arms – the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) work primarily with governments and together are commonly known as “the World Bank”. Two other branches – the International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA) – directly support private businesses investing in developing countries. The fifth arm is the International Center for Settlement of Investment Disputes (ICSID), which arbitrates disagreements between foreign investors and governments. This webpage outlines key features of the two arms that are now collectively referred to as the World Bank: IBRD and IDA.

Objectives of the World Bank

- This includes providing long term capital to its member nations for economic development and reconstruction.
- Thus, it helps in inducing long term capital for improving the balance of payments and thereby balancing international trade.
- Also, it helps by providing guarantees against loads granted to large and small units and other projects for the member nations.
- So, it ensures that the development projects are implemented. Thus, it brings a sense of transparency for a nation from war-time to a peaceful economy.
- Also, it promotes the capital investment for member nations by providing a guarantee for capital investment and loans.
- So, if the capital investment is not available than it provides the guarantee and then IBRD provides loans for promotional activities on specific conditions.

Functions of the World Bank

- It helps the war-devasted countries by granting them loans for reconstruction.
- Thus, they provide extensive experience and the financial resources of the bank help the poor countries increase their economic growth, reducing poverty and a better standard of living.
- Also, it helps the underdeveloped countries by granting development loans.
- So, it also provides loans to various governments for irrigation, agriculture, water supply, health, education, etc.
- It promotes foreign investments to other organizations by guaranteeing the loans.
- Also, the world bank provides economic, monetary, and technical advice to the member countries for any of their projects.
- Thus, it encourages the development of of-industries in underdeveloped countries by introducing the various economic reforms.

Purposes of the World Bank

- ➢It wants to create an environment that is a pro-investment.
- ➢Also, it wants to improve the omic stability by reducing poverty.
- ➢So, it is working towards achieving sustainable growth.
- ➢Increasing the opportunities for jobs and business in member nations which are underdeveloped.
- ➢Through investment, it plans to promote the socio-economic status of the society.
- ➢Also, it wants to ensure that the judicial and legal systems are developed and individual rights are protected.
- ➢Strengthing the government of its member nations by promoting education.
- ➢Combating corruption and to ensure that there are adequate training opportunities and research facilities.
- ➢It wants to provide loans with low-interest rates and interest-free credits.

Insurance and Credit Guarantee Corporation of India :

Deposit Insurance and Credit Guarantee Corporation (DICGC) is a subsidiary of Reserve Bank of India. It was established on on January 1, 1962 under Deposit Insurance and Credit Guarantee Corporation Act, 1961 for the purpose of providing insurance of deposits and guaranteeing of credit facilities. DICGC insures all bank deposits, such as saving, fixed, current, recurring deposits for up to the limit of Rs. 100,000.

The concept of insuring deposits kept with banks received attention for the first time in the year 1948 after the banking crisis in Bengal. The question came up for reconsideration in the year 1949, but it was decided to hold it in abeyance till the Reserve Bank of India ensured adequate arrangements for inspection of banks. Subsequently, in the year 1950, the Rural Banking Enquiry Committee also supported the concept. Serious thought to the concept was, however, given by the Reserve Bank of India and the Central Government after the crash of the Palai Central Bank Ltd., and the Laxmi Bank Ltd. in1960. The Deposit Insurance Corporation (DIC) Bill was introduced in the Parliament on August 21, 1961. After it was passed by the Parliament, the Bill got the assent of the President on December 7, 1961 and the Deposit Insurance Act, 1961 came into force on January 1, 1962.

The Deposit Insurance Scheme was initially extended to functioning commercial banks only. This included the State Bank of India and its subsidiaries, other commercial banks and the branches of the foreign banks operating in India.

Since 1968, with the enactment of the Deposit Insurance Corporation (Amendment) Act, 1968, the Corporation was required to register the 'eligible cooperative banks' as insured banks under the provisions of Section 13 A of the Act. An eligible co-operative bank means a co-operative bank (whether it is a state co-operative bank, a central co-operative bank or a primary co-operative bank) in a state which has passed the enabling legislation amending its Co-operative Societies Act, requiring the State Government to vest power in the Reserve Bank to order the Registrar of Cooperative Societies of a state to wind up a co-operative bank or to supersede its committee of management and to require the registrar not to take any action for winding up, amalgamation or reconstruction of a co-operative bank without prior sanction in writing from the Reserve Bank of India.

Further, the Government of India, in consultation with the Reserve Bank of India, introduced a Credit Guarantee Scheme in July 1960. The Reserve Bank of India was entrusted with the administration of the scheme, as an agent of the Central
Government, under Section 17 (11 A)(a) of the Reserve Bank of India Act, 1934 and was designated as the Credit Guarantee Organization (CGO) for guaranteeing the advances granted by banks and other credit institutions to small scale industries. The Reserve Bank of India operated the scheme up to March 31, 1981.

The Reserve Bank of India also promoted a public limited company on January 14, 1971, named the Credit Guarantee Corporation of India Ltd. (CGCI). The main thrust of the Credit Guarantee Schemes, introduced by the Credit Guarantee Corporation of India Ltd., was aimed at encouraging the commercial banks to cater to the credit needs of the hitherto neglected sectors, particularly the weaker sections of the society engaged in non-industrial activities, by providing guarantee cover to the loans and advances granted by the credit institutions to small and needy borrowers covered under the priority sector.

With a view to integrating the functions of deposit insurance and credit guarantee, the above two organizations (DIC and CGCI) were merged and the present Deposit Insurance and Credit Guarantee Corporation (DICGC) came into existence on July 15, 1978. Consequently, the title of Deposit Insurance Act, 1961 was changed to 'The Deposit Insurance and Credit Guarantee Corporation Act, 1961. Effective from April 1, 1981, the corporation extended its guarantee support to credit granted to small scale industries also, after the cancellation of the Government of India's credit guarantee scheme. With effect from April 1, 1989, guarantee cover was extended to the entire priority sector advances, as per the definition of the Reserve Bank of India. However, effective from April 1, 1995, all housing loans have been excluded from the purview of guarantee cover by the corporation.

Objective of DICGC: To contribute to stability and public confidence in the banking system through provision of deposit insurance and credit guarantee to small depositors and borrowers.

Cost of credit:

The cost of credit is the additional amount, over and above the amount borrowed, that the borrower has to pay. It includes interest, arrangement fees and any other charges. Some costs are mandatory, required by the lender as an integral part of the credit agreement.

Thanks