Types of Business

Business

A business is an organization that uses economic resources or inputs to provide goods or services to customers in exchange for money or other goods and services.
Business organizations come in different types and forms.

3 types of business

There are three major types of businesses:

1. **Service Business**
   A service type of business provides intangible products (products with no physical form). Service type firms offer professional skills, expertise, advice, and other similar products.
   Examples of service businesses are: schools, repair shops, hair salons, banks, accounting firms, and law firms.
2. **Merchandising Business**
   This type of business buys products at wholesale price and sells the same at retail price. They are known as "buy and sell" businesses. They make profit by selling the products at prices higher than their purchase costs. A merchandising business sells a product without changing its form.
   Examples are: grocery stores, convenience stores, distributors, and other resellers.
3. **Manufacturing Business**
   Unlike a merchandising business, a manufacturing business buys products with the intention of using them as materials in making a new product. Thus, there is a transformation of the products purchased. A manufacturing business combines raw materials, labor, and factory overhead in its production process. The manufactured goods will then be sold to customers.
   Hybrid Business
   Hybrid businesses are entities that may be classified in more than one type of business. A restaurant, for example, combines ingredients in making a fine meal (manufacturing), sells a bottle of cold drink (merchandising), and caters to customer's orders (service).
   Nonetheless, these entities may be classified according to their major business interest. In that case, restaurants are more of the service type – they provide dining services.

Forms of Business Organization

The following are the basic forms of business ownership:

I. Sole Proprietorship

A sole proprietorship is a business owned by only one person. It is easy to set-up and is the least costly among all forms of ownership.

The sole proprietorship form is usually adopted by small business entities because they are relatively easy to start up. Also, the owner is entitled to all the profit that the sole proprietorship collects. On the other hand, sole proprietorships can be risky because there is no separation between the owner and the business. The owner faces unlimited liability. In other words, the owner remains personally liable for any losses or debts that the sole proprietorship incurs. They can also be held legally responsible for violations committed by the business or its employees.

A sole proprietorship does not involve many of the complex filing requirements associated with other types of business structures such as corporations. Sole proprietorships allow persons to report business income and expenses on their individual tax returns.

Advantages of a Sole Proprietorship

There are many reasons why a person would choose to start their business up using a sole proprietorship structure. Some of the main advantages of sole proprietorships include:

1. **Ease of formation:**
   Starting a sole proprietorship is much less complicated than starting a formal corporation, and also much cheaper. The proprietorship can be named after the owner, or a fictitious name can be used to enhance the business' marketing.

2. **Decision making:**
   Control over all business decisions remains in the hands of the owner. The owner can also fully transfer the sole proprietorship at any time as they deem necessary.

3. **Tax benefits:**
   The owner of a sole proprietorship is not required to file a separate business tax return. Instead, they will list business information and figures within their individual tax return. This can save additional costs on accounting and tax filing. The business will be taxed at the rates applied to personal income, not corporate tax rates.

4. **Employment:**
   Sole proprietorships can hire employees. This leads to job creation which is greatly encouraged specially in developing countries.

Disadvantages of Sole Proprietorships
Forming a sole proprietorship does involve some risks, mainly to the owner of the business, as legally speaking they are not treated separately from the business. Some disadvantages of sole proprietorships are:

1. **Liability:**
   The business owner will be held directly responsible for any losses, debts, or violations coming from the business. For example if the business must pay any debts, these will be satisfied from the owner's own personal funds. The owner could be sued for any unlawful acts committed by the employees.

2. **Lack of "continuity":**
   The business does not continue if the owner becomes deceased or incapacitated, since they are treated as one and the same.

3. **Difficulty in raising capital:**
   Since the initial funds are usually provided by the owner, it can be difficult to generate capital. Sole proprietorships do not issue stocks or other money-generating investments like corporations do

So, while sole proprietorships do not necessarily create more liabilities, they do expose the business owner to a risk of being sued. Lawsuits can be filed against the business owner for legal violations, as well as to collect any outstanding debts.

II. Partnership
A partnership is a business owned by two or more persons who contribute resources into the entity. The partners divide the profits of the business among themselves. In general partnerships, all partners have unlimited liability.
Definition of Partnership as per Indian Partnership Act, 1932:
"Partnership is the relation between persons who have agreed to share profits of a business carried on by all or any one of them acting for all."
Persons who have agreed to enter into partnership with one another are called individually called "partners" and collectively a "firm", and the name under which their business is carried on is called the "firm name."

Essential elements of Partnership:
From the statutory definition of partnership, the essential elements of partnership can be understood as:

1. Persons: There should be at least two persons to form a partnership or partnership firm.
2. Agreement: There should be an agreement between those persons who are forming a partnership. The agreement is the foundation of partnership. Partnerships can only arise out of contract and not from status
3. Profits of a business: There should be a business carried on by the partnership and that too with an intention to make and share profits of that business. Therefore it follows that - no business no

partnership, and no intention to share profit, no partnership. Though no specific mention of loss is made, it is assumed that sharing profits implies sharing losses also

4. Carried on by all or any one of them acting for all: The business may be carried on by any one or more than one of the partners. "Acting for all" implies that a partner conducting the business on should be understood as conducting business on behalf of all the partners. Each partner would be responsible for the acts of every other partner in relation to the firm. As far as outsiders are concerned, the partners and the firm are one and the same.
5. Mutual agency: A partner is an agent of the firm for the acts that he does on behalf of the firm, whereby he can bind the other partners for such acts. The other partners would be in the position of a principal for such acts. With regards too other partners' acts, he will be in a position of a principal.

Advantages of Partnership

1. Easy to set up
2. More capital can be brought into the business.
3. Partners bring new skills and ideas to a business
4. Decision making can be much easier with more brains to think about a problem.
5. Partners share responsibilities and duties of the business.
6. Division of labour is possible as partners may have different skills.

Disadvantages of Partnership

1. There is unlimited liability: All the partners are responsible for the debts of the firm and if the business goes bankrupt, all the partners will have to clear the debts even if they have to sell of their personal belongings.
2. Disagreement among the partners can lead to problems for the business.
3. There is a limit to the capital invested. Because of the fact that maximum 100 members are allowed, the business may find it difficult to expand after a certain limit.
4. There is no continuity of existence. Partnership is dissolved if one of the partners die or resigns or becomes bankrupt.

** Earlier the maximum limit of partners was:- In case of banking business – 10. In case of any other business – 20. As per the new Companies Act, 2013, the same has been simplified and the limit has been raised to 100 partners for any business.*

Partnership Deed

Before starting a partnership business, all the partners have to draw up a legal document called a Partnership Deed of Agreement. It usually contains the following information:

1. Names of included parties - includes all names of people participating in this contract
2. Commencement of partnership- includes when the partnership should begin. The date of the contract is assumed as this date, if none is given.
3. Duration of partnership - includes how long the partnership should last. It is automatically assumed that the death of one of the contracting parties breaks the contract, unless otherwise stated.
4. Business to be done - includes exactly what will be done in this partnership. This section should be very particular to avoid confusion and loopholes.
5. Name of firm - includes the name of the business entity.
6. Initial investments - includes how much each partner will invest immediately or by installments.
7. Division of profits and losses - includes what percentages of profits and losses each partner will receive. If it is not a limited partnership, then there is unlimited liability (each partner is responsible for all partners' debts, including their own).
8. Ending of the business - includes what happens when the business winds down. Usually this includes three parts: 1) All assets are turned into cash and divided among the members in a certain proportion; 2) one partner may purchase the others' shares at their value; 3) all property is divided among the members in their proper proportions.
9. Date of writing - includes simply the date that the contract was written.

There is another form of partnership which combines the ease of formation with limited liability as in the case of companies. It is known as Limited Liability Partnership (LLP). Minimum number of members is 2 but there is no no limit on maximum number. In India LLPs are governed by the Limited Liability Partnership Act, 2008

III. Company

A company can be defined as "An artificial person created by law, having a separate legal entity, with a perpetual succession."

A joint stock company (or simply company) is a voluntary association of persons generally formed for undertaking some business activity for which the members contribute money. The money so contributed constitutes the capital of the company. The capital of the company is divided into small units called shares. Since members invest their money by purchasing the shares of the company they are known as shareholders and the capital of the company is called share capital.

In India, the joint stock companies are governed by the Companies Act, 2013 (previously the Companies Act, 1956).

Characteristics of Company:

1. **Artificial person:** It is created by law and does not have any physical attributes of a natural person. But it has got a legal status as a natural person.
2. Formation: the process of formation of company is time consuming and complex compared to proprietorship and partnership. A company comes into existence only when it is registered under the Companies Act, which requires preparation of several documents and compliance with several legal requirements.
3. **Separate legal entity:** Being an artificial person, a company exists independent of its members. It can enter into contracts, buy and sell goods and services, employ people, conduct any lawful business, sue and be sued in the court of law. A shareholder cannot be held responsible for the acts of the company.
4. **Common seal:** Common seal is the official signature of the company. Since the company has no physical existence, it acts through its Board of Directors. Any document with the common seal duly signed by authorized signatory is binding on the company.
5. **Perpetual existence:** The company enjoy continuous existence. Even if the shareholders cease to be so due to death, lunacy, insolvency or any other incapacitation the company continues to exist. It is a creation of law and can only be dissolved by law.
6. **Membership:** A minimum of 2 persons are required to form a private limited company and the maximum number is 200 (as per Companies Act, 2013). A minimum of 7 persons can form a public limited company but there is no limit on the maximum number.
7. **Limited liability of members:** The liability of the shareholders is limited to the extent of the amount of shares he holds. In other words, a shareholder can only be held liable to the extent of face value of shares he holds and if he has already paid it, which is usually the case, he cannot be asked to pay any further amount. Face value is the value of the share which is mentioned in the share certificate as distinguished from the market value which is the value at which it is bought and sold.
8. **Transferability of shares:** The shareholders of a public company are free to transfer their shares as and when they wish without any need for consent from other shareholders.
9. **Separation of ownership and management:** Shareholders across the globe may invest in the company. It is neither possible nor practicable that they participate in its day to day management. The day to day affairs are managed by their elected representatives called directors. These directors act as an agent as well as trustee for the shareholders. The shareholders participate in deciding the general policies through annual general meetings.

Types of Companies

The broad classification of companies is done on the limit on membership namely:

1. Private company: a company whose shares may not be offered to the public for sale and which operates under legal requirements less strict than those for a public company.
2. Public company: a company whose shares are traded freely on a stock exchange.

Difference between Private company and Public company

No.	Basis	Private company	Public company
1.	Number of members	Minimum 2 members; maximum 200.	Minimum 7 members; maximum – no limit
2.	Nature of ownership	Usually family owned companies where members more or less are known to each other	Owned by public at large which may be across a nation or the globe
3.	Minimum paid up capital	Rs. 1 lakh	Rs. 5 lakh
4.	Name	Must suffix "Private Limited" to its name	Must suffix the word "Limited" to its name
5.	Public subscription	Cannot raise capital by offering shares to the public	Can invite the public to purchase its securities through issue of debentures
6.	Commencement of business	Can commence business immediately after incorporation	Can start business only after obtaining certificate of commencement of business
7.	Transfer of shares	Transfer of shares restricted	Shareholders can freely transfer shares

Other classifications:

a. **Government company:** where the Government owns not less than 51% of the share capital. E.g. Bharat Sanchar Nigam Ltd. (BSNL), Coal India Ltd., Indian Oil Corporation
b. **Statutory company:** A company created by special Act of the Parliament. E.g. Life Insurance Corporation of India, Securities Exchange Board of India
c. **Foreign company:** A company which is registered in a country outside India having its business in India. E.g. Citi Bank, Honda Motors
d. **Indian / Domestic company:** A company registered in India under the Companies Act. E.g. Tata Iron & Steel Company, Reliance Industries Ltd.
e. **Multinational company:** A company which is registered in one country but carries on business in number of other countries. E.g. Nestle, Coca Cola, Microsoft

IV. Cooperative Society

A cooperative is a business organization owned by a group of individuals and is operated for their mutual benefit. The persons making up the group are called members. Cooperatives may be incorporated or unincorporated. Some examples of cooperatives are: water and electricity (utility) cooperatives, cooperative banking, credit unions, and housing cooperatives.

Difference between Partnership and Company form of organization

The most common forms of business in India are Proprietorship, Partnership and Company. Proprietorship form of business is used when there is a single owner of the business. When the number of owners are more than one, partnership or company form of organization are resorted to. The differences between Partnership and Company form of organization can be summarized as below:

1. Number of members: The minimum number of members in case of partnership as well as private company is 2 whereas the minimum number of members in case of public company is 7. The Companies Act, 2013, has prescribed the maximum number of members in case of a partnership firm should not be more than 100. *(As per the previous Companies Act, 1956, the maximum limit in case of partnerships was 10 and 20 for banking and other business respectively.)*
   In case of private companies, the maximum limit has been increased by the new Companies Act, 2013, from 50 to 200. There is however no maximum limit on the number of members in a public company.

2. Separate legal entity: A Partnership firm has no separate legal entity distinct from its partners. A Company on the other hand, is a separate legal entity distinct from its members.

3. Liability: In partnership, each partner has unlimited liability and is personally liable for the debts of the firm. In a company, on the other hand, a shareholder has limited liability – limited to the extent of share capital subscribed by him.
   In order to facilitate the concept of limited liability in partnerships as well, a new form of partnership entity has been introduced under which the liability of the partners in a partnership firm is also limited and such form of organization is called Limited Liability Partnership.

4. Management: All the partners in a partnership firm are entitled to take part in the management of the business unless stated otherwise but in the case of company the right to control and manage the business is vested in the Board of Directors elected by the shareholders.

5. Transfer of interest: A partner cannot transfer his interest in the partnership firm without the consent of all the partners. He may however assign his share in the partnership but the assignee merely becomes entitled to the financial benefits in respect of the share and does not become a partner unless the other partners agree. In case of private companies, transfer of share requires the permission of the Board of Directors. But in case of a public company a shareholder can transfer his shares freely without restriction and the transferee succeeds to all rights of membership.

6. Audit of accounts: In case of companies, annual audit of accounts are mandatory. However in case of partnership firms, audit is necessary only if the annual turnover of sales exceed certain specified limits.

7. Registration: A partnership firm may or may not be registered. However in case of a company, registration is essential.

8. Minimum paid-up capital: In case of partnership there is no minimum prescribed capital. In case of private company the minimum paid-up capital is Rs. 1 Lakh and in case of public companies the minimum paid-up capital is Rs. 5 Lakhs.

9. Distribution of profits: In a partnership firm, the profits are shared among the partners as per the partnership deed. In case of a company, the members get a share in profits only when dividend is declared by the Board of Directors and approved by the members.

10. Winding up: A partnership can be wound up any time by any partner if it is 'at will' without any legal formalities. In case of company, no one member can require it to be wound up at will and winding up involves legal formalities.

Company or Partnership – which form is advisable

A company form of organization is preferred where the business is of potentially large size involving high amount of capital investment. Also since a partnership cannot raise money from the public it must convert itself into a company if it needs large amount of capital. It should however that formation formalities, compliance requirement and cost of running a company is fairly high compared to a partnership firm.

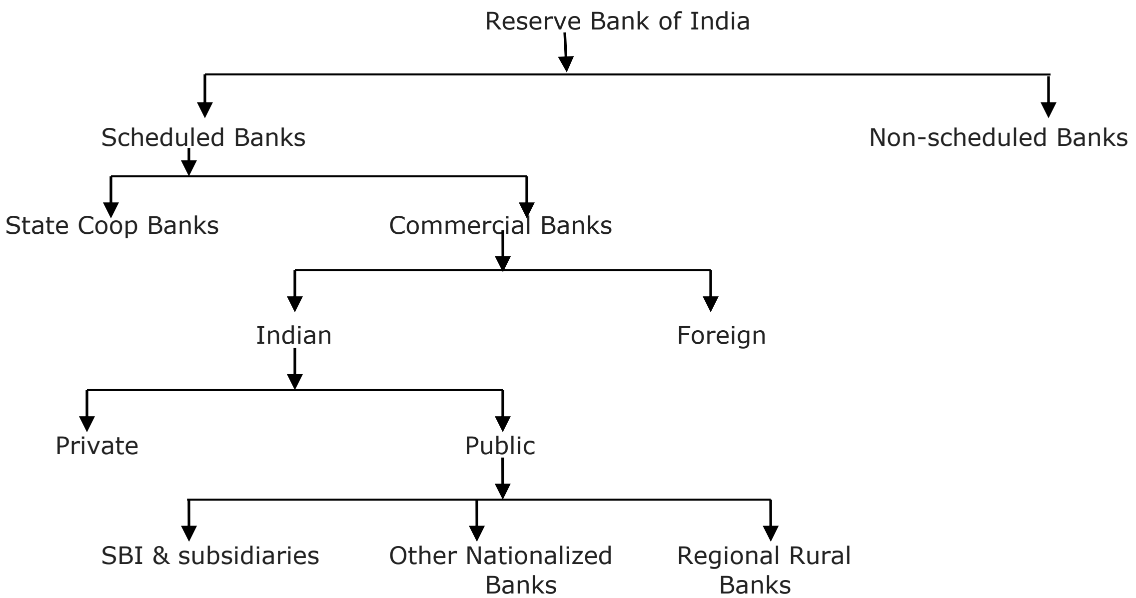
On the other hand setting up a partnership is an easy process and there are not many compliance requirements as well. Thus for a small business it is advisable to opt for a partnership firm of business structure as not only the cost of setting up is less but there are hardly any statutory regulations that needs to be complied with. It is pertinent to note that if a partnership has grown in size it can always be converted into a company any time.

Commercial banks

A bank is a financial institution which deals with deals with deposits and advances and other related services. It receives money from those who want to save it in the form of deposits and lends to those who need it. Banks that accepts deposit from the general public and gives loan to customers and traders are called commercial banks.

Therefore the primary functions of commercial bank in India are accepting deposits from the public and granting credit to all sectors of the economy after making provisions for reserves as per the RBI regulations. Apart from receiving and lending functions, commercial banks undertake various secondary or incidental functions such as agency services and general utility services.

Structure of Banking system in India



Scheduled Commercial Banks are those which are listed in the IInd Schedule of the Reserve Bank Act, 1934.

Nationalized banks include State Bank of India and its associates and 27 public sector scheduled banks (majority shares held by Govt. of India and listed on the stock exchange).

The functions of commercial banks are explained below:

PRIMARY FUNCTIONS:
- Collection of deposits
- Making loans and advances

Collection of deposits: The primary function of commercial banks is to collect deposits from the public. Such deposits are of three main types: current, saving and fixed.
Current account is used for business purposes. A customer can deposit and withdraw money from the current account subject to a minimum required balance. If the customer overdraws the account, he may be required to pay interest to the bank. Cash credit facility is allowed in the current account.
Savings account is an interest yielding account. Deposits in savings account are used for saving money. Savings bank account-holder is required to maintain a minimum balance in his account to avail of cheque facilities.
Fixed or term deposits are used by the customers to save money for a specific period of time, ranging from 7 days to 3 years or more. The rate of interest is related to the period of deposit. For example, a fixed deposit with a maturity period of 3 years will give a higher rate of return than a deposit with a maturity period of 1 year. But money cannot be usually withdrawn before the due date. Some banks also impose penalty if the fixed deposits are withdrawn before the due date. However, the customer can obtain a loan from the bank against the fixed deposit receipt.

Loans and advances: Commercial banks have to keep a certain portion of their deposits as legal reserves. The balance is used to make loans and advances to the borrowers. Individuals and firms can borrow this money and banks make profits by charging interest on these loans. Commercial banks make various types of loans such as:

1. Loan to a person or to a firm against some collateral security;
2. Cash credit (loan in installments against certain security);
3. Overdraft facilities (i.e. allowing the customers to withdraw more money than what their deposits permit); and
4. Loan by discounting bills of exchange.

Secondary functions

- Agency services
- General utility services

Agency Services: The customers may give standing instruction to the banks to accept or make payments on their behalf. The relationship between the banker and customer is that of Principal and Agent. The following agency services are provided by the bankers:

1. Payment of rent, insurance premium, telephone bills, installments on hire purchase, etc. The payments are obviously made from the customer's account. The banks may also collect such receipts on behalf of the customer.
2. The bank collects cheques, drafts, and bills on behalf of the customer.
3. The banks can exchange domestic currency for foreign currencies as per the regulations.
4. The banks can act as trustees / executors to their customers. For example, banks can execute the will after the death of their clients, if so instructed by the latter.

General Utility Services: The commercial banks also provide various general utility services to their customers. Some of these services are discussed below:

1. **Safeguarding money and valuables:** People feel safe and secured by depositing their money and valuables in the safe custody of commercial banks. Many banks look after valuable documents like house deeds and property, and jewellery items.
2. **Transferring money:** Money can be transferred from one place to another. In the same way, banks collect funds of their customers from other banks and credit the same in the customer's account.
3. **Merchant banking:** Many commercial banks provide merchant banking services to the investors and the firms. The merchant banking activity covers project advisory services and loan syndication, corporate advisory services such as advice on mergers and acquisitions, equity valuation, disinvestment, identification of joint venture partners and so on.
4. **Automatic Teller Machines (ATM):** The ATMs are machines for quick withdrawal of cash. In the last 10 years, most banks have introduced ATM facilities in metropolitan and semi-urban areas. The account holders as well as credit card holders can withdraw cash from ATMs.
5. **Traveler's cheque:** A traveler's cheque is a printed cheque of a specific denomination. The cheque may be purchased by a person from the bank after making the necessary payments. The customer may carry the traveler's cheque while travelling. The traveler's cheques are accepted in banks, hotels and other establishments.
6. **Credit Cards:** Credit cards are another important means of making payments. The Visa and Master Cards are operated by the commercial banks. A person can use a credit card to withdraw cash from ATMs as well as make payments to trade establishments.

In developing countries like India commercial banks perform certain promotional / developmental activities. For example, nationalized banks in India provide credit to the top priority sectors of the economy such as agriculture, and small-scale and cottage industries. In this way commercial banks help to promote the socio-economic development of the country.

Role of Commercial Banks in economic development

1. Mobilizing savings for capital formation:
The commercial banks help in mobilizing savings through network of branch banking. People in developing countries have low incomes but the banks induce them to save by introducing variety of deposit schemes to suit the needs of individual depositors. They also mobilize idle savings of the rich people. By mobilizing savings, the banks channelize them into productive investments. Thus they help in the capital formation of a developing country.

2. Financing industry:
The commercial banks finance the industrial sector in a number of ways. They provide short-term, medium-term and long-term loans to industry. In India, the commercial banks undertake short-term and medium-term financing of small scale industries, and also provide hire- purchase finance. Besides, they underwrite the shares and debentures of large scale industries. Thus they not only provide finance for industry but also help in developing the capital market too.

3. Financing trade:
The commercial banks help in financing both internal and external trade. The banks provide loans to retailers and wholesalers to stock goods in which they deal. They also provide facilities such as discounting and accepting bills of exchange, providing overdraft facilities, issuing drafts, etc. Moreover, they finance both exports and imports by providing foreign exchange facilities to importers and exporters of goods.

4. Financing agriculture:
The commercial banks help the large agricultural sector in a number of ways. They provide loans to traders in agricultural commodities. They open a network of branches in rural areas to provide agricultural credit. They provide finance directly to agriculturists for the marketing of their produce, for the modernization and mechanization of their farms, for providing irrigation facilities, for developing land, etc.
They also provide financial assistance for animal husbandry, dairy farming, sheep breeding, poultry farming, pisciculture and horticulture. The small and marginal farmers and landless agricultural workers, artisans and petty shopkeepers in rural areas are provided financial assistance through the regional rural banks in India. These regional rural banks operate under a commercial bank. Thus the commercial banks meet the credit requirements of all types of rural people.

5. Financing consumer activities:
Majority of the population in developing countries have low incomes and do not possess sufficient financial resources to buy durable consumer goods. The commercial banks advance loans to consumers for the purchase of such items as two-wheelers, refrigerators, etc. Home loans are also provided so that people can purchase or construct their own homes. In this way commercial banks help in raising the standard of living of the people.

6. Financing employment generating activities:
The commercial banks finance employment generating like loans for the education of young person's studying in engineering, medical and other vocational institutes of higher learning. They advance loans to young entrepreneurs, medical and engineering graduates, and other technically trained persons in establishing their own business. Such loan facilities are being provided by a number of commercial banks in India. Thus the banks not only help in human capital formation but also in increasing entrepreneurial activities in developing countries.

7. Help in monetary policy:
The commercial banks help the economic development of a country by faithfully following the monetary policy of the central bank. In fact, the central bank depends upon the commercial banks for the success of its policy of monetary management in keeping with requirements of a developing economy.

Thus the commercial banks contribute much to the growth of a developing economy by granting loans to agriculture, trade and industry, by helping in physical and human capital formation and by following the monetary policy of the country.

RESERVE BANK OF INDIA

The Reserve Bank of India (RBI) began its operations as the India's Central bank in April, 1935. Originally, it was a private shareholders' bank, but since January 1949 it has been functioning as the nationalized Central Bank.

RBI plays an important role in Indian economy. The RBI as the leader of the Indian money market and as the India's Central Bank performs the following useful functions:

1. Acting as Note-issuing Authority

The authority for the issuance of currency (other than one rupee coins/notes and subsidiary coins) in India is Reserve Bank of India. For the purpose of note issue, at present it has to keep a minimum reserve in foreign securities and in gold. It can however, dispense entirely with the holding of foreign securities if circumstances so require.

2. Acting as a Banker to the Government

The RBI transacts the banking business of both the Central and the State Governments. It is entrusted with the management of the public debt and the issue of new loans of Governments. It also holds the cash balances of the government free of interest. Besides, it sells Treasury Bills whenever necessary on behalf of the Government. It also gives advice to both the Central and the State Governments for raising finance for development plans. The RBI acts as adviser to Government on various banking and financial matters. It also helps the Government to remit the funds from one place to another.

3. Acting as a Banker to the Other Banks

The RBI acts as a banker to other banks. It keeps a certain percentage of their deposits as reserve and gives them rediscounting facilities against some specified bills and furnishes advances against government securities. It also gives them free remittance facilities. Against these facilities the scheduled banks are required by law to keep a certain percentage of their deposit liabilities as reserve.

4. Monetary Regulations

The RBI controls the volume of bank advances to implement its monetary and credit policy. It possesses various methods of credit control such as the Bank Rate Policy, Open Market Operations, Variable Reserve Ratio, Selective Credit Controls, etc. At present, it has been implementing the policy of controlled expansions of bank credit.

5. Supervision and Control of Commercial Banks

The Banking Regulations Act 1949, has empowered the RBI to supervise and control the operations of the commercial banks regarding their, paid up capital and reserves, licensing, branch expansion, cash balance, liquid assets, submission of periodical reports to the RBI, suspension of business etc.

6. Maintenance of Exchange Value of the Rupee

The RBI has also an important role to play in the maintenance of the exchange value of the rupee. For this purpose, it is entrusted with the custody and management of the country's international reserves. It acts also as the agent of the government in respect of India's membership control in accordance with the Government's trade policy.

7. Development and Promotional Functions

With the progress of the economy, the RBI has been undertaking various development functions relating to mobilization of savings, extensions of banking facilities in the un-banked centers, finance for agriculture and industries, protection of depositor's interest through deposit insurance., etc.

8. Control of the Activities of Non-banking Companies and Other Institutions

Recently, the RBI has been empowered to lay down the regulations regarding the acceptance of deposits from the public by non-banking companies and institutions. It can also demand the statement regarding such deposits from these institutions.

9. Implementation of the Plans

The RBI also gives its opinion to the Governments on economic and financial matters relating to the implementation of the Plans. It assists the government in undertaking deficit financing, maintaining price stability and providing credit for the priority sectors.

10.Other Functions

The other functions relate to the regular publication of reports on banking and currency, conducting the clearing houses, developing bill markets, appointing committees and commissions on various economic aspects of the country, etc.

Monetary Policy of RBI (Or How RBI controls inflation)

The Monetary Policy of RBI is not merely one of inflation control through credit restriction, but it has also the duty to see that legitimate credit requirements are met and at the same time credit is not used for unproductive and speculative purposes. RBI has various weapons of monetary control and by using them it hopes to achieve its monetary policy.

A. Quantitative Credit Control Methods

In India, the legal framework of RBI's control over the credit structure has been provided under the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949. Quantitative credit controls are used to maintain proper quantity of credit or money supply in market. Some of the important general credit control methods are:

1. Bank Rate Policy

Bank rate is the rate at which the Central bank lends money to the commercial banks for their liquidity requirements. Funds are provided either through lending directly or discounting or buying money market instruments like commercial bills and treasury bills. Increase in Bank Rate increases the cost of borrowing by commercial banks which results in the reduction in credit volume to the banks and hence declines the supply of money. Increase in the bank rate is the symbol of tightening of RBI monetary policy. As of April 05, 2016, the Bank Rate stands at 7%.

2. Cash Reserve Ratio (CRR)

The Cash Reserve Ratio (CRR) is an effective instrument of credit control. Under the RBI Act, 1934 every commercial bank has to keep certain minimum cash reserves with RBI. The RBI is empowered to vary the CRR between 3% and 15%. A high CRR reduces the cash for lending and a low CRR increases the cash for lending. The present CRR is 4%on and from 05.04.2016.

3. Statutory Liquidity Ratio (SLR)

SLR is used by bankers and indicates the minimum percentage of deposits that the bank has to maintain in form of gold, cash or other approved securities. Thus, it can be said that it is ratio of cash and some other approved liability (deposits). At present it is 21.25%.

Both Cash Reserve Ratio (CRR) and SLR are instruments in the hands of RBI to regulate money supply in the hands of banks that they can jump in economy. SLR restricts the bank's leverage in pumping more money into the economy. On the other hand, CRR, or cash reserve ratio, is the portion of deposits that the banks have to maintain with the Central Bank to reduce liquidity in banking system. Thus CRR controls liquidity in banking system while SLR regulates credit growth in the country. The other difference is that to meet SLR, banks can use cash, gold or approved securities whereas with CRR it has to be only cash. CRR is maintained in cash form with central bank, whereas SLR is money deposited in government securities.

4. Repo And Reverse Repo Rates

Repo means Sale and Repurchase Agreement. Repo rate is the rate at which the Reserve Bank of India lends money to commercial banks in the event of any shortfall of funds. Repo rate helps commercial banks to acquire funds from RBI by selling securities and also agreeing to repurchase at a later date. Repo rate is used by monetary authorities to control inflation. In the event of inflation, RBI increases repo rate as this acts as a disincentive for banks to borrow from the central bank. This ultimately reduces the money supply in the economy and thus helps in arresting inflation. RBI takes the contrary position in the event of a fall in inflationary pressures. Repo and reverse repo rates form a part of the **liquidity adjustment facility**.

Reverse repo rate is the rate that banks get from RBI for parking their short term excess funds with RBI. Repo and reverse repo operations are used by RBI in its Liquidity Adjustment Facility. RBI contracts credit by increasing the repo and reverse repo rates and by decreasing them it expands credit. Current Repo rate is 6.5% and Reverse repo rate is 6%

Bank rate usually deals with loans, whereas, repo or repurchase rate deals with the securities. The bank rate is charged to commercial banks against the loan issued to them by RBI, whereas, the repo rate is charged for repurchasing the securities.

5. Open market operations

It refers to buying and selling of government securities in open market in order to expand or contract the amount of money in the banking system. This technique is superior to bank rate policy. Purchases inject money into the banking system while sale of securities do the opposite. During last two decades the RBI has been undertaking switch operations. This policy aims at preventing unrestricted increase in liquidity.

B. Selective / Qualitative Credit Control Methods

Under Selective Credit Control, credit is provided to selected borrowers for selected purpose, depending upon the use to which the control try to regulate the quality of credit - the direction towards the credit flows. The Selective Controls are:

1. Ceiling On Credit

The Ceiling on level of credit restricts the lending capacity of a bank to grant advances against certain controlled securities.

2. Margin Requirements

A loan is sanctioned against collateral security. Margin means that proportion of the value of security against which loan is not given. Margin against a particular security is reduced or increased in order to encourage or to discourage the flow of credit to a particular sector. It varies from 20% to 80%. For agricultural commodities it is as high as 75%. Higher the margin lesser will be the loan sanctioned.

3. Discriminatory Interest Rate (DIR)

Through DIR, RBI makes credit flow to certain priority or weaker sectors by charging concessional rates of interest. RBI issues supplementary instructions regarding granting of additional credit against sensitive commodities, issue of guarantees, making advances etc.

4. Directives:-

The RBI issues directives to banks regarding advances. Directives are regarding the purpose for which loans may or may not be given.

5. Direct Action

It is too severe and is therefore rarely followed. It may involve refusal by RBI to rediscount bills or cancellation of license, if the bank has failed to comply with the directives of RBI.

6. Moral Suasion

Under Moral Suasion, RBI issues periodical letters to bank to exercise control over credit in general or advances against particular commodities. Periodic discussions are held with authorities of commercial banks in this respect.

As on and from 5th April 2016:
Bank Rate 7%; CRR is 4%; SLR is 21.25%; Repo Rate is 6.50%; Reverse Repo Rate 6%

As on and from 2nd August 2017:
Bank Rate 6.25%; CRR is 4%; SLR is 19.5%; Repo Rate is 6%; Reverse Repo Rate 5.75%

International Trade

International trade is the exchange of goods and services between countries. This type of trade gives rise to a world economy, in which prices, or supply and demand, affect and are affected by global events.

Trading globally gives consumers and countries the opportunity to be exposed to goods and services not available in their own countries. Almost every kind of product can be found on the international market: food, clothes, spare parts, oil, jewelry, wine, stocks, currencies and water. Services are also traded: tourism, banking, consulting and transportation. A product that is sold to the global market is an export, and a product that is bought from the global market is an import. Imports and exports are accounted for in a country's current account in the balance of payments

International trade not only results in increased efficiency but also allows countries to participate in a global economy, encouraging the opportunity of foreign direct investment (FDI), which is the amount of money that individuals invest into foreign companies and other assets. In theory, economies can therefore grow more efficiently and can more easily become competitive economic participants.

For the receiving government, FDI is a means by which foreign currency and expertise can enter the country. These raise employment levels, and, theoretically, lead to a growth in the gross domestic product. For the investor, FDI offers company expansion and growth, which means higher revenues.

Foreign Exchange Reserves
Reserves are generally maintained by countries for meeting their international payment obligations — both short and long terms, including sovereign and commercial debts, financing of imports, for intervention in the foreign currency markets during periods of volatility, besides helping to boost the confidence of the market in the ability of a country to meet its external obligations and to absorb any unforeseen external shocks.

India's Foreign Exchange Reserves

India's Forex reserves as on 22/7/2016 (in billion rupees)

1 Total Reserves	24,234.1
1.1 Foreign Currency Assets	22,584.1
1.2 Gold	1,391.3
1.3 SDRs	99.1
1.4 Reserve Position in the IMF	159.6

The **Foreign exchange reserves of India** are mainly composed of US dollar in the forms of US government bonds and institutional bonds. Foreign-exchange reserves are assets held by RBI, usually in various reserve currencies, mostly the United States dollar, and to a lesser extent the euro, the pound sterling, the Japanese yen.

A **gold reserve** is the gold held by a RBI, intended as a store of value and as a guarantee to redeem promises to pay depositors, note holders (e.g. paper money), or trading peers, or to secure a currency. India currently holds 557.7 tonnes of gold, making up 9.9 percent of the country's total forex reserve.

The Special Drawing Right (SDR) is an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. Countries can exchange SDRs for hard currency at the IMF. The SDR also serves as the unit of account of the IMF and some other international organisations. Its value is based on a basket of key international currencies.

Reserve Position in the IMF - Reserve tranche position (RTP) in the International Monetary Fund (IMF): The proportion of the required quota of currency that each International Monetary Fund (IMF) member country must provide to the IMF, but can designate for its own use. The reserve tranche portion of the quota can be accessed by the member nation at any time, whereas the rest of the member's quota is typically cannot be accessed.

The International Monetary Fund

The IMF was first conceived at a UN conference in 1944, among the 44 attending countries, before it was officially created in 1945. These countries wanted to globally stabilize exchange rates and financial communication between countries, especially following the disastrous Great Depression and World War II. Goals included international cooperation and trade, the reduction of poverty and financial crises, and economic growth. Although the Fund has evolved over the years to become what it is today and adapt to changing times, it still operates around the same guiding principles.

The IMF played a large role in the economic restructuring of the post-World War II world. After the war, some countries were in economic distress, and others were reluctant to trade with certain countries after the fighting. The Fund helped smooth over the economic post-war transition period and restabilize the global economy so it could move toward prosperity, using systems such as fixed exchange rates.

Currently, there are 188 member countries in the IMF, which is based out of Washington, D.C. Each country or region is represented by a member on the Fund's Executive Board and numerous staff members. The ratio of board members from each country is based on the country's global financial position, so that the most powerful countries in the global economy have the heaviest representation. The United States has the highest voting power, followed by Asian countries such as Japan and China and Western European countries like Britain, Germany, France and Italy.

World Bank

The World Bank was established in December 1945 at the United Nations Monetary and Financial Conference in Bretton Woods, New Hampshire. It opened for business in June 1946 and helped in the reconstruction of nations devastated by World War II. Since 1960s the World Bank has shifted its focus from the advanced industrialized nations to developing third-world countries.

World Bank performs the following functions:

1. Granting reconstruction loans to war devastated countries.
2. Granting developmental loans to underdeveloped countries.
3. Providing loans to governments for agriculture, irrigation, power, transport, water supply, educations, health, etc
4. Providing loans to private concerns for specified projects.
5. Promoting foreign investment by guaranteeing loans provided by other organisations.
6. Providing technical, economic and monetary advice to member countries for specific projects
7. Encouraging industrial development of underdeveloped countries by promoting economic reforms.

IMF vs. World Bank

The IMF works hand-in-hand with the World Bank, and although they are two separate entities, their interests are aligned, and they were created together. While the IMF provides only shorter-term loans that are funded by member quotas, the World Bank focuses on long-term economic solutions and the reduction of poverty and is funded by both member contributions and bonds. The IMF is more focused on economic policy solutions, while the World Bank offers assistance in such programs as building necessary public facilities and preventing disease.

Asian Development Bank

The ADB was founded in 1966 with the goal of eradicating poverty in the region. The Asian Development Bank (ADB) is a multilateral development finance institution whose mission is to reduce poverty in the Asia Pacific region.

Functions:

i. Provides loans and equity investments to its Developing Member Countries (DMCs)

ii. Provides technical assistance for the planning and execution of development projects and programs and for advisory services

iii. Promotes and facilitates investment of public and private capital for development

iv. Assists in coordinating development policies and plans of its DMCs

Balance of Trade and Balance of payments

In today's world, all countries import some goods and services from other countries and also export certain other goods and services which are surplus in their country. The difference between the value of goods and services exported out of a country and the value of goods and services imported into the country is balance of trade. If a country has a balance of trade deficit, it imports more than it exports, and if it has a balance of trade surplus, it exports more than it imports.

The balance is said to be favorable when the value of the exports exceeded that of the imports (i.e. exports exceed imports), and unfavorable when the value of the imports exceeded that of the exports (i.e. imports exceed exports).

Balance of Payment is a system of recording all the economic transactions of a country, with the rest of the world over a period, say one year. Typically, the transactions included in BoP are country's exports and imports of goods, services, financial capital, and financial transfers. Thus, in nutshell we can say, the BoP accounts summarize international transactions for a specific period, usually a year, and are prepared in a single currency, typically the domestic currency for the country concerned.

It can be concluded that:

The balance of payments (BOP) is an accounting of a country's international transactions for a particular time period. Any transaction that causes **money to flow** into a country is a credit to its BOP account, and any transaction that causes money to flow out is a debit.

The BOP includes the *current account*, which mainly measures the flows of goods and services; the *capital account*, which consists of capital transfers and the acquisition and disposal of non-produced, non-financial assets; and the *financial account*, which records investment flows.

The BOT is typically the biggest bulk of a country's balance of payments as it makes up total imports and exports.

BOP is said to be favorable balance of payments, when more payments are coming in than going out, and will be unfavorable when less payments are coming in than what is going out.

Difference between Balance of Trade and Balance of payments

Basis of Difference	Balance of Trade (BOT)	Balance of Payment (BOP)
1. Definition	Balance of Trade is defined as 'difference between export and import of goods and services'	Balance of Payment is defined as the 'flow of cash between domestic country and all other foreign countries'. It includes not only import and export of goods and services but also includes financial capital transfer.
2. How calculated	BOT = Net Earning on Exports - Net payment made for imports	BOP = BOT + (Net Earning on foreign investment i.e. payments made to foreign investors) + Cash Transfer + Capital Account +/- Balancing Item **or** BOP = Current Account + Capital Account +/- Balancing item (Errors and omissions)
3. When considered as favorable or unfavorable	If export is more than import, at that time, BOT will be favorable. If import is more than export, at that time, BOT will be unfavorable.	Balance of Payment will be favorable, if the country has surplus in current account for paying all past loans in the capital account. Balance of payment will be unfavorable, if country has current account deficit and it took more loan from foreigners. After this, it has to pay high interest on extra loan and this will make BOP unfavorable.
4. Solution to being unfavorable	To buy goods and services from domestic country.	To stop taking of loan from foreign countries.
5. Factors	Main factors which affect BOT: 1. cost of production 2. availability of raw materials 3. Exchange rate 4. Prices of goods manufactured at home	Main factors which affect BOP: 1. Conditions of foreign lenders. 2. Economic policy of Govt. 3. all the factors of BOT