

Money and Banking
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Lecture - 22

So, what we were talking about? We were talking about commercial bills and commercial bills in India have come into existence many, many years back. The oldest form of commercial bills that you see in India is in the agricultural sector and they have a Indian name, they are known as hoondis. And there are two kinds of hoondis I told you, one is the demand hoondi, one is the usage hoondi. The demand hoondi is the the (()) and the usance one.

Now, the hoondi market have survived for such a long time in some areas, because of the indigenous banks. The indigenous banks, which are unorganized sector banks not recognized by RBI. They do not get any help from RBI, but they have existed for a long time and they are at least they are known in two areas of India; one is in Gujarat, one is in Tamilnadu and there are indigenous banks elsewhere also. But I do not have the entire picture with me. They have very specific name in Gujarat they have a name, in Tamilnadu they have a name and they are running very well and they support the hoondi market a lot because they make a lot of money from the hoondi market. Why would banks support without making money from the hoondi market, alright.

Now, let us talk about now the state of affairs of old bills, this is the conceptual part and there are other kinds of bills I told you clean bills, documentary bills. Then the trade bills, the export bill, the import bills. So, I talked about all this kinds of bills. So, there are inland bills and foreign bills also.

Now, let us talk about the bill market in India, well in what shape, is it in. Now, I have been reading about it for a long time, now I have found something from (()) of a (()) book primarily and that other book you can get which is an old book its unedited it has not been revised not unedited what I mean, it has not been recently revised. But that is a useful book it has lot of information it is the Delhi university's faculty book Suraj (()) Gupta's (()) economics that book also has something about these markets, if you want to read up you can read there. The bill markets if you want to look at the bill market there is, there are lots of foreign books of course, some very good books are out there. If you

read them you will see the bill market development requires certain features like a country's development requires essential things like infrastructure. If infrastructure is poor like a country like in India, the development state is also poor it does not develop well. It is a very common understanding.

So, the bill market developed properly you require certain features; one, since bills are often usance based, so the payment made in future not now. The commercial banks have to be participating in the bill market because commercial banks have a lot of cash and if there is an incentive for the commercial banks to make more money its good because, the commercial banks with their cash back up can help the bill market to develop alright.

So, how do commercial banks help? You know how commercial banks help, commercial banks can serve as an intermediate between the both parties can hold the bill, forward the cash to the seller of the goods now who wants it now, and wait since it has lot of cash it can wait till the bill matures.

So, commercial bank participation is necessary, number one point. Number two, there this is kind of as soon as you trust as soon as you start talking about commercial bank's role you are talking about the secondary market coming into the picture. This commercial bank is a third party, but you have to remember one thing the commercial banks themselves if they have to participate in the bill market extensively then, it also requires a secondary market to exist proper secondary market to exist. So, that if necessary they can part with the commercial bills, sell it off in the secondary market. Like share markets have secondary markets, sell them off and get the cash. So, for commercial banks to participate actively in the bill market, there should be a well developed secondary market. Secondary market for the commercial bills, alright.

Number three, if commercial banks and other organizations it can be nonbanks also participating in the bill market either the primary market or in the secondary market whatever, sometimes they directly participate in the primary market may be as a guarantor between the two parties, because the two parties may have a lack of confidence trust. So, if a bank says I know both the parties then a bill can be created; then i am coming to those services then, commercial banks and their also putting in money investing in commercial bills.

As happens in any other country, it is probably has become quite thing in the recent world as I realized which I did not know until this financial crisis happened. Central bank should also have a line of credit or help extended to the commercial banks if the bill market has to develop let me put it this way. Suppose, you are trying to develop the bill market, now commercial banks do not have an incentive right now because the incentive is low. But, if commercial banks are given a line of credit some cash directly by the central banks to say look this is the money I am giving you to get involved with the bill market if this help requires like you are trying to open your business you're not so much interest in that area. But, your some mentor, father, mother, guardians, somebody tells you I am giving you some cash to begin that business, alright. With this help, which is like an incentive commercial banks will find it easier to go into the bill market and participate

Otherwise, if commercial banks cannot go into the bill market on its own, it has to be given some incentive and the central bank is in the best position to give an incentive. This is how with incentives many other things have developed in India also. Like the nonbanks organizations like IDBI etcetera. They were directly funded by the government of India and RBI, to essentially provide loans some categories of loan like (()) were directly funded directly funded by RBI to give certain kinds of loans which usually commercial banks decline for instance small loans, a poor farmer he needs the money, but, the commercial banks says are [FL] to return [FL] normally a profit making organization would be interested. But, if there is an assistance then he would say fine, I will give you the money because even if it is defaulted it is not money my money that I am going to lose. But, since I am there in business they know me and I also know them I can actively engage them in the bill market.

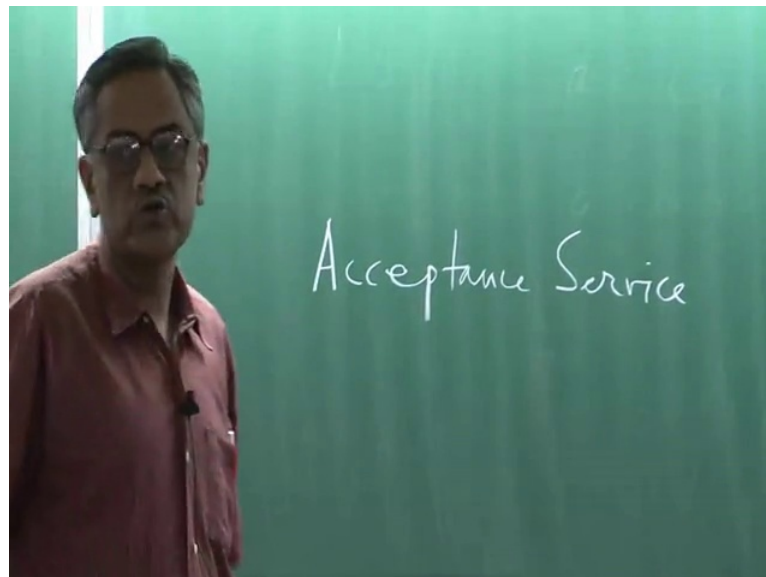
Same way nabard gives loans to the rural part of the country in India. Particularly, in a developing country like India same way which the industries started developing with the non banks like IDBI etcetera, they did not just exist as a profit making organization started by a big business family they were organizations deliberately set up by the government of India and RBI with their funds to help out industrial development.

Sidbi. Sidbi is what? Sidbi is essentially for the small industries development normally many banks shy away from that, do not put money. So, where would the money come from for small industries development suppose you open a small industry become a

small entrepreneur tomorrow after your studies here. Sidbi one of place to go to because they help out even Sidbi on campus does some activities.

It is not exactly like charity, but, it has a high risk of default . So, profit making good organizations often sigh away. So, central bank assistance is also very important this is the third point. Fourth point which is very important, this exists if you read foreign books particularly english books, english banking system etcetera where commercial bills started and there is a lot of discussion as many, many years back there has been many many lot of discussion about same 30 years back, 40 years back, 50 years back

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There have been books around and may be more years says something called acceptance service which is known in western countries where the bill market is very well developed. Acceptance services alright. Now, acceptance service (()) this word you should learn these two words, is a service that specializes the institutions that specialize in the development of commercial bills at a low cost what do they do; they stand as a guarantee, acceptance is a guarantee that it accepts something is a guarantee that it provides to the drawer of the bill that if you create a bill with this party in (()) do when you are selling a good, selling some goods, the bill will not be defaulted. So, the acceptance service it can be a bank providing it knows both the parties one is faking whose selling the goods to the buyer in Kanpur who would pay later. So, the commercial bill is going to be created and if there is an acceptance service a trustworthy respectable

organization who knows that the the the company in Kanpur can give the guarantee in whatever form it is to the drawer of the bill in Madras the example that I gave you create a bill do not worry I am there the bill will not be defaulted. In order to provide that guarantee, the acceptance service which may be a bank who knows who provides the service banks specialize in many things other than commercial banking you know that they flow mutual funds, they often go into merchant banking activity all sorts of subsidiaries they open they can open a subsidiary acceptance service. But, that of course, the guarantee would be provided against a commission. Because, acceptance services are specialized institutions which hire people, work there, they collect a whole lot of information and it becomes more important these acceptance services particularly when it talking about trade.

A company in India in Gujarat is buying something from a company in Germany or a company in Gujarat is selling something to a accompany in Germany alright now that of course, there is this issue about the quality of the product suppose the quality has been very fine through technical expertise, but, how about the financial aspect whether the payments will come through or whether they would default particularly first world country often lack trust first world countries lack trust in developing countries' companies, if you are a Tata and a Birla and you roam around all over the world you have you have acquisition in England us everywhere everybody knows it you know what Tata has been doing they have even bought land rover the famous that car company what (()) in England they bought a land rover they brought out Tetley tea tea the famous company in England then it is a different story, but, suppose suppose some other companies new companies doing well good business in India they require acceptance services who knows these companies in India who is respected by a foreign economy agency and therefore, a trade can take place commercial bill can come into existence all sorts of things will follow alright

So, acceptance is like a guarantee essentially which provides in this it may not directly be involved in funding remember acceptance service is not banking service operate in the bill market they often come with money your bill will be paid three months later I will buy it or I will discount it whatever you get the money, but, you would not get that amount because you do not betting off see years three months I am going to wait three months and I will get the money from the what you call the drawer of the bill in (())

Acceptance service are not necessarily involved not at all involved maybe with providing funds, but, it is for providing guarantee. So, they are like guarantors in commercial bills and this has become quite this is quite common in the first world countries or any country which has a well developed bill market there are well developed acceptance services companies have developed and they are known in UK for instance they are known as accepting houses in UK United Kingdom it is known as accepting houses and often commercial banks commercial banks who know a whole lot of (()) because they are doing these business then they are by giving loans etcetera open a subsidiary and accepting it (()) which does not deal with money directly, but, provides a handover service alright.

So, they have to they have they have they carry an enormous number of up-to-date updated information on companies are they doing otherwise how would you provide the guarantee you have to know how the company has been doing its not ten years back I should know him that kind of a statement would not create much confidence in the in the drawer of the bill who is writing that bill and selling the goods. So, they carry a whole lot of information. So, it is a very active work with computers internets etcetera it has become easy must be because information technology or information collection and assimilation etcetera processing of this kind of service center as much must have become much easier now with the internet etcetera and computers, but, they exist from pre internet age remember they are just on the new ones they are there for many many years now alright.

And finally, one more point this is the fourth point I have mentioned finally, one more point I have to mention you may read a books you may find many more issues than I tell you with. Final one last point I want to mention is that, if a secondary market has to exist; what you need a good secondary market like a share market from a stock market is a very good, efficiently running secondary market in shares. How does it run, who are the who are the who are the institutions a group of units who run it, who operate it who are what are they called not underwriter, underwriter is in the primary market, but, the secondary market who runs them the brokers and dealers.

And some of the brokers and dealers are millionaires, they have big companies, they are brokers, simple brokers who can become a broker in the share market. So, the brokers and dealers who run the secondary market, suppose you want to develop a secondary

market in the housing sector which exists very well in foreign countries I have seen. These are the like brokers, middle man some company who collect information on all houses that people want to sell, collect information on all the people who want to buy them, alright and they mediate that. So, a secondary market will function efficiently if you have a well developed system of brokers and dealers in that market.

So, the last point is if you want a commercial bill market to have a good secondary market also, which is sometimes very necessary for financial organizations to come in and participate because they know there is an exit route if I want I can sell them off at a secondary market and get out because I need that cash for some reason. So, a well developed set of brokers and dealers are required for any any any item to have a good secondary market and effective secondary market. So, the same point comes here as well, brokers and dealers are required alright.

Now, let us see how has been the Indian bill market doing, alright. There is a lot of discussion that is what I have been reading also, reading up on them. There is a lot of discussion on these brokers, on the development of bill market. First of all, when I will show you the data, the bill market the way data exists we hardly have any data on the unorganized bill market, the hoondi market etcetera we do not have any data at least I do not have. Researchers can go into these markets and collect some information, but, that will be one time information it cannot be updated on a regular basis. So, on a regular basis you do not have data much.

Now, if you look at the organized sector bill market in India I will show you data, it is very small organized sector bill market data. And one of the reasons is that, the bill market the people the way people have come to know has been a characteristic feature of the unorganized sector. In the organized sector, business have not been run with use of commercial bills in India the practice hasn't been there, the way it has been in the western countries first world countries it hasn't been there in India alright.

But what did they do SBI and also RBI from time to time try to develop the bill market. But, it is very unfortunate that for instance State Bank of India's participation in commercial bills completely stopped after 1965 it is very interesting.

And the reason is the State Bank was asked by RBI which had two two twice at least they came up with schemes called bill market schemes one in 1952 and one in 1970 to

develop the bill market. What RBI basically did was one thing it wanted to tell them is that initially that you try to develop the organized market bill market. So, that the indigenous bill market which is the hoondi market which has been either to the largest bill market the unorganized bill market will slowly accept and start participating and coming to the organized market. So, it becomes part of the organized market. So, the approach of RBI was in the bill markets schemes, you try to develop funds were made available from RBI to the public sector banks which is SBI in particular to develop the organized sector bill market fine. And the idea also was to develop it in a way so that the hoondi market is forced to become part of the organized sector because there funds are available, but, the hoondi market has been running on its own, with the unorganized sector funding alright.

So, what happened hoondi market never got funds of course not, the organized sector market did not develop well for whatever reason it may be because we do not have a habit of participating in commercial bills creating, commercial bills and one of the objectives that RBI had in the bill market's schemes is to bring that unorganized sector like there are people illiterate people to develop an education system in a way impart education to the local people, but also try to incorporate the uneducated people into your education system so that the general level of education goes up. But, what you did you did your focus on them in fact you were trying to compete with them. So, they got more scared and shied away more from you and in eventually started teaching who are already educated. So, this job wasn't done with the RBI bill markets schemes and finally, SBI said we are unable to develop that much.

Why was the job not done, because business is in India initially after independence that you've seen in that course was kept with the government sector and the private sector wasn't given much freedom to develop. So, for a long time thirty forty years after independence what you had in India was a public sector dominated economy the private sector wasn't allowed to develop much alright.

So, who would create bills there would be some bills between public sector sometimes, not much because public sector companies mistrust other public sector companies because they all know are the children of the government. Indian oil doing business with air India how much of a fight will be there how much of a lack of trust will be there the climate is entirely different you are talking about bill market in the private sector, where

the parties do not know they want to expand are trying to grow and whether there is a support system for the bill market to develop. So, how would the bill market be developed kind of economy you had bill market could not develop alright.

Next, acceptance services were never thought of the entire bill market develop in England because of these accepting houses which hardly existed in India. So, even if funds are available there is no trust. So, banks would have money there, but, banks would not be lending them or using them. Government may have given them, RBI may have given them money, but, they were not using them. And accepting house accepting services were not there no guarantor there alright.

And then what they did was very interesting they said commercial banks are unable to develop the bill market in India RBI said other institutions since after the second bill market scheme 1970 they said bring other nonbanking solutions ICI, LIC, UTI, GIC, ICICI which is a private sector nonbanking. All these come in and have tried to help develop the bill market because banks were unable to develop them, initially they were trying to develop through the banks and particularly SBI. So, when I would talk about the loan the interest rate in the bill market, the bill market rate has mentioned SBI rates because SBI was functioning there and it used to be called the SBI rate alright i am coming to that.

The LIC, GIC etcetera they all were asked to participate, but, these nonbank finance institutions had other headaches. Their headache was not so much of bills, short term bills, money market bills. They are not funding services, they are not accepting others they were meant to do other things merchant banking, finance industrial development, big big things they had it still did not work. While you open the door to the nonbanks bill market hasn't been developing in India alright.

Often what happened was, that the bill financing banks; bill financing by banks is the was often look upon as very interesting if there is a respectable company like Tata etcetera where bills were created and you hold the bills as a middle man or something you purchase the bills or something. Often what happened was these bills these institutions were using as mortgages to get a loan from bank. So, the bank funding was giving loan against the bills and bills were the mortgages because the bills were so respectable a few companies who were using bills are so well known companies they

have bills were like mortgages like holding shares and bonds, very interesting banks were funding that giving out loans against them alright.

They were no rediscounting facility available from RBI regarding bills. Suppose commercial bank has bought a bill it needs cash there is no secondary market, bill market need secondary market now you go to RBI to rediscount them because you need cash alright. Already you have discounted it bought them or something hold them now you go to RBI to rediscount them because you need cash. RBI was not given them any support. So, no rediscounting facility was available through the banks on this bills.

So, RBI had a scheme you do it without much support from us alright. And then gradually they found often commercial bills as in India were not genuine real bills, bills were written between two parties because of a financial transactions no real goods really ever changed hands, they were not genuine commercial bills, they were financial transactions between two parties no goods transaction which has created bills and this created enormous problems these were not genuine bills either alright.

Now. So, now, when I look up RBI data site I find commercial bill data and I got puzzled they had inland bills which is fine foreign bills which I (()). So, lot of bills getting created these days not much compared to the total credit I will come to that number whatever for inland business within India Chennai se Kanpur Gujarat bill tayar ho gaya India se bahar jarahehe bahar se India arahehe foreign bills were getting (()) good. So, I looked at the numbers how is the number showing for overtime inland volume of bills and the foreign bills, but, then I found two words here which puzzled me purchase and discount. And I was wondering if a bill I as a commercial bank is investing where I look at the banking sector I found commercial bill data and bank I am putting in money why would I make a distinction between purchase of a bill and a discount of a bill because bill is easily discounted. Because a bill would be paid later so, I discount the bill so, you get the money now and that discount factor is my income two months later. Say say crore bill [FL] I discounted I give you 98 lakhs or 99 lakhs something, 50 thousand or 60 thousand or 80 thousand, 20 thousand remains that is the discount factor that will get 2 months later that is my income.

Where is the purchase data, I got very puzzled and RBI does not explain. Purchased bills both inland and foreign, discounted bills both inland and foreign where is the purchase

coming from? Then I realized, what happened hunting up and down the inland bills which would be paid as soon as goods arrive with the buyer from the seller, as I gave you that example when I buy some durable goods Kanpur seller that shops; ship that good yesterday I went there, I booked something with some advance payment and they will ship it and these are demand bills they create as soon as the goods reach my home I found it safe and okay I say received on a memo like thing and I can make the remaining cash payment. The transporter carries the cash from me to the [FL], shop owner. This, I have done millions of times whenever I have bought TV, fridge you know whatever, even others small items also.

Then I understood what purchase bills meant purchase essentially meant that these demand bills; it will take a few days to reach or few weeks to reach, but, the seller cannot wait even a few weeks. So, these bills were also at some price they were purchased, there is a discount rate also purchase by the bank, where bank is putting in money and wait out three weeks to get the cash from the buyer of the goods in Kanpur.

So, purchase data refer to the demand bills and the discounted data on commercial things inland or foreign refer to the usance bills. I understood that later quite late I did not understand initially alright. So, RBI data when i will show you'll see that purchase data and discounted data on commercial bills. You can open it tonight if you want RBI site you will get that number.

And inland bills purchase to discounted ratio was very interesting. Purchase is less than discounted demand bills are less than usance bills in terms of commercial bank participation. It is like point three, point three means what thirty percent; thirty percent of the discounted bills where I purchased goods. So, this is how it went alright.

Indian bill market rates have been very funny, if you open voley you'll find it. There is one bill market rate which when RBI used to rediscount these bills for commercial banks was the bank rate. Bank rate is like the central bank's interest rate. When central bank is helping a bank it charge an interest rate which is called bank rate bank rate is nothing but that. Commercial banks interest rates are known as lending rates, deposit rates, fixed deposit rates, semi deposit rates, lending rates etcetera. When RBI or a central bank lends to somebody higher bank or a non bank or somebody then that interest rate is called bank rate.

So, the bank rate was often used to decide the commercial bank's lending rates etcetera against commercial bills. Then SBI had a hoondi rate very interesting, it is called SBI hoondi rate. So, when SBI would discount hoondis which belonged to the unorganized sector at once upon a time they used to do that; they used to use this is to be called sbi hoondi rate, but, it does not exist anymore it does not discount hoondis anymore what I have heard.

Then these unorganized sector shrafs and multans and shetias indigenous banks they deal a lot with these hoondis etcetera commercial bills, unorganized sector commercial bills and you know what they call this interest rate there they have a term also call the interest rate they call that the bazaar rate is there in books bazaar rate.

Unorganized sector banks call the interest rate on hoondis in which they do a lot of business with hoondis unorganized sector hoondi [FL] unorganized sector ka hi he and unorganized sector banks the multans, shrafs, shetiya they use a term there called the bazaar rate [FL].

Then, at at one point and still it exists some commercial banks other than SBI discount bills that is why I have the data on RBI site; RBI is not dealing with the commercial bills directly, commercial banks are dealing with them and they are known as the commercial bank's bill finance rate, commercial bank's bill finance rate. And it is very interesting that SBI has now probably does deal with a little bit with the directly with some first class bills only.

SBI [FL] position he public sector bank [FL] they deal with only with (()) hoondi hoondi market, they deal with the big companies commercial bills Tata's and Birla's etcetera and they call that the SBI discount rate they call that the SBI discount rate and the commercial banks discount rate is known as commercial bank's bill finance rate. So, over four five names you will find regarding the interest rate of the discount rate of the commercial bills. In the literature you will find them.

Now, I do not have any information on these interest rates. If you ask SBI if you go to them maybe you will get the information I haven't got any commercial bill interest rate information. One small point I want to mention, there is another type of commercial bills which not many people know which do not belong to the money market at all, they are very long term commercial bills and in this long term commercial bills institutions like

IDBI, SIDBI, big big nonbanks participate. What kind of bills, these bills are very interesting bills. These bills are IDBI what does it do it helps you to develop industries. So, suppose you have you need a big machine, but, you cannot afford to purchase it IDBI will lend it to you or you need some cash for specific investment alright IDBI will lend to you. Similarly, IDBI often lends which are also called long term commercial bills when a company wants to purchase something a machine it cannot make the payment immediately, IDBI stands as just not like a guarantor stands as a financier for the company in purchasing that machine set from another country, a foreign land an expensive it will be imported. So, IDBI finances it, creates a bill in favor of that company where the company pays over a period of time like a loan. These are also known as commercial bills because IDBI is not a bank so IDBI cannot give a loan in the true sense of the word, cannot create credit what IDBI does is that (()) you do not have the cash do not worry I know you I will get it, procure it, but, a bill will be created long term bill according to that you will be repaying money to me like a fixed payment loan or something alright.

And the maturity is sometimes five years and can even go up to seven years time the gift that bill maturity the bill to mature entire payment to be done, is a very interesting thing Industrial development going on, a company wants to buy a machine IIT Kanpur (()) a new educational institution wants to buy some equipments for the lab it does not have the funds. So, somebody comes and purchases it, but, creates a bill and this institution over a period of five years, seven years repays that money it is not like a bank credit; bank is bank collects deposits and creates credit multiple of that here it has a corpus it gives a loan indirectly it does not demand the cash, it purchases it on your behalf and temporarily the ownership maybe with the IDBI and then hand is over ownership of machine to you alright.

And there is a thousands of crores of IDBI have found data up to 95, 96 I do not have data since mid sixty IDBI started this business. IDBI and some other nonbanks and thousands of crores they have given out as commercial created this kind of long term commercial bills; where the payment will be made in future alright some transactions took place real goods basically a good has come from there to here, IDBI will make the payment now for them and then will recover the fund from local producer, commercial

bill gets created local producer over a period of time. Long term commercial bills not short term money market [FL] it is not that case it is a different kind of commercial bill.

So, these are what we have found is that the IDBI rediscount rate here etcetera whatever it does business has been lower than shorter bills and even RBI rates IDBI has been very generous in that sense.

These nonbanks have helped your country to develop a lot, particularly IDBI SIDBI etcetera. You have seen SIDBBI, how much it does for you even for IIT Kanpur Students. They want to do something, develop a prototype, develop a new technology from their lab, their students and Sidbi helps them with some funding. So, these organizations do a lot for India still development and other things

These are not banks remember, these are nonbanks they have a corpus and they lend out of it they do not create credit, they do not create a multiple of that; loan five times that amount loan. [FL] bank [FL] business [FL] and then I recover the money over a period of time.

So, some more company in India buying a machine from Germany they get into a agreement with IDBI standing in between they know each other very well, being a national institute, national institution and Germany agrees to sell it and IDBI makes a payment. German [FL] payment [FL] clear this is a very long term bills [FL]. So, I guess this is enough for your commercial bills.

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