UNIT 5 INDIAN FINANCIAL SYSTEM

Objectives

After reading this unit, you should be able to :

- explain the importance of the financial system;
- describe the structure and working of the money market and capital market;
- outline the structure of the banking system; and
- examine the working of the capital market along with its various instruments and intermediaries.

Structure

5.1 Introduction
5.2 Financial System and Working of Financial Markets
5.3 Structure of Money Market
5.4 Banking Structure in India
5.5 Reserve Bank of India
5.6 Scheduled Banks in India
5.7 Structure of Capital Market
5.8 Summary
5.9 Key Words
5.10 Self -Assessment Questions
5.11 References/ Further Readings

ignou THE PEOPLE'S UNIVERSITY

5.1 INTRODUCTION

Before dwelling into the various intricacies of the financial system you need to understand capital accumulation and its importance. In the previous units, you have read about different theories of economic growth and have realised that for an economy to achieve higher levels of both economic growth and indeed economic development, the role of capital formation is indispensable. Capital formation means an addition/increment in the existing stock of real capital available in the country. Capital in economics terminology does not mean money alone. It is a wider term that encompasses both physical and human capital. Physical capital like machines, tools, infrastructure, raw material, etc. leads to more production, profits and

the creation of assets in future. Human capital on the other hand includes skills, training, education, etc which improves the productivity of individuals and especially labour.

Saving and investment are two core components of capital formation. Saving in the simplest sense means the part of income that is not consumed. When saving is used in such a manner that it gives returns in future it becomes an investment. For example, you saved a certain proportion of your income and bought a piece of land. So buying land is an investment because if you sell it then the sale price of land will be higher than your purchase price and the margin between the two will be the profit. Now, instead of selling that land, you constructed a building on that land and then you gave it on rent. So, this rent will be an extra income for you and it will add to your current level of income or profit. So when savings are properly channelised it increases the stock of income or capital. As saving is important for an individual it is of paramount importance for an economy. A higher level of savings leads to more investment and capital formation which in turn becomes the source of economic growth. So, it is the creation of savings, mobilisation of savings and conversion of savings into capital assets that leads to capital formation.

There are large numbers of factors that affect the rate of capital formation in the country like income levels of the people, institutional factors like availability, number and coverage of financial institutions, the monetary and fiscal policy of the country, prevailing rate of interest, population, size of the market, etc.

5.2 FINANCIAL SYSTEM AND WORKING OF FINANCIAL MARKETS

A financial system consists of a set of institutions, instruments and markets which brings the savers and the investors to a common platform and provide the means by which savings are translated to investment. The principal objective of the financial system or financial markets is to channelise the savings into the most productive opportunity/avenues. In financial markets, there are two players namely lenders and borrowers. Individuals/ Households generate savings and have surplus funds. They can either put this amount of money in gunny bags and hide it or keep it under lock and key as was done in yester years. This form of savings did not yield any return and the constant fear of theft always lured upon the savers. On the other hand, capitalists/ entrepreneurs could not undertake new projects of production or expand the existing production capacity of the plant due to a dearth of capital. The major role of the financial system of the financial market is to bring these two together. Those who have savings (savers or lenders) put funds into banks and other financial institutions and

those in need of money or finance (borrower) take the money from these financial institutions. In this interaction both the lenders and borrowers gain and ultimately due to increased efficiency, production and exchange the whole economy gets benefitted.

The working of financial markets can be understood from the flow chart (Figure 5.1). The households save money in the financial system and these funds are channelised and in the form of loans are provided to the borrowers.

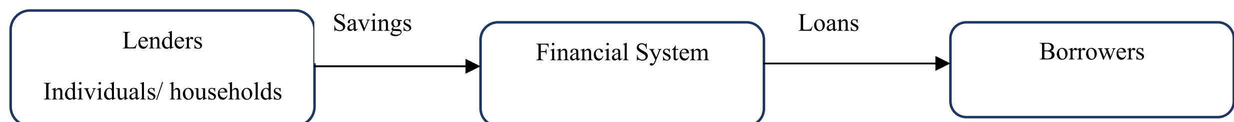

Figure 5.1 : Working of Financial Markets

Financial markets perform many functions like:

- To connect borrowers and lender of funds and to lead to the process of price discovery/determination.
- To provide liquidity in the system by allocation of funds in an efficient manner.
- Easy access of funds to the borrowers which in turn reduces the cost of the transaction.
- Provides a way for managing uncertainty and controlling risks.

5.3 STRUCTURE OF MONEY MARKET

Financial markets have two main components money market and capital market and they both are essential for the economic development of the country. In the following section, you will read about the money market, its importance and various instruments. The money market is a market for short-term financial assets and assets which are close substitutes of money. Short term implies time period of less than one year and close substitutes of money refer to those financial assets that can be converted to money with minimum/no transaction cost and without loss in value. The major participants in the money market are scheduled commercial banks (excluding regional rural banks or RRBs), cooperative banks (excluding land development banks) and primary dealers (PDs).

Objectives

The broad objectives or functions of the money market are :

- To provide equilibrating mechanism between short term surpluses and deficiencies.
- Maintaining liquidity in the system.
- Providing access to short term funds to the borrowers at minimum or realistic cost.
- To enable the central bank of the country intervention to influence and regulate liquidity in the economy.

Instruments of the Money Market

The main instruments traded in the money market and the sub-market are:

- Call Market/ Notice Market
- Commercial Papers (CPs) Market
- Treasury Bills (T-Bills) Market
- Commercial Bills Market
- Certificate of Deposits (CDs) Market
- Money Market Mutual Funds (MMMFs)

Let us now discuss them in brief.

- **Call Market/ Notice Market**

  It is a market for short term financial fundsthatare payable immediately and in full when the lender demands them. It is for this reason that call money is also known as "money at call". The maturity period variesfrom one day to a fortnight (14 days). When the funds are browed/lent for a day it is called call (overnight) money. If the duration of funds borrowed/lent is more than a day and upto 14 days it is called notice market. For conducting transactionsin the call/notice market there is no need for any collateral security.The major players in the call market are banks and primary dealers.The interest rate payable on call loans is known as the call rate.

- **Commercial Papers(CPs) Market**

CPs are short term unsecured instruments issued by companies to raise short term debts. They are issued in the form of promissory notes and in India they were introduced in 1990. Large corporations, primary dealers and Financial Institutions (FI) are authorised to issue CPs. The maturity duration of CPs is a minimum of 7 days and a maximum of up to one year from the date of issue. They are typically issued to short term financial obligations like funding of the new project. They can be issued in denomination of Rs 5 lakh or multiples thereof.Further, all eligible participants need to obtain a credit rating for the issuance of CPs. They need to have a minimum credit rating of A2 as per the Securities and Exchange Board of India (SEBI) definition and rating symbol. CPs are issued discount to face value basis (as discussed in the T-bills example). They have many advantages like the option of diversification for the source of finance, higher returns and liquidity.

- **Treasury Bills or T- Bills**

T-bills are short term borrowing instruments by the government of India. These are a form of a bill that does not arise from any genuine transaction in goods. They are a kind of promissory note issued by the Reserve Bank of India (RBI). The government uses T-bills to raise short term funds to bridge the temporary/seasonal gaps when a deficit arises due to shortfall (situation when receipts fall short of expenditure). At present T-bills of 91 days, 182 days and 364 daysare issued. These bills are bought and sold on a discount basis means they are zero-coupon securities and yield no interest. For example, a 91 days T-bill of Rs 200 (which is the face value) may be issued at say Rs 198.20. So the discount on this T-bill is Rs. 1.80 and at the time of redemption it will be redeemed at the face value (i.e. Rs. 200). The return which investors gain is the difference between the face value (maturity value) and the issue price. T-bills are issued by RBI through auctioning.RBI conducts auctions of T-bills with a maturity period of 91 days, 182 days and 364 days every Wednesday. The date and place of auction, maturity time period and the method of auction is announced by the RBI from time to time.There are two main types of auctions namely multiple-price auction and uniform-price auction.The main features of T-bills are they are negotiable instruments, highly liquid because of the short time period, secured as they are backed

by the government guarantee, assured yield and low transaction cost. The net short term market borrowing of the government through 91 days, 182 days and 364 days T bills stood at Rs.37,528 crore during 2019-20.

... **Commercial Bills Market**

Commerical bills include bills of exchange and promissory notes. A promissory note is a form of financial instrument in which the note's issuer and the note's payee undertake a written promise whereby the issuer promise to pay a definite sum of money either on demand or at a specified future date to a particular person or to the bearer of the instrument. Commerical bills originate due to original trade transactions. There are many types of bills like trade bills, commercial bills, inland bills, foreign bills, indigenous bills and others. Rediscounting of bills is an important segment of the bill market. Commercial banks often make use of such facilities.

Let us understand the concept of rediscounting with a help of an example. Suppose a commercial bank buys 91 -days T-Bill at Rs 1000 and receives Rs 1100 at the time of maturity. In this case, the difference between the purchase price and face value of the bill is Rs 100 is called the discount. Re-discounting occurs when the short-term negotiable debt instrument is discounted for a second time. In continuation with the above example, let's assume that the same bank needs money urgently for say 30 days, it will approach the central bank of the country and the central bank can purchase some of the bills from the bank say for Rs 1050 for a period of next 30 days but before 90 days the date of maturity. In this case, the rediscount or the difference between the purchase price and the face value is Rs. 50.

... **Certificate of Deposits (CDs) Market**

CDs are negotiable money market instrument against funds deposited in a bank or other financial institutions for a fixed time period at a specific rate of interest. They are the bearer documents and issued in dematerialised form. Scheduled commercial banks (except RRBs and local area bank) and selected all India FIs can issue CDs in a minimum amount of Rs. 1 Lakh and in the multiples of Rs. 1 Lakh. The maturity period of CDs is a minimum of 7 days and a maximum up to one year. They are issued at a discount on face value. Banks have to maintain appropriate reserve

requirements i.e., Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) on the issue price of CDs.

... **Money Market Mutual Funds (MMMFs)**

To increase the participation of individuals and small investors in the money market and to provide additional short term funds avenues to the investors MMMFs were introduced in April1991 and the detailed scheme of MMMFs was announced by RBI in 1992. A mutual fund is an investment scheme mostly run by an asset management company. Money is collected from a large number of investors and this pool of money is invested in stocks, bonds and other securities. MFs are mostly beneficial for small investors like the salaried class who park their funds in MMMFs and can gain better returns. They offer diversification of short terms assets in terms of issues, maturity and volume, thereby spreading the risk. Whenever investor buys mutual funds they are allotted units/share of the mutual fund. These MFs are professionally managed and investors earn income in the proportion to the number of units owned by them. Initially, only banks, FIs and their subsidiaries were allowed to set up MMMFs but corporates and others were allowed for the same from 1996. All MMMFs are governed and regulated by SEBI.

Structure of Money Market in India

The structure of the money market in India is presented in Figure 5.2. The money market is divided into two parts i) Organised and ii) Unorganised.

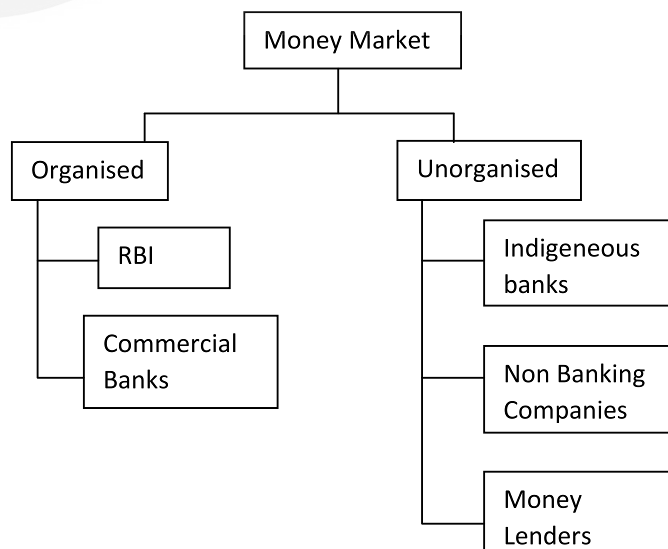

Figure 5.2 : Structure of Money Market in India

The organised sector consists of the central bank of India or RBI, commercial banks both nationalised and private. Further, foreign banks, cooperative banks, the discount and finance house of India and other financial institutions like IFCI, ICICI, LIC, GCI and mutual funds also operate in the money market. The unorganised sector consists of non-bank financial intermediaries, indigenous bankers and money lenders.

5.4 BANKING STRUCTURE IN INDIA

As discussed previously banks are one of the most important segments of the money market. Let us read about the banks, their functions, the structure of the banking system in India with special reference to RBI.

Definition of Bank

According to the Banking Regulation Act 1949, a banking company is a company that transacts the business of banking in India and banking means accepting deposit of money from the public for the purpose of lending or investment however with the promise of repayment on the demand by the depositor with the facility of withdrawal by cheque, draft, order or otherwise.

The functions of banks have changed from traditional (accepting deposit and lending credit) to many more functions like collection and payment of cheques, bills and promissory notes, sale and purchase of securities, remittances of funds, merchant banking, services of automated teller machines (ATM), electronic fund transfer system, dealing in foreign exchange, and others.

ignou THE PEOPLE'S UNIVERSITY

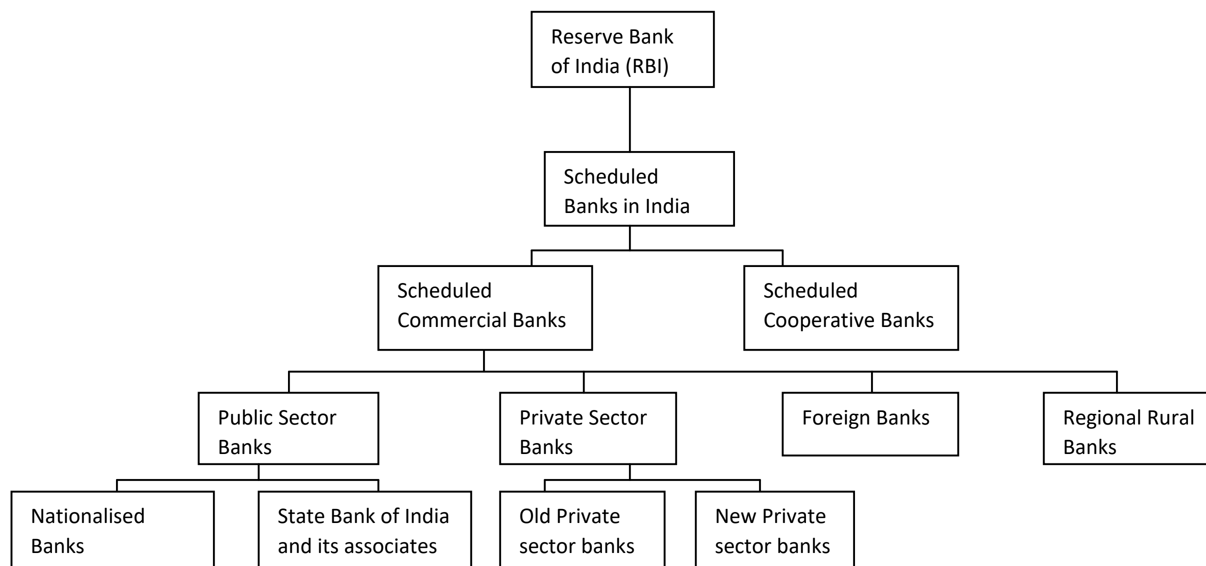

Figure 5.3: Banking Structure in India

The structure of banking in India is presented in Figure 5.3. At the helm of the affairs, there is RBI which is the regulator of the banking sector and supervises the monetary policy of the country. After that, we have scheduled banks that are further classified as scheduled commercial banks and scheduled cooperative banks. Public sector banks, private sector banks, foreign banks and Regional Rural Banks(RRBs). Within the Public sector, there are nationalised banks and the State Bank of India (SBI) and its associates. Private sectors banks have two categories old and new private sector banks. In the following sections, you will briefly read about them.

5.5 RESERVE BANK OF INDIA (RBI)

RBI is an apex bank of the country and acts as the regulator of the financial and monetary system in the country. It was established after the recommendation of the 'Hilton- Young Commission'. It was established as a banker to the central government by the Reserve Bank of India Act 1934 and it began its operations from April 1935 as a private shareholders bank with the paid-up capital of Rs.5 crore and in 1949, RBI was nationalised.

Functions of the RBI

Some of the major functions of RBI are:

- Note Issuing authority
- Banker to the Banks

- Banker of the Government and Debt Manager
- Banking Sector Regulator
- Foreign Exchange Manager
- Maintaining Financial Stability
- Development Role
- Regulator of the Monetary Policy

Note Issuing Authority

RBI has a monopoly over note-issuing in India other than one rupee notes/coins and coins of smaller denomination. RBI ensures that both currency notes and coins are available in an adequate amount in the country. The currency notes issued by RBI are legal tender in the length and breadth of the country. RBI can issue currency notes up to the denomination of Rs. 10,000. At present notes in the denomination of Rs 2, Rs 5. Rs 10, Rs 20, Rs 50, Rs 100, Rs 200, Rs 500 and Rs 2000 are issued. Similarly, coins in circulation comprise Rs 1, Rs 2, Rs5 and Rs 10.

Banker to the Banks

All the banks in the country havean account in the RBI via which banks settle inter-bank transaction and customer transactions. It also enables banks in maintaining statutory reserve requirements like SLR and act as lenders of the last resort. It also provides short term loans and advances to banks as and when the need arises.

Banker of the Government and Debt Manager

RBI acts a banker to the central government of the country along with those state governments which have agreed with RBI. It maintains the government accounts and does financial transaction from this account along with the transfer of government funds. It manages the government domestic debt and raises the money both from the public and financial market to bridge the shortcoming of revenue.

Banking Sector Regulator

RBI regulates and supervises the banking system of the country in accordance with the various provisions of the RBI Act and Banking Regulation Act. RBI as a regulator does a wide range of activities like providing licenses, prescribing capital requirement like capital adequacy norms, paid-up capital and lending to the priority sectors of the economy like farmers, women, etc. Regulation of interest rate, an inspection of the banks and bank branches, setting of different regulatory norms and also to initiate new regulation in accordance to changing circumstances.

Foreign Exchange Manager

As you may have read that trade is very essential for any economy. For conducting trade adequate stock of foreign exchange reserves are an important requirement. RBI plays an important role in both the development and regulation of the foreign exchange market. It regulates the transactions which are related to both exports and imports and ensure smooth conduct in the domestic foreign exchange market. It is the custodian of foreign exchange reserves and the golds reserves of the country. The banks and selective institutions which wish to deal in the foreign exchange need to have a license from RBI.

Development Role

RBI aims at promoting financial literacy and education among the public and also ensures that credit is available to the productive sectors of the economy. For the development purpose RBI has established many institutions like the National Bank for Reconstruction and Rural Development (NABARD), Unit Trust of India (UTI), Deposit Insurance and Credit Guarantee Corporation, Industrial Development Bank of India (IDBI) among others.

Regulator of Monetary Policy

Monetary policy is the policy of RBI through which it regulates the financial market of the country and most importantly it is used for credit control. Credit creation is one of the chief functions of the bank. Before we move forward let us understand what is credit creation. Whenever the bank accepts a deposit from the customer, it retains some proportion(which is

mandatory) of this deposit for the requirement of the depositor and the rest is given as a loan to the buyer. So bank creates money out of money this process is called credit creation. It is through credit creation that money flows into the system. However, both the excess and deficiency of money circulation is damaging for the economy. If the supply of money is more than the demand then we have the problem of inflation which you have read in previous units. In contrast, if the money supply is less than demand then we have the problem of deflation. So, RBI uses monetary policy to control credit. Methods adopted by RBI for credit control are classified as i) Quantitative and ii) Qualitative.Lets us discuss these methods in detail in the following sections and once we have discussed these methods we can understand with the help of illustration how these methods are adopted for credit control.

Quantitative Methods

Quantitative methods are used to control total quantity or volume and the cost of the credit created by banks. Within Quantitative methods, we have direct and indirect instruments. Cash Reserve Ratio (CRR), Statutory Liquidity Ratio (SLR) and Refinance facilities are direct tools. Bank rate, Repo and Reverse repo rate, Liquidity Adjustment Facility (LAF), Open Market Operations, Market Stabilisation Scheme (MSS) and Marginal Standing Facility (MSF) are indirect instruments.

Cash Reserve Ratio (CRR)

It is the minimum amount that banks keep with RBI as a proportion of their Net Demand and Time Liabilities (NDTL). The CRR percentage is notified from time to time by RBI. CRR ensures that banks have sufficient cash for their depositor's requirement.

Statutory Liquidity Ratio (SLR)

It is the percentage of NDTL that banks have to mandatory maintain in safe and liquid assets like cash, gold or government securities. SLR restricts the expansion of bank credit, increases bank's participation in the security markets especially government securities, and it also ensures the solvency of banks.

ignou THE PEOPLE'S UNIVERSITY

Refinance Facility

This facility is used by RBI to provide adequate credit to selective sectors like the export sector.

Bank Rate Policy

According to RBI Act, 1934, a bank rate is "the standard rate at which RBI is prepared to buy or rediscount bills of exchange or other commercial paper eligible for purchase under this act". The bank rate has been aligned to the Marginal Standing Facility (MSF) and it changes automatically when MSF changes.

Repo Rate

It is the rate at which RBI lend to the banks overnight against the collateral of government and other approved securities under the arrangement of Liquidity Adjustment Facility (LAF). In simple terms, it is the fixed interest rate at which banks borrow from RBI for the short term. At present, Monetary Policy Committee (MPC) decides this policy rate along with the reverse repo rate.

Reverse Repo Rate

It is a fixed interest rate at which RBI borrows from the banks in order to absorb liquidity for the short term (overnight basis). RBI borrows against the collateral of eligible government securities under the LAF.

Liquidity Adjustment Facility: This facility was introduced by RBI after it was suggested by the Narasimham Committee on Banking Sector Reform of 1998. It is a mechanism for managing the liquidity needs of the bank. It aims to inject/absorb liquidity from the system in the situation of shortages and excess. The repo, reverse repo, term repo (auction), overnight variable rate repo (auction), overnight variable rate reverse repo (auction) are the components of LAF.

ignou THE PEOPLE'S UNIVERSITY

Policy Rates as on Arpil, 2021	
Cash Reserve Ratio (CRR): 3.50 %	Repo Rate: 4.00 %
Reverse Repo Rate: 3.35 %	Marginal Standing Facility Rate: 4.25 %
Bank Rate: 4.25 %	Statutory Liquidity Ratio: 18%

***Source*: Reserve Bank of India**

Open Market Operations

It refers to buying and selling of government securities by RBI in the money market. Both the purchase and sale of these securities may lead to expansion and contraction of the money supply. For example, at the time of inflation, RBI sells these securities and banks buy them. When banks buy these securities then bank credit is directed away from the public to RBI which leads to less credit creation and less supply of money in the market.

Market Stabilisation Scheme

In 2004 this scheme of RBI was launched in order to withdraw excess liquidity from the market by selling government bonds. The problem of excess liquidity was due to RBI purchase of foreign currency. The bonds which the RBI sells are called Market Stabilisation Bonds (MSBs) and they are owned by Government of India.

Marginal Standing Facility

It is a facility for banks that can be used in an emergency. Under this facility scheduled commercial banks can borrow up to one percent of their NDTL at 100 basis points (1 percent) more than the repo rate for the short term (overnight) from RBI. It provides a safety value to banks against unanticipated liquidity shocks.

ignou THE PEOPLE'S UNIVERSITY

INFLATION/ DEFLATION AND QUANTITATIVE METHODS

Lets us take an illustration to demonstrate how RBI uses these methods in the time of Inflation/deflation.Lets us assume that CRR is 10 percent and NDTL are to the tune of Rs.100. Now CRR is the proportion of NDTL which banks have to keep with RBI. So out of this Rs.100 banks have to keep Rs 10 with RBI so they can now create credit worth Rs.90. Now suppose that economy is witnessing inflation in which supply of money is greater than demand for money. At the time of inflation, RBI can increase CRR (Repo, Reverse repo and bank rate) to 15 percent, so now instead of Rs 10 banks have to keep Rs 15 with RBI and they can create credit worth Rs 85 only. So by increasing CRR (or other policy rates) RBI can curb the credit creation capacity of banks and reduce supply of money. On the other hand at time of deflation RBI reduces reserves so that more liquidity can be pumped into economy.

Qualitative Methods/ Selective Methods

These methods focus on certain sectors only. By using these methods RBI can divert the flow of credit from one sector to another. The different qualitative methods used by RBI are credit rationing, consumer credit regulation, increasing margin requirement, moral suasion, direct action and others. We will only discuss some of them in this section.

Credit Rationing

Under this method, RBI controls and regulate the purpose for which credit is granted by banks. The central bank can put a ceiling on the amount of loans that can be advanced to the banks.

Consumer Credit Regulation

This method helps in controlling excess spending by the consumers. RBI can direct banks to fix a minimum percentage of down payment, instalment amount, loan duration, etc.

Margin Requirement

Margin requirement is the difference between the market value of the security which is pledged for taking a loan and the maximum amount of loan which can be disbursed against this security. For example, the margin requirement is 10 percent and you wish to take a loan. You approach a bank for a loan with security which is worth Rs 1000. As the prescribed margin is 10 percent the bank keeps this margin and will lend you only Rs 900. Now if there

is an excessive money supply in the economy then RBI can increase this margin to say 30 percent. So instead of Rs 900, you will get a loan of Rs 700 against the same security. So in the situation of inflation, this margin is increased and during deflation, it is reduced.

Moral Suasion

RBI requests or persuades commercial banks to behave in a particular manner according to the financial situation of the economy. For example, during inflation RBI requests commercial banks to restrict bank advances.It is a sort of advice and there is no compulsion by RBI. The effectiveness of this policy depends upon coordination between RBI and commercial banks.

Direct Action

It refers to the direction and the controls which RBI enforces on particular or all banks in case of default or no adherence to advise of RBI. RBI can reject the request of banks for grants or rediscounting facilities or it may levy penal rate interest on loans that banks borrow beyond the prescribed limit.

5.6 SCHEDULED BANKS IN INDIA

Scheduled banks are those banks that are included in the second schedule of the RBI Act, 1934. These banks need to have paid-up capital and reserves of not less than Rs 5 lakhs. These also need to maintain CRR balance with RBI and they can raise debts and loans from RBI at the bank rate. Scheduled commercial banks are further classified as public sectors banks, State Bank of India (SBI) and its associates, old and new private sector banks and foreign banks.

Public Sector Banks(PSBs)

PSBs are those banks in which more than 50 percent of shares are held by the GoI. These are the major type of banks in India. At present (2021) there are 12 PSBs namely SBI, Bank of Baroda, Bank of India, Punjab National Bank (PNB), Indian Overseas Bank, Punjab and Sind Bank, Indian Bank, UCO Bank, Bank of Maharashtra, Central Bank of India, Canara Bank and Union Bank of India.

SBI and its Associates

SBI is the biggest commercial bank in the country with nearly 25 percent market share and has over 22000 branches and 58500 ATMs. SBI came into being on 1 July 1955 when the GoIpassed the State Bank of India Act, 1955 by taking over assets and liabilities of the Imperial Bank of India. Imperial Bank of India was formed in 1921 through the amalgamation of three presidency banks namely Bank of Madras, Bank of Bombay and Bank of Bengal. At present, SBI is a Fortune 500 company and is headquartered in Mumbai. SBI initially had 7 associates namely State Bank of Bikaner and Jaipur, Hyderabad, Indore, Mysore, Patiala, Saurashtra and Travancore. However, in 2008 and 2009 State Bank of Saurashtra and Indore was merged with SBI and the remaining 5 associate banks were merged in 2017.

Private Sector Banks

Private sector banks are those banks in which the majority of the stake is owned by private shareholders. In India, private sector banks are classified as Old and New private sector banks. The private banks which were not nationalized (in the year 1969) are collectively known as the old private sector banks and include banks such as The Jammu and Kashmir Bank Ltd., Lord Krishna Bank Ltd. etc. As of April 2021, the number of private sector banks in India was 22. Some of the famous private sector banks are ICICI, HDFC,etc.

Foreign Banks

Foreign banks are those banks which have headquarter in a different country but has branches in India. As of July 14, 2020, there are 46 foreign banks in India. These banks have to follow rules both of home and host country. Bank of America, Bank of Ceylon, National Australia Bank, BNP Paribas, etc are some of the foreign banks in India.

Regional Rural Banks (RRBs)

They were established in 1975 to develop the rural economy and creation of additional channel to the cooperative credit structure to enhance the reach of institutional credit for the rural and agriculture sector. There were 43 RRBs as of April 2021.

Scheduled Co-operative Banks

Cooperative banks function on the concept of cooperative credit societies wherein the members of the society join together to extend a loan to each other at a subsidised rate of interest. Scheduled Co-operative Banks are of two types Scheduled State Co-operative Banks and Scheduled Urban Cooperative Banks. There are 23 Scheduled State Co-operative banks and 53 Scheduled Urban Cooperative banks.

> **Narasimham Committee on Banking Sector reforms**
>
> Government of India set up two expert committees under the chairmanship of M.Narasimham for the restricting of Banking sector popularly known as Narasimham Committee-1 (1991) and Narasimham Committee-II (1998).

Activity 1

1. Suppose you are hired as an advisor to the finance minister and the country is witnessing a high rate of inflation. What advice would you offer regarding changing the policy rate like CRR, Repo Rate, etc. and why?

____
____
____
____
____
____

2. The Govermnet of India is planning for more mergers of banks. How do you look about this decision?

____
____
____
____

5.7 STRUCTURE OF CAPITAL MARKET

In the previous section, you have read about the money market which provides short term funds to investors for less than one year. However, business units and investors need funds for a longer duration also for undertaking business expansions or technology upgrading and in this regard they approach the capital market. A capital market is a market for long term securities or financial instruments having a maturity period of more than one year. Capital markets are important for channelising savings, capital formation and industrial growth. The structure of the capital market in India can be better understood with the help of Figure 5.4

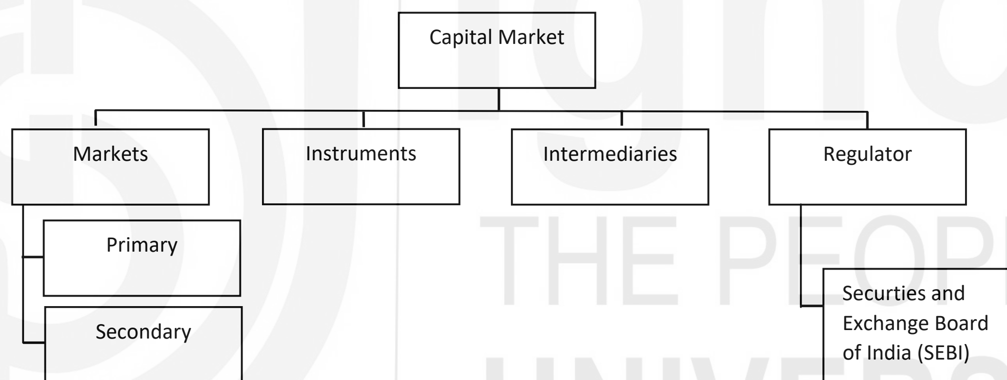

Figure 5.4: Structure of Capital Market in India

Capital markets comprised of two markets i) Primary Market and ii) Secondary Market. The primary market is also known as the New Issue Market (NIM) where the issuer of the securities (shares and bonds) sell the new securities to the investors directly without any intermediaries. Whenever the securities are offered for sale for the first time by the companies they are called Initial Public Offering (IPO). IPO is issued to raise capital for funding purpose. Both the companies and government raise funds by the sale of new stocks in the primary market.

The secondary market is also known as the stock market. It is a place where shares, bonds, options, etc which were sold earlier are sold and purchased. In India, you must have heard

about the Bombay Stock Exchange (BSE), National Stock Exchange (NSE) they are some of examples of stock exchanges. The secondary market can be either an auction market or Over-the-Counter. In the auction market, trading of securities is done through the stock exchange. In Over-the-Counter the trading is conducted without using the platform of stock exchange, it does not have any physical location and trading is done electronically.

Financial Instruments

Some of the major financial instruments used in capital markets are discussed below.

Shares

A share indicates a unit of ownership by the buyer of shares called shareholder/holers of the company. A shareholder has ownership in the company and has voting rights and shares the company profit or loss. The benefit which a shareholder receives out of company profit is called a dividend. Let us understand it with an example. Assume that there is a company know as XYZ limited and it needs funds (Rs 100 crore) for further expansion. For raising this fund the company will go to the public. This capital of Rs 100 crores is divided into 1,000,000 shares of Rs. 1000 per share. Now assume that there are two investors A and B and they want to invest in this company so they will buy some shares. Investor A buys 500 shares and investor B buys 800 shares so they are investing Rs 500000 and Rs 8000000 in this company and have become the shareholders and will share the profit or loss of the company in the proportion to their holdings. Further, shares are of two types namely equity shares and preference shares.

Bonds

Bonds are issued by state and central governments, companies and municipalities to raise money for a variety of projects and activities. They are debt instruments in which the entities borrow the funds for a defined period of time at a variable or fixed interest rate. It is fixed-income security and essentially a loan agreement between a bond issuer and an investor. The bondholders unlike shareholders do not have any ownership of the company or have voting rights.

Debentures

Debentures are also a type of debt instrument which is issued by companies for raising funds but they are not secured by physical assets or collateral. An investor buys debentures based on the reputations and the creditworthiness of the issuer. The interest rate on debentures is higher than that of bonds.

SENSEX also known as Sensitive Index (or S&P BSE Sensex Index) is a benchmark index of Bombay Stock Exchange. It is the market weighted stock of 30 companies.

Gilt Edge Market : The gilt-edged market refers to the market for Government and semi-government securities and is backed by the RBI. Government securties are called Gilt -edged means 'of the best quality' because they are highlighy liquid and risk free

Capital Market Intermediaries

There is a large number of intermediaries in the capital markets some of which are discussed below:

Merchant Bankers

Merchant Bankers are intermediaries between the investors and the company. They act as an advisor who advises the entrepreneurs from the stage of the conception of the project till the production begins. SEBI defines merchant bankers as "any person who is engaged in the business of issue management either by arranging for buying, selling or subscribing to securities or acting as manager, consultant or rendering corporate advisory services in relation to such issue management".

Underwriters

When a company decides to go public to raise funds all of its securities maybe not fully subscribed by the public, so there is a need for someone who can subscribe to those securities. This work is done by the underwriter he agrees with the issuer company that in the case of securities that are not subscribed then the underwriter would subscribe to the securities itself or by others the unsubscribed securities. He is paid a fee called 'underwriting commission' for this job. Underwriters can be both institutional (for example IDBI, UTI) or non-institutional. All underwriters need to be registered with SEBI.

Portfolio Managers or Portfolio Management Services (PMS)

A professional who enters into a contract with the client to advise or direct or undertake investment decisions on behalf of the client. Portfolio managers are of two types discretionary portfolio managers and non-discretionary portfolio managers. When the portfolio manager manages the funds of the client independently according to the needs of the client they are called discretionary portfolio managers. Whereas non-discretionary portfolio manager manages the funds following the directions of the client. Some of the examples of major **Portfolio Management Services** in India are Motilal Oswal PMS, Kotak PMS, ICICI Prudential PMS, etc.

Stock Brokers

A stockbroker is an individual or firm which is an intermediary between an investor and a securities exchange. The stockbroker trades in the stock exchange on the behalf of their clients. In return for their services, they are paid commissions of fees. They handle all the paperwork and maintain records of all transaction, manages their client's portfolio and advise the investors on formulating different investment strategies in the dynamic world of financial markets. All stockbrokers are registered with the SEBI.

Regulator of the Capital Market /SEBI

In India, the capital market is regulated by the Securities and Exchange Board of India (SEBI). SEBI was established in 1988 as a non -statutory body but with the passing of SEBI Act 1992, it was accorded statutory power. The major objectives of SEBI are to protect the interest of investors and development and regulation of stock exchange, to prevent deceitful malpractices and to regulate and develop a code of conduct for intermediaries such as brokers, underwriters, etc. SEBI performs various functions like registration of stock exchanges, mutual funds, underwriters, brokers and sub-brokers. Levys various fees and other charges promote investors educations, audit and inspection of stock exchanges and various intermediaries, prohibits unfair trade practices relating to the securities market and insider trading.

Activity 2

1. Conduct a field survey of your neighbourhood and assess the awareness level of the stock market.

2. Nowadays there is a trend of investment among common man in Mutual Funds through Systematic Investment Plan (SIP). Try to collect some information in your neighbourhood about the factors which affect individuals decision to invest in MF.

ignou
THE PEOPLE'S
UNIVERSITY

5.8 SUMMARY

This unit has given you detailed information about the financial system. Initially, you read about the importance of the financial system whereby it brings the suppliers and the borrowers of funds in the common platform. In the subsequent sections, the importance, functions and instruments of the money market were discussed. One of the major components of money markets is banks. In India, RBI is the apex bank and it formulates and regulates monetary policy. Monetary policy has two instruments namely quantitativeand qualitative. Quantitative instruments include various policy rates like CRR, Repo and Reverse repo rate, bank rate, etc. which aims at controlling the quantum of credit. Qualitative methods like moral suasion, direct action and others aim at directing the credit flow to a particular sector or to prohibit the credit flow. RBI uses both instruments but quantitative methods are more visible and easy to administer.

In the next section, you developed an understanding of banks and the various functions of the banks along with the structure of banking in India. The different categories of banks like the public sector, private sector, foreign banks were discussed in some details. In the last section, an understanding of the working of the capital market was highlighted with the emphasis on the meaning of capital market, its various instruments, intermediaries and SEBI.

5.9 KEY WORDS

Financial System: It consists of a set of institutions, instruments and markets which brings the savers and the investors to a common platform and provide the means by which savings are translated to investment.

Cash Reserve Ratio (CRR): It is the minimum amount that banks keep with RBI as a proportion of their Net Demand and Time Liabilities (NDTL).

Statutory Liquidity Ratio (SLR): It is the percentage of NDTL that banks have to mandatory maintain in safe and liquid assets like cash, gold or government securities.

Bonds: Bonds are issued by state and central governments, companies and municipalities to raise money for a variety of projects and activities.

5.10 SELF-ASSESSMENT QUESTIONS

1. Differentiate between money market and capital market.
2. Differentiate between shares and bonds.
3. What are the major functions of RBI?
4. Write about some of the instruments of the money market.
5. Write a note on SEBI.

5.11 REFERENCES/ FURTHER READINGS

1. Mishkin, Frederic. S. (2007) *Financial Markets and Institutions*. New Delhi, Pearson Education Ltd.
2. Khan, M. Y. (2007). *Indian Financial System*. New Delhi. Tata McGraw Hill.
3. Machiraju, H.R. (2006). *Indian Financial System*. New Delhi. Vikas Publication.
4. Bhole, L.M. (2008). *Financial Institutions and Markets*. New Delhi. Tata McGraw Hill.

ignou
THE PEOPLE'S
UNIVERSITY

UNIT 6 INDUSTRIAL POLICY FRAMEWORK

Objectives

After reading this unit, you should be able to:

- trace the evolution of Industrial Policy in India;
- describe the framework of Industry Policy Formulation in India;
- identify the gaps in previous industrial policies and the need for New Industrial Policy;
- analyse the benefits and gaps of the present Industrial Policy;
- draw a comparison between State Specific Industrial Policies in India; and
- assess the importance of other policies supplementing the Industrial Policy.

Structure

6.1 Introduction
6.2 Industrial Policy Framework and Features
6.3 Stages of Industrial Policy Prior to1991
6.4 New Industrial Policy 1991
6.5 Analysis of the New Industrial Policy
6.6 State Specific Industrial Policies
6.7 Other Important Policies Focusing on Industrial Promotion
6.8 Summary
6.9 Key Words
6.10 Self-Assessment Questions
6.11 References/ Further Readings

6.1 INTRODUCTION

Industrial development is aimed to achieve economic prosperity and improving the lives of its people. India left no stone unturned to brace and strengthen its industrial development for which the quest started after independence in 1947. The initially conceived policy - The Industrial Policy Resolution of 1948 outlined and defined the role of the State in industrial development both as an entrepreneur and authority. For a stringent framework and better implementation of the Industrial Policy, enactment of Industries (Development & Regulation) Act, 1951 (referred as IDR Act) followed. This also allowed Union Government to direct investment into preferred areas of industrial activity through the mechanism of licensing and keeping abreast with national development objectives.

To fast-track industrialisation and to place India among global competitors, it was imperative to achieve sustainable growth, optimum utilisation of resources and growth in production with a focus on best possible utilisation of human resources and international competitiveness. To achieve sustainable growth, the policy explored prospects to deregulate

Indian industry while easing restrictions. Since 1991, economic reforms envisioned new and substantial role for private entities. In view of this, the policy has been progressively liberalized over the years. You will learn more about it in the following section.

6.2 INDUSTRIAL POLICY FRAMEWORK AND FEATURES

Indian economy was being built into a self-reliant and self-sustained unit with an aim to achieve industry-led-growth. The policy environment relied on import substitution, inward growth and subsidizations. Public sector in India soon witnessed a phenomenal expansion and economic prosperity.

However, it came to be afflicted with infirmities. At this point in time, it was realised that there was a need to make the public sector market-oriented. Hence, well-balanced improvements were needed to reformulate the policy accordingly. Public sector played a supportive role in the new policy framework but the initiative for growth was to be commenced from the private capital and enterprise. And so, the actual reformation started after 1995 and was influenced by three factors:

- Young entrepreneurs entered a competitive economy.
- Tariff rates started dropping down along with quantitative import restrictions becoming history.
- MNCs started entering India in greater numbers and created a competitive landscape from within.

Not just these factors but there are handful of other aspects that affected the industrial policy thereby impacting investment and production. Some of these were industrial licensing policy, control of monopolies and economic concentration, policies regarding technology import along with financial and fiscal policies affecting the provision of industrial finance, development of the capital market, as well as fiscal incentives/ disincentives to investment and production. It is in this context that we have to understand the evolution of industrial policy in India and know how it has worked as an effective tool to comprehend the objective of planned development. A look through the features of industrial policy will be focused upon.

6.3 STAGES OF INDUSTRIAL POLICY PRIOR TO 1991

The model of development and growth and the changes with time demands changes in economic policies and the need to create institutions for successful implementation of polices and to achieve growth. This means involvement of State is essential.

Industrial Policy and Strategy

From the time of Second Five Years Plan, Industry-led-growth strategy was a adopted and this strategy was based on the Industrial Policy Resolution (IPR) of 1956.

A number of changes had taken place during this time. So the IPR 1956 laid emphasis on the following:

- Fast-track expansion of heavy machine industry to lay the ground work for 'capital goods industries'.
- Involve private sector and make them co-partners.
- Expand heavy industry's base in the public sector.
- Promote and enhance growth of cottage and small scale industries by establishing large co-operative sector.

The IPR 1956 was commonly referred as the 'Economic Constitution' of India which established a base for cottage and small-scale industries and aimed to enhance their growth. A classification was made specifying industries into different groups while stating that both public and private sector was at the same time anticipated to be a part of the course of industrialisation in India. The demarcations of the industries were based on the following three schedules:

- **Schedule A:** Barring the industries for which permissions had already been given, 17 new industries to be set up by the State.
- **Schedule B:** Private sector industries - 12 in number to be set up with an aim to supplement the efforts of the State; and
- **Schedule C:** the developmental initiative was left entirely to the private sector except for the 29 above. Despite difference, it was always left open to the State to undertake industrial production in any of the areas keeping the national interest in mind.

Industrial Licensing

Industrial Licensing formed the backbone of State policy. The government initially insisted upon a written permission to an industrial unit allowing manufacturing of only those goods which were itemized in the permission letter was an important instrument which allowed the State to ensure that the manufacturing units follow the set of rules in place. The licence allotted to a manufacturing unit basically specified the whereabouts of the unit including site of the plant, merchandise to be manufactured, period within which the industrial capacity is to be established, etc.

The key objective behind licensing was the idea to work in unison or in agreement with the industrial policy. Any important alterations and modifications in industrial policy would need corresponding changes in the framework of Industrial Licensing.

The legislative framework for industrial licensing was represented in **three** different Acts:

- **Industries Development and Regulation (IDR) Act, 1951** – This was ordained to ensure that all industrial units obtain compulsory certificate of registration and new industrial units to be recognized as industrial units only after obtaining a license from the central government.
- **Monopolies and Restrictive Trade Practices (MRTP) Act, 1969** – The primary role of this framework was to control and curtail the concentration of economic

influence and discourage monopolies. It enforced restrictions on the acquisition and transfer of shares of, or by, certain corporate bodies, control monopolistic trade practices and restrict unfair trade practices. Another primary objective was to control monopolistic trade practices by promoting healthy competition.

… **Foreign Exchange Regulation (FERA) Act, 1973** –This was enacted to control the acquisition of foreign exchange or holding foreign exchange in any form. Basically, FERA 1973 was an extension of the Foreign Exchange Regulation Act, 1947. This Act empowered the Reserve Bank of India and the central government to ensure that foreign exchange earned by exports or otherwise are properly accounted for.

It was obligatory to take the permission from the Reserve Bank of India to carry out any trade activity either commercial or industrial in nature. Even the purchase of shares of any company required permission and this scrutiny was applied to any acquisition of any undertaking in India.

Phase of Liberalisation

Four decades after independence, the industrial landscape underwent a drastic change. The industrial policy's initial approach was to safeguard and protect the Indian industry during the initial stages of development and economic fluctuations. But this approach did not allow the industry to expand and adapt. Therefore, far-reaching expansions to the initial idea were made:

- **Mid-1970s Onwards:** During mid-1970's advancements and experimentations within internal trade witnessed liberalisation. This decade marked liberation from controls including an increase in license capacities and ease in licensing restrictions. Licensing policy underwent constant changes on complex features during 1970s and 1980s.
- **Mid-1980s Onwards:** To keep a check on fiscal, monetary and trade policies, industrial policy was reoriented and gained a push after the mid-1980s. Accelerated Growth and an improvement in domestic resources was the primary aim for this momentum.

Need for an Accelerated Growth: To meet the accelerated growth, expansions were made as follows:

- An improvement in imports meant improvement in production and hence imports was given attention;
- Amplified exports to pay for increased imports and avoid risks of heavy debt burden, a trait associated with large scale commercial borrowings;
- Progresses in terms of sharpening the competitive edge of exportable goods; and

ignou THE PEOPLE'S UNIVERSITY

- Revisions in industrial, trade and fiscal policies to increase benefit for exportable goods.

Domestic Resource Condition and the need to improve: There was an urgent need felt to improve the condition of domestic resources and there are few reasons listed below to understand why this was needed

- Government budgets were no longer enough sources of investment and finances.
- Any reduction in defence spending was not an option for the government;
- Subsidies can be reduced only at a slow pace to avoid any major social and political hitches; and
- Now the only way to raise additional funds was to make tax system more comprehensive and ensure that public sector enterprises generate more and more resources.

The above two proposals were immensely helpful in establishing the role of market and helping expand the concepts like broad banding, minimum economic capacity and de-licensing.

Moving further, let's keep in mind that the period beginning with 1985 witnessed development of rule based industrial policies. This included tax and tariff based interventions and dual pricing making direct price, output or capacity controls obsolete.

Activity 1

1. Briefly enumerate the key features of evolution of India's Industrial Policy.

____
____
____
____
____
____
____
____
____
____
____

2. Briefly explain the framework for devising the industrial policy.

____
____
____
____
____
____

ignou THE PEOPLE'S UNIVERSITY

6.4 NEW INDUSTRIAL POLICY 1991

By now when economic imbalances reached precarious levels, it was understood that the growth strategy pursued earlier was not sustainable as it led to deficit financing. A rise in Balance of Payments (BoP) deficit cannot be sustained with domestic resources. All these fluctuations led to a loss of foreign exchange capital and other funds and resources.

This was a call to adapt and modify while adopting measures to adjust budgetary deficits. The new amendments and sudden changes led to a slowdown of economy. What added to the problem were resource constraints in the public sector which could not provide the much needed support for demand creation. Hope for the revival of growth process was undermined due to the twin deficits - fiscal and BoP deficit.

This required immediate consideration and the government responded with a suitable set of macro-economic policies along with a new industrial policy. The new industrial policy was essentially based on the neo-classical paradigm which was designed to push growth and help restore macro-economic and financial stability.

A new set of policy structure and new objectives gave birth to a revised policy and a new industrial policy was announced on July 24, 1991. The principal objectives of the new industrial policy (NIP 1991) was to amalgamate the assets and advances gained during the four decades of economic planning over 1951-91 and ensure that the weaknesses majorly low productivity with high production costs are paid close attention. The new policy focussed on improving and maintaining a sustained growth in industrial productivity with ample employment opportunities. A major area of attention was to achieve international competitiveness. It was also emphasised that these objectives will keep a check on sustainability concerns vis-a-vis protection of environment and efficient use of available resources.

Alterations in Policy

This section will discuss the major changes in the NIP 1991 and the preceding changes:

a) **Industrial Licensing Policy:** With a new wave, Industrial licensing was eliminated for all projects excluding some industries. These industries were primarily those industries which were of security and strategic concern, involved in production of hazardous substances, leading to environmental degradation or destruction etc. Industries specifically cited to procure industrial licensing are:

- Distilleries and alcoholic drinks breweries;
- Defence equipment, electronic aerospace and defence aircraft
- Warships
- Aerospace substitutes;
- Industrial explosives including detonating fuses, safety fuses, gun powder, nitro-cellulose and matches.
- Tobacco products.

There were three more industry groups exclusively reserved for the public sector. These were recognised due to security and strategic concerns:

- Generation of atomic energy;
- Substances notified by the Department of Atomic Energy; and
- Railways (private funds permissible to limited amount)

There was no need for permissions and approvals from the central government for any other industries except for the ones mentioned above. However, it specified that locations of industries based on the level of pollution and distance from the cities with minimum thresholds of population.

b) **Foreign Investment:** The new wave witnessed new features, some of them are:

- Barring a few sensitive sectors, automatic approval is available to Foreign Direct Investment (FDI) in almost all sectors. The industries are classified into groups and automatic approval is available for up to 100 percent in specified industry groups.
- Companies which are involved in export of products, majority foreign equity holding of up to 51 percent will be allowed for an easy access to international markets.
- For the purpose of negotiations with international firms and for approval of direct foreign investments, a Foreign Investment Promotion Board was constituted.

c) **Foreign Technology Agreements:** For foreign technology agreements in high priority industries, automatic permission be given while on a lump sum payment of $ 2 million, 5 percent royalty for domestic sales and 8 percent for exports. This was subject to a total payment of 8 percent of sales over a 10 year period from the date of agreement or 7 years from commencement of production (Department of Industrial Policy and Promotion (DIPP).For all other industries - other than those specifically mentioned, automatic permission will be given subject to the same guidelines as in cases where no foreign exchange is required for any payment.

d) **Public Sector:** The new policy was a breath of fresh air for public sector. It was specified that public sector investments will be made in strategic areas. Public sector was given more freedom in terms of entering in areas not reserved for it. Also, reservations were made for the public sector. All those public enterprises which were

in a bad shape had to be referred to the Board of Industrial and Financial Reconstruction (BIFR) for revival schemes. Furthermore, attention was given to encourage wider public involvement in order to increase resources. A new view on shareholding was offered. In the public sector, apart of the government's shareholding was opened to mutual funds, financial institutions, general public and workers.

e) **MRTP Act:** The MRPT Act allowed more freedom in terms of removing pre-entry restrictions, prior approvals from the government for establishing a new undertaking or while getting involved in amalgamations or merging of industrial units. It also removed the threshold limits of assets in respect of MRTP companies and dominant undertakings.

6.5 ANALYSIS OF THE NEW INDUSTRIAL POLICY

With advancement and an entry into a new and a more liberalised era popularly referred to as economies of scale and quality, it was realised that the Indian industry has become far more unstable than earlier. The burden was mostly felt on the marginalised sections of the society. At this point in time, it was important to understand and focus specifically on the weaknesses of the new industrial policy and how the changes made it unstable and weak. Before we proceed, let's understand the strengths first.

Announcement of NIP 1991 opened up avenues and liberalisation got a robust push with major reforms but it was also realised that

- A suitable export policy was missing
- Distortions in investment patterns, some industries were booming while others were struggling with a slow pace of investments.
- A bond between new sectors with that of older ones was missing and thus there was a need realised in order to encourage modernisation and new product development.
- Modernisation, deviations and reformations often lead to displacement of labour. Labour displacement and rehabilitation issues were equally concerning.
- Lack of technological and innovative efforts intertwined with an absence of incentives based policy to encourage efficiency.
- Failure to designate or define a proper industrial location policy.
- Highly skewed income distribution and its related consequences

The **major strengths** of the new policy can be identified as:

- Changes in industrial licensing system were a major breakthrough and a key step towards liberalisation. Abolishment of extensive physical controls, lowering of taxes combined with better administration of revenue collection to attract investment were some of the best changes made to achieve growth. It also expanded the role of financial incentives in directing investments.

- For efficiency and to strengthen domestic firms, internal deregulation was encouraged. This is expected to inject much more competition in to the system, creating incentives for cost reduction.
- It also looked at strengthening legal framework with the formulation of Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. This act basically allows banks and financial institutions to enforce their claims on collateral for delinquent secured credit, without judicial intervention.
- At the same time, the Competition Act, 2003 prohibited anti-competitive practices and abuse of power through healthy competition and regulation of companies beyond a particular size.
- This in turn allowed internal liberalisation via open access to imports and other interventions such as technological advancement, modernisation and overall improvement in the industry with an aim to reduce costs and maintain a progressive environment.
- Although the system was in pressure to maintain, efficiency, advancement and adapt to modern technological solutions but the rationale to justify this was the view that pressure commensurate with the ability of the system to respond helps maintain efficiency. However, pressure beyond one's ability will only be disruptive.

All in all, the aim of the policy changes aimed to introduce an integrated economic package and to create a suitable environment for promotion of efficiency, productivity and industrial growth through a well-coordinated structure.

Activity 2

1. Briefly state the key features of New Industrial Policy.

____
____
____
____
____
____
____
____
____
____
____

2. Briefly enumerate the pros and cons of New Industrial Policy.

____
____
____
____

ignou THE PEOPLE'S UNIVERSITY

6.6 STATE SPECIFIC INDUSTRIAL POLICIES

With technology and innovation, India is catching up with its global counterpart while pioneering business models and strategies. The state governments have shown immense progress. Policies of states in Southern region are a perfect example of how consistent compliant policy helped the region in developing private enterprises and making investments beneficial while nurturing MSMEs. This helped in curtailing unemployment at a drastic rate. The state specific industrial policies have focused on simplification and developments in the following areas:

- Single window clearance
- Labour regulation
- Online tax return filing
- Inspection reform
- Commercial dispute resolution
- Availability of land
- Construction permit
- Access to information and transparency
- Obtaining electricity connection
- Environment registration

A Brief Comparison of State specific Policies is outlined below:

State	Policies adopted
Andhra Pradesh	Single Window System to setup industry within 21 days Spot Registrations under Professional Tax, Registration of Shops and Establishments Approval on self- certification Incentive for Subsidisation of GST, Stamp Duty Simplification in Land Allotment and Labour Laws Setting up of Skill Development Centres
Karnataka	Registrations/ approvals of 10 departments provided online Commercial Tax related Services provided Online Online Information on Availability of Land in Industrial Areas Timelines fixed for providing most of the Industry related Services Property Registration fully Computerized Online Consent for Establishment

	... Online Project Monitoring System for Tracking the Application ... Interest free Loans ... Exemption of Stamp Duty ... Concessional Registration Charges ... Setting up of Skill Development Centres
Kerala	... Single Window Clearance for Industrial Units ... Setting up of Industrial Development Zones ... Incentives only to New Entrepreneurs ... Relocation of Industries to Mitigate rising Pollution ... Eco-friendly Transportation Modes ... Allotting of Land through Government Portals ... Encouragement of Women Entrepreneurs ... Employing Skilled Labourers
Puducherry	... Single Window Application has been developed Online ... Interest Subsidy ... Fixed Power Cost ... Environment Related Reforms ... Skill Development
Tamil Nadu	... Single Window Facilitation for Pre- project Clearances ... Employment Intensive Subsidy ... Environmental Tax Reforms ... Skill Development
Telangana	... Strengthening of Existing Single Window Clearance System ... Reimbursement of 50% net VAT/CST or SGST ... Women owned Enterprises Additional 10% Investment Subsidy ... 25% Subsidy on specific cleaner Production Measures

The above comparative analysis helps in understanding the initiatives of various states in terms of industrialisation and thus also suggests way forward for other states to devise and implement industrial policies in each state.

Case-1

The state of Tamil Nadu is an example to look and learn from. This is one state which can boast of an impeccable infrastructure in terms of road and railway connectivity. With 3 major and 23 minor ports along with 7 airports, Tamil Nadu also has the most prosperous automobile industry reflecting on how it is an epitome of effective government policy.

According to the Annual Survey of Industries Report, there is three digit raise in employment rate between 2007-2008 and 2014-2015. Their manufacturing of motor vehicles, trailers and semi-trailers, saw a 170 per cent increase in the same time period. The state has a remarkable share of employment which saw a jump from 7 per cent in 2007-2008 to 12 per cent in 2014-2015.

ignou
THE PEOPLE'S
UNIVERSITY

Building of Automotive Suppliers Parks and new auto cluster districts was a smart move which helped create auto cities, design and tech parks and logistics hubs while keeping a check on costs. This highlighted how shared facilities and technological advancement help in growth and building sustainable models to enhanced growth in the sector. The government is involved in developing two major corridors namely Chennai-Kanyakumari corridor with an aim to spur growth across the state.

6.7 OTHER IMPORTANT POLICIES FOCUSING ON INDUSTRIAL PROMOTION

India being an agriculture based economy has built and helped evolve small scale enterprises and is known across Asia and the world for building the most elaborate development programmes for small enterprises and for providing assistance both on an individual and institutional level. These developmental programmes are not confined to certain areas but have been rolled out both for urban as well as rural settings.

With an era of advancement during the post-reform period, the focus shifted to promotion and up gradation. The quest for promotion demanded modernisation of Small Scale Industry (SSI) units, an improvement in quality of output and technological advancement which needed massive funding. Therefore, access to technology, finances and innovation were few pre-requisites to sustain competition.

Moreover, access to marketing opportunities and assistance in marketing are key requisites apart from these three core areas - quality, finance and technology. So, a broad policy package was announced for small-scale industry in March 1994. These new sets of policies were based on the recommendations of S.P. Gupta Committee with inputs from others in June 1998. The success of the new SSI policy was intertwined with many other linked schemes such as quality control, technology up-gradation, introduction of better marketing schemes besides single window clearance scheme for composite loans, etc.

To ensure this, various other policies played an important role. The Competition policy was an important intervention to ensure healthy competition and promotion of SSI's.

Competition Policy

As discussed earlier, there were many constraints on competition in the pre-reforms era:

- Apply for and procure license which restrained investments;
- Restrictions to enter for new enterprises;
- There were restrictions on acquisition of economic control through MRTP;
- Widespread monopolies due to reservation for public sector and other industries;
- Small scale industries were under constraints of product reservation;
- High tariffs and other policy interventions to restrict trade.
- Foreign direct investments were under strict scrutiny.

For a healthy competitive environment and to ensure efficient production, two factors were recognised as vitally important. **One** was to allow Indian players become independent and competitive globally and **second** was to create an accessible atmosphere in the domestic market. This was introduced to help increase competitive edge of Indian players and boost competitive strength of Indian economy.

To achieve this, encouraging competition to achieve efficiency, better allocation of resources and at the same time ensuring consumer well-being was the key. This can be achieved only when other policies and laws are in sync.

To bring the different aspects of economic growth and to ensure strong market presence, a single law was much needed which could help bring mutually supporting laws, other economic policies and institutional structures under one umbrella including those relating to FDI, infrastructure and international trade.

It was realised that there was an urgent need to promote competition in view of the international developments. This necessitated comprehensive design, thinking and a policy structure in place. So, under the chairmanship of Shri S.V.S. Raghavan, the Government of India set up a nine-member committee in October 1999 to recommend a judicial and administrative framework.

On recommendation of the expert committee, the government passed the Competition Act, 2003 replacing the MRTP Act. This came into existence with a key aim of supporting and promoting competition while prohibiting anti-competitive practices.

The Competition Commission of India (CCI) was soon established and set up under the Competition Act, 2003 with an aim to promote spirited competition while preventing abuse of dominance.

Some major **objectives** of the Competition Commission of India are:

- To stop practices which adversely affect competition
- Encourage and endure competition in market
- Ensure quality of products and services is up-to mark.
- Consumer welfare
- Allow freedom of trade in the markets of India

For CCI to work as a market regulator, other bills were passed such as the Competition Amendment Bill (2007).

It was laid to ensure

- good quality products and services are available
- promote fair and healthy competition

- easy and fast mergers and acquisitions
- regulation of acquisitions and mergers within the threshold limits
- preventing abuse while allowing control

Despite concerns, the new competition law in India is based on a robust competitive market model which is consistent and in sync with fresh competition ready to meet the new challenges. India appears to have taken a significant step but the measurement of success depends on implementation.

The Special Economic Zone (SEZ) Act, 2006

The Special Economic Zone (SEZ) Act, 2006 emphasised on the development of specific areas for promoting manufacturing and exports. The main incentives are:

- Duty-free import of capital goods, raw materials, consumables and spares
- Tax exemption on export profits for the first five years
- Exemption from minimum alternate tax (MAT)
- Goods purchased from domestic tariff area (DTA) are exempt from sales and service tax
- Exemption from stamp duty, registration fee and electricity duty
- No tax on income from dividends and long-term capital gains tax
- 100% FDI allowed for developers.

Activity 3

1. Briefly enumerate State Specific Industrial Policies.

____
____
____
____
____
____
____
____
____
____
____
____

2. Briefly explain the importance of other policies supplementing industrial policy framework in India.

____
____
____
____
____

ignou THE PEOPLE'S UNIVERSITY

6.8 SUMMARY

India opted for Industrial development and initially conceived the Industrial Policy Resolution, 1948. Industries (Development & Regulation) Act, 1951 (referred as IDR Act) was also enacted to keep abreast with national development objectives. To achieve sustainable growth, the policy explored prospects to deregulate Indian industry while easing restrictions. Since 1991, economic reforms envisioned a new and substantial role for private entities. Since Industrial Policy Resolution (IPR) of 1956, Industry-led-growth strategy was adopted and led to involvement of private sector, expansion of heavy industry's base in the public sector and further promoting and enhancing growth of cottage and small scale industries by establishing large co-operative sector.

In 1991 when economic imbalances reached precarious levels, it was understood that the growth strategy pursued earlier was not sustainable as it led to deficit financing. A new set of policy structure and new objectives gave birth to a revised policy and a New Industrial Policy, 1991. The principal objectives of the New Industrial Policy (NIP) 1991 was to amalgamate the assets and advances gained during the four decades of economic planning over 1951-91 and ensure that the weaknesses majorly low productivity with high production costs are paid close attention. The new policy focused on improving and maintaining a sustained growth in industrial productivity with ample employment opportunities. With technology and innovation the state governments have shown immense progress. Southern region is a perfect example of how consistent compliant policy helped the region in developing private enterprises and making investments beneficial while nurturing MSMEs. This helped in curtailing unemployment at a drastic rate. With an era of advancement during the post-reform period, the focus shifted to promotion and up gradation. The quest for promotion demanded modernization of SSI units, an improvement in quality of output and technological advancement which needed massive funding. Therefore, access to technology, finances and innovation were few pre-requisites to sustain competition. Moreover, access to marketing opportunities and assistance in marketing are key requisites apart from these three core areas - quality, finance and technology.

ignou THE PEOPLE'S UNIVERSITY

6.9 KEY WORDS

Broad-banding: This was one concept introduced to give flexibility to licensed units. Under this, the product-mix within the overall ceiling was sanctioned to licence holders.

Minimum Economic Capacity: An efficient scale of production was recognised - production at a scale which allows overall low average costs. More generally, there was no ceiling but only a threshold floor level prescribed.

Delicensing: Exempted from licensing requirements.

Public Sector: It includes public goods and governmental services such as the military, law enforcement, infrastructure, transport, education, healthcare, etc.

Tariff Rates: A tariff is a tax imposed by a government on goods and services imported from other countries that serves to increase the price and make imports less desirable, or at least less competitive, versus domestic goods and services.

Monopolies: A monopoly refers to when a company and its product offerings dominate one sector or industry.

Liberalisation: Removal or reduction of restrictions or barriers on the free exchange of goods between nations.

Single Window Clearance: It is a trade facilitation concept which allows to provide information required by various official agencies via one regulatory body.

Small Scale Industries: Those industries in which the manufacturing, production and rendering of services are done on a small or micro scale. These industries make a one-time investment in machinery, plant, and equipment, but it does not exceed Rs. 10 crore and annual turnover does not exceed Rs. 50 crore.

Special Economic Zones (SEZs): An area in a country that is subject to different economic regulations than other regions within the same country. The economic regulations of Special Economic Zones tend to be conducive to—and attract—Foreign Direct Investment (FDI)

Domestic Tariff Area: An area within India that is outside the Special Economic Zones and EOU/EHTP/STP/BTP. The units operating under certain specific schemes such as EPZ/SEZ/EOU are expected to carry out their activities within a customs bonded area.

ignou THE PEOPLE'S UNIVERSITY

Foreign Direct Investment (FDI): FDI is an investment made by a firm or individual in one country into business interests located in another country. Generally, FDI takes place when an investor establishes foreign business operations or acquires foreign business assets in a foreign company.

The Goods and Services Tax (GST): GST is a value-added tax levied on most goods and services sold for domestic consumption. The GST is paid by consumers, but it is remitted to the government by the businesses selling the goods and services.

6.10 SELF-ASSESSMENT QUESTIONS

1. Critically compare the pre and post New Industrial Policy 1991 in India.
2. Give a roadmap for adoption of State Specific Industrial Policies by all states of India.
3. Suggest changes in the present trade and industrial policy of India to ensure adequate growth of the country.

6.11 REFERENCES/ FURTHER READINGS

1. Bhaduri, Amit, (2009): *The Face You were Afraid to See: Essays on the Indian Economy,* Penguin.
2. Deshpande, Ashwini (ed.), (2007): *Globalisation and Development*, Oxford Unviersity Press, New Delhi.
3. Gregory, Neil, (2009): *New Industries From New Places*, Stanford University Press.
4. Gokarn, Subir et. al. (eds.), (2004): *The Structure of Indian Industry*, Oxford University Press, New Delhi.
5. K.L. Krishna and Uma Kapila (ed.), (2009): *Readings in Indian Agriculture and Industry*, Oxford, New Delhi.

ignou THE PEOPLE'S UNIVERSITY

UNIT 7 AGRI-BUSINESS ENVIRONMENT

Objectives

After reading this unit you should be able to:

- analyse the trends in agricultural production, sales and exports in India;
- explain the framework of evolution of Farm Policies in India;
- analyse the Farm Reforms 2020;
- identify the gaps and key players in the Agriculture Sector;
- draw a comparison between State Specific Industrial Policies in India; and
- assess the role and importance of Agriculture Marketing.

Structure

7.1 Introduction
7.2 Trends in Agricultural Production, Sales and Exports
7.3 Evolution of Farm Policies in India
7.4 Farm Reforms 2020
7.5 Key Players in the Agriculture Sector
7.6 Role and Importance of Agricultural Marketing
7.7 Summary
7.8 Key Words
7.9 Self-Assessment Questions
7.10 References/ Further Readings

7.1 INTRODUCTION

Since independence, the agricultural sector has witnessed a mixed path withsignificant progress in agricultural development in India. The progress can be witnessed through increase in crop production, productivity, diversification, and technological developments. During the initial years, there were some hiccups and growth stagnated. However, since the mid-1960s, growth rate started moving up and gained momentum especially during the mid-1980s but started losing the pace in 1990s and this was tilted towards foodgrains to address the issue of food security. In recent years for those dependent on agriculture as a key source of livelihood, it is turning un-sustainable in terms of economic and social consequences - majorly agrarian crisis with a sweepingmigration to the cities and farmers' suicides etc.This cast doubt on the future growth prospects of the Indian economy, which is majorly dependent on the growth performance of agriculture.Besides, our import needs are well-established when it comes to essential food products such as pulses and edible oils.

So, to understand the various trends and factors responsible in shaping India's agricultural landscape, it is essential to know the economic reforms and regeneration with a sustained and broad-based agricultural development. This calls for an understanding of the factors that may

have contributed to shaping past trends and will also help in designing the future strategy of development. This unit brings forth some of the important issues in order to understand the agriculture environment in detail.

7.2 TRENDS IN AGRICULTURE PRODUCTION, SALES, AND EXPORTS

More than half of the country is reliant on agriculture since it is the prime source of living and employment for about 58% of Indian population. The latest data highlights that growth in Gross Value Added (GVA) in agriculture and allied sectors stood at 4% in 2020. Considering this, the Indian food industry is on the threshold of massive growth, increasing its contribution to world food trade every year. The food industry has a huge potential for value addition with a bright prospect, where the food processing industry where the Indian food processing industry accounting to 32% of the country's total food market.It is one of the largest industries in India and is ranked fifth in terms of production, consumption, export and expected growth (IBEF 2020).

Currently, the food and grocery market in India is the sixth largest globally, with retail contributingto 70% of the sales and the agriculture, forestry and fishing growth is predicted to be 3% in the 2021.

India is one of the leading exporters of agricultural products globally. The food grain production was estimated to reach a record 295.67 million tonnes (MT) during the year 2019-20 and the government has set a higher food grain production target in 2020-2021. According to Indian Sugar Mills Association (ISMA), the production of sugar in India reached 26.46 MT between October 2019 and May 2020 whereas horticulture crops in India stood at a record 320.48 million metric tonnes (MMT) in 2020.The organic food sector is pacing at an advanced rate andis expected to reach Rs. 75,000 crore (US$ 10.73 billion) by 2025.

Various government initiatives, investments and interventions have helped the Indian food processing industry to attract Foreign Direct Investment (FDI) inflow. The business has attracted US$ 10.20 billion between April 2000 and September 2020 according to the figures released by Department for Promotion of Industry and Internal Trade (DPIIT). Few other initiatives in the sector that helped boost growth are subsidiaries in agricultural loans, introduction of forest fresh organic products, Pradhan Mantri Fasal Bima Yojana which collates data infrastructure for farmers. Another initiative is the introduction of animal husbandry infrastructure and launch of National Animal Disease Control Programme (NADCP), which aims to eradicate foot and mouth disease. Launch of various mega food parks including one in Punjab, launch of PM Matsya Sampada Yojana, e-Gopala App and several initiatives in fisheries production, dairy, animal husbandry and agriculture, along with a Transport and Marketing Assistance (TMA) programme to provide financial support for transport and marketing of agriculture products (IBEF 2020).Other major intervention was the approval of the Agriculture Export Policy, 2018 which aims to increase India's agricultural export to US$ 60 billion by 2022. Enhancing the aptitude of food processing

sector in India and allowing 100% FDI in promotion and marketing of food products and in food product E-commerce under the automatic track are other major interventions to escalate productivity and growth.

There have been many notable achievements in the sector such as in line of mega food parks and other sectors. Of the total 37 food parks, 21 mega food parks are operational, coffee export has shown promising results and stands at US$ 742.05 million in 2020 while tea exports stand at US$ 709.28 million in FY20. After the launch of Electronic National Agriculture Market (e-NAM) in April 2016, more than a thousandmarketplaces (mandis) are linked to e-NAM. This was an initiative to create anintegrated market for agricultural products.

The farming and food production in India is expected to fast-track its pace of growth in the coming years and is expected to achieve its aspiring aim of amplifying farm income by 2022. This has become possible because of increased investment in agricultural infrastructure such as irrigation facilities, ware-housing and cold storage. An overall increase in usage of genetically modified crops will likely improve the yield for Indian farmers with the help of concerted efforts of scientists. Self-reliance in pulses in next few years with the help of minimum support price will be another step. Other areas focussing on adoption of good manufacturing, food safety and quality assurance mechanisms is essential for development and enhancement. This will immensely help in achieving Quality Management and Good Hygienic Practices by the food processing industry and will in turnopen more avenues and offer benefits.

7.3 EVOLUTION OF FARM POLICIES IN INDIA

Legislative powers are distributed between the centre and the states through the Seventh Schedule of the Indian Constitution. Agriculture is part of the State List therefore only individual states have the power to legislate on such matters, but the Central Government has residual powers.

Domestic Agricultural Policies

1947-1965

During the initial years, achieving self-sufficiency was the primary objective of India's agricultural policies which was aimed to improve food security. Since the principal aim of the land reforms was to get rid of challenges imposed by middlemen with an improvement in production while focussing on establishing worker ownership and equity in rural society. In view of this, the first major reform that was enacted by the states post-Independence was the Zamindari Abolishment Act (1950s). To place an upper limit on the size of agricultural land holdings, establishing state control on vacant lands and to distribute the acquired idle land to the disadvantaged rural population was established to provide security to the renters.

1965-1980

The era marked Green Revolution, launched in 1965. It focussed on using innovative techniques and increasing crop productivity with the help of technology. India started importing high yielding varieties (HYVs) of wheat and rice and adopted improved pesticides, fertilisers and irrigation methods which led to increased food grain production. For further amendments, the government set up important institutions in 1965. One was the Commission for Agricultural Costs and Prices (CACP) previously called the Agricultural Prices Commission and the Food Corporation of India (FCI).

To lend money to farmers and increase lending by enhancing flow of credit to the agriculture sector, new financial institutions including the National Bank for Agriculture and Rural Development (NABARD) and Regional Rural Banks (RRBs), were set up and 14 largest commercial banks were nationalised in 1969 in view of this.

1980-1991

The focus was on improving crop production during the Green Revolution, so the corresponding years focussed on expansion in the use of green revolution technologies to other crops and regions. As agricultural output rose, production began to diversify into high value commodities, such as fish, poultry, milk, fruits, and vegetables.

1991 onwards

The agricultural reforms lagged the general economic reforms but over time the policies regulating agricultural trade were relaxed. A major step was the transition from the Public Distribution System (PDS) to the Targeted Public Distribution System (TPDS) in 1997 aimed to ensure that impoverished people get access to food at subsidised prices. In July 2000, the Government of India announced the country's first ever National Agriculture Policy (NAP). This policy aimed at achieving a growth rate more than 4% per annum in the agriculture sector. The objectives of this policy were to create employment opportunities for rural population, accelerate the growth of agro businesses, explore and realise the massive untapped growth potential of Indian agriculture, promote better standard of living for rural population, discourage relocation from rural to urban population and to overcome the trials arising due to economic reforms of 1991.

Marketing Policies

The National Policy for Farmers (NPF) approved by the Government in 2007 recognized a need to emphasise on increasing farmer's incomes along with production. The five-year plans also recommended policy initiatives to enhance the working of the agricultural sector. The National Food Security Act (NFSA) was enacted on 12 September, 2013 with the objective to provide for food and nutritional safety by guaranteeing access to a good amount of quality food at affordable prices.

Essential Commodities Act (ECA)

An earlier amendment to the Indian Constitution granted the Union Government a statutory right to standardise and regulate the production, pricing, and delivery of essential commodities.

The most fundamental policy instrument is the Essential Commodities Act, 1955 (ECA), which aims to control production, supply, distribution, and pricing of essential commodities to ensure that essential commodities are made available to the consumers at fair prices. Under this Act, Centre and State Governments have the power to impose stock limits on the identified commodities to prevent hoarding. They can also direct a stockholder to compulsorily sell their stock to the government, regulate prices and ban the holding back of a product or good for sale.

Agricultural Produce Market Regulation Acts (APMC)

During the 1960s and 1970s, most of the states passed Agricultural Produce Markets Regulation (APMR) Acts. These Acts are popularly called the APMC Acts since they regulate markets through Agricultural Produce Market Committees (APMCs). A State's APMC Act authorizes the state to set up regulated wholesale markets (mandis or APMC markets) for agricultural products. The APMCs have the power to controlagricultural markets and regulate all features of marketing, including the imposition of a mandi tax for trade taking place both on and off the wholesale markets.

The Act covers the entire state and makes these mandis the required channel for trading farm produce, and does not allow private players from setting up markets. In 2003, the Ministry of Agriculture created a model APMC Act and circulated into the states so that they could modify their individual acts. This was followed by the model APMC rules in 2007.

Minimum Support Price

The pricing policy defined in the ECA and APMC Acts aims to ensure that farmers receive lucrative prices for their produce while also ensuring that it is affordable for consumers. In order to do so, the central government sets a Minimum Support Price (MSP) for 24 crops every year. The FCI and several state level agencies working in support of the FCI are required to procure the specified commodities from farmers at the notified prices (MSP). But this mechanism operates effectively only for a few commodities (primarily for wheat, rice and cotton) and only in a few states. A large number of farmers are required to tradewith other buyers at prices lower than the specified MSP, especially in eastern India due to ineffective procurement and lack of alternative buyers.

Activity 1

1. Briefly enumerate the key trends in India's Agri-Business Environment.

2. Briefly explain the framework for evolution the farm policies in India?

7.4 FARM REFORMS 2020

On 27th September 2020, Ram Nath Kovind, the President of India gave his acceptance to the 3 farm bills that were earlier passed by the Indian Parliament. These Farm Acts are as follows:

ignou THE PEOPLE'S UNIVERSITY

Farmers' Produce Trade and Commerce (Promotion and Facilitation) Act, 2020

This Act permits farmers to sell their produce outside the APMC regulated mandis but it does not abolish them. It aims to provide lucrative prices to farmers via alternative trade channels. It also prohibits state governments from imposing any tax on the trade of produce outside the mandis.

Farmers' (Empowerment and Protection) Agreement on Price Assurance and Farm Services Act, 2020

It creates a national framework for contract farming. Although contract farming was legal prior to the enactment of this act as well, this act aims to provide a completecomprehensive outline for such an arrangement. This will enable farmers to contract a guaranteed price for their produce prior to production/sowing.

Essential Commodities (Amendment) Act, 2020

The ECA has been amended to state that the Government of India will list few commodities as essential and control their supply and prices only in cases of war, famine, extraordinary price rises, or natural calamities. Other produce including cereals, pulses, potato, onion, edible oilseeds, and oils have been deregulated. The amended act also states that the government will impose stock limits on essential commodities only when the rise in price is at least 100% for horticultural produce and 50% for non-perishable agricultural produce.

The enactment of these acts has created fear in the minds of farmers and has led to widespread protests. Despite several rounds of talks, the government and the farmers have not been able to arrive at a mutually agreeable solution. The farmers fear that increased private sector participation will lead to exploitation and that their interests will not be safeguarded. Although the government has made several attempts to pacify the farmers, they have all been in vain.

Activity 2

1. Briefly enumerate the key features of India's new farm policies.

____
____
____
____
____
____
____
____
____

2. Briefly compare the old agricultural policies with farm laws 2020.

7.5 KEY PLAYERS IN THE AGRICULTURE SECTOR

With growth and increase in production, the active role of middlemen in the movement of agricultural commodities which specialise in performing marketing roles and are involved in marketing of products has increased. The number of mediators can be classified into five groups as follows.

- Merchant Middlemen
- Agent Middlemen
- Speculative middlemen
- Processors
- Facilitative Middlemen

Merchant Middlemen

Merchant middlemen are the ones who take title of the goods they deal in while buying and selling. Their earningor loss depends on the sale and purchase prices. They are of **four** types:

a) **Wholesalers**: Those who buy agricultural commodities in large quantities directly from farmers or from other wholesalers. They mainly assemble the goods from

various localities and store produce and often release them in the off-season since they store them in the peak arrival season.

b) **Retailers**: They buy from wholesalers and sell it directly to consumers in small quantities. Retailers are the closest to consumers in the marketing channel.

c) **Village merchants:** The vendors or retailerswho move from village to village to directly purchase the produce from the cultivators. Village merchants purchase the produce of those farmers who have either taken finance from them or those who are not able to go to the market. Village merchants also supply essential consumption goods to the farmers. They often act as the financers of poor farmers and sell the collected produce in the nearby market or the villages.

d) **Mashakakhores:** It is a colloquial term for big retailers who often act as small wholesalers and majorly deal in fruits and vegetables. They usually sell to bulk consumers like hotels, para-military units or small retailers/vendors. Over the years, they have started dealing with all types of customers without the condition of a minimum quantity and are working like ordinary retailers.

Agent Middlemen

They are basically representatives of clients and do not own the products. They act as negotiators between sellers and buyers and help them in sale and purchase of products. They usually receive commission or brokerage on sale. Agent middlemen are of **two** types:

a) **Commission Agents:** A commission agent generally operates in the wholesale market and acts as the proxy of either a seller or a buyer by representing them in buying and selling of products.
b) **Brokers:** They act as communicators between buyers and sellers to bring them on the same platform while facilitating personal services to their clients in the market. They may claim brokerage from buyer, sellers or both depending upon the market situation as they simply wander to render their services to clients.

Speculative Middlemen

These middlemen are the ones who buy products at a low price when arrivals are sizable usually in off-season when prices are high. They take claim of the product and risk associated with anaim to make a profit on it.

Processors

Processors are the ones who hire agents to buy for them from areas where production is high either and bring on their businesses either on their own or on custom basis. Agents may also store the products and may deal with it throughout the year on continuous basis. They often

ignou THE PEOPLE'S UNIVERSITY

are involved in advertising to generate demand for their managed goods and add form utility to farm goods.

Facilitative Middlemen

As the name suggests, these middlemen facilitate buying and selling while assisting in the marketing process. Theyget their income in the form of fees or service charge since most of them are labourers who help in physical movement of goods and products while loading and unloading them. Weighmen and graders also fall into this category since they facilitate weighing of produce and grade products according to different categories. They are often termed as thecore of the marketing wheel.

Transporters who assist in movement of the produce from one market to another and communication agencies including advertising agenciesthat majorly help in decision making about the purchase of goods are a part of this group. Auctioneers who help in exchange of produce by putting the produce for public sale and bidding by the consumersor buyers are equally important and help in ironing out the marketing system.

7.6 ROLE AND IMPORTANCE OF AGRICULTURAL MARKETING

Agricultural marketing has a vital role as it helps in encouragingthe process of production and consumption. It equally helps in accelerating the pace of fiscal developmentsince it is an important multiplier of agricultural development.

A shift from traditional to modern agriculture system has been a challenge and marketing has been a big experiment in the entire process. But the role of marketing remains utmost important. The importance of agricultural marketing is revealed from the following.

Optimization of Resource use and Output Management

The key role of an efficient marketing system is to help the market in pulling down the losses and accelerating the marketable surplus. The marketing losses often arise due to inefficiency in processing, storage and transportation of products. An efficient marketing wheel will help in optimization of resources and output management and a well-thought out system of marketing can help in even distribution of available stocks. Taking everything into account, it is indeed a modern approach to sustainable growth and sustains it.

Increase in Farm Income

Reducing the number of middlemen while ensuring higher level of income to restrict the cost of marketing services and the malpractices is what a good marketing system would aim at achieving. An efficient system assures improved prices for farm products and encourages them to invest their surpluses in buying modern inputs so that yield and produce may increase.

Widening of Markets

When a system widens the market by taking the products to remote corners both within and outside the country is considered profitable since it increases the demand on a continuous basis while guaranteeing a higher income to the producer.

Growth of Agro-based Industries

Agri-dependant industries rely on the supply of raw materials such as cotton, sugar, edible oils, food processing and jute on farm produce and therefore require an efficient system to help in the growth to encourage the overall development process of the economy.

Price Signals

Efficient marketing systems allow farmers in scheduling and arranging their production in accordance with the needs of the economy. This work is carried out through transmitting price signals.

Adoption and Spread of New Technology

Adapting to demands and adopting latest technologies and scientific knowledge always leads to growth. But a technology upgrade requires greaterinvestment and farmers would invest only if they are guaranteed of ago-ahead at remunerative price.

Employment Creation

This is a system of marketing which focuses on employment generation and engages millions of people in activities, such as wrapping, packing, transferring, storing and doling out.

Persons like commission agents, brokers, traders, retailers, weighmen, hamals, packagers and regulating staff are directly employed in the marketing system. Apart from them, several others are able to look for employment opportunities when dealing with supply of goods and services.

Addition to National Income

Marketing events are value additions to the product since they increase the nation's gross national product and net national product.

Improved Living

Development that adds togrowthwhile diminishing poverty of the populationand adds to foreign exchange while eliminating economic waste should be given special attention. The development of an efficient marketing for food and agricultural products is also vital to overall economic development. The marketing system is the key for the success of the development programmes which are aimed to uplift people.

ignou THE PEOPLE'S UNIVERSITY

Activity 3

1. Briefly enumerate the key stakeholders in the Agriculture Sector in India.

2. Briefly explain the importance of agricultural marketing.

ignou THE PEOPLE'S UNIVERSITY

7.7 SUMMARY

The agriculture sector in India has come a long way since Independence in India. With initial roadblocks post independence to major reforms in 1960s which escalated growth to a downfall in mid 1980s and 1990s to a shift in production pattern to food grains to cater to growing food security issues. Majority of the population in India depends on the agrarian sector as a prime source of livelihood but shift in patterns of employment and migration to cities has caused a doubt on the growth prospects of Indian agriculture sector. In 2020, it was seen that 58% of India's population depends on agriculture as the primary source of livelihood and growth of the sector stood at 4 percent. India is one of the leading exporters of agricultural products globally. A number of government initiatives, investments and

interventions have helped the Indian food processing industry to attract Foreign Direct Investment (FDI) inflow. In the coming years, the Indian agricultural sector aims at doubling farm income and introducing better infrastructural facilities for irrigation and storage. The minimum support price also aims at making each sub sector of the agricultural sector self sufficient.

From 1947-1965, achieving self sufficiency was the key objective and thus improving food security along with abolishing of the Zamindari System. In 1965, Green Revolution was launched and a number of innovative techniques, irrigation methods, pesticides and setting up of key institutions were introduced. To strengthen flow of credit to the agricultural sector, Banks were nationalised and new financial institutions were set up specifically for the agricultural sector. In the 1980s, production in the agricultural sector diversified to high value commodities like poultry, fisheries and dairy. In 1997, a major step was the transition from the Public Distribution System (PDS) to the Targeted Public Distribution System (TPDS). The National Agriculture Policy was announced in July 2000 in order to create employment opportunities for rural population, accelerate the growth of agro businesses, explore and realise the massive untapped growth potential of Indian agriculture, promote better standard of living for rural population and to discourage relocation from rural to urban population. In 2007, National Policy for Farmers (NPF) and in 2013 National Food Security Act (NFSA) was enacted. These acts helped in increasing farmer incomes and guaranteeing nutritional security by regulating food prices.

The agriculture sector has been well protected by the Essential Commodities Act , 1955 according to which government controls the production, supply, distribution, and pricing of these commodities to ensure that they are made available to the consumers at fair prices along with the APMC Act regulated by states. In 2020, new farm reforms were enacted and now farmers are permitted to sell their produce outside the APMC regulated mandis but it does not abolish them. It aims to provide lucrative prices to farmers via alternative trade channels. A national framework for contract farming has also been introduced. The Essential Commodities Act was also amended in 2020 and it states that certain commodities will be listed as essential and government will regulate their supply and prices only in cases of war, famine, extraordinary price rises, or natural calamities. Several commodities including cereals, pulses, potato, onion, edible oilseeds, and oils have been deregulated.

To increase production of agricultural commodities, a number of players/middlemen have emerged over the years. Only enhancing production will not be of any help, hence agricultural marketing as a concept has picked up pace. These intermediaries are primarily Merchant middlemen acting as wholesalers, retailers, Village merchants and Mashakakhores. Then there are agent middlemen who cater to activities like negotiations between buyer and seller for commissions. Speculative middlemen buy products at a low price when arrivals are sizable usually in off-season when prices are high. Processors are the ones who employ agents to buy for them from areas where production is high either and carry on their businesses either on their own or on custom basis. Facilitative middlemen facilitate buying and selling while assisting in the marketing process. Transporters who assist in movement of

the produce from one market to another and communication agencies including advertising agencies which majorly help in decision making about the purchase of goods are a part of this group.

Agricultural marketing has a vital role as it helps in Optimization of Resource use and Output Management, Increase in Farm Income, Widening of Markets, Growth of Agro-based Industries, Price Signals, Adoption and Spread of New Technology, Employment Creation, Addition to National Income and Improved Living.

7.8 KEY WORDS

Gross Value Added (GVA): It is an economic productivity metric that measures the contribution of a corporate subsidiary, company, or municipality to an economy, producer, sector, or region. GVA thus adjusts gross domestic product (GDP) by the impact of subsidies and taxes (tariffs) on products.

Foreign Direct Investment (FDI): FDI is an investment made by a firm or individual in one country into business interests located in another country. Generally, FDI takes place when an investor establishes foreign business operations or acquires foreign business assets in a foreign company.

Minimum Support Price (MSP): It is an agricultural product price, set by the Government of India to purchase directly from the farmer. This is not enforceable by law. By definition, this rate is to safeguard the farmer to a minimum profit for the harvest, if the open market has lesser price than the cost incurred.

Legislative Power: It is exercised for giving exemption from licensing requirements.

Green Revolution: It is the Third Agricultural Revolution, is the set of research technology transfer initiatives occurring between 1950 and the late 1960s that increased agricultural production worldwide, beginning most markedly in the late 1960s.

Commission: Getting paid for an activity.

Liberalisation: Removal or reduction of restrictions or barriers on the free exchange of goods between nations.

7.9 SELF-ASSESSMENT QUESTIONS

1. Critically compare the pre and post 2020 Agricultural Reforms in India.
2. Give a roadmap for modifying the existing farm laws and also state their shortcomings.

3. Suggest changes in the present Agricultural Policy of India to ensure adequate growth of the country.
4. How will contract farming change the agriculture landscape in India? Discuss in detail.

7.10 REFERENCES/ FURTHER READINGS

- Mishra, Srijit and D. Narasimha Reddy (2011): Persistence of Crisis in Agriculture: Need for Technological and Institutional Alternatives (in India Development Report, 2011, edited by D.M. Nachane, Oxford University Press, New Delhi).
- Deshpande R S and Shah Khalil (2007), Agrarian Distress and Agricultural Labour, The Indian Journal of Agricultural Labour, Vol. 50(2), July.
- India Brand Equity Foundation, www.ibef.org

ignou
THE PEOPLE'S
UNIVERSITY