

LESSON 7



Money Matters - Borrowing and Sources:

The need for money may be of various reasons. It may be for purchase of something or construction of a house or business establishment etc. When the amount of money that one has is short for the purpose, then the person will look for a source to get the money needed. Take the example of Tomba. He hurriedly went to his school. At school, when he opened his bag, he realized that he had forgotten his pen. He wanted to buy one but it would cost 30 rupees and he had only 20 rupees. So, he looked for someone who would help him. He then asked his friend Chaoba to help him and give him 10 rupees which he would return the next day. Tomba thus borrowed from Chaoba when he had less money than what he needed to spend.

The sources of borrowing are many. But they are largely categorized into two. We sometimes borrow money from our friends, members of our family, relatives etc. These are known as internal sources of borrowing or borrowing from people we personally know. Apart from these we borrow money from banks and other financial institutions like Non-Banking Financial Companies. These are known as external sources of borrowing.

While borrowing money from a financial institution, the borrower has to sign an agreement. The agreement is about the terms and conditions of the repayment of the borrowed money which the institutions and banks provide as a loan.

Loan is a sum of money borrowed from a financial institution and it is repaid with an interest in the manner agreed upon over a period of time. In this way banks and other financial institutions lend to people who need them for various purposes such as setting up business, buying equipments for a factory, to buy a house or flat, to pay for education expenses etc. Thus, banks serve to the needs of the people. However, banks charge interest on the money lent to people (which they called loan) and this interest forms part of the income to the bank. If one fails to

make repayment of the loan, the interest increases and becomes a burden to the borrower. On the other hand, if the loan is timely repaid, bank would be more helpful to oneself in future.

Interest is the extra money that we pay along with the principal amount borrowed. In other words, principal amount is the amount of money that one borrowed. As an example, let us assume that David borrowed 10,000 rupees from a bank. This is called the principal amount. After one year, David repaid the amount of money borrowed to the bank with an additional amount of 1000 rupees. The additional amount is the interest given to the bank. This is because the bank lent the money to David when he sought it from the bank as a loan. Common interest is expressed in terms of percentage. In this case David paid an interest of 10% on the loan. The interest amount is an income to the bank. But why do financial institutions like banks take interest? It is because banks accept deposits from people who have savings and interest is paid at a certain rate in percentage. Again, the bank pays salaries for its employees and the rent for the use of the office building. From time to time, the office has also to be renovated. Above all, as the business of bank deals with the affairs of money, interest plays an important role in the banking

system. But banks and other financial institutions cannot run their businesses as they wish it to be. An organization that works as the central bank regulates and monitors the banking and financial system. In India, the central bank is the Reserve Bank of India, and in short, it is known as the RBI.

EXERCISE

Glossary:

Categorized	:	put into groups.
Principal amount	:	(here) amount of money lends or invests to earn interest.
Regulates	:	controls by means of rules.
Monitors	:	watches and checks over a period of time.

Comprehension:

Answer the following questions in one or two sentences:

- (i) What did Tomba want to buy?
- (ii) Why did Tomba borrow money from Chaoba?
- (iii) What are the different sources of borrowing money?
- (iv) What are internal sources of borrowing?
- (v) What is loan in terms of financial institutions?
- (vi) Why do banks take interest from the borrowers?
- (vii) What is the long form of the RBI?
- (viii) What does the RBI do?