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Measures of credit control

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Quantitative and Qualitative Measures for Credit Control

Methods of Credit Control

Quantitative or General Methods
1. Bank Rate
2. Open Market Operations
3. Variable Cash Reserve Ratio

Qualitative or Selective Methods
1. Credit Rationing
2. Direct Action
3. Moral Persuasion
4. Publicity
5. Regulation of Consumer’s Credit
6. Regulating the Marginal Requirements on Security Loans.
RBI controls the Money Supply in the Economy through the following methods –

- **Quantitative or General Methods**

- **Qualitative or Selective Methods.**

**Quantitative Methods**

- **Bank Rate Policy**

  If the Central Bank wants to control credit, it will raise the **bank rate**. As a result, the market rate and other lending rates in the money-market will go up. Borrowing will be discouraged. The raising of bank rate will lead to contraction of credit.

  Similarly, a fall in **bank rate** will lower the lending rates in the money market which in turn will stimulate commercial and industrial activity, for which more credit will be required from the banks. Thus, there will be expansion of the volume of bank Credit.
Quantitative and Qualitative Measures for Credit Control

- **Quantitative Methods**
  - **Open Market Operations:**

  This method of credit control is used in two senses:
  
  (i) In the narrow sense, and
  
  (ii) In broad sense.

  **In narrow sense**—the Central Bank starts the purchase and sale of Government securities in the money market. But in the **Broad Sense**—the Central Bank purchases and sell not only Government securities but also of other proper and eligible securities like bills and securities of private concerns.

  - When the banks and the private individuals purchase these securities, they have to make payments for these securities to the Central Bank.

  This gives result in the fall in the cash reserves of the **Commercial Banks**, which in turn reduces the ability of create credit. Through this way of working the Central Bank is able to exercise a check on the expansion of credit.
Quantitative and Qualitative Measures for Credit Control

Quantitative Methods

- **Variable Cash Reserve Ratio:**

Under this system the Central Bank controls credit by changing the Cash Reserves Ratio.

*For example*—If the Commercial Banks have excessive cash reserves on the basis of which they are creating too much of credit which is harmful for the larger interest of the economy. So it will raise the cash reserve ratio which the Commercial Banks are required to maintain with the Central Bank.

- This is done by tweaking the CRR & SLR.
Qualitative or Selective Method of Credit Control:

The qualitative or the selective methods are directed towards the diversion of credit into particular uses or channels in the economy. Their objective is mainly to control and regulate the flow of credit into particular industries or businesses.

The following are the important methods of credit control under selective method:

- Rationing of Credit:

Under this method the credit isrationed by limiting the amount available to each applicant. The Central Bank puts restrictions on demands for accommodations made upon it during times of monetary stringency.
Quantitative and Qualitative Measures for Credit Control

- Qualitative or Selective Method of Credit Control:
  - Moral Persuasion:

This method is frequently adopted by the Central Bank to exercise control over the Commercial Banks.

- Under this method Central Bank gives advice, then request and persuasion to the Commercial Banks to co-operate with the Central Bank is implementing its credit policies.

- If the Commercial Banks do not follow or do not abide by the advice or request of the Central Bank no gross action is taken against them. The Central Bank merely was its moral influence and pressure with the Commercial Banks to prevail upon them to accept and follow the policies.
Qualitative or Selective Method of Credit Control:

Direct Action:

Under this method if the Commercial Banks do not follow the policy of the Central Bank, then the Central Bank has the only recourse to direct action.

- This method can be used to enforce both quantitatively and qualitatively credit controls by the Central Banks. This method is not used in isolation; it is used as a supplement to other methods of credit control.

- Direct action may take the form either of a refusal on the part of the Central Bank to re-discount for banks whose credit policy is regarded as being inconsistent with the maintenance of sound credit conditions.
Quantitative and Qualitative Measures for Credit Control

❑ Qualitative or Selective Method of Credit Control:
  
  o Method of Publicity:
  In modern times, Central Bank in order to make their policies successful, take the course of the medium of publicity. A policy can be effectively successful only when an effective public opinion is created in its favor.

  o Regulation of Consumer’s Credit:

    • This Method is used by Lowering/ Increasing the Down Payments.
    • Increasing / Decreasing the Tenure of Loans

  o Changes in the Marginal Requirements on Security Loans:
  Under this system, the Board of Governors of the RBI has been given the power to prescribe margin requirements for the purpose of preventing an excessive use of credit for stock exchange speculation.
  This system is specially intended to help the Central Bank in controlling the volume of credit used for speculation in securities.