CHAPTER III

FINANCE CORPORATIONS IN INDIA
INTRODUCTION

The Finance Corporations is one of the agencies in the unorganised sector along with moneylenders, Indigenous Bankers, Nidhis and Chit firms. The fact tells all other forms of agencies have emerged from moneylenders. Though there is a dichotomy between organised and unorganised the relationship between those two can not be dispensed with. The primary objective of finance corporation is to earn profit by lending the money from the resources of personal investment and deposits mobilised from relatives, friends etc. The finance corporations have emerged into good competitors to the Commercial Banks, Regional Rural Banks, Co-operatives in organised sector due to the facilities and incentives offered to their deposit holders as well as borrowers. The Finance Corporations has assumed both proprietary and partnership concerns. Further, they have
diversified their activities into several areas like, film finance, auto finance besides general finance.

The Finance Corporations differ in many a way from commercial banks, moneyleders, indigenous bankers. The primary object of establishing the first corporation was to extend financial assistance to agricultural operations. The corporations which have been floated for helping the farm operations especially in Karnataka, have been spread to all Southern states making their way into all kinds of financial operations. As a result Government of India has imposed several legislative and administrative regulations.

OBJECTIVES OF FINANCE CORPORATIONS

The primary object of a corporation is to earn profit in lending money. They are collecting public deposits either from individuals or institutions by offering fairly high rate of interest. In the field of deposit mobilisation they are acting as competitors with commercial banks. They are lending all most the entire amount including own capital at prevailing market rate. They are accepting deposits whose maturity ranges from 1 to 5 years providing 18 to 21 per cent interest. In certain special cases, Finance Corporations are extending services to their customers (i.e., depositors and borrowers) in the field of filing income tax returns, obtaining insurance contracts, extending donations and charities, legal advice in case of accidents to vehicles etc.
The finance corporations are retaining their popularity in the field of banking activity as they are attracting the deposits in suitable methods with and appropriate facilities like evasion and avoidance of tax and also granting credit to those areas in which the commercial Banks dare not to enter. The units are not examining the utilisation of fund except in continuous default. Finance Corporations are very much accessible to the borrowers and they obtain credit very easily as there are no many legal formalities to fulfill when compared to commercial banks. Finance Corporations are considering financial soundness, capacity for repayment of debt and personal acquaintance with the borrower while granting credit.

FUNCTIONS OF FINANCE CORPORATIONS

The main function of any finance corporation is to collect public deposits by offering attractive and high rate of interest and grant credit to different agencies for various economic, commercial and personal needs. Collection of deposits, recovery of debits, again granting of credit is a continuous process for any finance corporation and for its success it must recover the debt irrespective of capital contributions and public deposits collected. Dependence of public deposits and bank borrowings should gradually reduce with increased volume of collections. High rate of collection is absolutely essential to speak about the efficiency and proper functioning of any finance corporation. Now finance corporation is recognised as a good
competitor to the commercial banks in the process of deposit mobilisation as they offer high percentage of interest rate in the range of 18-21 percent. The general status of deposit holders are friends, relatives, doctors, engineers, lawyers, landlords, pensioners, employees, widows and businessmen. In most of the cases the contributions from friends and relatives constitutes a major share. The borrowers are mainly merchants, people with regular sales income, private transport operators, cine theatre proprietors, hotel and lodge owners and salary income group.

FINANCIAL AGENCIES IN UNORGANISED SECTOR

The organisational pattern of financial corporations in unorganised money market in India can be categorised into two forms viz.,

i) Proprietary concerns and

ii) Partnership concerns.

i) Proprietary Concerns

It is the simplest form of organisation in which an individual starts business of borrowing and lending money after obtaining a licence under Money Lenders Act. The Proprietor accepts public deposits in the name of the concern, from not more than 50 members due to the restriction prescribed in the Act. The money is lent irrespective of the purpose of utilisation, whether for productive or consumptional needs of the borrower. He grants credit on the basis of personal security against a demand
promisory note. In the process of granting credit he will consider the repayment capacity and credit worthiness of the borrower besides personal acquaintance with him. The rate of interest is market related, which normally varies in between 14-18 percent flat. There are three distinct methods of recovery of loans, viz., daily, weekly and monthly instalments. The moneylender collects the interest in advance while granting loan considering the time for repayment. The details of working to know the difference between the interest rates collected and real interest presented in chapter V.

Generally, a moneylender, besides his investment and the members of his family invites relatives and friends to invest their money in the concern. The confidence to mobilise the deposits from his kith and kin will be a motivating factor for the establishment of corporation and its expansion.

11) Partnership Concerns

Partnership concern is an association or a group of persons who contribute capital and collect public deposits for the purpose of lending, with a motive to earn profit. These units have been registering under the provisions of Indian Partnership Act, 1932. The main purpose of establishing a unit is, to collect more deposits from relatives, friends and employees by offering attractive rates of interest, manage the business collectively by
sharing managerial responsibilities and experiences for
common purpose and lend the entire fund including own
capital at a higher rate of interest. In partnership concern
a ceiling of 50 deposits is prescribed for each partner with
a maximum of 250 deposits for the corporation. Deposits
accepted from relatives are however excluded while
calculating the total number.

STRUCTURE OF FINANCE CORPORATIONS

Finance Corporations can be classified into five
important categories based on their areas of lending, viz.,
General Finance Corporations, Film Finance Corporations,
Auto Finance Corporations, Chit firms and Pawn Broker Units.
Every finance corporation extends credit only on the basis
of security, may be personal or movable or immovable
properties.

The General Finance Corporation extend credit to
any individual against the promissory note accepted and
signed by the borrower. It grants advance both for
productive and consumptional needs. The unit is not
considering the purpose of utilisation of fund but ensures
the recovery of debt granted. These corporations are also
conducting chit business besides their regular banking
activity.

The Film Finance Corporations are financing the
film industry by way of granting credit for construction of
theatres, film production and distribution. They are also granting credit for construction of buildings, acquisition of real estates, personal consumptional needs, purchase of durable commodities against promisory notes or on security of tangible assets under an obligation to repay the debt in instalments. The unit while granting credit for film production three agreements will be executed with different individuals, viz., producer, distributing agency and production lab controller.

The Auto Finance Corporations are providing useful service facilitating credit to large number of transport operators under hypothecation agreement in particular and to the other industrial products, consumable durables in general. Goods or vehicles are hired to the user and the corporation enjoys ownership rights till the receipt of final instalment.

The chit fund is an association of partners, established exclusively to promote and to conduct a chit under the provisions of Chit Fund Act. The foreman is competent to enroll and manage the affairs of the Chit for which he is entitled to certain fixed percentage of commission subject to the conditions in the bye laws. He will register every chit with the Registrar of Chits before conducting it.
The Pawn Broker units are associations, who grant credit against the security of jewellery or gold and in special cases household utensils also. They grant credit depending upon the value of movable properties. The personal acquaintance of the borrower by any partner will be a prerequisite condition to have credit other than hypothecation contract.

FINANCE CORPORATIONS vs. COMMERCIAL BANKS

The main difference between finance corporation and commercial bank is in the areas of granting and recovery of loans. Finance Corporation binds the borrower with personal and legal obligation i.e., promisory note, whereas commercial bank only with legal obligation. In finance corporation the credit worthiness of the borrower will be judged by the partner, whereas in commercial bank the officials judge credit worthiness and repayment capacity of a borrower. As an employee he may do more favour to the borrower as his personal interest is not affected. Borrowers in commercial banks may take legal obligation very lightly as they can postpone the repayment obligation by prolonging the case in court of law and finally requesting the court to provide permission to repay the debt in easy instalments in near future. The cost of bank credit is less than that of financial corporations.
INDIGENOUS BANKERS VS. COMMERCIAL BANKS

The commercial banks specialise exclusively in the banking business but the indigenous bankers generally combine banking with trading or business activity. Both allow withdrawal of deposits but in the case of commercial bank withdrawal is usually made through cheques while in the case of indigenous banker withdrawal is made in cash. (32) The proportion of deposits to the total resources form a small portion in indigenous bankers, but these forms major portion in commercial banks. The commercial banks in India maintain the approval list of indigenous bankers to facilitate transactions i.e., granting of loans, discounting of bills and securities. Commercial banks in practice determine the maximum amount of credit to be provided to indigenous bankers considering the credit worthiness. The degree of contact can be measured by the proportion of the total credit advanced. KARKAL (33) identified that it is the method rather in the nature of business that indigenous bankers stand in marked contrast with commercial banks.

(32) Gatak Subrata - RURAL MONEY MARKETS IN INDIA, Macmillan & Co., India Ltd., 1976, p. 18

INDIGENOUS BANKERS Vs. MONEYLENDERS

Moneylenders usually provide loans to cultivators and petty traders in rural areas, whereas indigenous bankers prefer to grant loans to trading, commercial and industrial activities. The indigenous bankers accept deposits or deal mainly in hundis, whereas moneylenders do not usually accept deposits or deal in hundis but are primarily concerned with moneylending.\(^{(34)}\) GHOSH\(^{(35)}\) views that dealing in hundis and not accepting deposits are the major features of indigenous bankers. Hence, both are mainly interested in moneylending, but indigenous bankers deal in hundis and may or may not accept deposits, whereas the moneylender neither deal in hundis nor accept deposits. Moneylenders are less organised, loans are smaller, turnover is low than indigenous bankers. Moneylenders are present almost everywhere, whereas indigenous bankers operate mainly in commercial centres. KARKAL\(^{(36)}\) views that the interest rates of moneylenders are usually greater than that of indigenous bankers. According to INDIAN CENTRAL BANKING ENQUIRY COMMITTEE\(^{(37)}\) deposits form a small portion of working capital and some indigenous

\(^{(34)}\) Jain, L.C - INDIGENOUS BANKING IN INDIA, Macmillan, London, 1929, p. 3.


bankers accept deposits from public and the other accept deposits only from relatives, friends or business associates. Both indigenous bankers and moneyminders provide advances partly with and partly without security but the indigenous bankers more often with than without and the moneyminder probably more often without than with. The indigenous bankers are generally particular about the utilisation of fund by the borrower whereas the moneyminder is not. It was observed that most of the clients of indigenous bankers repay the debt punctually and most of the moneyminders have to be persued.(38)

MONEYMINDERS Vs. FINANCE CORPORATIONS

In India Finance Corporations are licenced under Money Lenders Act. But moneyminders and Finance Corporations differ from each other in several respects. The main difference is that moneyminder grant credit only out of his personal savings for consumitional purposes whereas the Finance Corporation collects deposits from public particularly through friends, relatives, employees, landlords and pensioners and advances them including their own capital contributions mostly for productive purposes. The moneymender grants credit in small amounts to large number of people but finance corporation grants sizable credit to small number of customers. Finance Corporation maintains

proper records in a systematic manner subject to audit to create confidence in the minds of partners.

CHITS Vs. NIDHIS

In early days both chit and trust are grouped together, because the characteristic feature of Nidhi is identified by CENTRAL BANKING ENQUIRY COMMITTEE,\(^{(39)}\), is that of a terminating society of members who contribute monthly an amount which is available for loans to members is similar to that of chit. The committee adds that, this characteristic has now largely disappeared. In Nidhi's the monthly subscriptions to share capital has been replaced by a recurring deposit and a fixed small share capital which may or may not be withdrawn.

PROGRESS OF FINANCE CORPORATIONS IN INDIA

The Finance Corporations operating in Indian Credit market were identified as Bangalore type of Finance Corporations by a study group on Non-Banking Financial Intermediaries, constituted as per the guidance of Banking Commission in 1971. It was estimated that 90 per cent of the total number of Finance Corporations in India are established only in Southern States viz., Karnataka, Andhra Pradesh, Kerala and Tamil Nadu.\(^{(40)}\) But Commission never


made an attempt for detailed investigation and analysis, due to the paucity of statistical data and non-availability of details of working of these corporations. They also specifically mentioned in their report that the time has been one of the major constraints to make a detailed investigation about the operations of the corporations.\(^{(41)}\)

The Bangalore type of finance corporations are also identified in Andhra Pradesh in the districts of Anantapur, Kurnool and Chittoor. The Institute of Financial Management and Research, Madras has identified that the oldest finance corporation in Andhra Pradesh was 'Commercial Benefit Corporation' established in 1949 at Madanapalli of Chittoor district.\(^{(42)}\) The unit was established with a prime motive to provide adequate short term credit facilities for agricultural operations. The growth of finance corporations in Madanapalli had its effect in the neighbouring state of Karnataka. The retired commercial bank executives during 1960’s have hold full time jobs and invested huge funds. On account of high degree of managerial talents of those retired people during 1970’s the corporations were recognised as mini-commercial banks. Corporations also conducted chit business among employees, traders and businessmen. During 1974-75 there were about 100 units in Bangalore city alone. But most of the corporations were also

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\(^{(42)}\) Somanatha Nayar, C.P - FINANCE CORPORATIONS (A STUDY OF UNREGULATED BANKS), Institute of Financial Management and Research, 1982, p. 82.
liquidated due to mismanagement and misappropriation of funds. But even today the existing units in Karnataka are providing credit to mulberry cultivation, processing of silk production, rearing of cocoons and extraction of silk, as most of the agriculturists favour this crop to have immediate and profitable returns.

Kerala State

The oldest firm identified by the Institute of Financial Management and Research, Madras, in Kerala was 'Mutual Aid Bankers', established in 1928 at Ernakulam. This institution predates the spread of modern banking and the advent of British Rule in India. These institutions in Kerala were popular in agricultural and commercial crop trading centres in the districts of Ernakulam, Palghat and Idikki besides townships of Calicut, Kottayam and Trichur. It was identified that the average deposits were about Rs. 20 lakhs in Kottayam and Rs. 10 lakhs in other places. The corporations at Kottayam were accepting discounting of trade bills and documentary bills.

Tamil Nadu

In Tamilnadu the finance corporations were concentrated in the districts of Salem, Coimbatore and Kerur.

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besides Madras city. The important feature of this state was that the units have their own branches spreaded over in different centres and states and they attract the deposits through advertisement — whereas in Kerala and Andhra Pradesh that was not the case. In Andhra Pradesh and Kerala, corporations have their sister concerns managed and invested by their own partners and relatives under the advice of single managing consultant who possesses high degree of business experience and knowledge, especially in the field of advances. It was estimated that the average outstanding deposits and loans in Tamilnadu was Rs. 16 lakhs. In Tamilnadu the ratio of owned fund to deposits was higher than that of Bangalore but not as high as in Andhra Pradesh.

REGULATORY ASPECTS

The agencies in unorganised sector requires assistance, guidance and proper control by competent authority because of their diversified credit policies, absence of regulated discount market in bills, lack of uniformity in documentation, charging high rate of interest, informality in dealing, lack of consistency in credit policies, clubbing of business and trading activities with moneylending, increase in volume of overdues, diversification of fund for unproductive purposes etc.

Money Lending

In the absence of control, moneylending demoralises both lender and borrower. The legislations or acts should aim at improving their methods of operations, registrations, fixation of interest and maintenance of records. It should provide a base to rectify the defects in working of indigenous financial agencies in order to protect the interest of both borrower and lender.

In India a number of legislations in the form of Acts were enacted for controlling moneylending business. The important acts among them are:

1) The Deccan Agriculturists Relief Act, 1879 - through which the courts are given powers to go into the history of a credit transaction to judge its reality and to grant relief to the agriculturist borrowers by way of reducing interest rate or allowing repayment of debt in instalments.

2) Land Improvement Loans Act 1883 and Agricultural Loans Act 1884 - both drive the states to break down the monopolistic situation of moneylenders in rural area by supplying funds for economic development.

3) The Land Alienation Acts - are to prevent the transfer of landed property by the agriculturist borrowers to the non-agriculturist moneylenders with an intention to protect the interest of debtors.

4) Ususirioua Loan Act of 1981-1989 is to achieve direct control over registration, issue of licences, fixation
of interest rates, maintenance of books of accounts etc. to carry on moneylending activity.

v) Moneylenders Act - is to eradicate and control the evils of moneylending. The act imposes restrictions in respect of registration, licensing, maintenance of books of accounts in proper form, submission of periodical statements to the debtors, computation of interest, power of the court to limit interest and protection of debtors from certain actions of the lenders.

Finance Corporations

Finance Corporations are registering under partnership Act, 1932. There are no regulations relating to the functioning of finance corporation under Partnership Act. The provisions in Banking Companies Act, 1949, is not applicable though they are carrying banking business, because an exception has been granted to firms with a capital of less than Rs. 1 lakh, under the Banking Laws (Miscellaneous provisions) Act, 1963. Hence, corporations are functioning without any regulatory control.

It was the first time in 1972 the Banking Commission took up the study of Finance Corporations and recommended that no corporation should work without obtaining licence from Reserve Bank of India, it should maintain prescribed ratios between own fund and deposit besides liquidity ratios, periodical inspection of the
operation by Reserve Bank of India and to fix maximum deposit ratio over and above the commercial banks.\(^{(46)}\)

Accordingly the Reserve Bank of India constituted a study group and it has expressed that regulation of finance corporation activities by imposition of ceiling on borrowings and also the manner of utilisation of funds was necessary.\(^{(47)}\) Taking into the views of the study group Banking Laws (Amendment) Bill 1978 was presented to the parliament to amend Chapter II B of R.B.I. Act. The relevant portion is:

1) Sec. 45 (1) Sub Section (ii) Clause (d) - which originally reads as "firm means a firm as defined in the Indian Partnership Act 1932 of which the capital subscribed by its partners exceeds one lakh of rupees". The amendment suggested - the deletion of the words "of which the capital subscribed by its partners exceeds one lakh of rupees".

ii) The amendment proposed a new chapter (Chapter II C) after chapter II B of the RBI Act according to which - 45 S(1) "No person being an individual or a firm or an unincorporated association of individuals shall at any time, have deposits from more than the number of depositors specified against each in the table below:

\(^{(46)}\) Government of India - BANKING COMMISSION \(^{(1972)}\), Reserve Bank of India, Bombay.

\(^{(47)}\) Government of India - REPORT OF STUDY GROUP ON NON-BANKING COMPANIES, Reserve Bank of India, Bombay, 1975, para 5-7.
a) Individual --- Not more than 10 depositors;

b) Firm --- Not more than 10 depositors per partner and not more than 40 depositors in all;

c) Association of --- not more than 10 depositors per individuals individual and not more than 40 depositors in all;

iii) Where at the commencement of the Banking Laws (Amendment) Act, 1978 the deposits held by any such person are not in accordance with sub-section (1) he shall repay such of the deposits as shall fall due for repayment immediately after the commencement of that act, so as to bring the number of depositors within the relative limit specified in that sub-section. But in the Parliament the proposed amendment was given as exemption explaining that small firms where operations were on a small scale should not be brought within the purview of control in the beginning. Keeping this exemption as an advantage, the corporations are registering under Moneylenders' Act by attracting large volume of deposits from public.

Finance Corporation also requires legislative control because their capital contributions are very limited to total turnover, deposits are not covered by Deposit Insurance Corporation, transfer of fund among sister concerns, difficulty in assessment of partner's net worth, lack of coordination and leadership among partners, acceptance of deposits in binami names to suit the
convenience of tax evasion, charging high rate of interest, increasing of overdues, lack of uniformity and consistency in lending operations, demanding advance interest, manipulation of book of accounts, obtaining thumb impressions or signatures on blanks papers, obtaining conditional sale deed for assets, lack of incentive to mobilise rural savings, conservative approach, conventional practices in business etc.