Chapter 2

Chit Funds

in the Indian Financial System
CHAPTER II

CHIT FUND IN THE INDIAN FINANCIAL SYSTEM

2.1. INDIAN FINANCIAL SYSTEM

The economic development of any country depends upon the existence of a well-organised financial system. It is the financial system which supplies the necessary financial inputs for the production of goods and services which in turn promote the well-being and standard of living of the people of a country. The responsibility of the financial system is to mobilise the savings in the form of money and monetary assets and invest them in productive ventures. An efficient functioning of the financial system facilitates the free flow of funds to more productive activities and thus promotes investment.

The growth of output in any economy depends on the increase in the proportion of savings investment to a nation's output of goods and services. The financial system and financial
institutions help in the diversion of rising current income into savings and investments.

A financial system may be defined as a set of institutions instruments and markets which foster savings and channels them to their most efficient use. The system consists of individuals (savers), intermediaries, markets and users of savings. Economic activity and growth are greatly facilitated by the existence of a financial system developed in terms of the efficiency of the market in mobilising savings and allocating them among competing users.

2.2. ORGANISED INDIAN FINANCIAL SYSTEM

The organised financial system comprises an impressive network of banks, other financial and investment institutions and a range of financial instruments, which together function in fairly developed capital and money markets. Short-term funds are mainly provided by the commercial and co-operative banking structure. Nine-tenth of such banking business is managed by twenty-eight leading banks which are in the public sector. In addition to commercial banks, there is the network of Co-operative Banks and Land Development Banks at State, District and Block levels.

The following charts give a brief account of the Indian Financial System as well as Non-Banking Financial System.
CHART - 2.2

**FINANCIAL INSTITUTIONS**

Regulatory
- RBI
- BIFR
- SEBI
- CCI

Non-intermediaries
- IFCI
- IDBI
- NABARD
- NCDC
- ICICI
- IRBI
- EXIM BANK
- TFCI

Others
- DICGC
- ECGC
- TCO
- DFHI
- SHCI
- CRISIL
- Merchant banking
- Money lenders

Intermediaries

Insurance
- GIC
- LIC

Banking
- RBI
- Commercial banks
- Co-operative banks
- Post Office
- Savings bank
- Rural banks

Non-Banking
- Hire Purchase
- Lease Finance
- House Finance
- UTI
- Chit Funds
- Mutual Funds
- HDFC
- Venture Capital
- HUDCO
- Nidhi
- Investment Trusts
- Provident Fund
- Pension Funds

Source: Financial markets and institutions Dr. S. Maria John.
2.3. Non-Banking Finance Companies

The role of Non-Banking Finance Companies (NBFCs) in transferring the funds from lenders to borrowers has been well recognised. The main advantages of these companies lie in the lower transactions costs of their operations, their quick decision-making ability, customer orientation and prompt provision of services. Partly on account of these advantages NBFCs have in recent years grown sizeably both in terms of their number as well as the volume of business transaction. The number of such financial companies grew more than seven-fold from 1981 to 1996. In the year 1981, their numbers were 7,063, 55, 995 in 1995 and 51,929 in 1996. Of these, only 10,161 or merely 20 percent of these companies used to submit returns to the Reserve Bank. The regulated deposits of the reporting companies amounted to Rs. 38,679.5 crore in 1996. As a percentage of household sector saving in gross financial assets, the share from a non-bank deposits increased from a low of 3% percent during 1980-81 to 10.6 percent during 1995-96.

The Reserve Bank accorded registration to 624 NBFCs as deposit-taking entities up to August 31, 1999, which are covered under the Reserve Bank’s Comprehensive regulatory/supervisory process, while another 7,231 NBFCs were registered as non deposit accepting/holding entities subject to, inter alia, their having the minimum required NOF. The aggregate public deposits of NBFCs in terms of survey data as reported by 1724 NBFCs stood at Rs. 20,237 Crore as on March 31, 1998 and was equivalent to 3.4 percent of the aggregate deposits of commercial banks. Consequent upon the amendments to the Reserve Bank of India Act, 1934, during 1997, the Reserve Bank narrowed down its focus by confining its regulatory attention only in relation to public deposits.3
<table>
<thead>
<tr>
<th>Non-Banking Finance Company</th>
<th>Principal business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment Leasing Company (EL)</td>
<td>Equipment leasing or the financing of such activity</td>
</tr>
<tr>
<td>Hire Purchase Finance Company (HP)</td>
<td>Hire Purchase transaction or the financing of such transactions.</td>
</tr>
<tr>
<td>Loan Company (LC)</td>
<td>Providing finance by making loans or advances, or otherwise for any activity other than its own; excludes EL / HP / HFCs.</td>
</tr>
<tr>
<td>Investment Company (IC)</td>
<td>Acquisition of securities and trading in such securities to earn a profit.</td>
</tr>
<tr>
<td>Mutual Benefit Financial Company (MBFC) i.e., Nidhi Companies</td>
<td>Notified by the Central Government under section 620A of the companies Act, 1956.</td>
</tr>
<tr>
<td>Miscellaneous Non-Banking Company (Chit Fund Companies)</td>
<td>Managing, Conducting or supervising as a promoter, forman or agent of any transaction or arrangement by which the Company enters into an agreement with a specified number of subscribers that every one of them shall subscribe certain sum in instalments over a definite period and that every of such subscribers shall in his/her turn, as determined by lot or by auction or by tender or in such manner as may be provided for in the arrangement be entitled to the prize amount. The financing of the acquisition or construction of houses including the acquisition or development of plots of land. These companies are supervised by the National Housing Bank.</td>
</tr>
<tr>
<td>Housing Finance Companies (HFC)</td>
<td></td>
</tr>
<tr>
<td>Residuary Non-Banking Companies (RNBC)</td>
<td>Company which receives deposits under any scheme or arrangement, by whatever name called, in one lump sum or in instalment by way of contributions or subscriptions or by sale of units or certificates or other instruments, or in any manner. These companies do not belong to any of the categories as stated above.</td>
</tr>
</tbody>
</table>
2.4. New Regulatory Framework

The RBI Act was amended in January 1977 by effecting comprehensive changes in chapter III - B, III - C and V of the Act, thereby testing considerable powers with the Reserve Bank for effective regulation of NBFCs to ensure that they integrate their functioning within the Indian Financial System. The amended Act provides for entry point norm of Rs. 25 lakhs as minimum capital funds. Under the Act, the Reserve Bank was vested with the powers of enhancing the minimum NOF of NBFCs to Rs. 2 Crore. In the Monetary and Credit Policy Statement for the year 1999 - 2000, it was proposed that in respect of new NBFCs, which are incorporated on or after April 20, 1999 and which seek registration with the Reserve Bank, the requirement of minimum NOF will be Rs. 2 Crore. This stipulation will not apply to NBFCs which are already registered with the Reserve Bank or whose application are presently under consideration. In terms of section 45 - 1A of the RBI Act, registration of an NBFC with the Reserve Bank has been made mandatory. The companies existing on January 9, 1997 were given time upto July 8, 1997 to make a special audit of the companies having asset base of Rs. 5 crore and above to expedite the process of registrar of NBFCs. Approximately 1400 companies were subjected to special audit to ascertain their eligibility criteria.
### Table 2.2
**Position of NBFCs for Issue of Certificate of Registration**

<table>
<thead>
<tr>
<th>Sl.No</th>
<th>Criteria</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Total Number of applications received</td>
<td>37,390</td>
</tr>
<tr>
<td>2.</td>
<td>Number of NBFCs having NO F of Rs.25 lakh and above (i.e. fulfilling primary eligibility criteria)</td>
<td>10,486</td>
</tr>
<tr>
<td>3.</td>
<td>Number of approved applications of which Number of NBFCs permitted to hold / accept public deposits</td>
<td>7855</td>
</tr>
<tr>
<td></td>
<td></td>
<td>624</td>
</tr>
<tr>
<td>4.</td>
<td>Number of rejections</td>
<td>1167</td>
</tr>
<tr>
<td>5.</td>
<td>Number of NBFCs whose applications are under process</td>
<td>1464</td>
</tr>
<tr>
<td>6.</td>
<td>Number of NBFCs having NO F below Rs.25 lakhs</td>
<td>26,904</td>
</tr>
</tbody>
</table>

*Note*: Position as on August 31, 1999.

*Source*: RBI Bulletin


The Finance Minister announced in July 1998 the setting up of a Task Force for reviewing the regulatory framework for non-banking finance companies. The recommendations of the Task Force, submitted in October 1998, have been guided by the twin considerations of creating an environment for healthy growth of sound NBFCs. While at the same time, providing an enhanced degree of comfort to the depositors in NBFCs.
The recommendations of the Task Force can be categorised under four broad heads:

1. The recommendations which can be implemented with immediate effect through changes in the RBI Directions for NBFCs and issue of notification under RBI Act for unincorporated bodies.

2. The recommendations, the implementation of which requires suitable statutory amendments. For this, the necessary action by the Reserve Bank will be initiated in consultation with the Banking Division, Ministry of Finance, Government of India.

3. The recommendations which are to be implemented over a period of time by amending the directions within the existing powers already available under the RBI Act; and

4. The recommendations which need no amendments to the Directions or the Statute, but are to be implemented over a period of time through administrative action.
# Table 2.3

## Deposits with Non-Banking Corporate Sector (As at the End of March 1997)

(Amount in Crores)

<table>
<thead>
<tr>
<th>Category</th>
<th>Number of Reporting companies</th>
<th>Regulated Deposits</th>
<th>Exempted Deposits</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Banking Corporate Sector</td>
<td>95-96</td>
<td>96-97</td>
<td>95-96</td>
<td>96-97</td>
</tr>
<tr>
<td>(1+2+3)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Non-Financial Companies</td>
<td>2336</td>
<td>2376</td>
<td>8040.1</td>
<td>9592.0</td>
</tr>
<tr>
<td></td>
<td>(18.6)</td>
<td>(17.0)</td>
<td>(15.0)</td>
<td>(13.4)</td>
</tr>
<tr>
<td>2. Financial companies</td>
<td>9060</td>
<td>10122</td>
<td>38673.5</td>
<td>52893.3</td>
</tr>
<tr>
<td></td>
<td>(72.3)</td>
<td>(72.5)</td>
<td>(72.3)</td>
<td>(73.9)</td>
</tr>
<tr>
<td>3. Miscellaneous</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Banking Companies</td>
<td>1134</td>
<td>1473</td>
<td>6763.9</td>
<td>9130.3</td>
</tr>
<tr>
<td></td>
<td>(9.1)</td>
<td>(10.5)</td>
<td>(12.7)</td>
<td>(12.7)</td>
</tr>
</tbody>
</table>


P: Provisional 

@: includes money received by way of borrowings from Central, State Governments, local authorities, Foreign Government Authorities, Banks and Financial Institutions, Deposits from Share holders, Directors, Security Deposits from Employees, Purchasing selling other Agents, Fixed deposits, Debenture from public, subscription to shares and convertible Debentures Bonds pending allotment transactions of conventional chit fund, kuri and intercorporate deposits and others.

Notes: Figures in parentheses indicate rate with respective column totals.
TABLE 2.4
CHIT FUND COMPANIES
GROWTH IN AGGREGATE DEPOSITS OF SCHEDULED COMMERCIAL BANKS NON-BANKING CORPORATE SECTOR: 1991-1997
(Amount in crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Scheduled Commercial Banks Number of Reported Companies</th>
<th>Deposits with Non-Banking corporate sector (NBFC)</th>
<th>Rate of change (%) Scheduled commercial bank deposit</th>
<th>Total NBC deposit</th>
<th>Regulated deposits as % of SCBS deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>204773.9</td>
<td>6746.9</td>
<td>44073.4</td>
<td>-</td>
<td>3.3</td>
</tr>
<tr>
<td>1992</td>
<td>230758.0</td>
<td>43688.3</td>
<td>51184.8</td>
<td>12.7</td>
<td>16.1</td>
</tr>
<tr>
<td>1993</td>
<td>274562.3</td>
<td>9177.9</td>
<td>148097.4</td>
<td>19.0</td>
<td>189.3</td>
</tr>
<tr>
<td>1994</td>
<td>324720.7</td>
<td>23202.4</td>
<td>1857980.7</td>
<td>18.3</td>
<td>25.4</td>
</tr>
<tr>
<td>1995</td>
<td>376011.0</td>
<td>211308.8</td>
<td>248604.0</td>
<td>15.8</td>
<td>33.8</td>
</tr>
<tr>
<td>1996</td>
<td>420449.0</td>
<td>53480.5</td>
<td>295344.7</td>
<td>11.8</td>
<td>18.8</td>
</tr>
<tr>
<td>1997</td>
<td>496402.0</td>
<td>285537.4</td>
<td>357153.0</td>
<td>18.1</td>
<td>20.9</td>
</tr>
</tbody>
</table>

Table showing the comparison of Chit fund companies deposits with scheduled commercial banks deposits (in crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Deposits of SCB of chit funding</th>
<th>Deposits of NBCs SCB</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>204773.9</td>
<td>44073.4</td>
<td>21.52</td>
</tr>
<tr>
<td>1992</td>
<td>230758</td>
<td>51184.8</td>
<td>22.18</td>
</tr>
<tr>
<td>1993</td>
<td>274562.3</td>
<td>148097.4</td>
<td>53.94</td>
</tr>
<tr>
<td>1994</td>
<td>324720.7</td>
<td>185780.7</td>
<td>57.21</td>
</tr>
<tr>
<td>1995</td>
<td>376011</td>
<td>248604</td>
<td>66.12</td>
</tr>
<tr>
<td>1996</td>
<td>420449</td>
<td>295344.7</td>
<td>70.25</td>
</tr>
<tr>
<td>1997</td>
<td>496402</td>
<td>357153</td>
<td>71.95</td>
</tr>
</tbody>
</table>

Source: RBI Annual Report

From the above table, it is clear that the contribution of Non-Banking companies when compared to the deposits of scheduled commercial bank is steadily raising year by year. The Average deposit of NBCs to the Scheduled commercial bank is 51.88%.

The table below presents the growth in aggregate deposits of banks and non-banking companies between 1981 and 1995. Aggregate deposits with non-banking companies were 4,188 crores as compared to Rs. 37,988 crores with commercial banks in 1981. Deposits of non-banking companies in 1991 were Rs.44,073 crores while deposits of commercial banks were
Rs. 2,04,774 crores and as a proportion they formed 3.3 percent of commercial bank's deposits. Deposits of non-banking companies became really significant in 1995 at Rs. 2,44,006 crores and formed 8.7 percent of deposits with commercial banks (3,76,011 crores)
### Table 2-6

Growth in Aggregate Deposits with scheduled Commercial Banks and Non-Banking Corporate Sector during 1981 - 1995

| Year (end March) | Scheduled Commercial Banks | Deposits with Non-Banking Companies | Percentage rate of growth | | | | |
|------------------|-----------------------------|------------------------------------|--------------------------|-------------------|-------------------|-------------------|
|                  | Exempted Borrowing | Regulated deposits | Total deposits | Exempted Borrowing | Regulated deposits | Total deposits | Percentage of col(4) to col (2) |
| 1981 | 37,988.0 | 2,830.7 | 1357.3 | 4188.0 | . | . | . | 3.6 |
| 1982 | 43,733.0 | 3,921.1 | 1519.7 | 5491.8 | 15.1 | 12.0 | 31.1 | 3.6 |
| 1983 | 51,358.1 | 7,216.8 | 1,977.5 | 9194.3 | 17.4 | 21.8 | 67.4 | 3.9 |
| 1984 | 60,772.0 | 8,789.5 | 2,334.5 | 11124.1 | 18.3 | 18.1 | 31.0 | 3.8 |
| 1985 | 72,571.0 | 13,865.6 | 2,815.3 | 16,140.4 | 19.5 | 20.6 | 45.1 | 3.9 |
| 1986 | 85,704.0 | 14,805.6 | 3,266.5 | 18,072.1 | 18.1 | 16.0 | 31.0 | 3.8 |
| 1987 | 1,02,938.4 | 17,323.4 | 4,076.8 | 21,400.2 | 20.1 | 24.8 | 18.4 | 4.0 |
| 1988 | 1,18,678.0 | 19,469.3 | 4,735.0 | 24,204.3 | 15.1 | 16.1 | 31.0 | 4.0 |
| 1989 | 1,46,150.0 | 23,197.8 | 5,407.1 | 28,604.9 | 18.1 | 14.2 | 31.0 | 3.9 |
| 1990 | 1,75,441.0 | 30,084.0 | 5,997.4 | 36,082.0 | 25.2 | 15.9 | 31.0 | 3.4 |
| 1991 | 2,04,773.9 | 37,326.5 | 6,746.9 | 44,137.4 | 16.7 | 24.1 | 22.1 | 3.3 |
| 1992 | 2,30,758.0 | 43,688.3 | 7,496.3 | 51,384.8 | 12.7 | 11.1 | 16.1 | 3.2 |
| 1993 | 2,74,562.3 | 1,38,919.5 | 9,177.9 | 1,48,097.4 | 19.0 | 22.4 | 18,93.3 | 3.3 |
| 1994 | 3,24,720.7 | 1,62,578.3 | 23,202.4 | 1,85,878.0 | 18.3 | 22.8 | 3.2 | 7.1 |
| 1995 | 3,76,011.0 | 2,11,305.0 | 32,701.2 | 2,44,406.2 | 15.8 | 40.9 | 31.3 | 8.7 |

Source: Growth of Deposits with Non-Banking Companies, 1994 - 95, RBI, Bulletin, August 1997
### TABLE - 2.7

**Deposits of Companies with total deposits of Rs. 25 lakhs and more (Submitted returns in 1995)**

<table>
<thead>
<tr>
<th>Category of companies</th>
<th>Number of Companies</th>
<th>Exempted Borrowing</th>
<th>Regulated Deposits</th>
<th>Aggregate Deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. A reported Companies</td>
<td>10,682</td>
<td>2,11,305.0</td>
<td>32,701.2</td>
<td>2,44,006.2</td>
</tr>
<tr>
<td>a) Financial Companies</td>
<td>7410</td>
<td>58,567.3</td>
<td>25,391.9</td>
<td>83,959.2</td>
</tr>
<tr>
<td>b) Misc. Non-banking Companies</td>
<td>1116</td>
<td>1487.3</td>
<td>48.6</td>
<td>1535.9</td>
</tr>
<tr>
<td>c) Non-financial Companies</td>
<td>2156</td>
<td>151,250.5</td>
<td>7260.7</td>
<td>1,58,511.2</td>
</tr>
<tr>
<td>2. Companies with reported total deposits Rs. 25 lakh and more</td>
<td>4875</td>
<td>2,11,185.6</td>
<td>32,545.4</td>
<td>2,43,731.0</td>
</tr>
<tr>
<td>a) Financial Companies</td>
<td>2417</td>
<td>58,495.9</td>
<td>25,244.7</td>
<td>83,740.6</td>
</tr>
<tr>
<td>b) Misc. Non-banking Companies</td>
<td>583</td>
<td>1455.2</td>
<td>44.8</td>
<td>1500.0</td>
</tr>
<tr>
<td>c) Non-financial Companies</td>
<td>1875</td>
<td>1,51,234.6</td>
<td>7,255.9</td>
<td>1,58,490.5</td>
</tr>
<tr>
<td>3. Percentage of</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) All Companies with total deposits Rs. 25 lakh or more to all reported Companies</td>
<td>45.6</td>
<td>99.9</td>
<td>99.5</td>
<td>99.9</td>
</tr>
<tr>
<td>b) 2(a) to 1 (a)</td>
<td>32.6</td>
<td>99.9</td>
<td>99.4</td>
<td>99.7</td>
</tr>
<tr>
<td>c) 2(b) to 1 (b)</td>
<td>52.2</td>
<td>97.8</td>
<td>92.2</td>
<td>97.7</td>
</tr>
<tr>
<td>d) 2(c) to 1(c)</td>
<td>87.0</td>
<td>100.0</td>
<td>99.9</td>
<td>100.0</td>
</tr>
</tbody>
</table>


Of the reported companies of 10,682 financial companies (7,410) constituted 69.4 per cent, miscellaneous non-banking Companies (1116) 10.4 per cent and non-financial Companies (2156) 20.2 per cent.

### 2.6 Deposits of Non-Banking Companies (1994-95)

Financial Companies with deposits of Rs. 25 lakhs and more in March 1995 including Miscellaneous Non-Banking
Companies accounted for 45.6 per cent of all reporting companies and 99.9 per cent of deposits (Miscellaneous Non-Banking Companies 583) accounted for 12 per cent of all reporting companies and their deposits formed 6.1 per cent of aggregate deposits. The Financial Companies including Miscellaneous Non-Banking Companies held in 1995 regulated deposits of Rs.25,440.5 crores and exempted borrowing of Rs.60,056 crores.

**Table - 2.8**

**Deposits with Non-Banking Corporate Sector (As at the end of March 1996)**

<table>
<thead>
<tr>
<th>Category</th>
<th>Number of reporting Companies</th>
<th>Regulated Deposits</th>
<th>Exempted deposits</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate deposits</td>
<td>12,530</td>
<td>53,479.3</td>
<td>2,418,642.2</td>
<td>2,953,433.5</td>
</tr>
<tr>
<td>Aggregate deposits of which held by:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) Non-financial companies</td>
<td>2,336</td>
<td>8,040.1</td>
<td>1,788,691.1</td>
<td>1,869,092.2</td>
</tr>
<tr>
<td></td>
<td>(18.6)</td>
<td>(15.3)</td>
<td>(74.0)</td>
<td>(63.2)</td>
</tr>
<tr>
<td>b) Financial Companies</td>
<td>9,060</td>
<td>38,675.5</td>
<td>61,048.8</td>
<td>99,724.3</td>
</tr>
<tr>
<td>c) Misc. Non-banking and residuary non-banking companies</td>
<td>1,134</td>
<td>6,763.7</td>
<td>1,946.3</td>
<td>8,710.0</td>
</tr>
<tr>
<td></td>
<td>(9.1)</td>
<td>(12.7)</td>
<td>(0.8)</td>
<td>(3.0)</td>
</tr>
</tbody>
</table>


The aggregate regulated deposits of Non-Banking companies as reported by 10,914 companies amounted to Rs.45,439 crores in March 1996 which constituted 10.5 per cent
of the aggregate deposits of scheduled commercial banks at the end of March 1996 as against 7.8 per cent a year ago.$^{10}$

### 2.7 Recent Development (RBI)

RBI has instituted a comprehensive regulatory and supervisory framework for the NBFC sector in Jan. 1998, pursuant to the amendments effected to the RBI Act 1934. As part of the consultative process the RBI has constituted an Informal Advisory Group consisting of representatives of the NBFC sector. While helping orderly growth of this important sector, steps are also being taken to increase investor awareness of their own responsibility in regard to investments made by them. Considering the large number of NBFCs functioning, their geographical distribution and their diversified activities, the RBI has been keen to promote the concept of self regulatory organisation among NBFCs particularly for smaller NBFCs and discussions with industry are continuing. A committee constituted by the Bank to suggest formats of B/S with adequate disclosures has also submitted its report. The RBI proposes to introduce these formats and disclosure norms as recommended by the Committee after getting the views of the Industry and Department of Company Affairs of the Government of India.

The registration process for larger NBFCs envisaged under the Act is now more or less complete. Of 10,486
applications of NBFCs which were prima facie eligible, registration has been granted to 7855 NBFCs, Out of which 624 NBFCs have been permitted to accept public deposits.

Further the applications of 1,167 companies have been rejected for registration as on August 31, 1999. In addition, as many as 26,904 companies with Net Owned Fund below Rs.25 lakh have been given time under the RBI Act upto Jan.8, 2000 to achieve the minimum level of Rs.25 lakhs. All NBFCs in this category should strictly adhere to the above time limit. The RBI may not in the normal course, grant extension of time to those NBFCs which have not attained the prescribed minimum of various statutory returns of NBFCs is in place. Besides, special formats for off-site surveillance of NBFCs with asset size of Rs.1 billion and above have been devised11.

At present, only MF is registered as Co-operatives and NBFCs are regulated. The need for regulation and supervision arises from several considerations like protecting the interests of the small savers, ensuring proper terms of credit and financial discipline, institution of a proper reporting system as also for their orderly development. The regulation may cover registration, reserve requirements, compliance with prudential accounting norms and directions in respect of operations and reporting systems while supervision may comprise on-site inspection and of off-site supervision.12
2.8 MF-NBFCs

With a view to facilitating professionalisation of the mF sector, there could be a special dispensation for the NBFCs which take up mF exclusively. Such mF-NBFCs may need registration from RBI to GOI on the lines of Nidhi companies. The NOF for them may be prescribed at Rs.25 lakhs and they may be granted registration under Section 12(A) of the Income Tax, wherever necessary. Further, for encouraging the growth of mF, NBFCs necessary amendments may be made in the Societies Registration Act to allow NGOs to float specialised mF companies and hold equity in them.\textsuperscript{13}

The Department of Non-Banking Supervision (DNBS) is responsible for supervision and regulation of NBFCs. No NBFC can commence or carry on the business of a non-banking financial institution without obtaining a Certificate of Registration from RBI. The NBFC with NOF of Rs.25 lakhs and above (Since enhanced to Rs.20 lakhs effective from 20 April 1999) are mandatorily required to be registered with the RBI. Maintenance of liquid assets at a specified percent of public deposits is compulsory. The RBI is empowered to give directions to NBFCs and can even prohibit NBFCs which do not adhere to a set of prudential norms from accepting deposits and impose penalties under the provisions of the RBI Act. A system of on site examination based on CAMELS
rating models and off-site surveillance NOF of Rs.25 lakhs by
the stipulated date and accordingly their applications may not be
considered for registration.

The following further measures in respect of NBFC sector
are being notified with immediate effect.

i) The borrowings from mutual funds presently come within
the purview of public deposits as described in the Direction of
Acceptance of Public Deposits. It has been decided that
borrowings from mutual funds would be excluded from the
definition of public deposits.

ii) NBFCs should give public notice of 3 months in leading
newspapers before they decide to close a branch or before
effecting sale or transfer of ownership.14

2.9 NBFCs and the Reserve Bank of India

The RBI has a separate Department to deal with the
NBFCs. It was originally called the Department of Non-banking
Companies. Now, it is referred to as The Department of Financial
companies. The main objective of this Department is to exercise
some control over the NBFCs by collecting data, issuing directions
and inspecting them wherever necessary. Its central office is
situated at Calcutta and it has four regional offices.
2.9.1 Functions of the Department

The main functions of the Department of Financial companies are the following.

i) To identify financial companies and classify them.

ii) To review the classification of such companies then and there

iii) To attend to legislative matters and issue directions to NBFCs on various matters.

iv) To advise the Central Government and state Government on matters pertaining to NBFCs.

v) To receive and scrutinise the balance sheets, returns, accounts and statements of NBFCs.

vi) To inspect them and take follow-up action.

vii) To deal with sternly those companies which contravene any of the directions of the RBI.

viii) To consider requests for grant of exemptions.

ix) To carry out studies on the working of these companies.

x) To deal with the complaints received from the public and to do any other work which are incidental to the above functions.
2.9.2 RBI’s Control over NBFCs

In the interest of the economy as a whole and in order to pursue an effective monetary policy, it is desirable that the NBFCs should be brought under the control of the RBI in the same way as the commercial banks are controlled. It is so because whenever the RBI increases its bank rate or changes the lending rates or deposit rates, they will have no impact on the rates charged by these non-banking financial companies. Again, when the RBI follows a policy of credit squeeze the industrial houses can escape from the policy by resorting to the system of financing through ‘public deposits’. Besides, any person with any type of security can approach a NBFCs at any time and obtain a loan. The RBI has no say over it. Yet another drawback of these companies has been the conspicuous lack of transparency of operations and proper financial disclosure. Again, several residuary Non-banking companies are found to be operating with meagre capital and some of them even with negative capital. Moreover, some of the NBFCs have been found to be issuing misleading advertisements for attracting deposits. In these circumstances, the RBI cannot function effectively and implement its fiscal and monetary policies unless the NBFCs are brought under its control. Hence, the RBI has been taking several steps in this direction.
The NBFCs are playing a unique role in mobilising funds, directing investment, providing a push to development, especially in the industrial sector, catering to the varied financial needs of medium and rural sector. Above all, thriving healthy and growing non-banking financial sector is necessary for promoting the growth of an efficient and competitive economy. Thus, NBFCs have emerged as a unique institution in the Indian financial system bridging the credit gaps in several sectors.

2.10 Benefits of Chit Funds in the National Scene

2.10.1. Chit funds are in the front among the non-banking financial intermediaries in India. But the benefits that they offer to the members and the society at large are not fully understood even by those who try to control or regulate them with the intention of protecting the interests of the very same members. Here it has to be examined a) if chit funds extend economic benefits to their members and b) if they contribute anything to the national financial scene.

A chit fund scheme involves the following a) pooling the sums of money contributed by a group of individuals b) lending the pooled amount to a member of the group and c) continuing the process of collection and distribution of such amounts in rotation till all the members receive their contributions. In this time-bound programme, the group members enjoy facilities and conveniences which are generally not available in other financial units or intermediaries.
The rationale of an auction chit or business chit is that

i) it connects the borrowing class directly with the lending class and

ii) it links the process of borrowing with the process of saving.

2.10.2 Implications

The implications of the above two are below. The members meet to fix the rate of interest and decide the prize winner. In the presence of the foreman (organiser or intermediary) who is neutral in interest rate fixation, the members bid for the prize or chit amount and as there is more than one member bidding for one and the same prize amount a competitive interest rate (through the offer of discount at auction) is arrived at. The competition is however limited to the members. No outsider or outside action is involved in either raising the rate or lowering it. Thus the benefit of the scheme is enjoyed only by the members. The savers (those who are unsuccessful in taking the prize amount, though participated in the auction) through competitive offer by the borrower (the person who is successful in taking the prize amount) get the maximum return on their savings within the limited circle and the borrowers pay an interest rate which they calculate as profitable for a loan repayable in instalments over a fairly long period.
One important point to note here is the benefit that the members derive out of the passive role of the foreman. He doesn't prescribe or administer an interest rate for loan as is the practice in other financial institutions. He does not also receive any share of the intermediate amount. His commission is a percentage of the capital and the amount kept for bidding (intermediated amount) is independent(net) of his commission. By allowing complete freedom to the borrowers in fixing the rate of interest and taking the loan and also by allowing the members to share among themselves the profit or otherwise of the scheme with the exclusion of the foreman, a chit fund stands above the other financial intermediaries in respect of neutrality between borrowers and impartiality among the members in the offer of financial services.

Linking the process of borrowing with the process of saving is a unique feature. The borrowers are tied to the scheme till its end. If a member bids the prize amount at the first or second or any other instalment, he has to continue to subscribe the stipulated amount upto and including the last instalment. In other words, savings are made as a precondition for borrowing. The process of borrowing and the process of saving are inseparably linked. This is apart from the compulsory nature of savings of all members of a chit fund scheme.
2.10.3. Efficiency:

The efficiency of a financial intermediary from the angle of the clients who seek its services is measured generally by its intermediation charge. A financial intermediary acts as a middle man or an agent between the supplier (savers) and the users (borrowers) of funds. The savers expect the maximum interest on their savings while the borrowers expect the lowest interest on borrowed funds. In between, the intermediary wants charges for his services. The more the intermediation charge the less is the benefit of the other two and vice versa. With a constant intermediation charge, the savers can be paid more only at the expense of the borrowers, and borrowers can be charged less only at the expense of the savers. In between these two conflicting interest, the only way of satisfying both the savers and the borrowers is through a reduction in the intermediation charge. According to S. Madhur and C.P.S. Nayar "Efficiency in Financial Intermediation is inversely related to the cost of intermediation." This has been stated in a Project Report for the Organisation for Economic Co-operation and Development (OECD), Paris 1987. Experience shows that banks and all other financial institutions in India except the chit funds have raised their intermediation and other service charges over the years. Even if one looks at the commission charged by the foreman of chit funds as a cost of
intermediation (which is not the correct view because commission is independent of the intermediated amount and so can be considered as a service charge), it has remained stationary at about 5 percent of chit capital over the last seven and a half decades. Thus from the clients' angle the chit funds are least cost and hence the most efficient financial intermediary.

2.10.4. Commission:

The earliest chit fund regulation was the Travancore Chitties. Act, 1918. It was later amended in 1922, 1925 and 1933. In the Act and the amendments, the commission mentioned varied from one to 5 per cent. In the mean time, the Travancore Banking Enquiry Committee, 1930 recommended that "a scale of rate may be prescribed under which the rates may be in inverse proportion to the capital of the chitty and in no case should exceed three per cent." Later in 1945, a comprehensive Chit Fund Act, called the Travancore Chitties Act 1120 (M.E.) was passed. In this Act it was mentioned that the foreman is entitled "to such commission as remuneration not exceeding five percent of the chitty amount." Subsequent Chit Fund Acts like the Madras Chit Fund Act 1961, the Kerala Chitty Act 1975 and Central Chit Funds Act 1982 merely repeated what the 1945 Travancore Chitties Act has said. Thus the commission to the
foreman of a chit fund appears to have remained willy nilly, untouched during the past 76 years. A hidden danger involved in any chit scheme is regarding defaults in payment of subscriptions, especially by the prized subscribers. Even delays in making subscriptions on due dates will upset the payment schedule of a foreman who runs only a limited number of chits at a time. Defaults mean pumping in of outside fund to maintain not only the payment schedule but also to keep the fund alive. Defaulted amounts may be returned perhaps after some time if the chit fund is alive. Chronic defaults even by a few in each chit group will certainly pose a threat to the life of a chit fund in course of time. It is this danger that has escaped the attention of the framers of all Chit Fund Acts. The Commission of five per cent or so, of the chit capital treated as remuneration to the foreman does not take into account the "risk" element.

However, as a remedy for the temporary shortage of funds faced by the foreman of chit funds, the OECD Project Report by S. Madhur and C.P.S. Nayar recommended that "there should be some provision for these institutions to get refinance facilities from commercial banks fairly easily but at competitive interest rates and not subsidised administered rates."118
2.10.5. Benefits to Members:

A recent five country study on “Informal Finance: Some Findings From Asia”, by the Asian Development Bank and published by the Oxford University Press in 1992, explicitly gives some of the attractions of Chit funds to the members as

i) “reciprocity or the inbuilt provision for borrowing at short notice by bidding successfully for the kitty, sort of access to liquidity guaranteeing function especially to the businessmen.

ii) being able to save in instalments

iii) having to do so compulsorily once the initial decision to join had been made, by deferring other consumption expenditures if necessary and

iv) Convenience and the absence of formalities”19

2.11. Financial System

The contribution of chit funds in the Indian Financial System may now be noted. As the other financial intermediaries, chit funds also tap the savings of people and extend credit to them. In tapping savings if the chit funds dampen the morale of savers by paying a lower return on their savings they may be said to be inflicting a blow to their savings habit which will be against the interest of the national financial system. Similarly, while extending credit, if they burden the borrowers with unduly
high interest or if they are instrumental in directing credit for purposes considered undesirable by the monetary authorities they may be said to be working against the national interest.

The growing popularity of chit funds as evidenced in the year by year increase in the volume of business shows that savings through them are not only attractive but also preferred by many people.

Regarding the purposes for which credit is disbursed the OECD project Report by S. Madhur and C.P.S Nayar gives a break up of credit from chit funds as follows: Trade and business 30% acquisition of assets and livestock, jewellery and household equipment 17.5%, Building construction, renovation, repairs and acquisition of landed property 12.8%, personal consumption including social and religious ceremonies 14%, small business, Professionals and self-employed 7.5%, Cinema theatre and film industry 3.7%, Repayment of old debts 4.5%, Transport including purchase of used vehicles 3% and unspecified 7%. The figures show that about 41% of credit flows to direct economic activity, 30% to acquisition of assets while only 14% flows to personal consumption.20

The Present study reveals that 37% flows to personal consumption that is to family expenditure while 63% flows to direct economic activity.
Thus in respect of both mobilisation of savings and disbursement of credit, the chit funds contribute their might to the national financial system.

It can be concluded with two observations by international financial experts. "The general stance of policy towards the informal financial sector (including chit funds) in developing countries can be best described as an amalgam of being neglect and even prejudice, which is unwarranted considering that its scope and persistence testify, if anything, to its basic economic rationale deriving from its capacity to satisfy needs which are not met by the formal sector. Rather it supports the case for a positive and coherent policy towards the informal financial sector."\textsuperscript{21}

Prof. Dale W. Adams of Ohio State University and Delbert A. Fichett, Senior Economist in the World Bank say, "sustainable financial markets that operate efficiently and equitably are vital ingredients in rural development. The results of many formal agricultural credit programs in LICs (Low Income Countries) over the past 30 years have been disappointing, and informal finance appears to be doing a better job of servicing the financial needs of many people in these countries than do these formal efforts".\textsuperscript{22}
2.12. DISTINGUISHING FEATURES

The Chit fund scheme involves the following

a) Pooling the sums of money contributed by a group of individuals

b) Lending the pooled amount to a member of the group and

c) Continuing the process of collection and distribution of such amounts for a definite period till all the members are covered.

This time-bound operation of collection and distribution of funds is different from the functions of other financial intermediaries.

i) The payment of the agreed contribution at fixed intervals is obligatory in a chit fund. Once a person becomes a member of a chit fund, he has to subscribe regularly and compulsorily the instalment due during the period of the Chitty. While savings in banks and other savings institutions are made out of residual income, the subscriptions to chit funds are unavailable expenditures on the part of the subscribers. The obligation to pay the instalments is so strong that, at time, they postpone or even cancel other expenditures. This self-imposed obligation on the part of the subscribers to make regular savings cannot be
belittled, especially in a country where the ability as well as the will of the people to save is low.

ii) The credit distribution function of chit fund is also different from that of other financial intermediaries. The rationale of an auction chitty or the business chitty is that, firstly, it connects the borrowing class directly with the lending class and thereby eliminating the necessity of an intermediary like a commercial bank, which collects savings by offering a low rate and lends them at a high rate and appropriates the difference and secondly, it links the process of borrowing with the process of saving and thereby generating savings from borrowers. The borrowers and lenders meet to fix the rate of interest and since there is more than one borrower competing for the same amount, a competitive rate of interest is offered. The competition is of course limited to the members. No outside party or action is involved in either boosting the rate or depressing it. Thus the benefit of the scheme is enjoyed by the members.

iii) The chit fund is different from other savings and credit institutions is that it is more than a lender to the borrower. While the depositor in an ordinary savings institution gets back only what he has saved, the subscriber to a chit fund can take his future savings in advance. More than anything else, it is this facility for immediate realisation of future savings in a lump sum
that induces many people to subscribe to chit funds. Similarly
the borrower is tied to the chit fund till its end. He has to continue
to subscribe the stipulated amount till the termination of the chitty
so that he saves what he has obtained in advance.

iv) The chitty offers many facilities to the borrowers.

1. The loans in most cases are unconditional. They can
be used for any purpose, including the repayments of old debts.

2. They are mostly clean loans. Tangible assets are rarely
used as security.

3. They can be repaid in easy instalments. The instalment
amount can even be generated out of the investment of loan
amount.

4. No indignity or humiliation is involved in taking the loan,
because in a sense the present value of sums which the subscriber
will save over the life of the chit fund is being borrowed. The
borrower is not to get a sanction from somebody or satisfy anybody.

5. The borrower need not contribute a certain proportion
of the loan as his share in order to be eligible for it, as is the case
with certain loans from commercial banks, one or two instalments
form only a very small proportion of the loan amount.
v) There is a difference between credit from a co-operative credit society and credit from chit fund. In a co-operative credit society, the loanable fund is not fixed as is in a chit fund. Again, unlike the chit fund, the credit society fixes the rate of interest for loans in advance. The Chit fund offers a fixed quantity of money at a flexible rate of interest, the rate of interest moving up or down according to the demand for money. Thus it allows freedom to its borrowers in fixing the rate of interest on the loan. In fact, unlike in any other credit institution it is the borrower, and not the lender, who fixes the interest rate for his loan in a chitty. "The Co-operative credit society, on the other hand, refuses to take advantage of the needs of the necessitous since it insists on a uniform rate of interest and dispenses with the action of competing borrowers."23

vi) Another significant aspect of a chit fund is that it causes no drain of savings to outside areas. Being generally members of the same locality, the subscribers of a chit fund spend the borrowed money or prize amount in their own localities either on consumption or investment purposes. There is no chance of an outsider stepping in to get a loan from the chit fund for investment elsewhere.
2.13. Miseses :-

The Chitty has been exposed to a variety of malpractices. Many factors were responsible for such a state of affairs. Notwithstanding the fact that the Chitty was organised by a person of modest means, his all-in-all position in the transaction gave him opportunities to indulge in some undesirable and questionable practices. The subscribers seldom questioned his actions. In fact they individually longed to please him because his displeasure meant financial loss and difficulties in realising the prize amount. Failure to pay the instalments in time would entail penalty. But the foreman rarely collected penalties from his loyal subscribers. Again such subscribers got the prize amounts without much formality and security. Therefore, even if there was a misappropriation of funds or any other misdeed by the foreman, no subscriber dared to question him. This weakness of the subscribers and the indifference of the Government enabled some unscrupulous foremen to exploit the situation to their personal advantage at the cost of the subscribers.

The foremost malpractice in the past centred round the distribution of prize amounts. Many foremen failed to disburse the prize amounts in time due to various reasons. The subscribers delayed or defaulted payment of instalments and the foreman's financial position was not such that he could make up the deficient
amount from his pocket. Therefore when the subscribers delayed
the subscriptions, he delayed the disbursement of prize amounts
when some of them, especially those who had earlier won the
prize defaulted the instalments, he too defaulted the prize
amounts. The prize amount was delayed for other reasons also.
The prize winners failed to furnish the necessary security or surety
in time. This was incidentally one of the causes which gave the
foreman room for manipulation. On the plea that the security
furnished was insufficient or the surety unworthy, he could use
the amount for a considerable length of time for his personal
purpose. By the time the prize winner brought adequate,
acceptable guarantees for the future instalments, two or three
new auctions or drawings of lot would have taken place, enabling
the foreman to manage the prize amount of the person in question
from the subscriptions to the later instalments. This kind of
adjustment of prize amounts was easy because there was no
law stipulating that the prize amount should be paid by a particular
time. When the prize amounts of two or more draws/auctions fell
due simultaneously in a few chit groups (each foreman conducts
many chit groups at a time) or when there was a break in the
chain of adjustments, the foremen was left with no choice but to
close down his business. This was followed by litigation between
the foreman and the subscribers.
With a view to regulating the working of chit funds and providing safeguards to subscribers, comprehensive Chit Fund Acts were introduced in Kerala and Tamil Nadu, from time to time. But most other states in India have no Acts to control the working of chit funds and this situation was exploited by some unscrupulous foremen by opening branches in them with a view to starting chit funds and extending the same to the states covered by the Acts. They also tried to find out loopholes in the existing Chit Acts.

One provision which gives room for manipulation by the foreman is the substitution of subscribers. At the time of starting the chitty the foreman may not be able to fill up all the vacancies in his chitty. So, instead of waiting for more subscribers, he starts with the available subscribers plus the necessary imaginary ones. In the initial period, he remits the instalments of these bogus subscribers from his own pocket and when he manages to get some genuine subscribers he substitutes them for the bogus ones. The advantage of starting chitties with less than the requisite number of genuine members, from the foreman's point of view, are mainly two. In the first place, the foreman can make a large turnover, and also increases his income. Secondly, through the bogus subscribers, he can squeeze the credit-seeking subscribers at the time of the auction for making additional profit for him. All that is needed for the operation was some cash for adjustments.
Generally, failures of chit funds due to misappropriation of funds by the foreman were rare in the rural-based, small-sized, individual-type units because of the closely knit relationship between the foreman and the members. There were also instances showing the foreman disposing of his property in order to pay off the dues to the subscribers at the termination of the scheme, when some of the prized subscribers were defaulters. In all probability, malpractices might have started appearing with the launching of big-sized chit funds from the urban areas by some institutional foremen, excepting banks in the formal sector and the government owned corporations, accepting membership from different places and operating through several branches and paid managers. Nevertheless failure of chit funds conducted even by institutional foremen were only sporadic and the number of failures and the amount involved were insignificant when compared to the total number of chit fund companies and their turnover.

In order to pave the way for a healthy development of chit funds and to eliminate the malpractices in the system, the Chit Funds Act 1982, (No.40 of 1982), was passed by both the Houses of Indian Parliament and it received the assent of the President on 19th August, 1982. It will be brought into force in various states depending on their readiness to enforce its provisions.
with its enforcement, the entire country will be covered by a comprehensive Act, eliminating the possibility of some foremen searching for states without any Chit Act to conduct chit funds. It is expected that the Chit Funds Act, 1982, will help the institution of chit funds to grow on sound lines.24

2.14. MODERN FINANCIAL TECHNOLOGY

The three main features which chit fund possess to face the challenge of modern financial technologies are adaptability, flexibility and universality. They are adaptable to the conditions that prevail in the area in which they operate - nature of economy level and frequency of income of people, type of occupation, size of business or trade and the number as well as policies and business practices of other financial agencies. They are flexible in their operations in that they can adopt an individual - based, personal approach to their clients as against the standardised and remote - controlled approach of the commercial banks. They are universal in the sense that they can operate anywhere irrespective of rural, urban or metropolitan centres, serving the rich and poor alike, distributing the benefits equitably on a pro-ratabasis, and offering complete freedom to the participants in taking in advance their total contributions at their will and at a rate of their choice. This access to a lump sum which they can
use for any purpose from consumption to investment in any line, is in right contrast to a conditional, security-based, delay-involved and uncertain loan from a commercial or any other bank in the organised sector.

It is proved that the chit funds not only coexist with the fast growing formal banking sector but also form a significant proportion of it. If we add the share of another informal financial intermediary, namely Finance Corporations, which most foremen of chit funds, of late, are engaged in, to create an outside fund, with deposits from members of chit funds, and others, for lending and serving as a cushion when there are chit fund defaults, the proportion of deposit with, or credit from, these two informal financial agencies will amount to about 30 per cent of the deposits with or credit from the formal banking sector in the bankingly developed southern region of India. In chit funds alone, its share to the extent of about one-fifth of bank deposits in South India is a factor which speaks for the "newness" or "invincibility" of a traditional financial system.

2.15. CHIT FUNDS IN THE INTERNATIONAL SCENE

Chit funds as a financial technology are not peculiar to India. Such a technology has been in use in many countries in the third world. Known in different names such as djanggi (cameroon), esusu or osusu or asusu (Nigeria, sierra leone), chita, chitu and stock fair (South Africa), arisan (Indonesia), ko and tanomoshi (Japan) Kutu, Kongsi and tontime hui (Malaysia), ho,
hui (Taiwan, vietnam), chetti orhetus (SriLanka), esu (Bahamas),
consorcio (Brazil) throw a box and boxi money (Guy.,man,
Partners (Jamaica), sesus and boxes (West Indies), and so on, it
exists in most of the third world countries. Bouman listed in detail
the countries which used such a financial technology (commonly
called Rotating Savings and Credit Association {ROSCA}) and
the local names. What is peculiar to India is its stage by stage
development, introducing innovations and effecting modifications
to suit the changing requirements and environments with the
culmination of an institutional foreman at the helm of affairs. In
short in the Indian chit funds a traditional technology is tailored
to suit the modern conditions without losing its charm.

There is a possibility of introduction of chit funds, or
modifications in the existing schemes on the model of Indian Chit
Funds in the third world countries. In the absence of details of
the existing systems in different countries, it is difficult to offer a
model/models suitable under different economic conditions. Each
country with a sizeable transaction through the “ROSCA” may
compare the working of its ROSCA with the ROSCA of other
countries to improve the system. In certain countries, following a
particular religious order, there are taboos on the payment and
receipt of interest. Such countries may conveniently adopt chit
funds as a financial technology, because in them there is no
payment and receipt of interest, there is only sharing of gains or
losses.
In Europe it is conducted in the name of "Rotating Credit" (roscas). In the Philippines it is referred to as "Paluwagons". In Korea, it is named as "Key".

2.16. PROGRESS OF CHIT FUNDS

The Reserve Bank of India's reviews of the growth of deposits with non-banking companies give, on an annual basis, the number of chit fund companies and the subscriptions with them. The relevant details (culled from the reviews) are presented in the following table.

### Table: 2.9
GROWTH OF CHIT FUND COMPANIES IN INDIA

<table>
<thead>
<tr>
<th>Year (end march)</th>
<th>Number of Reporting chit fund Companies</th>
<th>Chit subscriptions</th>
<th>Approximate Annual turn over of chits</th>
</tr>
</thead>
<tbody>
<tr>
<td>1967</td>
<td>97</td>
<td>0.34</td>
<td>4.08</td>
</tr>
<tr>
<td>1968</td>
<td>106</td>
<td>0.25</td>
<td>3.00</td>
</tr>
<tr>
<td>1969</td>
<td>110</td>
<td>0.65</td>
<td>7.80</td>
</tr>
<tr>
<td>1970</td>
<td>100</td>
<td>1.20</td>
<td>14.40</td>
</tr>
<tr>
<td>1971</td>
<td>117</td>
<td>1.68</td>
<td>20.16</td>
</tr>
<tr>
<td>1972</td>
<td>189</td>
<td>0.70</td>
<td>8.40</td>
</tr>
<tr>
<td>1973</td>
<td>176</td>
<td>0.70</td>
<td>8.40</td>
</tr>
<tr>
<td>1974</td>
<td>213</td>
<td>0.70</td>
<td>8.40</td>
</tr>
<tr>
<td>1975</td>
<td>295</td>
<td>33.30</td>
<td>399.60</td>
</tr>
<tr>
<td>1976</td>
<td>404</td>
<td>30.80</td>
<td>369.60</td>
</tr>
<tr>
<td>1977</td>
<td>518</td>
<td>37.60</td>
<td>451.20</td>
</tr>
<tr>
<td>1978</td>
<td>502</td>
<td>35.20</td>
<td>422.40</td>
</tr>
<tr>
<td>1979</td>
<td>504</td>
<td>37.30</td>
<td>447.60</td>
</tr>
<tr>
<td>1980</td>
<td>509</td>
<td>146.30</td>
<td>1755.60</td>
</tr>
<tr>
<td>1981</td>
<td>555</td>
<td>156.40</td>
<td>1876.80</td>
</tr>
<tr>
<td>1982</td>
<td>541</td>
<td>208.06</td>
<td>2496.72</td>
</tr>
</tbody>
</table>

*Source: Reserve Bank of India Bulletin, Various issues.*
2.17. CORPORATE CHITS

Corporate Chit is a financial innovation. Chit groups are generally designed to target different individual income groups. It is not uncommon for traders and small business units to join chit groups of Rs.5 to Rs.15 lakhs. The concept of individual chit groups extended to corporate units is corporate chits.

Ideally, a corporate chit group should be of short duration of 12, 15 and 20 months. The Chit amount can be from Rs.15 lakhs to Rs.100 lakhs. This will have appeal for several small and medium scale units, which are not getting adequate working capital from banks. When a corporate chit group is formed for a specified amount, say Rs.60 lakhs, for twelve months members, each corporate member agrees to subscribe Rs.5 lakhs a month for the duration of the group. Each month, the chit amount is offered to one member, who bids for the highest discount - the maximum discount being 30 percent as prescribed in the Chit Funds Act.

Instead of holding the auctions every month to decide the prized subscriber, there are two ways by which the representatives of corporate bodies are not put to the trouble of visiting the chit fund office to participate in the auctions. One is to conduct all the eleven auctions in one go, the last instalment going automatically to the corporate which has not been successful
at the auctions. There is a legal hurdle in conducting all the auctions at one time, but that can be got over. The second way would be to pre-programme the prize amount and the discount at every instalment - the discount descending from 30% in the first instalment to 5% or less in the last instalment. The prized subscriber at every instalment can be decided in the presence of all the members by drawing lots. This will make each corporate member know with certainty the prize amount it will be entitled to and the month.

To solve the administrative problems and reduce transaction costs, the corporate members may be made to issue on the spot post-dated cheques for the remaining eleven months, for the future instalments, net of dividends. A letter from each corporate company member undertaking that the cheques when presented, would be honoured will be an additional safeguard. This will obviate the need for sending monthly intimation cards delay in receiving subscription cheques and collection time. The Prize amounts of the prized subscribers would be paid on specified dates instead of the legally permitted one month time.

The Chit Foreman need not be a member of a group. Even the foreman's commission of 5% of chit amount allowed under the Act can be reduced depending on the chit amount say 2 1/2 % for Rs.100 lakhs 3 % for Rs.50 lakhs, 4 % for Rs. 5 lakhs to Rs.50 lakhs and 5 % for chit amount of less than Rs. 25 lakhs. The idea
behind this is, since the chit value is high and the member or subscriber is limited, the overhead expense, could be more than covered by lower commission. Besides, it will remove the impression that chits are not run for the benefit of the foreman. A company can subscribe to more than one ticket in a group.

The benefits of a corporate chit are

1. Corporate have access to a new source of finance

2. Corporate chit finance is without conditionalities about the end use of funds and submission of returns.

3. By choosing the instalment at which to bid - if it is open auction - the corporate can decide the rate of interest or its cost of funds

4. The entire operation is open and transparent.

5. The competition in an open auction makes for supply - demand factors determine the prize amount in an efficient way. The corporate needing the funds urgently bids for the highest discount.

6. The benefit of discount comes to all the subscribers in the form of dividend reducing the effective cost of funds.
7. Finance from a corporate chit is neither an obligation or charity from the foreman. It is a matter of right to bid to the amount by each subscriber.

8. Being a self-help, mutual help arrangement it promotes co-operation among the corporates.

9. In a preprogrammed chit group each member knows the chit amount it is entitled to and the instalment. That will help financial planning by the corporate as there is a certainty about it.

However, the demerit is that corporate chit does not provide funds for the members when they want. All the corporate may require the funds at the first instalment itself but that would not be possible, unless, some kind of a bridge loan can be arranged by the foreman.

Next thing is regarding the nature of security for future liability. Where the corporates are assessed properly and the credentials found satisfactory a guarantee of the managing director or two directors or a bank guarantee or lodging company’s shares from the promoters for a value to be agreed upon, with blank transfer form would adequately protect the interest of the foreman. The postdated cheques and the undertaking letters may be adequate in the case of the last three four instalments.
with bank credit becoming uncertain, particularly for small and medium industries, corporate chits provide a good alternative or a supplement inadequate bank credit.

Corporates must shed their prejudice against chit funds being indigenous source. Further, corporate chits can be promoted only by companies with sound financial resources. At least corporates can check with those who have joined such groups about the credibility of the system and the company offering them.

As far as tax implications are concerned, it is now a settled law that chit loss is an allowable deduction while dividend income derived from chit fund is taxable. Alternatively the dividends can be set off against the loss during the chit period and the net profit or loss can be taken into account for tax purposes.

With a view to give a concrete shape to the Corporate chits, a company by the name of Model Chit Corporation Limited was floated in August 1995 by Mr. T.K. Ramkumar. The Rs.1 Crore chit which is named as “Century Line Series”. To assist smaller segments Rs.50 lakh and Rs.25 lakh Chit series have also been introduced which are branded as ‘Gold Line Series’ and ‘Silver line Series’ respectively. In just two years the company has attained a monthly ATO of 6.5 crore and BTO of Rs.300 crore which can be considered to be a record in the chit fund industry. The response from Trade and Industry has been very encouraging.
2.18. Macro-Household Savings and Investment

As per the RBI data, published from time to time, total financial savings and physical assets held by households are available for reference. During 1994-95, the data show that the net investment in financial assets and physical assets are 60% and 40% respectively.

The tables and chart below present the data on the proportion of investment in various firms by the public. As the Indian Public are risk averse, bulk of their investment is in LIC/P.C/Bank deposits.

**Table 2.10**

Average proportion in various Investment type:

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>LIC/NSC and the like</td>
<td>32%</td>
</tr>
<tr>
<td>B</td>
<td>FDS</td>
<td>31%</td>
</tr>
<tr>
<td>C</td>
<td>MFs</td>
<td>9%</td>
</tr>
<tr>
<td>D</td>
<td>Chits</td>
<td>6%</td>
</tr>
<tr>
<td>E</td>
<td>Jewellery</td>
<td>6%</td>
</tr>
<tr>
<td>F</td>
<td>Gold</td>
<td>3%</td>
</tr>
<tr>
<td>G</td>
<td>Secondary Market</td>
<td>5%</td>
</tr>
<tr>
<td>H</td>
<td>Primary Market</td>
<td>5%</td>
</tr>
<tr>
<td>I</td>
<td>Others</td>
<td>3%</td>
</tr>
</tbody>
</table>

The data above and in the Table below are as per a survey, Published in Business line. Jewellery 6%
Chart 2.3
Average proportion in various investment type
### Table 2.11

Current Portfolio By Socio-economic Classification

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>Total</th>
<th>A</th>
<th>B</th>
<th>C/D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary market</td>
<td>5</td>
<td>9</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Shares in Secondary market</td>
<td>5</td>
<td>9</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>Fixed deposits</td>
<td>31</td>
<td>27</td>
<td>31</td>
<td>38</td>
</tr>
<tr>
<td>MFs Other than UTI</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>U.T.I Units</td>
<td>8</td>
<td>9</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Chit funds</td>
<td>6</td>
<td>4</td>
<td>6</td>
<td>10</td>
</tr>
<tr>
<td>Gold</td>
<td>3</td>
<td>4</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Jewellery</td>
<td>6</td>
<td>8</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>LIC/NSS/P.O Savings</td>
<td>32</td>
<td>28</td>
<td>33</td>
<td>35</td>
</tr>
<tr>
<td>Teak Plantations/Orchards</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: Business line, A, B and C/D refers to Metro, Urban and Rural centres

Out of the total investment, Chit fund has been placed in the 4th place. In the Metro, it is placed in the 7th place, in Urban areas 4th place and in Rural areas, it got the 3rd place. Hence, it is apparently known that Chit funds are more popular and widely used in rural areas. At the same time, in Metro and Urban areas also, it is not being neglected but it is the one which is accepted and used by all the people.
REFERENCES


2. Dr. S. Maria John, Financial Markets and Institution, Palani Paramount Publications, 1995, P.4


4. Ibid P.163


6. Ibid P.377

7. Ibid P.378


9. Ibid P.7.10

10. Ibid P.7.11


12. Ibid P.1356

13. Ibid P.1359

14. Ibid P.1297

16. Ibid P.5
17. Ibid P.5
18. Ibid P.6
19. Ibid P.6
22. Ibid P.8
23. Nayar C.P.S Savings and Development, Can a Traditional Financial Technology Co-Exist with Modern Financial Technologies? The Indian Experience P.51
24. Ibid P.54
25. Ibid P.55
26. Ibid P.55
28. Nayar C.P.S OP.cit P.49