

**A STUDY OF CHIT FINANCE IN KERALA
WITH SPECIAL EMPHASIS ON
KERALA STATE FINANCIAL ENTERPRISES Ltd.**

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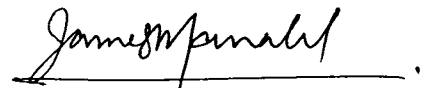
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CERTIFICATE

Certified that the thesis "A Study of Chit Finance in Kerala with Special Emphasis on Kerala State Financial Enterprises Ltd." is the record of bonafide research carried out by Smt. Sallyamma Job under my guidance. The thesis is worth submitting for the Degree of Doctor of Philosophy in social sciences.

Dr. James Manalel


(Supervising Guide)

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CHAPTER ONE

INTRODUCTION

The strategic role of the financial system is to channel funds from surplus units to deficit units. The financial system comprising the set of institutions, markets and instruments facilitates capital formation and accelerates the pace of economic development. The gap between gross capital formation and gross domestic savings in India necessitates the need for augmenting the growth rate of voluntary domestic savings. So, the working of different financial intermediaries for mobilising savings from various income categories will have to be widened and strengthened. It is in this context that one has to appreciate the role of the Non-Banking Financial Intermediaries in supplementing the functions of the Banking Institutions.

The Non-Banking Financial Intermediaries' ability to purvey funds depends to a large extent on the resources they can mobilise. Miscellaneous Non-Banking Companies or Chit Funds being a category of Non-Banking Financial Intermediaries, contribute significantly to the value of financial markets in India.

1.1 NON-BANKING FINANCIAL COMPANIES (NBFCs)

Non-Banking Financial Companies have emerged as an integral part of the Indian financial system. NBFC is a generic term, which includes a host of different types of institutions performing various types of financial services. Sub-section (b) of section 45-1 of the Reserve Bank of India Act, 1934 defines a Non-Banking Financial Company as: (a) a financial institution which is a company; (b) a non-banking institution which carries on the business of accepting deposits under any scheme, arrangement or any other manner or the business of lending in any manner and (c) any other non-banking institution or class of institutions which the Reserve Bank may

notify in the official Gazette with the previous approval of the Central Government.¹ They are generally categorised into the following types on the basis of their principal business.

- Equipment Leasing Company (ELC)
- Hire Purchase Company (HPC)
- Loan Company (LC)
- Investment Company (IC)
- Mutual Benefit Financial Company or '*Nidhi*' Company (MBFC)
- Housing Finance Company (HFC)
- Residuary Non-Banking Company (RNBC) and
- Miscellaneous Non-Banking Company (MNBC) ie., Chit Fund Company

1.2 MISCELLANEOUS NON-BANKING COMPANY

The principal business of MNBCs or Chit Fund Companies is managing, conducting or supervising as a promoter, foreman, or agent of any transaction or arrangement by which the company enters into an agreement with a specified number of subscribers that everyone of them shall subscribe a certain sum in instalments over a definite period and that each such subscriber shall in his 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.

Chit Funds are saving devices through pooling of money by a group of persons by way of periodical instalments of fixed amount paid over a fixed period of time under *inter-se* agreement that each member of the group is entitled to the pooled amount. The scheme involves three functions such as pooling together the scattered savings of a group of individuals, lending out the collected savings to a member of the group and continuing the process of collection and distribution of amounts for a certain period.

1.3 'CHIT' – AN AGREEMENT

The 'Chit' is an agreement by the subscribers with the foreman, who conducts the Chit. The Kerala *Chitties* Act ² defines the Chit agreement as the document containing the Articles of agreement between the foreman and the subscribers of the Chit. It contains provisions as to the number of instalments, amount payable for each instalment, provision of interest for default or late payment of instalments, manner of conducting the auction, determining the bidder in the auction, mode of disbursement of discount, limit if any on the discount, manner of disbursing the Chit amount, details of security to be offered by the prized subscribers, etc.

Chit foreman has been described as the hub of the *Chitty* wheel.³ It is the foreman, who links the savers and borrowers together for their mutual benefits. The small savings which otherwise might find little productive application have been mobilised and turned into tangible wealth by his catalytic action. Thus the foreman acts as a social functionary. From an individual foreman, with very limited resources and area of operations, the proprietor of a Chit has grown into a company managed by a Board of Directors or to a public sector Chit company, having abundant resources and wider frontiers of business. These changes have had far reaching influence in the sphere of Chit Finance in Kerala. This unique financial institution facilitates savings and capital formation even among the poor in the society.

1.4 ORIGIN OF CHIT FUNDS

This indigenous financial institution had its origin in the State of Kerala as Grain Chit or '*Dhannya* Chit', centuries back. 'Chit' means a written note on a small piece of paper. In Malayalam language, it is known as '*Kuri*', a synonym of Chit. The 'Chit' or '*Kuri*' is a derivative, the root being the 'lot'.

The Chit Fund business is administered by the respective State Governments through the offices of the Registrar of Chits. The Chit Fund

Companies are exempted from the requirement of registration under the RBI Act. However, the deposit acceptance activities of these companies are regulated under the Miscellaneous Non-Banking Companies (MNBCs) Directions, and those relating to the advertisement for soliciting deposits are governed by the Non-Banking Financial Companies and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977 framed by the Government of India under section 58 A of the Companies Act, 1956.

1.5 CONCEPTS AND DEFINITIONS

“*Chitty*” means a transaction, whether called Chit or *Kuri*, by which one or more persons, hereinafter called the “Foreman” or “Foremen”, enter into an agreement with a number of persons that every one of the contracting parties shall subscribe a certain amount of money or quantity of grain or other commodity by periodical instalments for a certain definite period and that each in his turn, shall be entitled to the prize amount, whether payable in cash, kind or any other article of value or in such other manners that may be provided for in the agreement.⁴

“*Chitty amount*” or ‘*sala*’ means the sum total of the subscriptions payable by all the subscribers for any instalment without any deduction for discount.

“*Discount*” means the amount of money or quantity of grain or other commodity, which a prize winner has, under the terms of the ‘*variola*’, to forego for the payment of ‘*veethapalisa*’, foreman’s commission or such other expenses as may be prescribed.

“*Variola*” means the document containing the articles of agreement between the foreman and the subscribers relating to the Chit.

“*Veethapalisa*” means the share of a subscriber in the discount available under the *variola* for rateable distribution among the subscribers at each instalment of the Chit.

“**Drawing**” includes the mode of ascertaining the prize-winner at any instalment of the Chit by lot or by auction or in such other manner as may be provided for in the ‘*variola*’.

“**Foreman**” means the person who, under the *variola*, is responsible for the conduct of the Chit and includes all persons taking his place under section 35 of the Act.

“**Subscriber**” includes a person who holds a ticket or fraction of a ticket and also a transferee by assignment in writing or by operation of law.

“**Ticket**” means the share of a subscriber in a Chit, which entitles the holder thereof to the Chit amount at any one instalment with or without any deduction by way of discount.

“**Prize amount**” means the Chit amount whether payable in cash, kind or in any other article of value, less the discount.

1.6 DIFFERENT CATEGORY OF CHIT FUNDS.

Chit Funds are of different categories, which come under the broad heading, ‘Chit Finance’. In Kerala they include the public sector Chit Company (The Kerala State Financial Enterprises Ltd.), Co-operatives, Private Chits and those in the informal sector.

1.7 KERALA STATE FINANCIAL ENTERPRISES LTD. (KSFE)

The KSFE, a fully owned Government Company was established in the year 1969 as a discipline factor to private Chit Funds. The share of KSFE in the total volume of Chit business registered in Kerala is 77 per cent as on March 2000, though the number of Chits registered is only 37.5 per cent. KSFE has been included in the few profit-making public companies in the State with a profit of Rs.793 Lakhs at the end of March 2000. There are over 11 Lakh subscribers in various schemes of KSFE. The number of Chits run by KSFE amounts to 7,446 with a total capital (*sala*) of over Rs.952 Crore.

Table 1.1
Number and *Sala* of Registered Chits
as on March 2000 (Rs. Lakhs) Institution-wise

Name of the Institution	Number of Chits / <i>Kuries</i>	Share of each to total Percentage	Capital <i>sala</i>	Share of each to total Percentage
1. KSFE	7446	37.5	95249	77
2. CO- OPERATIVES	8793	44.2	21101	17
3. PRIVATE CHITS	3633	18.3	7701	6
Total	19872	100	124051	100

Source: Government of Kerala, Legislative Assembly Interpretation Registration Dept. I.G of Registration, Trivandrum.

The Number of Chits run by Co-operative societies amounts to 8,793 (44.2%) with a total capital (*sala*) of Rs.211 Crore (17%) and the number of Chits run by Private Chit Funds amounts to 3633 (18.3%) with a total capital (*sala*) of Rs.77 Crore (6%) for the above period. It is thus clear that KSFE Ltd. has the predominant share in Kerala's Chit industry. Table 1.1 above presents the growth of the Chit Fund Industry in the registered sector only. The actual volume of Chit business would be several times greater if one included the volume of Chits in the informal sector and those with bases outside Kerala.

1.8 CO-OPERATIVES

Co-operative Institutions are also conducting Chit business as one of their most profit making schemes. Wide prevalence of co-operatives even in the remote villages enables the mobilisation of the scattered savings among the common people. To escape from certain provisions of the Kerala *Chitties* Act, the co-operatives have started 'Chit like' schemes ⁵ such as Monthly Deposit Scheme (MDS) and Mutual Benefit Scheme (MBS) without getting Chits registered with the Registrar. Though the number of registered Chits with the co-operatives forms 44.2 per cent, the share of it in the total volume of Chit business is only 17 percent.

