Regulation of Informal Financial Institutions: 
A Study of Money Lenders in Kerala

P. D. Jeromi*

Re-emergence of informal financial institutions (IFIs) in the provision of credit has been a policy challenge in recent years in India. Though they meet the credit requirements of a section of the society, who are not served by the formal financial institutions, their unbridled growth, unlawful activities and links with other institutions may pose threats to the stability of financial system and makes the monetary policy less effective. Furthermore, they create social problems when they charge usurious rates of interest and resort to unethical practices for recovery of loans, which in turn, leads to suicides committed by indebted farmers. In this context, the study attempts to analyse the working of money lenders in Kerala. Based on a sample survey, the paper has estimated the volume of deposits and credits of money lenders in Kerala and brought out the undesirable aspects of their working and its impact on the society. The paper finds that the existing legal provisions and regulatory and supervisory mechanisms are inadequate to protect the interests of both depositors and creditors. The paper calls for strengthening the Kerala Money Lenders Act by passing an Act for the protection of depositors and creating a separate wing for their registration, monitoring and supervision by the State Government. In the long-term, the strategy for financial inclusion, strengthening of co-operatives and promotion of self help groups will be helpful in bringing down the role of moneylenders.

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Introduction

In India, with the establishment of wide spread network of branches of commercial banks, the role of informal financial institutions (IFIs) has been on the decline for about four decades1. However, there are some indications about the rise in their role during the last one and half decades2 (Chavan, 2005, Mohan, 2006, and RBI, 2006). According to

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the National Sample Survey Organisation’s (NSSO’s) ‘Situation Assessment Survey’ 2003, the share of the institutional agencies in loans outstanding of farm households in India was only 57.7 per cent, which was 8.6 percentage points lower than the share of 66.3 per cent in 1991-92 (in respect of cultivator households). On the other hand, informal agencies provided 42.4 per cent of the outstanding loans of farm households in 2003 as against 30.6 per cent in 1991-92. The share of money lenders in total dues of rural households has increased from 17.5 per cent in 1991 to 25.7 per cent in 2003 (NSSO, 1998 and 2005). Furthermore, a Rural Finance Access Survey 2003, conducted by the World Bank and National Council of Applied Economic Research (NCAER), revealed that 79 per cent of the rural households had no access to credit from formal sources (Basu, 2005). The above facts point to the re-emergence of rising, albeit marginal, role of informal agencies in the provision of credit. It is, in this context, that the Reserve Bank of India (RBI) has taken measures for financial inclusion and constituted a technical group for review of legislations on money lending (RBI, 2006).

The above trend is visible in case of Kerala also - the share of formal sources in total debt outstanding of farmer households declined to 82.3 per cent in 2003 from 92.0 per cent in 1991-92. Despite strong presence of formal financial institutions like commercial banks and cooperatives, in Kerala, money lenders (informally known as ‘blade companies’) form an important segment of the financial sector of the State as they are engaged in deposit taking and money lending activities in a significant way. The operations of money lenders are not new to Kerala as they have been in existence for centuries in various forms. In recent years, however, developments like i) ban on accepting public deposits by Unincorporated Bodies (UIBs), ii) UIBs link with Non-Bank Finance Companies (NBFCs) and other entities, iii) rising indebtedness and suicides, iv) complaints from the public and v) emphasis on financial inclusion, warrants a thorough examination of working of these entities.

Review of Literature

It is surprising to find that while money lenders have been in existence in all parts of the country and they dominated the informal
credit market for a long time, there are not many studies on their operations. Perhaps, this is due to lack of data and information. The RBI’s Report of the All India Rural Credit Survey Committee (1954), Report of the All India Rural Credit Review Committee (1966) and Decennial All India Debt and Investment Surveys provide some information about the extent of operations of money lenders. Studies by Timberg and Aiyar (1984), Ghate (1988), Dasgupta (1989), Bell (1990), Swaminathan (1991) and others examined various dimensions of working of informal financial sector in the country. The following inferences can be made from these studies; i) operations of money lenders are very prevalent and they account for a sizeable share of credit availed by people, ii) there is sizeable gap between lending rates and deposit rates, iii) there is extreme variability in the interest rates within the same sub-economy, iv) loan default level is low, v) main purposes of borrowings are for production, trade and consumption, vi) rich people borrow more and pay lower rate of interest, and vii) with the spread of network of banks since nationalisation and tightening of legal provisions some segments and activities of informal credit markets have declined, while others expanded in response to new needs of growing trade and industry.

There is a dearth of studies on the working of money lenders in Kerala. Some individual researchers at Universities/Colleges in Kerala have studied their operations, of which only a paper (Prakash, 1984) is available in published form. Prakash (1984) noted the phenomenal growth of money lenders since the 1980s and reported their total number at around 12,000. A study by the State Planning Board (2005) found that i) there were 5,696 registered money lenders in the State, which was more than the number of branches of banks at 3376, ii) growth of money lenders has intensified in the recent period, iii) 72.5 per cent of surveyed money lenders charged interest rates in the range of 15-20 per cent and iv) unregistered money lenders charge interest rates between 24 to 120 per cent and in extreme cases upto 180 per cent.

Objectives of the Study

The above studies are not sufficient to provide comprehensive information on working of money lenders and point out the regulatory
and supervisory issues. In view of the above mentioned developments and dearth of literature, the study attempts to analyse the working of money lenders in Kerala. It is essentially based on primary data collected from the balance sheets of 97 sample money lenders in Ernakulam district, available with the Office of the Inspecting Assistant Commissioner (IAC) [under the Commercial Taxes Department (CTD) of Government of Kerala], as on March 31, 2001. The sample consists of small, medium and big financiers, selected in terms of their total liabilities. To understand the temporal variations in their operations, three years balance sheet details were also collected in respect of 49 financiers.

The remaining part of the paper consists of five sections. Section I provides a profile of working of money lenders in Kerala. Section II is devoted for analysing the assets and liabilities of sample money lenders. A critical review of legal provisions applicable to money lenders is provided in the Section III. The section also examines the details of the existing regulatory framework and supervision. Section IV identifies the areas of concern, measures needed and future scenario. The final section summarises the major findings of the paper and offers some suggestions.

Section I
Profile of Money Lenders in Kerala

Relative Position of Money Lenders in the Financial Sector

The relative position of money lenders among the various financial institutions in the State are assessed here in terms of major indicators like number of branches, deposits and advances. It can be seen from Table 1 that the number of money lenders is quite high as compared to the branches of formal financial institutions. Money lenders account for 68.4 per cent of total number of branches of financial institutions in the State. It indicates wider accessibility to the customers and the consequent high penetration rate. Population covered per money lender is estimated at 5,590 as against 9,431 per branch of commercial banks (State Planning Board, 2005). In case
of deposits, their relative share is small (5.3 per cent of total deposits of all institutions). However, when compared with the deposits of NBFCs it is quite high. On the credit side, money lenders have a larger share (18.4 per cent) in total credit outstanding of all institutions.

**Number and Features of Money Lenders**

There is no official data available on the number of money lenders in Kerala. Though the offices of Inspecting Assistant Commissioner, located in various parts of the State, have the information on the money-lenders registered with them, they are not regularly compiled at the State level to get an aggregate picture. State Planning Board (2005) reported the number of registered (under the Kerala Money Lenders Act, 1958) money lenders in the State at 5,696 in March 2004. Table 2 provides the district-wise number of registered money lenders in the State.

Besides the registered firms, there are numerous unregistered firms, centred on individuals, who are engaged in deposit taking and lending business similar to the business done by money lenders. These unregistered units are mainly doing business from their own houses or from their business establishments. There is no estimate of the number of money lenders in the unorganised sector. Some of the

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**Table 1: Relative Position of Money Lenders in Financial Sector of the State - March 2001**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Commercial Banks#</th>
<th>Cooperative Banks@</th>
<th>NBFCs</th>
<th>Money Lenders$</th>
<th>All Institution</th>
<th>% Share of Money Lenders</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Branches (No.)</td>
<td>3,262</td>
<td>2,131</td>
<td>151</td>
<td>12,000</td>
<td>17,544</td>
<td>68.4</td>
</tr>
<tr>
<td>2. Deposits (Rs. crore)$</td>
<td>42,178</td>
<td>8,926</td>
<td>36</td>
<td>2,864</td>
<td>54,004</td>
<td>5.3</td>
</tr>
<tr>
<td>3. Credit (Rs. crore)$</td>
<td>18,355</td>
<td>8,457</td>
<td>120</td>
<td>6,057</td>
<td>32,989</td>
<td>18.4</td>
</tr>
</tbody>
</table>

# : Including RRBs as on March 31, 2001. @ : Relate to SCB, DCCBs, PACs, SCARDB and PCARDBs. $ : Outstanding. * : Projection made by this study - relates to March 2001.

Source: 1. State Level Bankers Committee, Canara Bank, Thiruvananthapuram.
3. Estimate based on primary data collected for the paper.
experts feel that the number of unregistered firms will be at least as equal to the total number of registered money lenders in the State. Therefore, it is reasonable to consider the total number of money lenders in Kerala, both registered and unregistered, at around 12,000. Even people in the upper strata of the society like doctors, lawyers, bank employees, college teachers and politicians are reported to be involved in this business (some with unaccounted money) as it is very lucrative.

Money lenders in Kerala consist of both big and small firms. In terms of number of money lenders, majority of them are small firms run by individuals. On the other extreme, there are few business families having large number of money-lending firms across the State. For example, a business family is having around 220 firms across the State in the same name, all registered under Kerala Money Lenders Act KMLA, 1958 and their total liabilities would be around Rs. 900-1000 crore (our estimate based on the sample data collected).

Table 2: District-Wise Number of Money Lenders in Kerala – March 2004

<table>
<thead>
<tr>
<th>District</th>
<th>No. of Money Lenders</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Thiruvananthapuram</td>
<td>570</td>
</tr>
<tr>
<td>2. Kollam</td>
<td>675</td>
</tr>
<tr>
<td>3. Pathanamthitta</td>
<td>785</td>
</tr>
<tr>
<td>4. Alapuzha</td>
<td>976</td>
</tr>
<tr>
<td>5. Ernakulam</td>
<td>225</td>
</tr>
<tr>
<td>6. Kottayam</td>
<td>366</td>
</tr>
<tr>
<td>7. Idukki</td>
<td>344</td>
</tr>
<tr>
<td>8. Thrissur</td>
<td>488</td>
</tr>
<tr>
<td>9. Palakkad</td>
<td>144</td>
</tr>
<tr>
<td>10. Malappuram</td>
<td>162</td>
</tr>
<tr>
<td>11. Kozhikode</td>
<td>601</td>
</tr>
<tr>
<td>12. Wayanad</td>
<td>128</td>
</tr>
<tr>
<td>13. Kannur</td>
<td>139</td>
</tr>
<tr>
<td>14. Kasaragod</td>
<td>93</td>
</tr>
<tr>
<td>State-Total</td>
<td>5,696</td>
</tr>
</tbody>
</table>

Nature of Business

Though money lending firms are registered, under the KMLA, 1958, their nature of business is informal in the absence of well designed rules and procedures for the conduct of the business. It is left to financier to decide the modalities for accepting deposits and providing loans. The business is done in a very simple way with least paper work. From the accounting side also they are working like informal institutions as they are not recording all the transactions in the books of accounts.

One significant feature of the loans provided by the financier is its high frequency. The frequency of the loan is high because of two factors, viz., i) very short duration of the loan and ii) daily collection of loan amount. Some of the loans are given for a short period of 100 days or not exceeding 6 months. Generally, the repayment period of loan will not exceed 12 months. In many cases, there is a practice of daily collection of loan amount. In case of 100 days’ loan, the loan amount and interest is repaid daily in 100 equal installments. Daily collection is more prevalent among the traders and business people. It improves the liquidity position of the financiers and in turn more number of loans provided. Hence, the data on outstanding amount of loans, at the end of year, of a financier will not reflect the actual volume of business undertaken by the firm during that year.

In general, around two-third of the loans are given against security of gold. It is considered as a more secured business as they generally provide only around 80 per cent of the value of gold as loan. However, in case of gold loan also there is a risk. Some firms, who are very eager to expand loans, provide even more than 80 per cent (sometimes more than 100 per cent) of the value of gold as loan. In such cases, if the loan amount is not repaid within the stipulated time, the financier will loose money. There is also a practice of giving loans against promissory note, cheque, etc. Some financiers provide loans only on the basis of personal security.

Interest rates on the loans vary from customer to customer. Since customers approach money lender for urgent cash requirements, they
are not much bothered about the interest rates. Some of the customers
do not even ask what the interest rate on the loan is. For official purpose,
money lenders record only legally allowed interest rate (now fixed at
12 per cent) in their books of accounts. In reality, there will not be a
single case in which a money lender is accepting only normal interest
for their advances. The actual interest rate on loans varies from 24 per
cent to 60 per cent depending upon the customer, nature of the loans,
repayment period, security provided, etc. A survey conducted by the
Government of Kerala, revealed that 42.5 per cent of the money lenders
charge interest rates between 18-20 per cent. In case of unregistered
firms, the interest rate can go up to 120 to 180 per cent. The above
referred survey found that majority of the money lenders charge interest
rates in the range of 30 to 70 per cent (State Planning Board, 2005).

In some of the areas of the State, individual financiers from the
neighbouring state (Tamil Nadu) provide loans to people belonging to
lower strata of the society, consisting of labourers, petty traders and
unemployed, at an interest rate of Rs. 10 per Rs. 100 for a month
(120 per cent in a year). The loans are given without any security.
These individual financiers go around the villages and market places
to get their customers. Another example of unregistered financing
can be found in market places, where individual financiers provide
loan to small traders. They provide block loans, in which they first
block the interest by deducting it up-front from the loan amount. For
example, from a loan of Rs. 100, the borrower will be given only Rs.
90, (interest Rs.10 is deducted at the source). At the end of the day,
the borrower has to pay back Rs. 100 to the lender. In this case the
interest rate on a yearly basis comes to a whopping 4055.6 per cent.

Why People Approach Money Lenders?

In general, there are many prejudices about money lenders
and they are sometimes considered as an anti-social institution.
The main prejudices are that: i) informal lenders exploit their
clienteles; ii) informal credit is used in an unproductive way; and
iii) informal finance is not regulated and it may undermine monetary
policy (Schrader, 1994).
The above prejudices are not totally unfounded as there is some element of truth in these observations depending upon the nature of the financier, place of business, and regulatory and supervisory environment. Nevertheless, they have a definite role in providing finance for a target group. Hence, of late, policy makers realised that formal and informal finance may not necessarily be in competition but indeed may complement each other, as both aim at different target groups.

In the literature, there is an increasing recognition of the role and strength of informal finance in meeting the credit requirements of small borrowers. The overwhelming view is that informal sector responds remarkably well to the short-term credit requirements of lower income people and it allows them to access services not available from the formal institutions. Informal sector works in an environment which is suited to the low income people. Both financier and borrower know each other by face and cultural affinity creates the feeling of confidence in each other. The services provided by informal lenders are considered as valuable by their clientele as many times these services would not be available from elsewhere. However, from an economic perspective, the services of informal lenders may not be efficient as they usually charge prohibitive rate of interest. Hence, they cannot make efficient reallocation of resources throughout the economy and contribute to economic growth as in the case of formal finance (Bouman and Hospes, 1994).

Though Kerala has a wide network of formal financial institutions and bank penetration rate is one of the highest in the country, still, thousands of people approach money lenders for keeping deposits and taking loans. In case of deposits, the customers are mainly from the mid-income segment, who are very conscious about the interest rates that they want to get. A major section of the customers keep their deposits for the purpose of marriage of their daughters or for some other social functions. They are not much concerned about the risk involved in the deposits as many of the financiers are personally known to them for years. The earlier referred survey found that even unregistered money lenders are accepting deposits (State Planning Board, 2005).
In case of loans, customers prefer them as their operation is very informal, quick, without any time limit and gets adequate amount, unlike in the case of commercial banks and cooperatives where the whole process is cumbersome and one may not be sure of getting the loan. But, in case of money lenders, it is all simple and quick (of course, at a cost). In case of traders and business people, availability of adequate amounts in time is essential to gain from the business. Since, the profit from their activity is very high, they are not much concerned about the rate of interest charged by the financier. Thus, it is suitability, convenience, timeliness, adequacy and informal nature which attracts customers to money lenders. A section of the borrowers especially businessmen, are found to take loans from money lenders because they have already availed loan from formal institutions like commercial banks.

**Failure of Money Lenders**

There have been many reports about the failure of money lenders and the proprietors absconding from the place of business. There are also cases of financiers deliberately cheating the depositors. In some cases, the same financier will re-emerge in a new place by offering very attractive deposit schemes. Once they collect a good amount of deposits from that area, they simply vanish from the place of business. There is no systematic data on the number of firms closed down and amount lost by the depositors. In case of closure or failure of a firm, the offices of Inspecting Assistant Commissioner come into the scene only when it receives complaints from the public. By the time it acts on the complaint and starts some enquiry, the financiers would have taken enough precautions to make sure that they are caught free. Generally, the failure rate is high in case of firms run by individuals and when they are providing loans for highly risky business operations relating to real estate, share market, etc. As per a survey conducted by the ‘All Kerala Blade Companies Abolition Front’, about Rs.190 crore were cheated by private financiers in seven districts of the state during 1995-99 (State Planning Board, 2005).
Social Problems Associated with Money Lenders

Money lenders do meet the credit requirements of a section of the society, but easy availability of money often persuade the people to borrow even for wasteful expenditure. As it is a costly borrowing and many of the borrowers do not have regular income to pay back, often the repayment obligation multiplies beyond their capacity which leads to suicides, fleeing from homes or ends up in clashes and physical fights. One of the many reasons for the suicides committed by the farmers in districts like Wayanad was said to be due to harassment by money lenders. It is in this context that the Government of India had announced a scheme in 2004 to free farmers from the clutches of money lenders by providing loans by banks to farmers who are indebted to money lenders.

There have been some attempts by social organisations to deal with the problems created by the money lenders. ‘Blade Nirmarjana Samithi’ (organisation for eradication of blade companies), a social welfare agency in Kerala, had conducted a State-wide survey on the ill-effects of operations of money lenders in 1995-96. The survey revealed that 176 people committed suicide, 4,856 families fled from their homes and 86 persons, including 34 women, were arrested as they failed to repay the loans. A survey conducted in three districts of Kerala, viz., Kannur, Kasargod and Kozhikode, in 1996-97 had revealed the rising trend in social problems associated with the operations of money lenders (Table 3). It is estimated that in Kerala around 50 lakh people are affected either mentally or physically by the evils of money lenders. Realising the wider social problems created by these financiers, the ‘Blade Nirmarjana

Table 3: Number of People Affected by the Operations of Money lenders

<table>
<thead>
<tr>
<th>Social Problem</th>
<th>Kannur</th>
<th>Kasargod</th>
<th>Kozhikode</th>
</tr>
</thead>
<tbody>
<tr>
<td>i. Suicides</td>
<td></td>
<td>216</td>
<td>190</td>
</tr>
<tr>
<td>ii. Fled from homes</td>
<td></td>
<td>1303</td>
<td>2419</td>
</tr>
<tr>
<td>iii. Indicted by Court for</td>
<td></td>
<td>460</td>
<td>79</td>
</tr>
<tr>
<td>bouncing of cheques</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Blade Nirmarjana Samithi, reported in Malayalam, (magazine), 2001.
Samithi’ has filed a petition in the High Court of Kerala to curb the activities of these financiers (Malayalam, 2001). Social scientists, therefore, hypothesise that there could be a correlation between the number of suicides and the growth of money lenders.

The reasons for rising activities of money lenders can be found in: i) excessive consumerism of the people- people borrow heavily for purchasing consumer durables and vehicles; ii) borrowing for payment of dowry, construction of house and medical treatment; and iii) neglect of credit requirements of lower middle class by the nationalised banks.

Section II

Assets and Liabilities of Money Lenders

Data Limitations

As per KMLA, 1958, money lenders need to submit their balance sheet and profit and loss account as on March 31 of every year to the office of IAC. Although there is a prescribed format, the statements of accounts submitted by the money lenders are not uniform and some of the firms are not even providing the vital information required in a balance sheet. Furthermore, balance sheets submitted by them may not reflect the actual volume of business done by them (to avoid paying income tax and making adequate amount of security deposit). Despite these limitations, we are compelled to use the balance sheet data, for want of any other reliable data.

Liabilities

For the study, balance sheet data in respect of 97 money lenders as on March 31, 2001, were collected. It can be seen from Table 4 that the average total liability of the sample firms was Rs. 34.5 lakh and highest liability was Rs. 378.8 lakh. Owner’s capital accounts for about 57 per cent of total liabilities and share of deposits were around 35 per cent. Average outstanding deposit of the sample firms was Rs. 15.9 lakh (per firm) and the highest deposit was Rs. 121.9 lakh.

The estimate made for all the financiers in the State (numbering 12,000) shows that their total liabilities would be around Rs. 4,135
crore, of which outstanding deposits would be around Rs.1,432 crore. As the balance sheet figures submitted to the offices of IACs suffer from underreporting, we have blown up the data assuming that the underreporting may be around 1/4, or 1/3 or ½ of the reported data. As per this, the actual level of deposits of all firms would be in the range of around Rs.1,790 crore to 2,864 crore (Table 4).

**Assets**

The total loans and advances provided by the 97 sample firms were of the order of Rs.2,448 crore as at the end of March 31, 2001. The average amount of outstanding loans and advances of sample firms comes to around Rs.25 lakh. Among the sample firms, the highest amount of loans and advances was Rs. 320 lakh. Based on sample data, the estimated loans and advances of 12,000 firms comes to around Rs 3,029 crore. When underreporting is also taken into account (1/4, or 1/3 or ½ of the reported data), the total amount would in the range of Rs. 3,786 crore to Rs.6,057 crore (Table 5).
Among the various types of loans and advances, gold loan is the major one accounting for about 75 per cent of total assets. Around 90 per cent of the sample financiers have provided gold loan. The average amount of gold loan provided by a financier was around Rs.21 lakh; the lowest and the highest being Rs. 0.3 lakh and 236 lakh, respectively. Very few financiers have reported loans against the security of promissory note and investment.

**Table 5: Assets of Sample Money Lenders and Estimate for All Financiers - March 2001**

(Rs. lakh)

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Variable</th>
<th>Total Liabilities</th>
<th>Owner’s Capital</th>
<th>Deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>97 Sample Financiers (total)</td>
<td>2,448</td>
<td>1,837</td>
<td>153</td>
</tr>
<tr>
<td></td>
<td>i) Average</td>
<td>25.2</td>
<td>20.9</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>ii) Lowest</td>
<td>0.3</td>
<td>0.3</td>
<td>–</td>
</tr>
<tr>
<td></td>
<td>iii) Highest</td>
<td>320</td>
<td>236</td>
<td>–</td>
</tr>
<tr>
<td>II</td>
<td>All Financiers (Estimate for 12,000)</td>
<td>3,02,871</td>
<td>2,27,312</td>
<td>18,920</td>
</tr>
<tr>
<td></td>
<td>i) Scaled up by 1/4 of reported data</td>
<td>3,78,589</td>
<td>2,84,140</td>
<td>23,651</td>
</tr>
<tr>
<td></td>
<td>ii) Scaled up by 1/3 of reported data</td>
<td>4,03,818</td>
<td>3,03,075</td>
<td>25,227</td>
</tr>
<tr>
<td></td>
<td>iii) Scaled up by ½ of reported data</td>
<td>6,05,743</td>
<td>4,54,624</td>
<td>37,841</td>
</tr>
</tbody>
</table>

**Source:** Data compiled from the Office of the Inspecting Assistant Commissioner, Commercial Taxes Department, Government of Kerala, Ernakulam.

**Inter Temporal Variation**

We have also collected balance sheet information in respect of 49 firms for three consecutive years, viz., 1999, 2000 and 2001, to understand the changes in the business scenario over time. During these three years, total liabilities of 49 sample firms rose by Rs. 167 lakh or 18.7 per cent. However, deposits of sample firms rose by only Rs.37 lakh or 8.1 per cent from 1999 to 2001. On the other hand, owner’s capital has gone up by Rs.152 lakh or 53.1 per cent during the same period. It appears that with the amendments to Section 45 S of the Reserve Bank of India (RBI) Act, 1934, financiers are not mobilising deposits from the public in a big way. It is also possible that deposits are shown as owner’s capital. During the year ending 2001, there was considerable expansion in total loans and advances -
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Rs. 193 crore or 29.2 per cent (Table 6). Very few firms have paid income tax and the amount paid was very nominal.

Section III

Legal Provisions, Regulatory Framework and Supervision

This section reviews the relevant legal provisions contained in the RBI Act, 1934, and its amendments, Financial Companies Regulation Bill, 2000 and KMLA, 1958. The review is aimed at identifying the provisions which need to be strengthened for orderly working of money lenders.

Reserve Bank of India Act, 1934

i) Introduction of Chapter IIIC in 1984

Till 1984, the RBI Act, 1934 was silent on the deposit taking activities of Unincorporated Bodies (UIBs) like money lenders. However, Chapter IIIC on “Prohibition of Acceptance of Deposits by Unincorporated Bodies” was introduced in the RBI Act in 1984 (with effect from February 15, 1984). Under Section 45 S (in Chapter III C), no individual, firm or unincorporated association of individuals could accept deposits from more than 25 depositors per partner and not
exceeding 250 depositors in all, excluding deposits from relatives. In cases where individual, or firm or unincorporated association of individuals are having deposits from more number of people than as specified above, they are to be repaid within two years from the commencement of Section 10 of the Banking Laws (Amendment) Act, 1983 so as to bring down the number of depositors within the limits specified. However, this provision was not very effective in regulating deposit taking activities of UIBs as it was very easy for money lenders to suitably adjust the number of depositors without affecting the total amount of deposits held by them. Ideally, instead of fixing the number of depositors, the total amount of deposits should have been specified for better control and supervision. Another problem was that the RBI did not set up or designate any official machinery to see that the provisions are not violated.

ii) Amendments of Section 45 S in 1997

As the provisions of Chapter IIIC were very liberal and effective measures could not be taken for its implementation, UIBs continued to accept deposits without any problems. However, in 1997 the Government of India amended the RBI Act (Section 45 S) to prohibit deposit taking activities of UIBs. As per the RBI (Amendment) Act 1997, effective from April 1, 1997, UIBs are prohibited from accepting any deposits from the public. However, an individual or a partner of a firm is permitted to collect deposits from relatives (22 categories) as specified in the Act and also borrow from banks and financial institutions to carry on the business. Existing public deposits were required to be paid back either on maturity or within three years from April 1, 1997. Furthermore, UIBs are prohibited from issuing advertisement for mobilising deposits. As per the amendment, contravention of the provisions of Section 45 S is considered as an offence punishable with imprisonment or with fine.

Even though the RBI Act prohibits money lender from accepting deposits from public, due to lack of effective mechanism and machinery for the supervision and inspection, most of the money lenders continue to accept deposits from the public. However, in records submitted to the offices of IACs, deposits may be shown
against the names of specified relatives or simply shown as owner’s capital. For effective implementation of RBI provisions, the State Government should have efficient machinery for monitoring and supervision of money lenders, which is lacking.

*Financial Companies Regulation Bill, 2000*

Another significant development in the area of regulation of deposit taking activities of UIBs is the Financial Companies Regulation Bill, 2000. It is an outcome of the Report of the Task Force constituted by the Government of India (Chairman: Shri C.M. Vasudev) to review the regulatory and supervisory framework for NBFCs and UIBs. To implement the recommendations relating to statutory amendments, the Government has framed the Bill. The Bill also consolidates the laws relating to NBFCs and UIBs with a view to ensure depositors protection. The Bill contains new legislation to amend and consolidate the provisions contained in Chapter III-B, III-C and V of the RBI Act, 1934. The Bill was introduced in the Parliament in 2000 and has since been referred to the Standing Committee on Finance and now it is pending in the Lok Sabha. Main provisions in the Bill relating to UIBs are: i) UIBs will continue to be prohibited from accepting deposits and unauthorised deposit taking will be a cognizable offence, ii) the role of exercising the powers for enforcement of the provisions will be exclusively entrusted to State Governments, iii) District Magistrates will be vested with powers to call for information and to proceed against delinquent UIBs, and iv) the issue of advertisement by UIB is banned. A significant feature of the Bill is entrusting the State Governments exclusively for the enforcement of the provisions. Another feature of the Bill is the provision for call for information and to proceed against delinquent UIBs by district magistrates.

*Kerala Money Lenders Act, 1958*

The Kerala Money Lenders Act, 1958 is an Act ‘to provide for the regulation and control of the business of money-lenders in the State of Kerala’. The Act intends to regulate the interest to be charged by money-lenders and to afford protection to borrowers. Thus, the
original Act was passed basically for the interest of the borrowers. There had been 12 amendments to the Act till 2004. When the third amendment to the Act was proposed in 1983 (The Kerala Finance Act, 1983) it was challenged in a number of Original Petitions. On that occasion, the High Court held that the regulations introduced by the amendments were only measures necessary to safeguard both depositors and borrowers from the free dealing of money-lenders. Thus, the High Court considered that one of the purposes of the Act is also to safeguard the interest of depositors.

According to the KMLA, 1958, for the purpose of regulation of the money lending business and to ensure compliance with the conditions of the licence, the licence fee is collected, the penalty is imposed, the prosecution is ordered and the licence is cancelled. Furthermore, security is demanded and additional security is called for (Sugathan, 2005). However, all these provisions are either not very stringent or they can be easily violated without much punishment. Under the KMLA, 1958, the conditions for granting money-lending licence are very simple. They are: i) payment of a licence fee, ii) payment of security deposit (in relation to loans advanced), and iii) deposits shall be accepted only in accordance with the provisions of the RBI Act and rate of interest on deposits not exceeding the rates fixed by the RBI Act for NBFCs. Over the years, the licence fee has not been enhanced regularly, in tune with growth in the volume of business undertaken by money lender. Till March 1993, the licence fee was Rs.1,000, which has been enhanced to Rs.2,000 from April 1, 1993. Though there was an attempt to enhance the fee to Rs.10,000 in 1996, Government was forced to reduce it to Rs.5,000. The fee at present is only Rs.5,000 (revised in 1997), irrespective of volume of business undertaken.

According to the KMLA, 1958, the money-lender can charge interest on any loan at a rate not exceeding two per cent above the maximum rate of interest charged by commercial banks on loans granted by them. With the deregulation of interest rate on loans charged by the commercial banks, there was some ambiguity regarding the rate of interest which money-lenders can legally charge from borrowers.
Following this, in March 2005, Government of Kerala fixed the maximum interest rate on loans at 12 per cent per annum. Needless to mention, no financier provides loans at the prescribed interest rate. Ideally, if the Government wants to prescribe the interest rate on loans, it needs to notify a particular rate regularly (at least every year).

Under the Act, any inspector or licensing authority has the power to enter and search the places of business of the money-lender, but they are not allowed to enter or search in residential building or premises without specifically authorised in writing by the Member, Board of Revenue. This is a hindrance for conducting inspection in case of defaulting money-lenders. Under the Act, the punishment for charging higher rate of interest than what is shown in the accounts or Act, is imprisonment which may extend to six months or a fine which may extend to Rs.1,000 or both. In case money-lender molests or abets the molestation of any debtor for the recovery of any loan, the punishment is imprisonment (maximum 6 months) or with fine of maximum Rs.1,000. Furthermore, whoever undertakes business of money lending without a licence, the punishment is only a fine of Rs.1,000, which is paltry compared to the volume of business they are undertaking. In Kerala, where indebtedness to money lenders is very high, the role of the police in administrating the Kerala Money Lenders Act, 1958 was very limited because none of the sections of the Act were effective. This was mainly because the punishment imposed was not severe enough. The concern of the police was that suicides had been taking place because of the pressure tactics adopted by money lenders. In view of the above drawbacks, it is imperative to amend the KMLA, 1958 to enhance the licence fee, prescribe higher amount as security deposit, impose more severe punishment for erring money-lenders and provide more powers to inspecting officers for search in residential buildings.

The security deposit prescribed under the KMLA, 1958 is not effective. It is a common practice that firms generally show very low amount for the proposed lending so as to avoid providing higher security amount. Since there is no effective way of checking the true volume of business undertaken by them, this practice has been taking place for years. Here it may be noted that security deposit is a
prudential measure and not a source of revenue for the State Government, as Government is paying interest on it. Furthermore, under KMLA, 1958 there are six slabs for deciding the amount of security deposit which is not fixed scientifically as the effective rate of security deposit vary from slab to slab and it declines after the third slab (in case of both minimum and maximum amount of loans in these slabs). In case of last slab, the effective rate is very low - less than one per cent in case of loans above 50 lakh (Table 7). Thus, the existing slabs of security deposits favours big financiers as they need to make less amount of security deposit proportional to their level of advances.

Present Status of Control and Supervision

The Commercial Taxes Department (CTD) treats money lenders simply as a source of small revenue for the State and it is not seriously involved in their monitoring and supervision. Since the main preoccupation of CTD is the collection of taxes in the State, it finds only a limited time to deal with the money lenders. The CTD only makes sure that firms pay the stipulated licence fee and provide the stipulated security deposit with the State Treasury, when the financiers approach for new licence or for renewing the existing

Table 7: Slabs of Security Deposits and its Effective Rate

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Amount of loans and advances (Rs)</th>
<th>Security Deposit (Rs)</th>
<th>Effective Rate on Maximum loan (Security deposit as % of loan amount)</th>
<th>Effective Rate on Minimum loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Upto 1 lakh</td>
<td>5,000</td>
<td>5.0</td>
<td>20.0@</td>
</tr>
<tr>
<td>2</td>
<td>1 to 5 lakh</td>
<td>10,000</td>
<td>2.0</td>
<td>10.0</td>
</tr>
<tr>
<td>3</td>
<td>5 to 10 lakh</td>
<td>50,000</td>
<td>5.0</td>
<td>10.0</td>
</tr>
<tr>
<td>4</td>
<td>10 to 25 lakh</td>
<td>1,00,000</td>
<td>4.0</td>
<td>10.0</td>
</tr>
<tr>
<td>5</td>
<td>25 to 50 lakh</td>
<td>1,50,000</td>
<td>3.0</td>
<td>6.0</td>
</tr>
<tr>
<td>6</td>
<td>50 lakh and above</td>
<td>2,00,000</td>
<td>0.6*</td>
<td>4.0</td>
</tr>
</tbody>
</table>

* : Assuming total loan of Rs.320 lakh, which was the maximum reported among the sample financiers.
@ : Assuming total loan of Rs.25,000, which was the minimum reported among the sample financiers.
licence. In reality, there is no supervision, control and monitoring except collecting the registration fee and keeping the related documents. Offices of the IACs receive complaints from the public but it is difficult for them to enquire into the details as they are not equipped for conducting an enquiry. Moreover, even if a financier is found to be conducting illegal business, the punishment under the KMLA, 1958 is very low as mentioned earlier. It is essential that money lenders need to be supervised effectively to avoid illegal business practices, absconding cases, non-payment of depositor’s money, harassment of borrowers, etc. Given the relatively small size of business per firm, it may not be desirable to consider regular on-site inspection of all the financiers. However, it is advisable to conduct an on-site inspection of big financier who is having liabilities above Rs.100 lakh. Besides, the regular returns submitted by them in the office of IACs need to be examined carefully and if they are found to be incorrect or not reporting the actual volume of business, appropriate action has to be taken against them. If the financiers are to be supervised effectively, the State Government has to start a separate wing with sufficient staff who is having some experience in handling financial matters. It is also desirable to promote self regulation by the association of money lenders. The association can better monitor the illegal and unethical business practices, and advice the erring financiers to stop such practices. Such self-regulation can help in improving the image of financiers as the one who are doing fair business in meeting the credit requirement of needy people. Another option in this area would be credit rating of financiers.

Section IV
Areas of Concern and Future Scenario

Areas of Concern

In contravention of provisions contained in RBI Act, 1934 and KMLA, 1958, money lenders continue to take deposits from the public (not officially reported). At present, there is no guarantee for the depositors in case of failure of a financier as they need not keep any
statutory reserves like CRR, invest funds in secured bonds/debentures like SLR. Furthermore, deposits are not guaranteed by any institutions unlike in the case of banks. The State Government or any other institutions are not responsible for compensating depositors. The security deposits made by the firms are based on amount of total advances and they are not related to the deposits raised by them. In the current situation, one cannot expect much change in the deposit taking activities of money lenders for the following reasons: i) the KMLA, 1958 is very weak with minor fine/punishment for accepting deposits; ii) there is no well equipped State machinery for control and supervision of financiers; iii) financiers are raising deposits in the name of their sister concerns (not registered under KMLA) which are engaged in trading, construction, business, etc.; and iv) the RBI is not involved in monitoring their deposit taking activities. It is logical from the above that the KMLA, 1958 need to be amended to provide more teeth to the State Government to plug the existing loopholes and create a well equipped State machinery for control and supervision of money lenders. As of now, deposits made by the public with the informal financial agencies like money lenders, chit funds, etc., are not sufficiently protected by any of the laws in Kerala. It will be advisable for the State to pass an Act to protect the interests of depositors in line of similar acts passed by the States like Tamil Nadu and Maharashtra.

In case of borrowers, the concerns are relating to charging of high rate of interest, (often cumulative), than prescribed in the KMLA, 1958, and use of force and other illegal means for the recovery of loans. Financiers charge different rate of interest depending on the customer and surety provided. There is no practice of making public the rate of interest the firm will be charging on loans, like Prime Lending Rate (PLR) in case of commercial banks. In the books of accounts submitted to the office of IACs, only normal interest rate is shown to avoid legal action. On the recovery side, use of force and other illegal means has been on the rise, especially in case of advances given for purchase of vehicle.

The concerns for the State Government arise from their deposit taking activities, failure of firms, not meeting the liabilities to the
depositors, the practice of charging high rate of interest and use of force power and illegal means for the recovery of loans. Basically, the State Government need to see the operations of financiers not as a source of revenue, as it is now, but an activity which needs to be controlled, regulated and supervised effectively so that the financial requirements of a target group will be met without creating much distortion in the financial sector of the State. Deposit taking activities of firms in violation of RBI provisions are to be viewed as a major concern for the State Government and measures need to be taken to control it.

The concerns for the RBI are the violation of Section 45 S of the RBI Act and less effectiveness of monetary policy. The general impression of the public is that the activities of registered firm are controlled either by the RBI or the State Government. Hence, when there is a failure of money lender, people tend to complain about the RBI as it is the regulator in the financial sector. Furthermore, the failure of money lenders can have its impact on the working of some of the NBFCs in the state, because in some cases both are owed by the same family or group of people. Therefore, the RBI needs to be concerned about the working of private financiers to ensure the stability of the financial system in the State. The other aspect is relating to monetary policy. To get best results from the monetary and credit policy, all segments of the financial sectors should have a link with the monetary authority so that the impulses emanating from the monetary and credit policy will have its impact on the economy. The presence of informal financial sector makes the transmission mechanism of monetary policy less efficient\textsuperscript{10}.

What is the Future of Money Lenders?

The benefit of hindsight suggests that in developing economies both formal and informal financiers continue to do business, and over time, the role of informal financiers get reduced with the spread of more formal institutions. Since the provision of formal financial service is relatively costly, the process of replacing the informal financiers would take a long time and requires major improvements in
infrastructure and institutions. To be more realistic, informal financiers will not disappear all together, but they will occupy niches as formal finance is developed (Schrader, 1994, Bell, 1993 and Banerjee, 1996).

Literature suggests several possibilities in this regard (Sharma and Chamala, 2000). First, once the poor have been provided access to adequate credit under the micro finance schemes, the monopoly of money lenders would be weakened and, hence, their interest rates will come down. However, it is a very long process and it may take years to materialize. Second, link money lenders with the formal banking institutions as a conduit. Private and foreign banks may be interested in using this channel for disbursal of rural credit as the latter’s outreach is higher than the former. Furthermore, these banks may prefer to do business with money lenders as compared to co-operatives, which are highly politicised, and NGOs/SHGs, who are disorganised and unregulated. However, before adopting this route, a thorough cleansing and introduction of control and supervision of these entities are needed. Third, evolve a chit fund model (a saving-cum-credit mechanism) which may be operated by money lenders. Fourth, to make money lenders a part of the micro-finance system.

All these options involve complex processes and it may take years to evolve a suitable model. Given the size of the country and magnitude of the problem, ideally, we should choose the best elements of all the options. There is a view that all these options legitimise the money lenders. Ideally, the strategy has to be to reduce the dependence on money lenders by developing microfinance institutions and SHGs and reviving the rural cooperatives credit structure. In the long-term, the strategy of financial inclusion, advocated by the RBI and implemented by banks, will be helpful in bringing down the role of money lenders.

In Kerala, role of money lenders is not getting reduced as fast as was expected. There were few reports that the role of money lenders has come down of late due to restrictions imposed by the RBI, declining interest rate regime and aggressive entry of banks into new areas of finance. However, State Planning Board (2005) found that there was a rise in the number of money lenders in the recent period in Kerala. One of the niche areas of the money lenders is the gold
loan business. Even after the formal financial institutions started giving gold loans in a bigger way, their business was not affected much. In fact, some of the money lenders are taking gold loan from banks and utilising the money for their own lending against gold. Given the small size of majority of financiers, it is not possible for them to become a non-banking financial company (NBFC) and work like a formal institution with supervision and regulation by the RBI. On the other side, big business families doing money lending business through several outlets, may not be interested in being converting into NBFC or a bank, as it will invite strict regulation and supervision by the RBI.

If the State Government strictly monitors the deposit taking activities of these firms, in accordance with Section 45 S of the RBI Act, their role may come down for want of funds. In such a scenario, the co-operative credit societies/banks can meet a portion of the credit requirements. Given the profile of customers and their credit requirements, the best suited arrangement to reduce the role of money lenders would be promotion of Self-Help Groups (SHGs) throughout the state. The State has made some progress in promoting SHGs, especially through the Kudumbashree, a State supported initiative for the formation of SHGs for women.

Section V

Major Observations and Some Suggestions

Money lenders work on the grey fringes of legality and illegality. Besides, some of the Informal Financial Institutions (IFIs) are having links with formal financial institutions. Hence, there are risks associated with their working which can pose challenges for financial stability and effectiveness of monetary policy. In this context, the paper analysed the working of money lenders in Kerala to draw insights for their regulation and control.

The above analysis enables us to put forth a few major observations. The total number of registered money lenders in Kerala is estimated at around 5,700 and the number of unregistered firms is
around 6,000, thus taking their total number to 12,000, which is quite high as compared to the number of branches of formal financial institutions. Some of the financiers are very big and widely spread out throughout the State. Money lenders have a share of around 18 per cent of total credit outstanding of all institutions. To evade the law, some of the registered money lenders are raising deposits in the name of their sister concerns engaged in real estate, housing, medical care, retail business, etc. Interest rates on loans vary from 24 per cent to 60 per cent. However, in case of unregistered firm, the interest rate can go up to 120 to even 180 per cent. Suitability, convenience, timeliness, adequacy, and informal nature are the factors which attracts customers to money lenders. There are many instances of failure of money lenders and absconding from the place of business. The failure rate is high in case of firms run by individuals and when they are providing loans for highly risky business operations in real estate, shares, etc. The activities of money lenders are flourishing on account of a) excessive consumerism of the people, b) borrowing for payment of dowry, construction of house, medical treatment, and c) neglect of credit requirements of petty traders and lower middle class by the formal financial institutions. The total liabilities of all money lenders in the State are estimated at Rs. 8,270 crore, of which outstanding deposits would be around Rs. 2,864 crore. The total loans and advances are estimated at Rs.6,057 crore.

With the amendments to Section 45 S of the RBI Act, it seems that financiers are not mobilising deposits from the public in a big way. However, some of the deposits from the public are showing as owner’s capital. As per the proposed Financial Companies Regulation Bill, 2000, the Unincorporated Bodies will continue to be prohibited from accepting deposits and the role of exercising the powers for enforcement of the provisions has been exclusively entrusted to State Governments. It is doubtful whether the State Governments can shoulder the responsibility of enforcing the provisions. The KMLA, 1958 is very weak on the following counts: a) liberal conditions for the grand of licence, b) very nominal licence fee, c) inadequate security, d) insignificant punishment for violation of provisions, e) less powers for inspecting officials and f) silent on deposit taking
activities. It will be advisable for the State to pass an Act to protect the interests of depositors in informal financial institutions on line of similar acts passed by the States like Tamil Nadu and Maharashtra. The Commercial Taxes Department treats money lenders merely as a source of small revenue (registration fee). There is no system of regular inspection of their accounts and supervision of their activities. In case of erring money lenders, the punishment under the KMLA is very low—often leading to imposition of small fine. It is advisable to conduct on-site inspection of big financier who is having liabilities above Rs. 100 lakh. If the State Government strictly monitors the deposit taking activities of these firms, their role may come down for want of funds. In such a scenario, co-operative credit societies/banks can meet the credit requirements if they encourage formation of SHGs and follow strategies for financial inclusion.

Some Suggestions

It is imperative to amend the provisions of KMLA, 1958 to effectively control and supervise the working of money lenders and pass an Act to protect the interests of depositors. In case of KMLA, 1958, the provisions relating to deposit taking activities, prudential norms (security requirement), supervision, compliance and punishment for erring firms need to be strengthened. It is suggested that the security deposits need to be fixed as a proportion of total loans and advances. As their deposit taking activity is prohibited, the Government may obtain more detailed information on the sources of funds of financier at the time of registration/renewal of registration. It is prudent to prescribe a minimum capital base for money lenders to avoid their mushrooming. Deposit taking activities of sister concerns of money lenders need to be examined and controlled. The Government may consider insisting for credit rating of financiers. More importantly, the Government may set up a separate wing for policy formulation, monitoring and supervision of money lenders. It can also examine the complaints from the public. On-site inspection may be conducted in case of big financiers and off-site inspection in case of small firms. Self-Help Groups need to be promoted throughout the State and they in turn linked with bank finance so as to reduce
the dependence of people belonging to the lower strata on money lenders. Cooperative institutions and formation of SHGs should be further strengthened, especially in remote areas and places where money lenders are flourishing.

**Notes**

1. In India, the share of non-institutional sources in outstanding cash dues of cultivated households declined from 92.7 per cent in 1951 to 30.6 per cent in 1991.

2. In fact, an indication about this trend was visible during the 1980s itself. Data available from the All-India Debt and Investment Survey (AIDIS) 1991-92, conducted by the National Sample Survey Organisation (NSSO), revealed that the share of institutional agencies in debt outstanding of rural areas has declined from 61.2 per cent in 1981 to 56.6 per cent in 1991. [To make meaningful comparison of results of AIDIS, 1991-92 with that of the similar survey relating to 1981, Reserve Bank prepared few tabulations in addition to those generated by the NSSO, relating to indebtedness of households. Reserve Bank estimated total debt position of households by considering both cash loans and current liabilities, the latter was not considered by the NSSO and, hence, their estimate is not comparable with that of 1981 result. As per NSSO estimate, the share of institutional agencies in outstanding debts of rural households has gone up from 61.2 per cent in 1981 to 64.0 per cent in 1991 (RBI, 2000 and NSSO, 1998)].

3. With the passing of Reserve Bank of India (Amendment) Act 1997, money lenders are prohibited from accepting deposits from public under Section 45 S. Since the lending operations of money lenders are mainly depended on the deposits mobilised from the public, the amendment may change their mode of operations.

4. With the introduction of control and supervision of NBFCs by the Reserve Bank, there is a growing tendency among NBFCs to mobilise deposits through money lenders and their sister concerns, which are promoted by the NBFCs themselves.
5 There is an alarming rise in indebtedness of people in the State, especially among the farmers in rural areas. The number of people, who committed suicides, due to inability to pay back the loans taken from money lenders (and also from formal institutions) at usurious rate of interests, is also rising in the State. The average amount of outstanding loan per farmer household was very high in Kerala at Rs.33,907 as against the national average of Rs.12,585 (NSSO, 2005). Rising indebtedness is believed to be one of the immediate reasons for suicides committed by farmers (Deshpande and Prabhu, 2005). As per an estimate by the State Government, from January 1999 to July 2006, a total of 549 farmers committed suicides in the State. However, as per the State Planning Board, around 2,000 farmers committed suicide in the State (State Planning Board, 2006). Though the money lenders account for a lower share of the loans availed by farmers, the pressure exerted by them were too painful to withstand when compared to pressure by formal sources of borrowing (Mohanakumar and Sharma, 2006) and, hence, they are also held responsible for the suicides committed by farmers.

6 The authorities have been receiving numerous complaints from the public about the operations of money lenders. There are many instances of non-payment of depositor’s money and using unethical means to recover the loans (hence, they are called as ‘blade mafia’ in local parlance).

7 Average population per bank branch was 9,000 in Kerala as against 16,000 at the All-India level in June 2005.

8 The “Tamil Nadu Protection of Interests of Depositors (in Financial Establishments) Act, 1997” was passed to protect the interests of the depositors in financial establishments when they default on the return of deposits after the maturity period. The Act empowers the State Government to attach the money or other property alleged to have been procured either in the name of the financial establishment or in the name of any person from and out of the deposits collected by the financial establishment.

9 Maharashtra State has passed an Ordinance in 1999 [Maharashtra Protection of Interests of Depositors (in Financial Establishments) Ordinance, 1999]. The main objective of the Ordinance was the
realisation of the assets of a defaulted financial establishment and distributes the same in discharge of deposit liabilities. The provisions of the Ordinance will be brought in force in the event of failure to return deposits after maturity, failure to pay interest or other assured benefit to the depositor and failure to provide the services promised against the deposit (Government of Maharashtra, 1999).

10 There are divergent views on the effectiveness of monetary policy in the presence of informal credit markets. One view is that monetary policy has impact only on the formal credit markets and not in the informal market. Hence, the presence of a sizeable informal credit markets somewhat dilutes the effectiveness of monetary policy. The other view is that there are links between the formal and informal credit markets, and hence, depending upon the stance of the monetary policy, borrowers have the option to have alternate sources of funds. This will destabilise or frustrate the monetary policy. On this issue, while Acharya and Madhur (1983) found that monetary policy has substantial effects on the informal credit market, Sundaram and Pandit (1984) found that presence of informal credit markets are a threat to monetary policy.

References


