

CHIT FUNDS AS AN INDIAN SAVING SCHEME: A CONCEPTUAL STUDY**Prof. Silpy Gupta***Faculty Member, IBS Mumbai & Research Scholar, JJT University.***Abstract**

Non-banking financial companies are at all time high now a days. Many such companies have started offering lucrative schemes by promising high interest rates and borrowing schemes to their investors. These schemes, generally termed as Chit Funds Schemes today have become the easiest choice of saving and borrowing technique. Investors are becoming the victims and taking high risks in name of such chit funds. People are not able to identify the difference between a registered chit fund company which are legal and safe and the unregistered unorganized chit fund companies. This paper makes an attempt to illustrate the working principle of a recognized chit fund company/scheme, difference between registered and unregistered chit Fund Company thereby enhancing the awareness among people before making their choice and decision of choosing a chit fund scheme. This paper is based on the secondary data collected from government websites, interviews given by government officials and other published records.

Key words: *NBFC (non-banking financial companies), Chit Fund Companies, Chit Fund Schemes*

Introduction

India, a developing nation consists of nearly 63 percent of low-income rural population. This huge section of the country has little access to formal banking facilities. An innovative framework of parallel informal banking arose to fill the vacuum. The money lenders became the central part of this who started charging inflated rates of interest. This in turn gave rise to shady financial operators coming up with various Ponzi schemes which exploited the investors. Analysts blamed these kinds of fraudulent mass-marketers and their Ponzi schemes on greed rather than exclusion from formal banking systems.

The rural economy of our country has mostly relied on various small savings schemes run by the government. The lack of financial literacy and investor awareness, low interest rate offered by the financial institutions coupled with multi-layered process, absence of adequate legal deterrence, and regulatory arbitrage encouraged people to opt for those Ponzi schemes. Such companies offering Ponzi schemes offered much higher returns, easy processing and also borrowing facilities to their investors. These schemes, commonly referred as chit funds started flourishing and operating in India at different scale. The operators adopted different fraudulent tactics to convince and collect money from the depositors, many of which have been exposed. But that does not seem to deter people who continue on the same path of risky investment.

Chit fund is a financial savings instrument widespread from even before the formal banking system began. Such an arrangement is carried out based on coordination and trust between operators and members. Various schemes are operated by organized financial institutions whereas many unstructured schemes are also managed by small groups of people who know each other, can be relatives, friends and others. Chit fund companies are classified as NBFC i.e. non-banking financial companies.

'The Hindu' quoted that there are almost 193 registered chit funds which are operating in Bangalore and registered under the Chit Fund Act 1982. The turnover of all these are estimated to be around Rs. 4,000 Cr per annum. But the number of other unregistered chit fund operators is likely to be 100 times more than the registered ones. All India Association of Chit Funds are making attempts to build people awareness about the business of chit funds.

Chit Fund Concept

Chit fund is considered as traditional financial machinery operated by different institutions that prevail in India. It is an indigenous mechanism which together combines savings as well as credit. This scheme is looked as an innovative access to finance and growth of low-income household savings. Chit funds are operating across diverse countries but they are identified differently in different countries. Groups operating a chit fund scheme in India have to be registered under Chit Fund Act 1982.

The different acts governing the chit funds in India are:

- Union Government - Chit Funds Act 1982 (Except the State of Jammu and Kashmir)
- New Delhi: The Chit Funds Act, 1982 and Delhi Chit Funds Rules, 2007
- Maharashtra: Maharashtra Chit Fund Act 1975
- Tamil Nadu: Tamil Nadu Chit Funds Act, 1961
- Kerala: Kerala Chitties Act 1975
- Andhra Pradesh: The Andhra Pradesh Chit Funds Act, 1971
- Karnataka: The Chit Funds (Karnataka) Rules, 1983

Chit Funds Act 1982 defines a chit fund company as a company which conducts, manages and supervises a chit fund scheme. Section 2(b) of the under Chit Fund Act 1982 defines Chit as:

"Chit means a transaction whether called chit, chit fund, chitty, kuri or by any other name by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of grain instead) by way of periodical installments 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 other manner as may be specified in the chit agreement, be entitled to the prize amount.

Explanation: - A transaction is not a chit within the meaning of this clause, if in such transaction,-

- (i) some alone, but not all, of the subscribers get the prize amount without any liability to pay future subscriptions; or*
- (ii) all the subscribers get the chit amount by turns with a liability to pay future subscriptions*

Source : Financial Intelligence Unit – India, Ministry of Finance, Govt. of India

The process of joining a chit fund is easy as very little paperwork is needed. Moreover this entire system works on the foundation of trust. There are different types of chit funds that function in India. First, the chit fund groups/schemes controlled by the state governments or chit funds run by PSU. People can invest in this type of chit funds as they are the safest. Second are the registered chit funds which are run by big business houses and they are also considered to be safe. Third one is the chit funds which are not registered and are unorganized and run among the families and friends.

Chit Fund Working Model

In India, if the value of the chit run by a chit fund operator exceeds Rs. 100 and is not registered, it is considered to be an illegal chit fund. Every institutionalized and registered chit fund is safe and sound and offer greatest support to its customers. Before understanding the working model of chit fund, let us know few terminologies which are specifically used in the working of such schemes.

1. Chit Agreement - a legal contract with all detail of rules and regulations signed by foreman and investors
2. Chit Group – group of investors who are the part of registered chit fund group
3. Chit amount – the amount paid by the investors on specific period
4. Foreman – person/company who maintains records, responsible for collection of money and heads the auctions
5. Foreman’s Commission - 5% of the gross chit fund amount paid to the foreman
6. Prize money – Summation of all periodic collections minus maximum bidding amount (maximum bidding amount is inclusive of foreman’s commission)

For a particular chit fund scheme there is a chit group which has fixed number of investors. These investors have to contribute a fixed amount of money, presume Rs. 5,000 for at specific intervals for a period of time. The interval of paying the money is usually a month for the investors. The total duration of the scheme is equivalent to the number of members of the chit group. Suppose the group is of 10 members, then they have to pay for 10 months. The money thus collected from the members every month goes into a common fund. The money is then given to one member who is usually selected through a lucky draw. Auction is another process to give away the money to one member based on the bid. Foreman is responsible for the collection of the installments and heading this auction. Every member is allowed to bid every month in the auction for the chit fund money collected that very month. The member offering the lowest bid is awarded the bid. The bid is on the maximum percentage of discount the bidder is ready to offer on the collected money. The discount can go up to maximum of 40%. In other words, the bidder who is ready to take the lowest sum of money wins the bid. The person winning the bid is called the ‘prized member’ who receives the ‘prize money’. The winning bidder receives the amount after deduction of the percentage of discount s/he has offered and also the percentage of commission to be paid to the foreman. The amount accrued by way of discount excluding foreman’s commission is then distributed among other members of the chit fund group as dividend. The prized member is not allowed to bid any more in the remaining months of the scheme.

Critique of Chit Funds

According to Chit Fund Act 1982, all registered chit fund companies are barred from utilization and appropriation of the installments collected from the members as well as accepting any kind of deposits. The chit funds have always been looked upon as an alternative innovative banking framework and important source of finance for small businesses and low-income groups. They are a reliable source of funds in any emergency. But the registered chit fund operators faced difficulty in offering low value chit fund schemes to such groups due to the augmented charge of operating such schemes imposed by the regulators. Consequently they started offering mainly large schemes. These developments made it tough for the underprivileged and poor to take part in registered chit fund schemes.

The registered chit funds are thus considered to be safer than the unregistered chit fund companies. Despite of this, preceding years have seen a huge rise in the number of unregistered chit fund companies. The unregistered chit fund companies deliberately started keeping their schemes slightly

different so as to avoid the registration process as per the chit funds act. Another reason of avoidance is the complex and multifarious process of registration. Though many of these companies started making news following the collapse of their ponzi schemes, people are still seen inclined to become members devoid of doing a background check. Absence of any stringent law to control the operation of such chit fund companies also lead to the rise of unorganized chit funds as a savings and borrowing vehicle for the poor and lower income households in India.

Most people happen to be the members of unregistered chit fund operators as it is one of the easiest ways to invest a lot of money. Members can even borrow money in an uncomplicated flexible manner. There is no need of documents for participating in unregistered schemes compared to registered schemes.

Few Chit Funds Operators from India

The number of registration of the chit fund companies in India has dropped in last few years. Although the number of registered schemes has reduced, the valued has increased as the registered companies are now offering larger schemes to their members. There are numerous registered chit fund operators in different states of India with Chit Fund Registrars. India has around 15,000 chit fund companies. Only one percent of this number runs in registered form and remaining works in the unorganized setup. As per IFMR report the total amount of capital lent per year through registered chit funds is between 10 per cent and 50 per cent of all priority-sector lending which is extended by regular banks in these same States.

A chit fund company named Kerala State Financial Enterprise exists under the Kerala State Government is the largest chit fund company in India. This company operates throughout the state. In Kerala around 5,000 chit fund companies are functional with almost 3,000 located in Thrissur district. These operators offer employment to approximately 35,000 people directly and an equivalent number indirectly. Chit funds are not only popular in the southern states of India like Kerala, Tamil Nadu, and Andhra Pradesh but also in Maharashtra and Delhi. Another Hyderabad-based company which is a part of the Ramoji Rao group named Margadarsi Chit fund is also a big chit fund company. There are other companies like Mysore Sales International Ltd, Shriram chits etc. which are run by big business houses and are registered.

Chit Fund Scams in India

Recent years have seen a high rise in the number of fraudulent chit fund operations. They are making their way into the poor & middle class people by luring them with offers of high interest rates and returns. People are falling prey to such companies and their schemes despite of the number of detected fake companies and schemes. For some victims, such risks are extended to physical threats or risks, loss of their jewelry and homes, depression, and even suicide beyond their loss of personal savings or funds. Such frauds also have a considerable impact on economies and markets by dejecting consumer trust and confidence in legitimate businesses. Such companies are witty and quick to alter their modus operandi to reduce the risks of law enforcement detection and investigation and to respond to consumer and business awareness of their current methods. People need to be more aware and think before investing in such dubious companies.

The biggest chit fund scam ever heard in India is the Saradha Group Chit Fund Scam. This recent scam is considered to create a world record by slapping nearly 600 cases against Mr. Sudipta Sen, chairman of

Saradha Group. Over 10 million people have been duped by the investment schemes of Saradha Group which was a consortium of over 200 private companies

One more Rs. 100 Cr chit fund scam case has been busted by Patiala Police. The company claimed to double the money of its investors in one-and-a-half year. In this way they were able to lure and trap more than 10 thousand people to invest their money. The company showed the depositors that their money was invested on the ongoing projects of real estate sector, forestry and paper mills.

Another company which encouraged only women to invest in the schemes and join the chit fund group was The Reddamma Dasara Chit Fund Company promising them high returns. It is alleged that housewives and small-time workers had put their hard-earned money in the company and the deposits had exceeded Rs.3 crore.

Conclusion

The concept of chit funds existed in India even before the existence of a formal banking system. Every registered chit fund company and their successful schemes are not only governed by Chit Funds Act 1982 and Section 45(I) of the Reserve Bank of India but also administered by the individual state governments. Inadvertently the size of unregistered chit funds group is estimated to be 100 times larger than that of the registered ones in India. People now need to be more open, aware and conscious before choosing the right chit fund scheme for them. They have to become more alert instead of becoming the victim. There is also a need of more stringent law, regularized and easy procedure and transparency by the government in registration process and controlling the fraudulent cases.

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