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**Special
Supplement**

Chit Funds

We have nearly 63% of population residing in rural areas. Our country is a developing Nation. In rural areas, the populations have poor access to formal banking facilities, in some cases there is no accessibility to formal banking facilities. Rural populations, living with low income and coupled with poor access to formal banking facilities, approach money lenders for their financial needs. The money lenders, who charge high interest rate, exploit rural populations. The dire need for financial needs, gave rise to a informal system infamously known as "Chit Fund".



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Traces of chit fund, go back to Kerala. In earlier days, a small group of farmers operated a unique scheme, in the state. This scheme provided each farmer with a fixed quantity of grains in harvesting time to a selected trustee. Collected grains were kept aside with the trustee of the villager. Whenever, need arose among the group member, trustee provided the farmer with grains. Thereby, the farmer who received the maximum continued to give the fixed quantity till every member of the group received his lot.

The additional benefits, while receiving the lot earlier led to competition. Few members even took to forgo a certain portion, willingly like a discount of the lot, in order to get an earlier chance. So, an auction was held the lowest bidder got the lot. On the above basis, we today popularly know it as “chit fund scheme.” Understanding the concept of chit and how it is operational is simple. “Chit” defines a transaction, popularly called as chit, chit fund, chitty, kuris or by any other name by or under which an individual enters into an agreement with a specified number of individuals, that each and every individual shall subscribe a certain sum of money (or certain quantity of grain instead) by way of periodical installments over a definite period and that each such subscriber shall, in his or her turn, as determined by lot or by auction or by tender or in such other manner as many be specified in the chit agreement, be entitled to the prize amount.

Necessity is the mother of inventions! As the saying goes, need for chit fund too has its roots in the saying. Financial planning is key for socio-economic development of individuals/families/groups. In case of faced with adversities, chit funds help them sail through adversities. In rural and as well in urban areas, middle and lower income group individuals save money through chit fund schemes. Individuals save money on monthly installment basis for their future needs. After a given stipulated time, they avail lump sum money and use the money for various family needs. The various needs of families are; supporting children’s education, marriages, health treatment, housing, agriculture, family functions, festivities, rituals etc., However, in case of emergencies the individual member can avail chit fund money.

For all income households, chit funds prove to be successful. Chit funds provide access to finance at any given point, irrespective of time. Chit funds have easy accessibility to finance, reasonable good returns on savings and availability of finances. In this scheme, there is no concept of processing and processing delays, as whenever the member is in need of money, the foreman arranges for the money. Chit fund scheme functions on mutual trust and understanding between the subscriber and the foreman, making it simple, procedurally easy. The schemes are generally operated in village premises or in urban colonies, or in a given geographical areas. The scheme doesn’t require any documents and formalities. In chit fund schemes, foreman has the choice of providing advance to the subscriber on interest basis and it is dependent on relationship between subscriber and foreman. Therefore, it is very useful for all income category households.

In this scheme, every subscriber gets the credit on rotation based within the chit fund time. For business community people, the scheme is very popular, as they can avail credit easily, when compared to banking financial system. Chit funds operate on simple fact of mutual trust and understanding. It is a mutual benefit informal organization

run by a group of individual.

The main functions of this informal organization are as follows:

- Acceptance of savings.
- Disbursement of credit, to its members in the group.
- Interest rate is determined by the subscribers themselves, based on mutual decisions and varies from auction to auction.
- Member can avail money at any given point of time, without any procedural delays.

Chit fund transactions, the foreman renders service exclusively to the members only. If the services are rendered to non-members and money-lending operations are done, then it does not fall under the category of chit fund scheme. Chit funds have the advantage of both serving the need and also as an investment. Money in these type of schemes is provided on personal sureties too; unlike in case of banks and other formal financial institutions, which demand a tangible security. Chit funds are reliable, as they satisfy personal needs and the cost of intermediation is low. In running the chit fund scheme, role of foreman is key. The individual is the organizer and key role player too. He/She has number of subscribers in a group, in given geographical location. The foreman, collects money monthly and runs the scheme. Foreman collects the data of all subscribers and follows the procedures of auction on a particular date with the presence of subscribers in a particular time. The foreman keeps the subscriber informed on discount amount, commissions and other details.

To run chit fund scheme, foreman is credited with qualities of promptness, straight forwardness and honesty. These characteristics attract subscribers easily to be part of chit fund scheme. The foreman plays a dual role; that of an organizer and a subscriber in the group. He or she is entitled to obtain one chit amount. Foreman ensures prompt payment from subscribers and takes the risk in case of eventuality, when members default on payment of their installments or discontinuing their membership. Thus, ensuring that failure on the part of some members does not become an excuse for the Foreman to delay the bid payable amount to the subscribers. The foreman is entitled to a certain percentage of chit amounts, which should not be more than 5% of chit fund amount as his commission from each member.

Auctions are part of chit fund scheme. Foreman operating the scheme, auctions every month on a given date, time and office/premises. Every month, foreman invites all the subscribers to attend the auction of chit fund. On monthly basis, foreman deducts 5% commission on every chit, at times; it is less than 5% interest rate, as it is dependent on agreement between foreman and subscribers.

The auction has discount rate of maximum 40% of chit fund value. If the subscriber is in need of money, then they have to raise the discount amount. Here the foreman roles come into play, to negotiate with the bidders and share the chit value and finalize the lucky draw. Chit funds are of three types; a) simple chit fund; b) business chit fund; c) prize chit fund. Details are as follows:

Simple chit fund: It is a easier version, less complicated. The subscriber avails the amount through lottery method. Amount is collected from number of subscribers through monthly installment. In the end, subscription amount goes to the beneficiary of the subscriber. Foreman, deducts his/her commission, prior to giving amount to the beneficiary; the subscriber.

Business chit fund: Popularly known as auction chit. Registered by the government authority, prior to initiating the scheme, business of chit and time period is predetermined by the foreman or the chit company. Each subscriber has a number and names are mentioned by the foreman for easy identification purpose. This provides transparency to the chit fund company.

In few cases, subscribers are smaller in number than the installments. It creates the demand for the chit amount. In that situation, the subscribers are auction for the chit amount. Those, who auction more amount than subscriber get the chit amount. The auction amount is discount to the chit beneficiary when the given the chit amount. It means the subscription amount is less than the original amount. Whoever gets the amount in the auction, they cannot eligible in next time. If the subscriber have one and more investment in the chit, at that time to eligible for auction of chit fund scheme.

Prize chit fund: Infamously known as lottery chit. Foreman enrolls more number of subscribers, than the number of installments. In few cases, the members enroll as multiple numbers of installments and the foreman conducts lucky draw and pick out the lucky number. The members, who pay the amount, are included in the lucky draw. The lucky member gets the prize amount or the utility article, which is an excess than the subscription amount. The prize winner is not eligible for the next lucky draw. The non-prized member gets back to their subscriptions and also the nominal interest, when the last installment is paid. Here the lucky person in the first draw gets the maximum benefit.

The promoter organizes, prize chits, as he/she is able to collect a large amount of subscription, which remains in his/her possession after he/she disburses the prize amount profitably. He or she is not only pay the prize amounts to the prize winners at every installment, but also repay without difficulty. The subscription paid by members with interest at the end of the last installment, besides making a handsome profit for himself. In our country, we have two categories of chit funds; unregistered chit fund industry and registered chit fund industry. Unregistered chit fund industry, functions in informal way. It is not registered by any concerned authority. Informally run by people, who have good social contacts. The organizer or the manager of unregistered chit fund is a member in a religious group or is a reputed person in an area or village, reliable to everyone in that community.

Popular in rural areas, as they run the chit schemes as per their feasibility of the subscribers. It does not involve any procedures or formalities. The entire process runs on faith and inter-relationships with the members. In rare cases, subscribers default and foreman plays key role to protect the chit fund scheme. There are nearly 10,000 unregistered companies across united Andhra Pradesh with an annual turnover of 1, 40,000 crore. There are only 1200 companies are registered companies, with an annual turnover of only 15,000 crore. That means the unregistered chit fund companies in the state are 10 times greater than registered Companies. There are so many reasons why people invest in unregistered companies some of them are (a) Easy access to money; (b) No processing delays, whenever the money is required the foreman will arrange the money; (c) There are no much procedural formalities; (d) It is very accessible to low income people; (e) No collateral or nominal collateral is enough.

In organized sector, the chit fund company is registered under the local authority or under the State Government Act. The company follows the rules and regulations as the norm. The organized company is incorporated to do the business by the state or central laws. If any company is found to be fraudulent, then the government takes serious action on the company to protect subscriber's money. There are various legislations governing the chit funds in India. Chit fund schemes are actively run in various states and at times they are fraudulent to the subscribers involved in it. There is diversity of the regulatory provision made in various enactments. However, there is a need to have model law to regulate the business through the legislation acts in various states.

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
- Tamil Nadu: Tamil Nadu Chit Funds Act, 1961
- Andhra Pradesh: The Andhra Pradesh Chit Funds Act, 1971

- Kerala: Kerala Cities Act,1975
- Maharashtra: Maharashtra Chit Fund Act, 1975
- Karnataka: The Chit Funds (Karnataka) Rules, 1983

Chit funds provide direct employment opportunities to over 35,000 people. Indirect, but full time employment opportunities to another one lakh people working as agents. If a legislative environment is created and encourage entry of large and medium sized industrial houses into the business of chit funds, job creation can be done for next 10 years for 10 lakh in new jobs, without the government having to make any capital investment.

Source: (<http://www.ijbarr.com/downloads/290620148.pdf>)

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Significance of chit business can be realized from the fact that in Karnataka, there were about 500 foreman, who organized about 12,500 (min) groups involving about 5,00,000 subscribers and about rupees 500 crore, annual turnover as of 1993. In 2001 the volume of chit may be estimated at rupees multiple of 1000 crore.

Source:(<http://www.ijbarr.com/downloads/290620148.pdf>)

For a 20 month scheme, contribution per month is Rs.1000 per subscriber. A member, who pays a contribution of Rs. 3000 per month can participate in 3 out of the 20 auctions. The members can bid again only after 50% of the duration is completed (for instance, in case of a 20 month scheme, the member who has won the chit in first 10 months can bid again, only after completion of 10 months). Usually, only members with high credit worthiness will be allowed, such a privilege. Chit funds have another special feature, that they have great adoptability to the local conditions, lifestyles and earning capability of the customers.

Chit Loan; is a bridge between the actual financial need and the delay in chit getting prized to a subscriber. If a non-prized subscriber in a chit is remitted 10% of the total number of installment promptly, then he or she is eligible for an advance up to 50% of the total chit amount. The mode of payment is done through a cheque crossed A/C Payee only or by cash.

Source: http://shodhganga.inflibnet.ac.in/bitstream/10603/8650/12/12_chapter%204.pdf

In spite of having legislations in India, chit fund scams in our country is something that we all are familiar with. Poor access to formal financial institutions, financial illiteracy, low income levels force many rural and urban low income households to be subscribers in chit fund schemes and take to the risky investments. Attractive advertisements by the organizers trap the desperate low income households and fall prey to these tactics. In recent past, we have seen scams; Sharadha scam in West Bengal (WB), Agri-Gold Scheme in Andhra Pradesh. What attracts this risky investment is high interest rate returns of their savings. The impact of frauds fall upon local markets, chit fund company schemes loose their reliability, confidence with consumers. The informal system is not governed by the

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 10269 chit fund companies as per Ministry of Corporate Affairs (MCA). http://www.mca.gov.in/Ministry/pdf/Chit_Fund_Companies_6nov2008.pdf

Only 5% percent of this number runs in registered form and remaining works in the unorganized setup. As per Institute for Financial Management and Research (Chennai, India 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 RamojiRao group named Margadarsi Chit fund is also a big chit fund company. It has 105 branches in four states like Andhra Pradesh, Telangana, Tamilnadu, and Karnataka. This companies has 4300 employees, 8000 agents are directly get the livelihoods, it has 3, 46,574 subscribers and Rs.7750 crores of turnover till now. The company gets the 4% commission, agent get commission the1% from the chit fund.

Source: http://shodhganga.inflibnet.ac.in/bitstream/10603/8650/12/12_chapter%204.pdf,<https://www.margadarsi.com/AboutUsStatic.jsp>

Biggest chit fund scam ever heard in India is Saradha Group chit fund scam. A total of 600 cases were registered against the Saradha Group Management, 10 million people savings were at stake and it was run through 200 private companies. In erstwhile AP, the Agri-Gold company looted the public savings of Rs.7000 crores from 32 lakhs of poor people. As on date 70 depositors committed suicide, as they were not able to get the money back. The case is pending in High Court of Andhra Pradesh.

Source: <http://www.ijbarr.com/downloads/290620148.pdf>

Chit Fund Act, 1982. The number of unregistered companies is high, when compared to registered companies. The government needs to sharpen the acts and regulate fake chit fund companies. Chit funds are a lifeline to many households for betterment of their life holistically. ❖