

Failure of Chit fund Business and its Consequences

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Introduction

- ❑ Chit Fund is one of the financial institutions operating in India in general and in South India in particular
- ❑ The term chit fund is known as chit, chittie or kuries. But operation of chit fund is same throughout the India
- ❑ Chits are traditional financial instruments which are intended to mobilise the capital by individuals in times of need
- ❑ Under a chit, a group of persons join together to contribute specific sum of money periodically (monthly contribution is most common) and one person in the group taken the responsibility of organising the chit whom is called Foreman and he will be used these funds for the working of chitty. The other persons who contribute the money periodically are known as Subscribers.
- ❑ All the subscribers have the right to bid for the chit amount either by means of lot or by auction or by tender conducted for the purpose. The subscribers are willing for bidding the chit amount have to be

prepared to forego a portion of the total amount to which he is otherwise eligible for and that portion is known as the 'Discount'.

- The foregone amount by subscriber is utilised for distribute among all the subscribers in proportion to their tickets in the chit series in the form of 'Dividend' to meet the expenses running the chit and towards Foreman's commission.
- The money which the subscriber is eligible for after deducting the discount will be given to the successful bidder/prized subscriber and this is called Prize money. This process is being repeated every month.

These are the basic activities in chitty. When there is a default in any of these activities it leads to the failure of this business.

Statement of the Problem

- In order to protect from the unscrupulous and unethical methods in chit fund business, Parliament enacted THE CHIT FUND'S ACT, 1982, and the same was brought in to force in various states on different dates. It ensure and improve the efficiency of credit, monetary policy and healthy financial discipline in Chit Fund business.
- Still there are no: of collapse in chit Fund business. It resulting in severe financial loss to the umpteen no: of chit subscribers, especially the lower income peoples
 - ❖ Diversion of funds to non-chit fund business and violation of the legislative provisions are there prime reasons for this state of affairs.

Hence, this study, an attempt is made to analyse' the factors affecting the chit fund business, and also the reasons for the failure of Chit fund business.

Objectives of the study

- To study about the basic factors need for a chit fund business..
- To study about essential ingredients of a chit

- To analyse the reasons for the failure of chit fund and its consequences.

Scope of the study

- This study covers 3 major chit fund companies and 10 subscribers in Irinjalakuda.

Methodology

- The study is based on both Secondary data
- Primary data have been collected from major three chit fund business and about 15 failed subscribers in Irinjalakuda.

The essential ingredients of a chit are

- A foreman who organise the chit fund.
- There need subscribers who subscribe to certain sum of money
- There need to be an agreement between foreman and subscribers
- Subscribers subscribing to a specified chit amount for a definite period of time by specified installments.
- Number of subscribers equaling to the number of installments
- Equal opportunity to every subscriber to bid for the total chit amount
- Successful bid subscriber, who is known as prized subscriber who bids for the lowest amount (i.e. who is prepared to forego the highest discount) is eligible for the total chit amount.
- Foreman is entitled to a commission towards the services rendered by him in running the chit fund.

Basic Factors necessary for the chit fund business...

1. (1) Not chit shall be commenced or conducted without obtaining the previous sanction of the State Government

Provided that a sanction obtained under this sub-section shall lapse if the chit is not registered within twelve months from the date of such sanction or within such further period or periods not exceeding six months in the aggregate as the State Government may, on application made to it in this behalf, allow.

2. Prohibition of invitation for subscriptions except under certain conditions. No person shall issue or cause to be issued any notice, circular, prospectus, proposal or other document inviting the public to subscribe for tickets in any chit unless such notice, circular, prospectus, proposal or document contains a statement that the previous sanction required

3. Form of chit agreement. (1) Every chit agreement shall be is duplicate and shall be signed by each of the subscribers or by any person authorised by him in writing and the foreman and attested by at least two witnesses and it shall contain the following particulars, namely:

- (a) full name and residential address of every subscriber;
- (b) the number of tickets including the fraction of a ticket held by each subscriber;
- (c) the number of installment
- (d) the probable date of commencement and the duration of the chit;
- (e) the manner of ascertaining the prizing subscriber at each installment;
- (f) the maximum amount of discount which the prized subscriber has to forego at any installment;
- (g) the mode and proportion in which the discount is distributable by way of dividend, foreman's commission or remuneration or expenses for running the chit, as the case may be;
- (h) the date, time and place at which the chit is to be drawn;
- (i) the installment at which the foreman is to get the chit amount;

- (j) the name of the approved bank in which chit moneys shall be deposited by the foreman under the provisions of this Act;
- (k) where the foreman is an individual, the manner in which a chit shall be continued when such individual dies or becomes unsound mind or is otherwise incapacitated;
- (l) the consequences to which a non-prized or prized subscriber or the foreman shall be liable in case of violation of any of the provisions of the chit agreement;
- (m) the conditions under which a subscriber shall be treated as a defaulting subscriber;
- (n) the nature and particulars of the security of to be offered by the foreman;
- (o) the dates on which and time during which the foreman shall, subject to the provisions contained in section 44, allow inspection of chit records to non-prized and unpaid prized subscribers;
- (p) the names of the nominees of each subscriber, that is to say, the names of the persons to whom the benefits accruing to the subscriber under the chit may be paid in the case of the death of the subscriber or when he is otherwise incapable of making an agreement;
- (q) any other particulars that may, from time to time, be prescribed.

Explanation: For the purposes of this sub-section, it shall be sufficient if the signature of each subscriber is obtained in separate copies of the agreement.

(2) The duration of a chit shall not extend beyond a period of five years from the date of its commencement;

Provided that the State Government may permit the duration of a chit up to a period of ten years if it is satisfied that it is necessary so to do, having regard to:

- (a) the financial condition of the foreman;
- (b) his methods of operation;
- (c) the interests of prospective subscribers;
- (d) the requirements as to security; and
- (e) such other factors as the circumstances of the case may require.

(3) The amount of discount referred to in clause (f) of sub-section (1) shall not exceed their per cent, of the chit amount.

(4) Where the prized subscriber at any installment at any installment of the chit is required to be determined by auction and more than one person offer the maximum discount, the prized subscriber shall be determined by lot.

4. Filing of chit agreement. (1) Every chit agreement shall be filed in duplicate by the foreman with the Registrar.

(2) The Registrar shall retain one copy of the chit agreement and return the duplicate to the foreman with an endorsement that the chit agreement has been registered:

(3) Every endorsement made under sub-section (2) shall be conclusive evidence that the chit is duly registered under this Act and the registration of a chit shall lapse if the declaration by the foreman under sub-section (1) of section 9 is not filed within three months from the date of such endorsement or within such further period or periods not exceeding three months in the aggregate as the Registrar may, on application made to him in this behalf, allow.

5. Minimum capital requirements for the commencement, etc., of a chit, and chit, and creation of a reserve fund by a company. (1) Notwithstanding anything contained in the Companies Act, 1956, but subject to the provisions of this Act, a company shall not commence or carry on chit business unless it has a paid-up capital of not less than rupees one lakh.

(2) Every company having a paid-up capital of less than rupees one lakh and carrying on chit business on chit business on the commencement of this Act, shall, before the expiry of

a period of three years from such commencement, increase its paid-up capital to not less than rupees one lakh.

Provided that the State Government may, if it considers it necessary in the public interest or for avoiding any hardship, extend the said period of three years in respect of any company by such further period at periods not exceeding two years in the aggregate:

(3) Every company carrying on chit business shall create and maintain a reserve fund and shall, out of the balance of profit of each year as disclosed in its profit and loss account and before any dividend on its shares is declared, transfer to such reserve fund, a sum equal to not less than ten per cent, of such profit.

(4) No company shall appropriate any sum or sums from the reserve fund except with the prior approval of the Registrar and for the purpose of obtaining such approval, it shall an application in the prescribed form to the Registrar explaining the circumstances relating to such appropriation.

6. Commencement of chit. (1) Every foreman shall, after all the tickets specified in the chit agreement are fully subscribed, file a declaration to that effect with the Registrar

(2) No foreman shall commence any auction or the draw of any chit or appropriate any chit or appropriate any chit amount unless a certificate of commencement is obtained by him.

7. Copies of chit agreement to be given to subscribers. (1) A foreman shall, as soon as may be after he has obtained the certificate of commencement under subsection (2) of section 9, but not later than the date of the first draw of the chit, furnish to every subscriber, a copy of the chit agreement certified to be a true copy.

(2) A foreman shall, within fifteen days after the close of the month in which the draw for the first installment of the chit is held, file with the Registrar, a certificate to the effect.

8. Prohibition of transacting business other than chit business by a company.- (1) Except with the general or

special permission of the State Government, no company carrying on chit business shall conduct any other business.

(2) Where at the commencement of this Act, any company is carrying on any business in addition to chit business, it shall wind up such other business before the expiry of a period of three years from such commencement:

Provided that the State Government may, if it considers it necessary in the public interest or for avoiding any hardship, extend the said period of three years by such further period or periods not exceeding two years in the aggregate.

9. Aggregate amount of chits. (1) No foreman, other than a firm or other association of individuals of a company or co-operative society, shall commence or conduct chits, the aggregate chit amount of which at any time exceeds twenty-five thousand rupees.

(2) Where the foreman is a firm or other association of individuals, the aggregate chit amount of the chit conducted by the firm or other association shall not at any time exceed,-

- (a) where the number of partners of the firm or the individuals constituting the association is not less than four, a sum of rupees one lakh;
- (b) in any other case, a sum calculated on the basis of twenty-five thousand rupees with respect to each partner or individual.

(3) Where the foreman is a company or co-operative society, the aggregate chit amount of the chits conducted by it shall not at any time exceed ten times the net owned funds of the company or the co-operative society, as the case may be.

10. Utilisation of funds. (1) No person carrying on chit business shall utilise the moneys collected in respect of such business (other than commission or remuneration payable to such person or interest or penalty, if any, received from a defaulting subscriber), except for:

- (a) carrying on chit business; or
- (b) giving loans and advances to non-prized subscribers on the security of subscriptions paid by them; or

- (c) investing in trustee securities within the meaning of section 20 of the Indian Trusts Act, 1882; or
- (d) making deposits with approved banks mentioned in the chit agreement..

11. Alteration of chit agreement. A chit agreement shall not be altered, added to or cancelled except with the consent in writing of the foreman and all the subscribers to the chit.

12. Date, time and place of conducting chits. (1) Every draw in a chit shall be held on the date, at the time and place mentioned in the chit agreement and a notice therefore in such form and in such manner as may be prescribed shall be issued by the foreman to all the subscribers.

(2) Every such draw shall be conducted in accordance with the provisions of the chit agreement and in the presence of not less than two subscribers.

(3) Where any draw was not conducted on the ground that two subscribers required to be present at were not present or on any other ground, the Registrar may, on his own motion or on an application made by the foreman or any of the subscribers, direct that the draw shall be conducted in his presence or in the presence of any person deputed by him.

13. Minutes of proceedings. (1) The minutes of the proceedings of every draw shall be prepared and entered in a book to be kept for that purpose immediately after the closure of the draw and shall be signed by the foreman, the prized subscribers, if present, or their authorised agents, and at least two other subscribers who are present, and where a direction has been made also by the Registrar or the person deputed by him.

14. Copies of minutes to be filed with Registrar. A true copy of the minutes of the proceedings of every draw certified as such by the foreman shall be filed by the foreman with the Registrar within twenty-one days from the date of the draw to which it relates.

15. Security to be given by foreman. (1) For the proper conduct of the chit, every foreman shall, before applying for a previous sanction

- (a) deposit in an approved bank an amount equal to the chit amount in the name of the Registrar; or
- (b) transfer Government securities of the face value or market value (whichever is less) of not less than one and a half times the chit amount in favour of the Registrar; or
- (c) transfer in favour of the Registrar such other securities, being securities in which a trustee may invest money under section 20 of the Indian Trusts Act, 1882 (2 of 1882)., of such value, as may be prescribed by the State Government from time to time.

Provided that the value of the securities referred to in clause (c) shall not, in any case, be less than one and a half times the value of the chit amount.

(2) Where a foreman conducts more than one chit, he shall furnish security in accordance with the provisions of sub-section (1) in respect of each chit.

(3) The Registrar may, at any time during the currency of the chit, permit the substitution of the security:

16. Rights of foreman. (1) The foreman shall be entitled,-

- (a) in the absence of any provision in the chit agreement to the contrary to obtain the chit amount at the first installment without deduction of the discount specified in the chit agreement, subject to the condition that he shall subscribe to a ticket in the chit:

Provided that in a case where the foreman has subscribed to more than one ticket, he shall not be eligible to obtain more than one chit amount in a chit without discount;

- (b) to such amount not exceeding five per cent of the chit amount as may be fixed in the chit agreement, by way of commission, remuneration or for meeting the expenses of running the chit;

- (c) to interest and penalty, if any, payable on any default in the payment of installments and to such other amounts as may be payable to him under the provisions of the chit agreement;
- (d) to receive and realise all subscriptions from the subscribers and to distribute the prize amounts to the prized subscribers;
- (e) to demand sufficient security from and prized subscriber for the due payment of future subscriptions payable by him.

Explanation. A security shall be deemed to be sufficient for the purposes of this clause if its value exceeds by one-third, or if it consists of immovable properties, the value of exceeds by one-half, of the amount due from the prized subscriber;

- (f) to substitute subscribers in place of defaulting subscribers; and
- (g) to do all other acts that may be necessary for the due and proper conduct of the chit.

(2) Where any dispute arises with regard to the value of the property offered as security under clause (e) of sub-section (1), it shall be referred to the Registrar for arbitration under section 64.

17. Duties of foreman. (1) The foreman shall, on the prized subscriber furnish sufficient security for the due payment of future subscriptions, be bound to pay him the prize amount:

Provided that the prize subscriber shall be entitled to the payment of the prize amount without any security whatsoever if he agrees to the deduction therefrom of the amount of all future subscriptions and in such a case, the foreman shall pay the prize amount to the prized subscriber within seven days after the date of the draw or before the date of the next succeeding installment, whichever is earlier:

(2) If, owing to the default of the prized subscriber, the prize amount due in respect of any draw remains unpaid until the date of the next succeeding installment, the foreman

shall deposit the prize amount forthwith in a separate account in an approved bank mentioned in the chit agreement and intimate in writing the fact of such deposit and the reasons therefore to the prized subscriber and the Registrar:

Provided that where any prized subscriber does not collect the prize amount in respect of any installment of a chit within a period of two months from the date of the draw, it shall be open to the foreman to hold another draw in respect of such installment.

(3) Every payment of the prize amount or the amount of future subscriptions under sub-section (1), and the deposit of the prize amount under sub-section (2), shall be intimated to the subscribers at the next succeeding draw and the particulars of such payment or deposit shall be entered in the minutes of the proceedings of that draw.

(4) The foreman shall not appropriate to himself any amount in excess of what he is entitled to under clause (b) or clause (c) of sub-section (1) of section 21:

Provided that where the foreman is himself a prized subscriber, he shall be entitled to appropriate to himself the prize amount subject to his complying with the provisions of section 31:

Provided further that the foreman may appropriate to himself the interest accruing on the amount deposited under the second proviso to sub-section (1)

(5) The foreman shall not admit any person as a subscriber to a chit, if by such admission, the total number of tickets mentioned in the chit agreement is increased.

(6) The foreman shall distribute among the subscribers, in accordance with the chit agreement, the dividend either in cash, grain or by way of adjustment towards the subscriptions payable for the next installment, if any.

18. Books, records, etc., to be kept by foreman. The foreman shall maintain in his registered office, or as the case may be in the place or the principal place of his business,

or, where the foreman has any branch office, sub-office or any place of business for the conduct of chit business in a State other than the State in which his registered office or the principal place of his business is situated, in such branch office, sub-office or place of business in respect of the business conducted in that State-

19. Balance sheet. Every foreman shall prepare and file with the Registrar within such item as may be prescribed, a balance sheet as on the last date of each calendar year, or as the case may be the financial year of the foreman, and a profit and loss account relating to the year of account.

20. Liability of foreman to subscribers. (1) Every foreman shall be liable to account to the subscribers for the amounts due to them.

(2) Where there are more than one foreman in a chit, each one of them jointly and severally and if the foreman is a firm or other association of individuals each one of the partners or individuals thereof jointly and severally and if the foreman is a company, the company as such, shall be liable to the subscribers in respect of the obligations arising out of the chit.

21. Non-prized subscribers to pay subscriptions and obtain receipts.- Every non-prized subscriber shall pay his subscription due in respect of every installment on the dates and times and at the places mentioned in the chit agreement and shall, on such payment be entitled to obtain a receipt from the foreman.

22. Removal of defaulting subscribers.- A non-prized subscriber who defaults in paying his subscription in accordance with the terms of the chit agreement shall be liable to have his name removed from the list of subscribers and a written notice of such removal shall be given by the foreman to the defaulting subscriber within fourteen days of the date of such removal;

Provided that if the defaulter pays the defaulted installment with interest at such rate as may be prescribed within seven

days of the date of receipt of such notice, his name shall be re-entered in the list of such subscribers.

23. Substitution of subscribers. (1) A foreman may substitute in the list of subscribers any person in place of the defaulting subscriber whose name has been removed.

24. Amounts due to defaulting subscribers. (1) A foreman shall out of the amounts payable by and realized from the substituted subscriber towards the installments relating to the period before the date of the substitution (including the arrears due from the defaulting subscriber), deposit, before the date of the next succeeding installment, in a separate identifiable, account in an approved bank mentioned in the chit agreement, an amount equal to the contributions made by the defaulting subscriber, less such deductions as may be provided for in the chit agreement and shall inform the defaulting subscriber as well as the Registrar of the fact of such deposit and shall not withdraw the amount so deposited except for payment to the defaulting subscriber.

(2) The amount so deposited under sub-section (1) shall be paid to the defaulting subscriber as and when he claims the amount and the amount so deposited shall not be withdrawn by the foreman for any purpose other than for such payment.

(3) The contributions of any defaulting subscriber who has not been substituted till the termination of the chit shall be paid to him within fifteen days from the date of termination of the chit subject to such deductions as may be provided for in the chit agreement.

25. Prized subscriber to furnish security. Every prized subscriber shall, if he has not offered to deduct the amount of all future subscription from the prize amount due to him, furnish and a foreman shall take, sufficient security for the due payment of all future subscriptions and if the foreman is a prized subscriber, he shall give security for the due payment of all the future subscription to the satisfaction of the Registrar.

26. Prized subscriber to pay subscriptions regularly. Every prized subscriber shall pay his subscription regularly on the dates and times and at the place mentioned in the

chit agreement and on his failure to do so, he shall be liable to make a consolidated payment of all the future subscriptions forthwith.

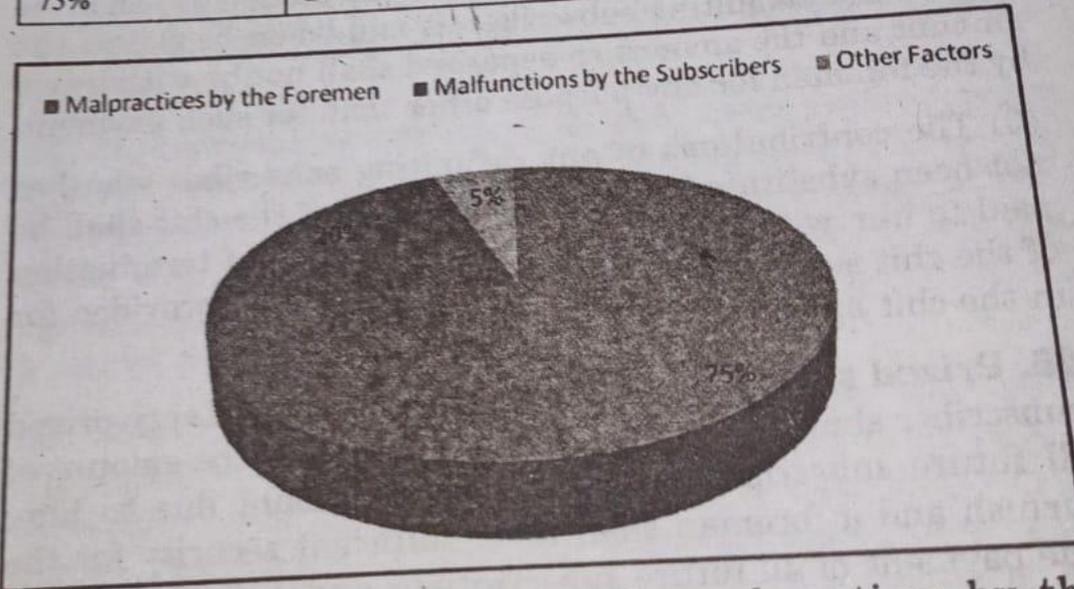
27. Foreman to demand future subscriptions by written notice. (1) A foreman shall not be entitled to claim a consolidated payment from a defaulting prized subscriber under section 32 unless he makes a demand to that effect in writing.

(2) All consolidated payments of future subscriptions realised by a foreman shall be deposited by him in an approved bank

28. Meetings of general body of subscribers. The foreman, may, on his own motion, convene a special meeting of the general body of subscribers for considering any proposal to pass a special resolution.

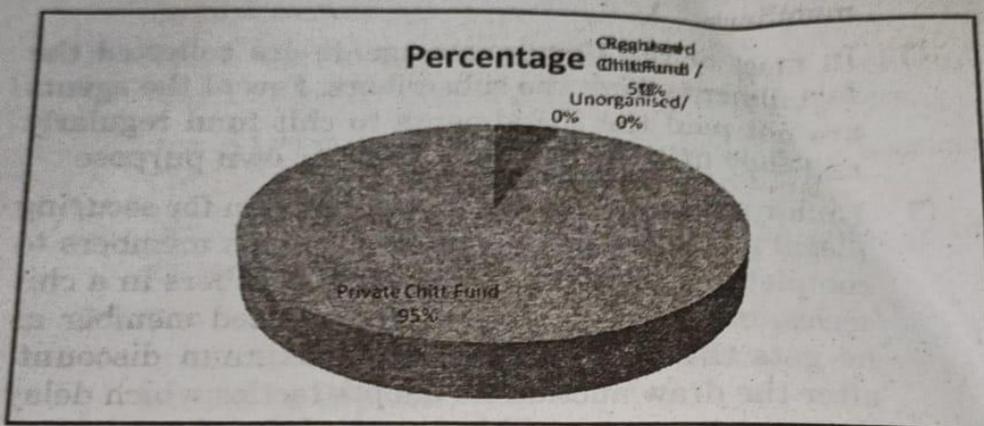
Major Reasons for the Cailure of Chitty

Malpractices by the Foremen	Malfunction by the Subscribers	Other Factors	Total
75%	20%	5%	100%



- 75% failure caused by the malpractices by the foreman
- 20% failure caused by the malfunctions by the subscribers.
- Only 5% caused by other factors

Registered/Organised Chitt	Unorganised/Private Chitt	Total
75%	20%	100%



From the collapsed Firm 95% are Unorganised/Private Chitt Firms.

Only 5% are Registered/Organised Chitt Firms.

Findings

- ❑ The major reasons for failure of chitty is the malfunction performed by the Foreman, because Foreman decides every thing about the chit- the no; of persons, the amount of installments, the chit amount, his commission, the installment at which he himself would return the prize, the penalties to be imposed on defaulting members etc.
- ❑ Diversion of funds to non-chit business and fragrant violation of the legislative provisions by the foreman is also prime reasons for this state of affairs.
- ❑ Another reason is that some foreman in addition to carrying on the business chits, also accept deposit from third parties, They are not used this fund as working fund of the chitty.
- ❑ Delay in getting sanction from the authority, the registered/organised chit companies lost their opportunity to start new chitties. By taking these opportunity private chit firm have entered in to that area.

- ❑ There is a false function in prize distribution and dividend to the members. No fixed amount is set aside for distribution among the non-prized members.
- ❑ In most of the Companies agents are collected the installments from the subscribers. Few of the agents are not paid the instalments to chit fund regularly and they utilised the fund for their own purpose
- ❑ Unfair methods adopted by the foremen for securing illegal gains like enrolment of fictitious members to complete the required number of members in a chit series, exploitation of needy non-prized member as he gets the prize only at the maximum discount, after the draw/auction he adopts tactics which delay the actual payment, false method for the selection of prize winning member etc. it losses the trust of public in chitty.
- ❑ Prized member often make default the payment of instalments. It is also a major reason for the failure of the chitty.
- ❑ Competition among chit fund companies. It leads to give publicity about unwanted, huge prize distribution.
- ❑ Organised and unorganised/private Individual's firm, both are running chit fund business. But Majority of the collapsed chit fund business are in unorganised/private/unregistered sector. Subscribers not get legal protection -as these are in unorganised and unregistered sector.
- ❑ Majority of the lower income group of persons invested their income in chit fund organised by the individual persons (unorganised). The main reason is that the subscription amount is comparatively low and a flexible legislation in compared with large organised chit fund. Therefore the failure of chit largely affected to the low income peoples.
- ❑ Collapse in chit fund business also affect the goodwill of other reputed chit fund companies

Suggestions

- Depending on the terms of the agreement a fixed amount is set aside for distribution among the non-prized members.
- Give more care to the prize and dividend distribution to prized and non-prized members.
- Avoid the practices for attaining illegal gains because it loses the confidence of the members.
- Bid or lots method must follow for the selection of prize winning members.
- The fund from third parties must be utilised as working funds and subscription from members are not treated as deposits.
- Foreman responsible for the collection of regular subscriptions
- If the prized member defaults in his instalments, litigations follow to recover the amount.
- If the defaulter is a non-prized subscriber, the foreman has to find out a suitable substitute.
- In the event of the default by the subscribers in payment of instalments on due dates, penalties are imposed.
- Foreman give care for the regular repayment of fund to the financial institutions which help to get finance. When there is a default it becomes doubled.
- Peoples who wish to join chit fund must take care about the factors like- the foreman has availed permission for starting chit fund business from competent authority and chit plan that you are entering is registered, financial back up and also the liquidity position of the chit fund business.
- Foreman only give the prize to the prize holders after furnishing security acceptable to foreman.
- Avoid agents for collecting instalments. Adopt direct collection method.

Conclusion

Chit fund is one of the oldest indigenous institution prevailing in India. It's existence can be traced beyond a century in South India though it has spread gradually throughout India. It is based on mutual cooperation of the members in times of need and became popular over the years due to several benefits inherent in the scheme of chit funds. For regulating the working of chit funds and to protect the interest of the chit subscribers Parliament enacted Chit Funds Act, 1982. Still there are number of collapse in this business. It has not lost its sheen for inherent advantages in compared to other financial instruments. So a little care must sustain the chit fund business and as it become the lowest financial instrument among the low income people.

REFERENCES

Keralakuries.com

