

# **A STUDY ON THE ROLE OF CHIT FUNDS AS MULTIFACET FINANCIAL COMPANIES IN THE STATE OF ANDHRA PRADESH**

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## **Abstract**

Chit fund institution is indigenous, simple, easy, readily understood, and widely accepted by rural and urban middle-class people. It is a popular borrowing instrument. The aim is to pool small savings managed by a foreman who acts as a trustee-cum-supervisor for the process of collection and allotment for the pooled amount to catch members by rotation. Chit funds represent an ancient form of savings and credit institution before the banking system in rural India. Most of the financial needs of rural and urban middle-class people are taken care of by Chit funds. They meet their specific needs for large family functions, festivals, education, housing, agriculture, business, and medical expenses: most people, irrespective of urban and rural, avail this avenue for reasonable returns. Chit funds offer complete parallel banking services as a vast network of small business people, homemakers and salaried individuals. The popularity of chit funds has not been affected by the increased awareness of the mutual funds and equity market. The chit funds played a crucial role in the Indian financial system and worked as a bridge between the age-old financial practices and the modern banking system. Today chit fund in India is highly standardized and stands in the financial industry's status. Even after the enormous expansion of bank branches all over the country, chit funds continue to exist and expand more popularly than banks in many regions of the country.

Keywords: Trustee cum supervisor, Mutual funds, Equity market.

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## 1. Introduction

Today chit funds in India are highly standardized and stand in the financial industry's status. Even after the expansion of bank branches all over the country, many rural areas are away from banks. The reason is the expansion of bank branches mainly concentrated in urban and metro cities.

The procedural formalities in getting bank loans made it difficult for rural farmers as many of these people are illiterate.

Subscriptions made by the members of a chit fund are analogous to the deposits made in the bank, and the prize amounts distributed by the former are comparable to the advances made by the latter. While periodicity of deposit in a bank, except for a recurring deposit, is optional, it is obligatory in a chit fund. Like co-operatives and Nidhis, Chit funds work on the principle of self-help and mutual help. The membership is voluntary, and members pool their resources for mutual benefit in all these organizations. The attractive advantage is there with chit funds as the borrower himself can decide the interest by making the auctions efficiently and get the things in his favour.

Money lenders may take advantage of the urgency of needs of the people, whereas chit funds offer loans with very little collateral security.

. Most of the time, the security will be less than the chit value.

Chit funds serve the needy by meeting their urgent requirements on time with no or few formalities.

The borrower can borrow without pledging his property upon his future subscriptions.

Unlike money lenders, chit funds meet the requirements of poor people without exploitation. Chit fund Companies have been increasing rapidly in the States of Andhra Pradesh, Karnataka, Tamil Nadu, Kerala, Maharashtra and Gujarat.

### ***1.1 Role of Chit Funds***

Chit is a humble homegrown, a handy artefact which caters to the location-specific, time-specific credit needs of the humble and the needy. Chit is an institution used for saving as well as borrowing. It is a unique body of borrowers and investors with a common goal of mutual help (Manjeshwar Ananth Pai,1995). The requirements of the business community are very sudden

and urgent. Chit funds are only the way for them to meet the urgent need, as commercial banks are reluctant to provide loans to this segment, mainly due to the administrative burden and cost involved.

***1.1(a) Chit funds offer more access to investment.***

People find chit funds close to their hearts because of their easy accessibility, good returns on savings and availability of money (S. Y. Krishnaswamy, I. C.S, 1974), and they are important sources of finance for SMEs operating in other sectors. They attract thousands of investors yearly, despite the expansion of banking into the remotest parts of the country. The popularity of chit funds has not been affected by the increased awareness of the mutual funds and equity market. Small traders and business people participate extensively in chit funds as Chit funds provide an opportunity for tiny business houses. It facilitates easy finance and savings on a daily or weekly basis.

***1.1(b) Chit Funds and Banks***

Chit fund business originated in the villages on a small scale to meet local demands. The money raised by chit funds meets consumption, household purposes, and agriculture and business needs. The banking sector lends for productive activities and hardly for consumption needs. Chit funds successfully meet the consumption needs.

Most banks have grown out of the womb of chit and kuri funds operating in many states of the country since ancient times. In the beginning days, the business of kuries or chitties formed a substantial portion of the banking business ( S.Radhakrishnan,). Chit funds companies come under the category of non-banking financial institutions and are treated as financial companies. From the view of mobilization of savings, however, the deposit in chitties carries more weight than the deposit in banks. Generally, banks' credit advancements are to the limited number of significant customers, that too, in varying amounts in different seasons for credit, and depending upon the lending policy of the bank in particular and the general credit policy of the banking system in general. But the loans from chit funds are available to all the subscribers, and the quantum of funds is set apart for further distribution. These loans can be repaid in small instalments over a reasonably long period.

### ***1.1(c) Chit Funds as Co-operative Societies***

Chit funds resemble co-operative credit societies in some respects. Co-operative credit societies and chit funds work on the same principles of self-help and mutual help ( Shri K.M.Balavenkataraman, 1974). Co-operatives enjoy tax benefits and concessions in the matter of stamp duty. Chit funds do not receive any special assistance from the Government but tend to be regulated in an increasing measure ( Prabhu Ghate, 1992).

### ***1.1(d) Chit Funds and Nidhis***

Some types of Nidhis operate in the same lines chit funds for helping the members to perform religious ceremonies, marriages, consummation ceremonies etc. Some Nidhis are designed to help the members to secure some lump sum amount gathered from the small contributions. So both chit funds and Nidhis work on the principle of mutual help and insurance against some unforeseen event.

### ***1.1(e) Chit Funds and Moneylenders***

Third-world countries' informal sector is more heterogeneous and comprises money lenders, pawnshops, merchants and petty traders, landlords, indigenous bankers and finance corporations. Chit funds treat all sections of people and charge reasonable interest rates, unlike money lenders, who charge very high-interest rates for the poor and favourable rates for the middle and upper-middle-class people.

### ***1.1(f) Chit Funds and Microfinance Institutions***

In Chit funds, the borrower can decide the interest on borrowing by better managing the group members and making the auction in his favour. Unlike microfinance institutions, Chit fund organizations require very little financial security to sanction the loans. These organizations are not exploitive and are successfully meeting the requirements of the poor people better than any other source of finance.

## **2. Objectives and Research Methodology**

1. To know the effect of the Level of Awareness on Various Financial Institutions on the Chit funds.

2. To find Preference of Chits over Various Financial Institutions and Occupation wise Reasons for preferring.

Two sets of questionnaires are used to collect the data, one set each for Chit Operators and Chit subscribers, respectively. The sample size of the chit operators consists of 228 managerial and operating staff of the select 12 registered chit fund companies in Andhra Pradesh, along with branches and six unregistered chit fund companies under study. On the other hand, the total sample of chit subscribers is 1220, of which 782 are from 12 registered chit fund company subscribers, and 438 are from 6 unregistered chit fund company subscribers/members, selected through random sampling from different regions of the state according to the population spread of the areas. A sample of 540 is collected from Telangana region, 615 from Coastal Andhra and 65 from Rayalaseema region.

### 3. Data Analysis

#### 3.1 The null hypothesis for the study is as follows,

Hypothesis  $H_0$ : the differences among the subscribers in preferring chit funds better than any other modes of existing finance is insignificant.

Hypothesis  $H_0$ : The difference among subscribers who invest in chit schemes is insignificant.

Hypothesis  $H_0$ : occupations do not differ significantly for various reasons for preferring chit funds.

**Table-1**  
**Preference of Chits over Various Financial Institutions and Chit Companies - Cross Tabulation**

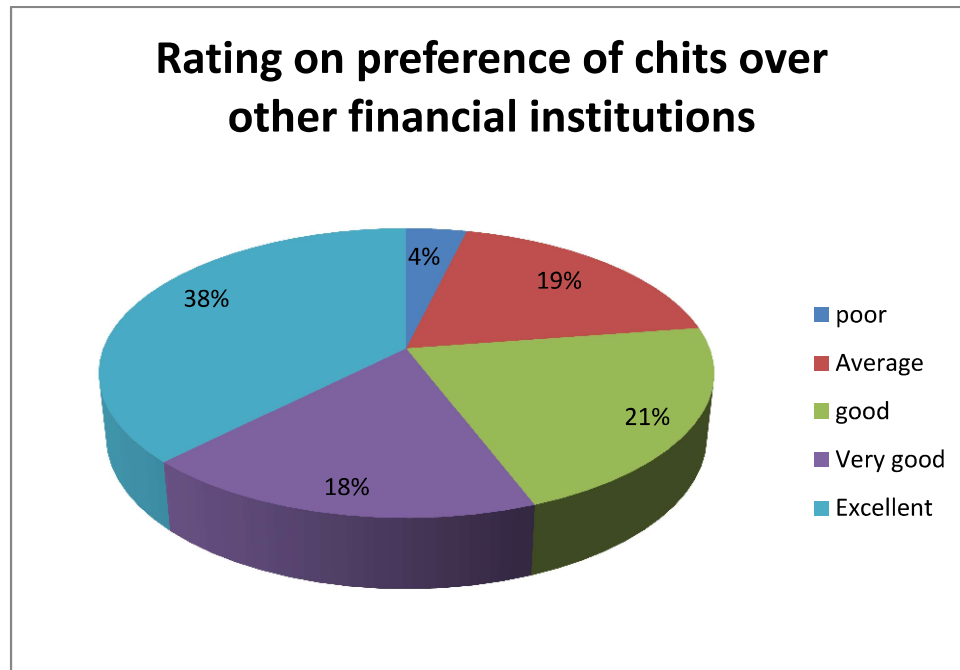
(Figures in NOs)

Preference	Preference for Chits over					Total
	Banks	Money Lenders	Micro Finance	Shares and Mutual Funds	Other Finance	
Poor	28(12.00) (2.00)	47(21.00) (4.00)	19(8.00) (2.00)	64(28.00) (5.00)	71(31.00) (6.00)	229(100.00) (4.00)
Average	345(30.00) (28.00)	183(16.00) (15.00)	253(22.00) (21.00)	124(11.00) (10.00)	246(21.00) (20.00)	1151(100.00) (19.00)
Good	403(31.00) (33.00)	107(8.00) (9.00)	262(20.00) (21.00)	257(20.00) (21.00)	288(22.00) (24.00)	1317(100.00) (22.00)
Very Good	204(18.00) (17.00)	246(22.00) (20.00)	203(18.00) (17.00)	243(22.00) (20.00)	213(19.00) (17.00)	1109(100.00) (18.00)
Excellent	240(10.00) (20.00)	637(28.00) (52.00)	483(21.00) (40.00)	532(23.00) (44.00)	402(18.00) (33.00)	2294(100.00) (38.00)
Total	1220(20.00) (100.00)	1220(20.00) (100.00)	1220(20.00) (100.00)	1220(20.00) (100.00)	1220(20.00) (100.00)	6100(100.00) (100.00)
<b>F Value (ANOVA)</b>	<b>11.103</b>	<b>3.676</b>	<b>0.809</b>	<b>16.980</b>	<b>1.872</b>	

Note 1. Figures in side brackets indicate per cent to Row Total.

2. Figures in lower brackets indicate per cent to Column Total.

Source: Survey



#### Preference of Chits over Various Financial Institutions

As it is observed from the table - 1, among the total respondents, 38 per cent of respondents rated chit funds as an excellent mode of finance than any other. 18 per cent of the respondents ranked as very good and 21 per cent of respondents rated it as good and 19 per cent rated it as average. Ninety-six per cent of the respondents rated chit funds as a good and excellent source of finance. From the table, it can be concluded that more than 40 per cent opined that chit funds are the better mode of saving and it is safer than money lenders(52.0%), Shares and Mutual Funds(44.0%) and Micro Finance(40.0%).

From the calculated values of ANOVA at 5 per cent level of significance and degree of freedom (4), Hypothesis  $H_0$  is rejected for Banks, Money lenders, shares and mutual funds. Hence, it is concluded that there is a significant difference among the subscribers in preferring the chit funds over the preference of Banks, Money lenders, shares and mutual funds.



**Table-2**  
**Purpose of preferring chit schemes for savings and The level of awareness on chits -**  
**Cross tabulation**

(Figures in NOs)

purpose	Rating				Friedman's Mean Rank	Total
	Very well	To some extent	Very little	Not aware		
To conduct & expand business	46(49.5) (7.4)	30(32.3) (7.5)	9(9.7) (6.2)	8(8.6) (15.7)	6.46	93(100.0) (7.6)
To buy consumer durables	65(78.3) (10.5)	8(9.6) (2.0)	8(9.6) (5.5)	2(2.4) (3.9)	6.41	83(100.0) (6.8)
To buy or build a house	77(51.3) (12.4)	42(28.0) (10.4)	26(17.3) (17.9)	5(3.3) (9.8)	6.74	150(100.0) (12.3)
For the education of the children	78(50.0) (12.5)	48(30.8) (11.9)	25(16.0) (17.2)	5(3.2) (9.8)	6.76	156(100.0) (12.8)
Saving for the old age	48(58.5) (7.7)	24(29.3) (6.0)	7(8.5) (4.8)	3(3.7) (5.9)	6.41	82(100.0) (6.7)
Marriage	50(52.1) (8.0)	29(30.2) (7.2)	12(12.5) (8.3)	5(5.2) (9.8)	6.47	96(100.0) (7.9)
Agriculture purpose	5(7.9) (.8)	47(74.6) (11.7)	11(17.5) (7.6)	0(0.0) (0.0)	6.31	63(100.0) (5.2)
To pay off old debts	47(49.0) (7.6)	37(38.5) (9.2)	8(8.3) (5.5)	4(4.2) (7.8)	6.47	96(100.0) (7.9)
To buy gold or ornaments	18(42.9) (2.9)	14(33.3) (3.5)	6(14.3) (4.1)	4(9.5) (7.8)	6.21	42(100.0) (3.4)
To meet the medical expenses	50(50.5) (8.0)	36(36.4) (9.0)	11(11.1) (7.6)	2(2.0) (3.9)	6.49	99(100.0) (8.1)
To lend /invest.	23(42.6) (3.7)	26(48.1) (6.5)	2(3.7) (1.4)	3(5.6) (5.9)	6.27	54(100.0) (4.4)
To meet the contingent liabilities.	115(55.8) (18.5)	61(29.6) (15.2)	20(9.7) (13.8)	10(4.9) (19.6)	7.00	206(100.0) (16.9)
Total	622(51.0) (100.0)	402(33.0) (100.0)	145(11.9) (100.0)	51(4.2) (100.0)		1220(100.0) (100.0)
<b>Chi Square Value</b>	<b>1.202</b>					

Note 1. Figures in side brackets indicate per cent of Row Total.

2. Figures in lower brackets indicate per cent to Column Total.

Source: Survey

### Purpose of preferring chit schemes for savings Vs Rate the level of awareness of working of chit business

The value of Chi-Square at 5 per cent level of significance (1.202) from table- 2 shows that the hypothesis  $H_0$ : is accepted, which means there are no significant differences among the subscribers to invest in chit schemes.

**Friedman's test** has been conducted to identify the purpose-wise preference of chits by the chit subscribers. The subscribers prefer the chits to meet the contingent liabilities (7.00) given first rank, for children's education (6.76), for building the house (6.74), to meet medical expenses (6.49), for paying off old debts and for performing marriages it is (6.47), to conduct and expand business(6.46), for buying consumer durables and saving for the old age it is (6.41). For agriculture purposes (6.31) and the purpose of lending, investing, and for gold ornaments, it is (6.27 and 6.21) respectively.

**Table-3**  
Occupation wise Preferring chit funds - Cross Tabulation

(Figures in NOs)

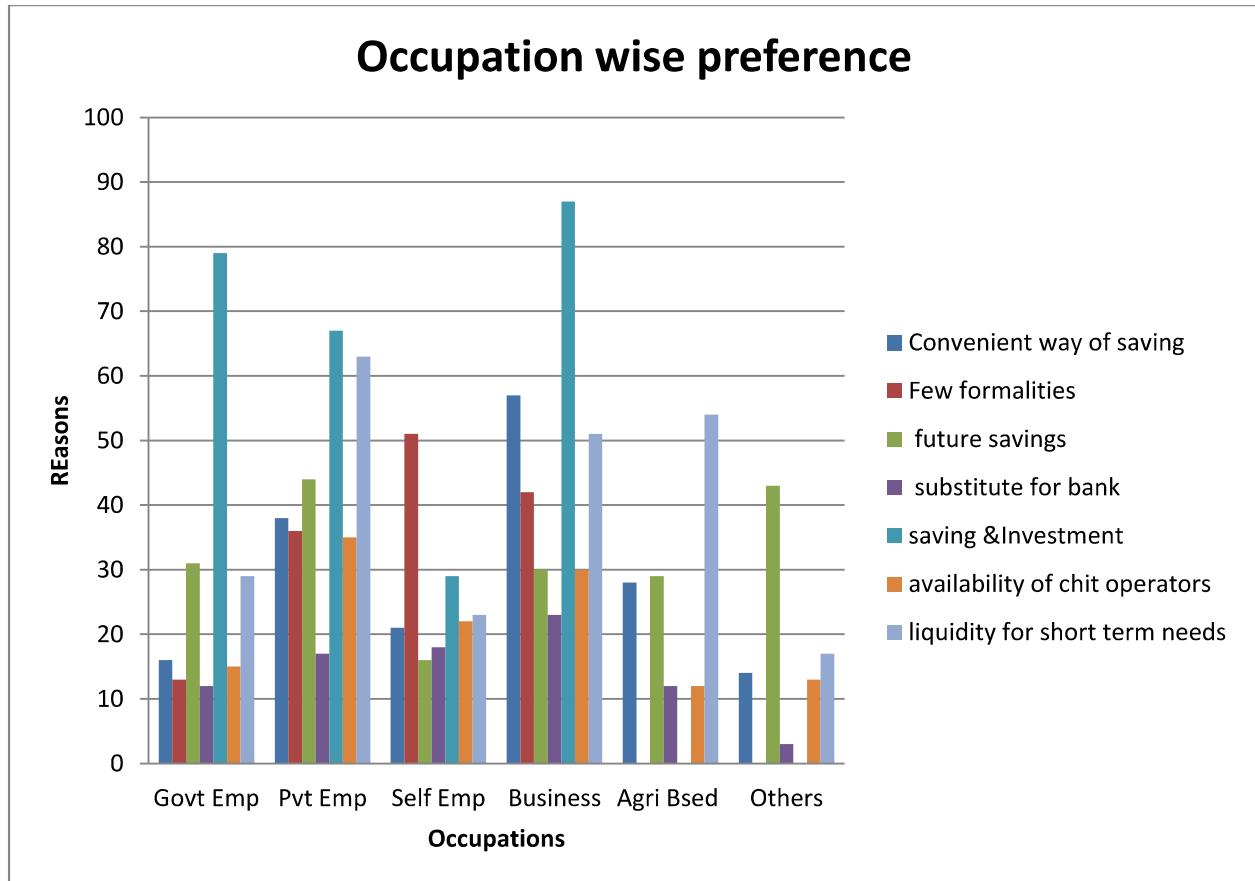
	Reasons for Preferring chit funds							Total
	A convenient way of saving	Few formalities	Future savings	substitute for bank loans	saving & Investment	availability of chit operators'	liquidity for short-term needs	
Government Salaried Employee	16(8.21) (9.2)	13(6.67) (9.15)	31(15.9) (16.06)	12(6.15) (14.12)	79(40.51) (30.15)	15(7.69) (11.81)	29(14.87) (12.24)	195(100) (15.98)
Private Salaried Employee	38(12.67) (21.84)	36(12.00) (25.35)	44(14.67) (22.8)	17(5.67) (20.00)	67(22.33) (25.57)	35(11.67) (27.56)	63(21.00) (26.58)	300(100) (24.59)
Self Employed	21(11.67) (12.07)	51(28.33) (35.92)	16(8.89) (8.29)	18(10.00) (21.18)	29(16.11) (11.07)	22(12.22) (17.32)	23(12.78) (9.7)	180(100) (14.75)
Business	57(17.81) (32.76)	42(13.13) (29.58)	30(9.38) (15.54)	23(7.19) (27.06)	87(27.19) (33.21)	30(9.38) (23.62)	51(15.94) (21.52)	320(100) (26.23)
Agriculture Based Employment	28(20.74) (16.09)	0(0.00) (0.00)	29(21.48) (15.03)	12(8.89) (14.12)	0(0.00) (0.00)	12(8.89) (9.45)	54(40) (22.78)	135(100) (11.07)
Others	14(15.56) (8.05)	0(0.00) (0.00)	43(47.78) (22.28)	3(3.33) (3.53)	0(0.00) (0.00)	13(14.44) (10.24)	17(18.89) (7.17)	90(100) (7.38)
<b>Total</b>	174(14.26) (100)	142(11.64) (100)	193(15.82) (100)	85(6.97) (100)	262(21.48) (100)	127(10.41) (100)	237(19.43) (100)	1220(100) (100)
<b>Pearson Chi-Square</b>		<b>2.991</b>						

Note 1. Figures in side brackets indicate per cent of Row Total.

2. Figures in lower brackets indicate per cent of Column Total.

Source: Survey





### Occupation wise Preferring chit funds

From Table-3, it is observed Government salaried respondents (40.5 per cent of them) and private salaried respondents prefer chit funds due to their dual feature of both saving and investment, 15 per cent of them it is due to better liquidity and future savings. Self-employed and business respondents prefer it because it is convenient with fewer formalities and dual nature. Agriculture and other occupational respondents prefer better liquidity (40 per cent of them) and saving. The motivating factors for choosing chit funds in the order are (1) dual feature of saving and investment; (2.) liquidity; (3) for future saving; (4) fewer formalities are involved.

From the Chi-Square value at 5 per cent significance (43.773), Hypothesis  $H_0$ : occupations do not differ significantly for various reasons of preferring chit funds, is accepted. The difference

between the occupational background of the respondent and their reasons for preferring chits is insignificant. Hence it is concluded that all the given reasons are influential in choosing chit funds by various occupations.

#### **4. Summary and conclusions**

It is observed from the total respondents that 96 per cent of the respondents rated chit funds as good to excellent source of finance over banks, money lenders, microfinance, shares and mutual funds and other finances. And also it is concluded that more than 40 per cent opined that chit funds are the better mode of saving. Hence, chit funds are suggested to fulfil all subscribers' financial needs. Chit funds serve better than any other source of finance. They meet the purposes of meeting contingent liabilities, children's education, building a house, meeting medical expenses, paying off old debts, performing marriages, conducting and expanding the business, buying consumer durables, saving for the old age, agriculture purposes, lending, and to buy gold ornaments.

The motivating factors for preferring chit funds in the order are dual features of saving and investment, liquidity for future saving, and fewer formalities involved. Government salaried respondents and private salaried subscribers prefer chit funds, due to its dual feature of both savings and investment and for better liquidity and future savings. Self-employed and business respondents prefer because it is convenient with fewer formalities and dual nature. Agriculture and all other occupational respondents prefer, for its better liquidity and next it is for saving.

Hence it can be concluded that chit funds are the most preferred financial organizations by all sectors of the society for fulfilling all kinds of financial needs by all the occupational people equally. Hence chit funds are treated as versatile financial organizations.

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