



A COMPARATIVE STUDY ON INTEREST RATES OF CHIT FUNDS AND PERSONAL LOANS

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ABSTRACT

A Chit fund is a kind of savings scheme practiced in India. A chit fund company is a company that manages, conducts, or supervises such a chit fund, as defined in Section of the Chit Funds Act, 1982. A Personal loan is credit that individuals can apply for and get from a bank or finance company to customers for any purpose such as wedding expenses, purchasing jewelry or gold, and vacations. This paper analyzes the interest rates at which the funds are available through chit funds and personal loans. This paper suggested the best source of funds between chit funds and personal loans for people those who are in need of money.

INTRODUCTION

Chit Funds

A Chit fund is a kind of savings scheme practiced in India. A *chit fund company* is a company that manages, conducts, or supervises such a chit fund, as defined in Section of the Chit Funds Act, 1982.

According to Section 2(b) of the Chit Fund Act, 1982:

"Chit means a transaction whether called chit, chit fund, chitty, karee 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".

Monthly Premium × Duration in Months = Gross Amount

E.g., $1000 * 50 = 50,000/-$ Where 1000 is the maximum monthly contribution needed from a subscriber, 50 is the duration of the chitty in months and 50,000 is the maximum sum assured. The duration also equals the number of subscribers, as there must be (not more or less) one subscriber to receive the prize money every month.

Personal Loan

A Personal loan is credit that individuals can apply for and get from a bank or finance company to customers for any purpose such as wedding expenses, purchasing jewelry or gold, and vacations. Similar to credit cards, these loans will usually have predetermined interest rates.

Personal loan is a simple hassle free process of acquiring personal finance with minimal documentation and within quick time. The bank will require the borrower's documents regarding the proof of identity, residence along with income proof / ITR of last 2 years to initiate the process for loan sanction. After verifying the documents and checking the borrower's credit score with Credit Information Bureau (India) Limited commonly known as CIBIL, the bank may decide whether to approve or reject the personal loan. Normally bankers will consider whose CIBIL score is equal or more than 700.

REVIEW OF LITERATURE

Subbaramaaiyar (1925) has described the working of 'changati kuri', where lot decides the person every month to whom the amount is to be paid. The chit fund offers money at a flexible interest rate and the interest rate depends on the demand of the money. Indira Rajaraman (1995) tried to explain Rotating Savings and Credit Associations and their similarities with Chit Funds

in India. The article showed that these associations are functional in various parts of the world including highly developed countries. Random ROSCAs are similar to Prize chits in India, while bidding ROSCAs are similar to our Auction chits.

Dr. V.T. Mathews (1975) strongly argues in favor of commercial banks entering into the chit fund field on the plea that such entry would help safeguard better the interests of small savers and reach out to the wider sections of the society which are important to banks in the present setting. Commercial banks with their reputation for solidity and efficient management will be able to ensure the safety of funds contributed by subscribers. And if banks take up chit funds, they would be arming themselves with an instrument which is capable of meeting the other requirements of the small man.

R.Kalyanasundaram (1975) opined that the chit funds have doubtless a positive role in the economy of the country and a separate department for chit funds to control them is an essential need. A commission at Government level is necessary to be set up to go into details of their working, giving chit funds an opportunity to represent their case. S. Narayanaswamy (1976) addressed that chit fund was attractive in so far as it proved a ready-money bank for the subscriber, what time it was equally attractive for the enterprising foreman, who got the feel of the subscriber's monthly contribution on which he paid no interest, though he was free to earn it himself by sagacious and shrewd investment.

Rajendran (1997) attempted to provide a brief resume of the evolution of credit in Kerala, the different practices and the institutions concerned, since the beginning of the 19th century. The role of chitties in terms of their number, extent and volume of operation up to 1936 has been included in the study. Bale Subramanian (2002) stated that the latest amendments in the Central Chit Fund Act will go a long way in making the ancient and India's own financial institution of Chit industry more vibrant and a healthy business.

These research papers analyzed chit funds individually or compared with some association funds, these research have not compared the chit funds and personal loan, as both serve the same purpose of providing funds to people when they are in need. So, this paper focuses on this research gap and tried to compare the interest rates offered by chit funds and personal loans.

OBJECTIVES OF THE STUDY

1. To examine the trends and pattern of interest rates paid by the customers for the funds availed in chit funds.
2. To assess and compare the relative interest rates of Chit funds and personal loans provided by banks.
3. To make suitable suggestions for customers to get better funds out of chit funds and personal loans.

SOURCES OF DATA

Collection of the data is an essential part of research. The nature of data which is collected and used for this research is secondary in nature. The relevant and required data has been collected from journals, dailies, annual reports, magazines, literature and websites of selected companies and through various search engines.

DATA ANALYSIS AND INTERPRETATION

Correlation

Correlation is a statistical measure that indicates the extent to which two or more variables fluctuate together. A positive correlation indicates the extent to which those variables increase or decrease in parallel; a negative correlation indicates the extent to which one variable increases as the other decreases.

Correlation analysis is made between the interest rates paid by customer in chit funds and personal loans. The results are tabulated as follows:-

		One lakh chit annualized interest rate	Bank Loan Interest Rate
One lakh chit annualized interest rate	Pearson Correlation	1	-.300
	Sig. (2-tailed)		.064
	N	39	39
Bank Loan Interest Rate	Pearson Correlation	-.300	1
	Sig. (2-tailed)	.064	
	N	39	39

Interpretation

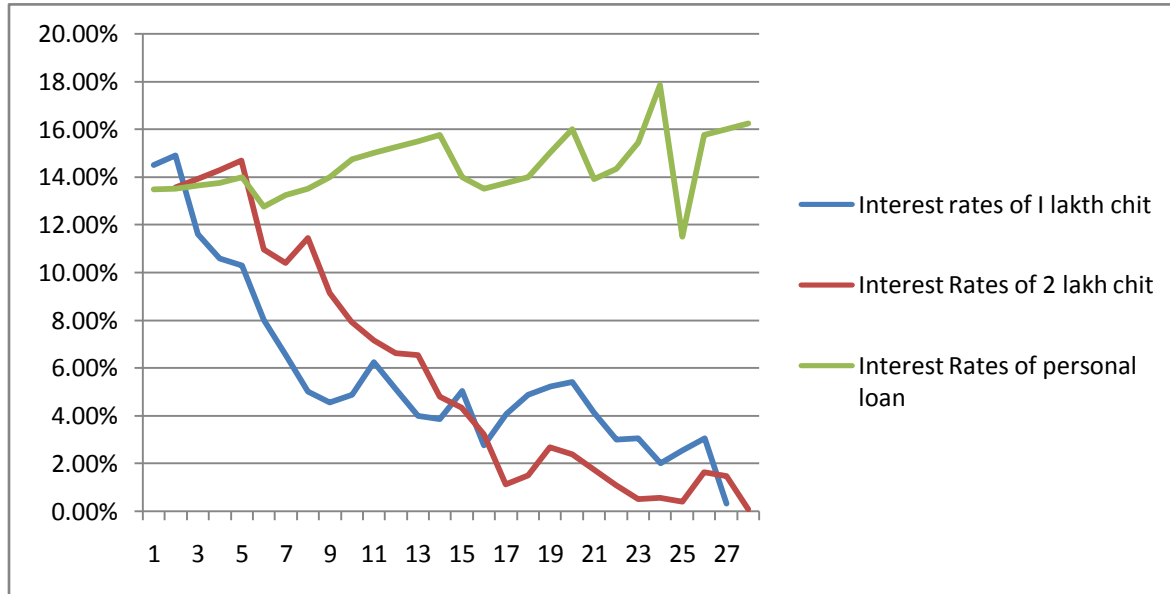
It can be inferred from the above table, that chit annualized interest rate and bank loan rates are negatively correlated with the value of -.300, which shows that, if value of chit annualized interest rate increases, the value of the bank loan decreases and vice versa.

1 Lakh chit interest rate:

Months	Returns	Amount Paid	Interest rates	Annualized interest rate
1	-	2500		
2	60000	1625	47.192	14.50%
3	60000	1625	47.192	14.90%
4	65000	1750	35.869	11.60%
5	67000	1800	31.813	10.60%
6	68000	1825	29.875	10.30%
7	72000	1925	22.659	8.01%
8	74900	1997	17.911	6.51%
9	77900	2072	13.369	5.03%
10	79000	2100	11.791	4.56%
11	78700	2092	12.217	4.89%

12	76800	2045	14.993	6.25%
13	78900	2097	11.933	5.11%
14	81000	2150	9.031	4.01%
15	81500	2162	8.36	3.86%
16	79900	2122	10.532	5.05%
17	83800	2220	5.39	2.77%
18	81900	2172	7.83	4.09%
19	81000	2150	9.03	4.89%
20	80900	2147	9.17	5.24%
21	81000	2150	9.03	5.42%
22	82900	2197	6.53	4.12%
23	84500	2237	4.52	3.01%
24	88000	2325	0.36	3.05%
25	86000	2275	2.692	2.02%
26	85600	2265	3.172	2.54%
27	86800	2295	3.579	3.06%
28	88000	2325	0.36	0.33%
29	89900	2372	1.763	-1.76%
30	91700	2417	3.691	-3.69%
31	93000	2465	5.038	-5.038%
32	93000	2467	5.038	-5.038%
33	93500	2462	5.545	-5.545%
34	94500	2487	6.545	-6.545%
35	95000	2500	7.037	-7.037%
36	95000	2500	7.037	-7.037%
37	95000	2500	7.037	-7.037%
38	95000	2500	7.037	-7.037%
39	95000	2500	7.037	-7.037%
40	95000	2500	7.037	- 7.037%

Comparative Charts showing the interest rates of One lakh chit, Two lakh chit and Personal loan



It can be inferred from the above line diagram for 1 lakh chit, the customer will pay the interest of 15% if they take the chit amount on 3rd month. On 12th the customer will pay the interest of 6% and 3% of interest will pay by the customer on 17th month. The customer will not pay any interest if they take the chit on 28th month. Similarly, for 2 lakh chit the customer will pay the interest of 14 % if they take the chit amount 5th month. On 7th month the customer will pay the interest of 10%. The customer will pay very low interest of nearly 2% from 17th month to 28th month. In case of personal loan, the customers are paying from 12.75% to 17.75% interest on personal loan from nationalized banks. On an average customer have to pay interest of around 14.85% for the personal loan of period from 2-3 years.

SUGGESTIONS

For customers those who are in need of funds can opt for chit funds than going to personal loan. If customers know the need for the funds in advance and if the chit is started before one year, then the customer may have to pay a very low interest rates for the funds availed through chit funds. But the trustworthiness of the chit funds company should be analyzed before going for the chit fund investments.

CONCLUSION

This paper helped us in understanding the interest rate of chits funds and personal loan. The main purpose of this study is to measure the interest rate of chits with personal loan. It is found that in Chit fund the customer will pay low interest compared to personal loans.

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