

A Fractured Trust: Examining the Case of the Saradha Chit Fund

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ABSTRACT

The Saradha Chit Fund scandal of 2013 is a pivotal event in India's financial history. This case study explores the elements that allowed this extensive Ponzi scheme to thrive, eventually cheating investors out of over 4,000 crore rupees. It investigates the social and psychological factors that made investors susceptible to the scheme's promises and scrutinizes the Saradha Group's operational practices, revealing how they exploited regulatory loopholes in the chit fund industry. Additionally, the paper examines the alleged political connections and possible Naxal links that may have enhanced the group's perceived legitimacy and enabled it to operate without significant interference. Based on the insights gained from this case, the study offers recommendations to strengthen regulatory frameworks, enhance financial literacy, and promote ethical conduct within financial institutions. By addressing the vulnerabilities revealed by the Saradha Chit Fund debacle, this case study aims to contribute to a safer and more transparent financial environment for all investors.

Keywords: Saradha Chit Fund, Ponzi Scheme, Sudipto Sen, Chit Funds Act 1982, Saradha Group

1. INTRODUCTION

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When someone has money to invest, they are always seeking a good investment scheme. But how can they recognize one? An ideal investment scheme should provide high returns and allow easy withdrawal of funds. Chit funds are one option that enables even those with lower incomes to invest and earn interest on their deposits.

As defined by Section 2(B) of the Chit Funds Act, 1982, a chit fund is a rotating savings and credit association system, commonly practiced in India. These schemes can be managed by financial institutions, unorganized money market players, or informally among friends, family, or neighbors. Some chit funds are tailored with specific savings goals in mind. They are especially popular in areas with limited banking access, where people prefer investing their money in a chit fund.

In a chit fund, a fixed number of investors commit their money with the promise that their investment will grow quickly with guaranteed returns. This system involves a specific group of subscribers making regular installment payments over a set period. A chit fund works by bringing together a group of members, known as subscribers. An organizer, who could be a company, a trusted relative, or a neighbor, forms the group and manages its operations. In return for their efforts, the organizer is compensated either monthly or at the time of withdrawal, though this fee might be waived in informal settings.

In a variation of the chit fund model called an auction chit, a designated lump sum (e.g., Rs. 100,000) is presented to a group of members through monthly auctions. Each member bids by proposing a discounted interest rate (e.g., starting at 5%) on the total amount. The member with the lowest interest rate bid wins the auction and receives the entire lump sum upfront.

Following the auction, the remaining members continue contributing their agreed-upon monthly share (e.g., Rs. 10,000) to a collective pool. This pool is utilized to pay the interest to the winning member and to accumulate the remaining sum. This cycle repeats for a fixed duration (e.g., 10 months), allowing each member an opportunity to participate in the auction to access the full amount. This approach offers potential advantages such as reduced interest rates for the winner compared to traditional loans. However, it also introduces competition and uncertainty. Members may not secure the auction early, leading to a delay in accessing the full sum. Additionally, the winning interest rate may vary based on the requirements of individual members.

How chit funds are registered?

The Chit Fund Act of 1982 governs the chit fund industry in India. Under this act, a "chit" encompasses any transaction, whether referred to as a chit, chit fund, chitty, kuri, or by any other name, where an individual enters into an agreement with a specific number of participants. Each participant commits to subscribing a certain sum of money (or an equivalent quantity of grain) through periodic installments over a defined period. Through a process determined

by lot, auction, tender, or another method specified in the chit agreement, each participant becomes eligible to receive a prize amount.

For a transaction to qualify as a chit, all members must subscribe and contribute for it to be eligible for the prize money. If only certain members, but not all, receive the prize amount without any obligation to pay future subscriptions, or if all members receive the chit amount by rotation with a commitment to pay future subscriptions, it cannot be categorized as a chit fund.

While chit fund companies are a form of Non-Banking Financial Company (NBFC), they are exempt from registration with the Reserve Bank of India (RBI). This exemption is due to the regulation of chit funds by other authorities, eliminating the need for RBI registration.

To establish a chit fund business in India, promoters must first incorporate a Private Limited Company with the specific objective of conducting a chit fund business. Once the private limited company is formed, it must apply to the relevant Chit Fund Registrar of the state for registration to operate as a chit fund company. The chit fund business can only commence operations after obtaining registration from the appropriate Registrar of the state.

Registration to operate a chit fund will be denied to:

1. Individuals or entities who have been convicted of an offense under the Chit Fund Act or any other Act governing the business, and have been sentenced to imprisonment for such an offense.
2. Individuals or entities who have defaulted in paying the fees or filing any required statements or records under this Act, or who have previously breached any provisions of this Act or its associated rules.
3. Individuals or entities who have been convicted of an offense involving moral turpitude and have been sentenced to imprisonment for such an offense, unless at least five years have elapsed since their release.

The Impact of Chit Funds on Microfinance

Chit funds play a significant role in microfinance, particularly for low-income individuals and those outside the formal banking system. Here's how:

- **Contribution and Lending:** Chit funds serve as a dual-purpose platform for savings and lending. Participants make regular contributions, forming a collective fund. This pool is then utilized by members through either an auction process or a predetermined schedule, offering a lump sum for various financial needs.
- **Financial Accessibility:** Unlike conventional banks, chit funds often impose fewer stringent criteria for participation. This accessibility renders them a vital source of funding for endeavors such as small-scale enterprises, home improvements, or unforeseen expenditures, particularly for individuals with limited credit history.
- **Community-Based Operation:** Chit funds typically operate within close-knit communities, fostering trust and social cohesion. This informal structure appeals to individuals uncomfortable with formal banking protocols or those lacking access to traditional financial institutions.
- **Competitive Interest Rates:** In contrast to the high-interest rates imposed by moneylenders, chit funds provide a more economical avenue for borrowing. Interest rates on loans are typically determined via auctions or predetermined calculations, potentially resulting in lower overall costs.
- **Encouraging Financial Responsibility:** The mandatory regular contributions within chit funds instill a sense of financial discipline among participants. This commitment to consistent saving can contribute positively to individuals' broader financial habits and stability.

However, it's important to acknowledge some limitations:

- **Fraud Vulnerability:** Informal chit funds are at risk of mismanagement or fraudulent activities conducted by organizers, posing a threat of substantial financial losses for participants.
- **Funding Constraints:** The lump sum provided by chit funds may not suffice for larger financial requirements.
- **Delayed Disbursement:** Members might experience delays in accessing the lump sum, depending on the auction system, potentially causing delays in their intended financial plans.

In summary, chit funds play a crucial role in microfinance by facilitating access to capital, promoting saving behaviors, and serving as an accessible alternative to conventional financial institutions. Nonetheless, effective regulations and awareness initiatives are essential to mitigate the risks inherent in informal chit funds.

Saradha Chit Fund : Since the exposure of India's largest chit-fund scandal, over 200 agents, depositors, and executives have tragically ended their lives. Primarily hailing from low-income backgrounds, these victims, feeling hopeless after losing their life savings, resorted to suicide. The Saradha group, the orchestrator of the scam, had amassed an estimated US\$ 4-6 billion from over 1.7 million depositors before its collapse in 2013. This scandal has been coined 'Bonzi,' a merging of Ponzi and Bengal, in reference to its magnitude and geographical origin.

Historical Context and Emergence. In India, a considerable portion of the population resides in rural areas and belongs to the low-income category. These individuals face two major financial challenges: finding a secure avenue for their savings and accessing fair loan sources. Addressing these issues, Sudipto Sen aimed to establish a chit fund, essentially operating as a Ponzi scheme under the guise of a chit fund. Despite government efforts to tackle these challenges through small savings schemes by postal savings banks, chit funds remain attractive due to the promise of high returns, sometimes up to 50%. While investors may perceive chit funds as less secure, Sen attempted to allay these concerns by incorporating religious elements into the Saradha group's operations.

Sarada Devi, the revered wife and spiritual companion of Ramakrishna Paramhansa in Bengal, holds immense respect among millions even today. Sudipto Sen recruited agents from local rural communities to sell the funds, offering them commissions ranging from 25-40% of the deposits, along with other enticing rewards. This, coupled with a false sense of security, astronomical returns, and a motivated army of agents, seemed like a magical success formula devised by Sen. Consequently, the Saradha group expanded its operations beyond Bengal, reaching states like Odisha, Assam, Tripura, Jharkhand, and Chhattisgarh. Operating as a Ponzi scheme, the scam involved utilizing new investors' deposits to fulfill the principal and interest obligations of earlier investors. The scheme's sustainability relied on the continuous recruitment of new investors, with its collapse imminent if new participants ceased to join. Saradha investors were often kept unaware of the true nature of their investments and were lured in with promises of substantial returns after a fixed duration. To sustain the scheme, a constant influx of new investors was crucial.

Sen strategically allocated the funds into ventures that boosted Saradha's marketing endeavors, including endorsements from celebrities and politicians. Leveraging substantial financial resources, investments were directed into the Bengal film industry. The Saradha Group engaged prominent personalities such as TMC MPs Satabdi Roy and Mithun Chakraborty as brand ambassadors for its media platforms. Furthermore, TMC MP Kunal Ghosh was appointed as the CEO of the media group. The conglomerate also acquired established local television channels and newspapers, owning eight newspapers in five languages, including English dailies like Seven Sisters Post and Bengal Post, Bengali dailies like Sakalbela and Kalom, and others such as Prabhat Varta (Hindi), Ajir Dainik Baturi (Assamese), Azad Hind (Urdu), and Parama (Bengali weekly magazine). Moreover, Saradha possessed Bengali news channels like Tara News and Chanel 10, as well as entertainment channels like Tara Music, Tara Bangla, and Tara Punjabi, along with TV Southeast Asia and an FM radio station.

In an endeavor to extend its influence, the group sponsored renowned football clubs in Bengal, including rivals Mohun Bagan AC and East Bengal FC, providing financial backing that enabled them to recruit players from Africa and other parts of Asia, and even arranging a football match featuring Argentine superstar Lionel Messi.

The group's operations persisted for an extended period due to payments made to several politicians. Additionally, to discourage investors from voicing concerns about the investment programs, Saradha employed the wives of local police officers.

2. OBJECTIVES OF THE STUDY

- To analyze the factors contributing to investors falling into the trap of Ponzi schemes, it's essential to examine the allure of high returns, lack of awareness about financial risks, and the persuasive tactics employed by scheme operators.
- To investigate the Saradha Group's rise, collapse, and subsequent financial fraud amounting to 4,000 crore rupees, it's crucial to delve into the company's history, its expansion into various industries, and the Ponzi scheme structure it employed.
- To comprehend the political and potential naxal connections that contributed to the Saradha Group's success, an examination of its affiliations with politicians, influential individuals, and alleged criminal elements is necessary.
- Lastly, discussing recommendations and policies to prevent future scandals and safeguard investor interests involves proposing regulatory reforms, enhancing financial literacy programs, strengthening oversight mechanisms, and holding accountable those responsible for facilitating fraudulent schemes.

3. BACKGROUND OPERATIONS

The modus operandi of the Saradha Group Ponzi Scheme primarily included the following tactics:

- A network of agents, often sourced from local rural communities, was enlisted by the group to solicit investments from potential investors. These agents were motivated with substantial commissions and other incentives for attracting new deposits.

- To bolster its credibility and extend its reach, the Saradha Group acquired established local television channels, newspapers, and other media platforms. By controlling these outlets, the group could shape public perception and promote its investment offerings.
- Utilizing celebrity endorsements, including those from politicians and prominent figures like Satabdi Roy and Mithun Chakraborty, lent an aura of legitimacy and reliability to the scheme, enticing more investors.
- Diversifying investments, the Saradha Group directed investors' funds into various ventures, such as the Bengal film industry and renowned football clubs. By investing in seemingly legitimate enterprises, the group aimed to create an impression of financial stability and success.
- Reports indicate that the scheme involved making substantial payments to politicians and law enforcement officials to evade regulatory scrutiny and silence potential whistleblowers.

The Saradha Group Ponzi Scheme employed a blend of misleading marketing strategies, manipulation of media, and diversification of investments to entice investors and perpetuate its fraudulent operations. Despite encountering numerous obstacles and receiving warnings from regulatory bodies like the Securities and Exchange Board of India (SEBI), the company persisted in its illegal activities.

In 2012, SEBI categorized the Saradha Group as a Collective Investment Scheme (CIS) instead of a chit fund and instructed it to halt its operations. The state government was also alerted to the company's wrongdoing. As per regulations, an existing CIS cannot launch new schemes or raise funds from investors without proper registration from SEBI. Nevertheless, under the leadership of its CMD Mr. Sudipta Sen, the Saradha Group disregarded SEBI's directives and continued its fraudulent practices. The scheme eventually collapsed in April 2013, prompting decisive actions from the Ministry of Corporate Affairs (MCA) and the government to safeguard investors and hold accountable those responsible. Despite these efforts, the Saradha Group managed to swindle investors of thousands of crores during its tenure as a Ponzi Scheme.

How companies can deceive banks through a systematic process

First, they establish and register a company with the Registrar of Companies (RoC). Then, they open current accounts in the company's name and deposit small amounts, usually between Rs 8 lakh to 10 lakh, into each account. Over time, these funds are circulated among these accounts. Because these accounts belong to corporate entities and exhibit consistent activity, banks perceive them as legitimate and active. This activity qualifies the sham companies for loans. After several years, the companies' accounts and ownership are sold for significant sums. The involved racket then refunds the money in cash, complicating investigators' efforts to trace the source. The extensive transactions further obscure the money trail, making it challenging for banks to monitor the movement of funds.

Loopholes Leading to the Emergence of Fake Companies

- **Non-filing of Mandatory Documents:** Many companies fail to submit the required documents to the Registrar of Companies (RoC) by the due date. This lack of compliance allows fraudulent companies to operate undetected for extended periods.
- **Outdated Records:** Records are often not updated promptly, leading to situations where stakeholders cannot access the current status of a company. This opacity provides a cover for fake companies to continue their operations without scrutiny.
- **Inspection Challenges:** The inability of stakeholders to inspect updated records makes it easier for fake companies to avoid detection and continue their fraudulent activities.

To address these issues, the Ministry of Corporate Affairs (MCA) introduced the Company Law Settlement Scheme 2011. This scheme targets defaulting companies under Sections 611(2) and 637B(b) of the Act. It imposes an additional 25% fee on the actual additional fee for filing delayed documents, incentivizing companies to comply with filing requirements.

Additionally, the MCA has implemented the 'MCA21 e-Governance Project,' which provides over 100 MCA services through a single portal. This project aims to streamline all registry-related services, including:

- Name availability
- Company incorporation
- Filing of annual statutory returns
- Registration, modification, and satisfaction of charges
- Statutory filings related to all events stipulated in the Act (excluding matters related to liquidation)
- Document inspection
- Issuance of certified copies
- Approvals from Regional Directors and the Central Government

- Handling investor complaints

All these services are offered through electronic filing and are accessible via a secure portal, ensuring better compliance and reducing the scope for fraudulent activities.

Political & Police Connection

Despite SEBI's scrutiny of the Saradha Group's fundraising activities, it became evident that such extensive operations could not have flourished without substantial political connections. Sudipto Sen, the group's leader, reportedly maintained close ties with TMC leaders and high-ranking officials in the West Bengal government. Sen demonstrated astuteness by strategically providing significant sums to various politicians and police officers to prevent any alarms from being raised against him. He even employed the wives of police officers to dissuade investors from questioning his investment programs, thereby contributing to the group's prolonged survival.

Several other ministers were implicated in the Saradha Group's activities. MP Srinjoy Bose was associated with the group's media operations, while Transport Minister Madan Mitra oversaw the group's employees' union. Sen purportedly spent approximately Rs. 18.6 million to purchase paintings by Mamata Banerjee, leading to a government directive for public libraries to procure and exhibit Saradha Group newspapers. Furthermore, the group engaged in financial transactions with Ganesh Dey, the confidential assistant of the finance minister from the former Left Front government.

Politicians beyond West Bengal also benefited from the group's generosity. The Saradha Group donated patrol motorcycles to Kolkata Police, and the government distributed ambulances and motorcycles sponsored by the group in Naxal-affected areas of the state. This extensive political influence and patronage were crucial factors in the group's ability to sustain its fraudulent operations for an extended period.

4. ANALYSIS OF THE STUDY

Reasons for the Collapse of the Saradha Chit Fund: A Multifaceted Analysis

The collapse of the Saradha Chit Fund in 2013 serves as a stark reminder of the vulnerabilities within informal financial systems. Analyzing the reasons behind this event requires a multifaceted approach, drawing upon relevant theories and frameworks. Here's a breakdown of some key contributing factors:

- **Characteristics of Ponzi Schemes:** The Saradha Chit Fund purportedly offered exceedingly high returns, a common trait of Ponzi schemes. These returns were likely sustained by using new investor funds to fulfill promised returns to earlier investors, creating a facade of sustainability.
- **Regulatory Oversight:** Chit funds in India are typically subject to state-level regulations, resulting in varying rules across different regions. This fragmented regulatory landscape may have allowed the Saradha Chit Fund to operate with limited oversight, potentially concealing their true financial status.
- **Socioeconomic Influences:** The level of financial literacy among investors significantly impacts their decision-making process. In areas with lower financial literacy, individuals may be more susceptible to enticing yet unsustainable investment opportunities. The Saradha Chit Fund may have exploited this lack of awareness to attract investors seeking high returns.
- **Psychological Tactics:** The Saradha Chit Fund could have utilized psychological strategies to exploit investor trust. Methods such as celebrity endorsements, a charismatic leader, and a perceived sense of community might have persuaded individuals to invest without questioning the legitimacy of the returns.
- **Weaknesses in the Chit Fund Model:** Traditional chit funds rely heavily on the integrity and financial stability of the organizer. In the absence of robust safeguards, an unscrupulous organizer can manipulate the system for personal gain, as potentially observed in the case of the Saradha Chit Fund.

Theoretical Framework:

Social Bond Theory and the Saradha Chit Fund Collapse. Social Bond Theory, proposed by criminologists Travis Hirschi and Michael Gottfredson, posits that strong social bonds deter individuals from engaging in deviant or criminal behavior. In the context of the Saradha Chit Fund collapse, this theory sheds light on how the organization may have exploited weak social bonds to gain investor trust. Here's how Social Bond Theory applies to the Saradha Chit Fund case:

Attachment. Social Bond Theory suggests that individuals with strong attachments to family, friends, and social institutions are less likely to engage in deviant acts. The Saradha Chit Fund, operating within tight-knit communities, might have fostered a sense of belonging and attachment among investors. By building relationships and presenting themselves as part of the community, the organizers could have lowered investors' inhibitions and made them more trusting of the organization, causing them to overlook red flags or unrealistic promises.

Commitment. The theory proposes that individuals with significant investments in their social roles (e.g., work, family) are less likely to engage in criminal activity. The Saradha Chit Fund likely targeted individuals with a strong desire to improve their social standing or financial security. This commitment to achieving a better future could have clouded their judgment and made them more susceptible to the promises of high returns, as they were highly motivated to invest in what appeared to be a promising opportunity.

Belief. Social Bond Theory emphasizes the importance of shared beliefs and values in deterring crime. The Saradha Chit Fund, by operating within familiar communities, could have leveraged shared cultural values or trust in local figures to build investor confidence. The organizers might have used community events, endorsements from trusted local figures, and culturally resonant messages to foster a sense of shared belief, which could have overridden any skepticism or questions about the legitimacy of the returns.

Social Control. The theory suggests that strong social control mechanisms within social groups discourage deviant behavior. In the case of the Saradha Chit Fund, the informal nature of the chit fund system, coupled with a lack of external oversight, might have weakened social control mechanisms. Without proper checks and balances, investors may have been less likely to challenge the authority of the organizers or raise concerns within the community. The absence of regulatory scrutiny and the informal network of trust allowed the scheme to operate with little resistance.

Limitations of Social Bond Theory. Social Bond Theory primarily focuses on individual behaviour. While it helps explain how investors might have been influenced by the social aspects of the Saradha Chit Fund, it doesn't fully account for the broader systemic issues that contributed to the collapse, such as weak regulations or manipulative marketing tactics. Applying Social Bond Theory shows how the Saradha Chit Fund may have exploited the social connections and trust inherent in these informal financial systems. This theory highlights the importance of fostering strong social bonds that promote ethical behaviour but also emphasizes the need for robust external oversight to prevent similar financial scams from taking root within communities.

Ponzi Scheme

Ponzi schemes, also known as pyramid schemes, are fraudulent investments where returns to earlier investors are paid from the contributions of later investors. People can be drawn into Ponzi schemes without a "hard sell" as long as the perpetrator can create an impression of credibility, often through personality and charisma.

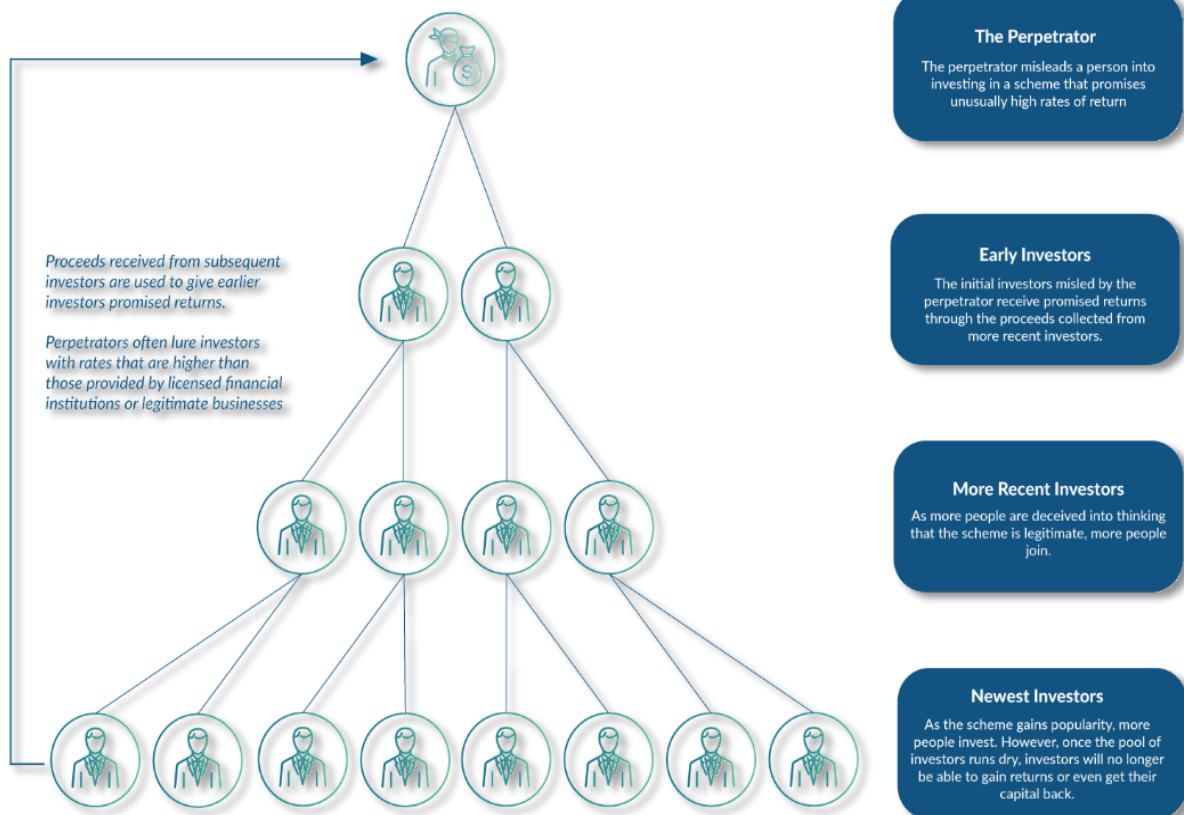
Named after Charles Ponzi, who in 1920 promised to double investors' money in 90 days by purchasing foreign postal coupons, these schemes initially appear successful by paying earlier investors their promised returns. However, they ultimately collapse when the perpetrator cannot pay later investors. Despite decades of media attention, Ponzi's methods are still in use. For instance, in 2009, investors lost about \$16.5 billion to Ponzi schemes, with the Madoff fraud alone surpassing that amount. Additionally, in early 2009, the SEC charged R. Allen Stanford with a "multi-billion dollar investment scheme," illustrating the ongoing prevalence of such frauds.

Elements of a Ponzi scheme comprise investor deposits, little or no legitimate business operations, minimal or no business profits or earnings, and returns to investors sourced from cash received from new investors. When a Ponzi scheme is uncovered, investors not only lose their invested principal but may also be obligated to repay amounts received from the investment (known as clawbacks) before the fraud's discovery. Moreover, should investors seek to recover any lost funds, they must file a formal public claim of loss with the bankruptcy court, exposing them to various legal notices, lawyer solicitations, and public identification.

Feature	Description	Example
Promise	Offering unrealistically high returns on investments with minimal risk	> Guaranteeing monthly returns of over 20%
Investment Model	No actual investment activities; instead, using funds from new investors to pay off earlier investors.	> Funds are not invested in real projects but are used to fulfill payouts to previous investors
Target Audience	Individuals seeking substantial returns with limited financial knowledge	> Often targets retirees or those lacking investment experience
Marketing Tactics	Relies on word-of-mouth referrals, a charismatic leader, and emphasizes community and trust	> Uses testimonials from satisfied investors and highlights a charismatic figure, promoting a sense of community and trust
Red Flags	Signs include unrealistic returns, lack of transparency regarding investment strategies, and difficulty in withdrawing funds	> Notable indicators include returns that seem too good to be true, ambiguity about investment methods, and challenges in accessing invested funds

Eventual Collapse	Occurs when the influx of new investors declines, rendering it impossible to meet promised payouts, leading to the scheme's collapse	> The organizer may vanish with remaining funds, or regulatory bodies may uncover the scheme's fraudulent nature
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How Ponzi Schemes Work



Victims of Ponzi schemes often consist of older, educated individuals. Despite initial doubts about investing, observing friends, neighbors, and relatives receive promised returns can sway them towards investing. Perpetrators employ impression management techniques, such as charitable giving, a display of wealth, and purported investment expertise, influencing potential investors. Rather than high-pressure sales tactics, perpetrators rely on word-of-mouth and impression management to attract new investors.

Regulatory failures contribute significantly to the success of Ponzi schemes. Here's how:

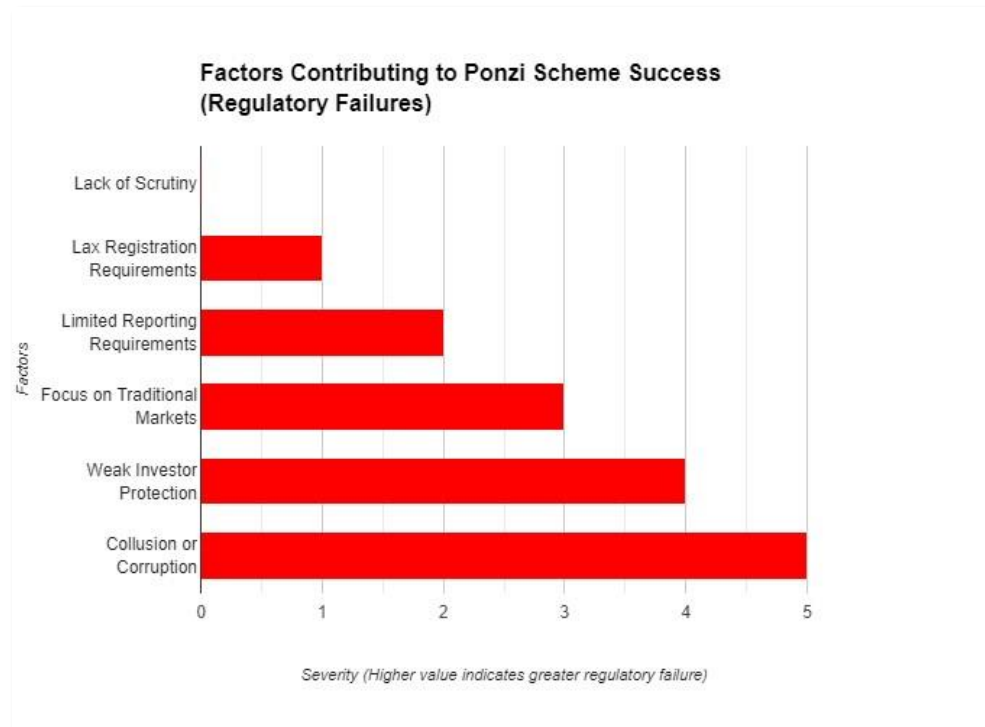
- **Lack of Scrutiny:** Regulatory bodies may lack resources or a mandate to thoroughly examine activities of smaller investment firms, enabling Ponzi schemes to operate undetected.
- **Lax Registration Requirements:** Easy registration processes for investment firms allow anyone to establish a seemingly legitimate operation without proper verification, facilitating Ponzi schemes.
- **Limited Reporting Requirements:** Regulations may not demand frequent or detailed reporting from investment firms, enabling Ponzi schemes to conceal their true financial state and evade detection.
- **Focus on Traditional Markets:** Regulatory bodies may prioritize overseeing established financial markets, neglecting oversight of informal investment structures like chit funds, which can be exploited for Ponzi schemes.
- **Limited Investor Protection:** Weak investor protection mechanisms expose individuals to misleading information and unrealistic promises.
- **Collusion or Corruption:** In extreme cases, regulatory officials may be bribed or influenced by Ponzi scheme operators, hindering detection and enforcement efforts.

Impact of Regulatory Failures:

- Regulatory failures foster an environment conducive to the proliferation of Ponzi schemes, resulting in substantial financial losses for investors.
- They undermine public confidence in financial markets and deter legitimate investment activity.
- Vulnerable populations, who are more likely to explore alternative investment avenues, are disproportionately affected by regulatory failures.

Strengthening Regulations:

- Implementing stricter registration requirements and continuous financial reporting obligations for investment firms to enhance transparency and accountability.
- Allocating additional resources to regulatory bodies to enable effective monitoring of investment activities and timely intervention in fraudulent schemes.
- Enhancing investor education initiatives to increase awareness about Ponzi schemes and equip individuals with the knowledge to recognize warning signs.
- Developing a more comprehensive framework for regulating informal financial systems like chit funds to mitigate the risk of exploitation for fraudulent purposes.



Socioeconomic factors influencing investor behavior:

1. Income Level:

- **Higher income:** Individuals with greater incomes typically possess more disposable funds for investment and may demonstrate a higher risk tolerance. They may opt for volatile instruments like stocks, seeking potentially higher returns.
- **Lower income:** Those with lower incomes may have restricted investable funds and prioritize security over high returns. They may prefer safer options such as savings accounts or bonds.

2. Financial Literacy:

- **Higher financial literacy:** Individuals well-versed in financial concepts can better assess investment risks and opportunities. They are more likely to make informed decisions aligned with their financial goals and risk tolerance.
- **Lower financial literacy:** Individuals lacking financial knowledge may be more susceptible to marketing tactics or susceptible to scams. They may rely on recommendations or emotions rather than sound investment principles.

3. Age:

- **Younger investors:** Typically possess a longer investment horizon, enabling them to weather market fluctuations and potentially benefit from compound interest. They may favor riskier investments with the aim of higher long-term returns.
- **Older investors:** Often have a shorter investment horizon and prioritize capital preservation. They may gravitate towards safer investments like bonds or income-generating assets to secure their retirement.

4. Education:

- **Higher education:** Individuals with advanced education levels are more likely to be financially literate and have access to investment resources. This may result in more informed and diversified investment strategies.
- **Lower education:** Those with limited education may have less exposure to financial education or resources. They may rely more on basic financial products or informal investment avenues.

5. Cultural Background:

- **Individualistic cultures:** These cultures often emphasize personal responsibility and achievement, fostering a proactive approach to managing finances and seeking investment opportunities.
- **Collectivistic cultures:** In contrast, collectivistic cultures prioritize family or community well-being over individual gain. As a result, individuals from these cultures may prefer secure investments that benefit the entire family or community rather than focusing solely on maximizing individual returns.

6. Risk Tolerance:

- **Risk-averse individuals:** Some people naturally exhibit aversion to risk and prioritize capital preservation. They tend to prefer low-risk investments, even if they offer lower returns, to safeguard their capital.
- **Risk-tolerant individuals:** Others are more comfortable with risk and are willing to accept higher levels of risk in pursuit of potentially higher returns. They may be inclined to invest in volatile assets like stocks or options, seeking opportunities for greater gains.

Psychological manipulation by the company plays a crucial role in the success of a Ponzi scheme, leveraging various tactics to deceive investors:

- **Charismatic Leader:** Ponzi schemes often rely on a captivating leader who cultivates a devoted following akin to a cult. This leader fosters trust and allegiance among investors, dampening any doubts about the scheme's authenticity.
- **Sense of Community:** Ponzi schemes fabricate a sense of camaraderie and belonging among investors, fostering the illusion of shared success. This communal ambiance discourages skepticism and dissent, as investors perceive themselves as part of a unified entity.
- **Fear of Missing Out (FOMO):** Ponzi schemes exploit investors' apprehension about missing out on lucrative opportunities by accentuating limited availability and high returns. This fear-induced tactic compels individuals to invest hastily without conducting thorough research.
- **Testimonials and Endorsements:** Falsified or cherry-picked testimonials from purportedly satisfied investors serve to validate the scheme and attract new participants. Moreover, celebrity endorsements, if secured, further enhance the facade of credibility and triumph.
- **Obfuscation and Complexity:** Ponzi schemes intentionally cloak their operations in intricate financial jargon and opaque investment strategies. This deliberate complexity obscures the scheme's true nature, leaving investors reliant on blind trust in the organizers.
- **Social Proof:** Highlighting the involvement of respected individuals or influential community members within the scheme imparts an air of legitimacy. This social validation convinces investors that the scheme is reputable and deserving of their trust.

Through these manipulative tactics, Ponzi schemes exploit fundamental human emotions such as trust, greed, and fear, deceiving investors into making ill-informed decisions based on false promises and distorted perceptions.

5. COLLAPSE & FURTHER IMPACT

A Ponzi scheme reaches a critical juncture when the cash inflows fail to match the cash outflows, signaling financial insolvency. Sudipto Sen, the orchestrator of the Saradha scam, encountered this dilemma in January 2013. Despite efforts to reassure depositors and agents, he was unable to secure additional funds, indicating the imminent collapse of the scheme. In a dramatic turn of events on April 6, 2013, Sen submitted an extensive 18-page confession to the Central Bureau of Investigation (CBI). Within the letter, he admitted to bribing numerous politicians and accused Kunal Ghosh of pressuring investments in unprofitable ventures. Following the dissemination of the letter on April 10, Sen went into hiding.

Amid the ensuing chaos following the exposure of the scheme, around 600 agents claiming to be Saradha employees gathered at the Trinamool Congress (TMC) headquarters, urging government intervention. An arrest warrant was issued for Sen on April 18, prompting a nationwide manhunt. Ultimately, on April 23, 2013, Sen, along with two associates, Debjani Mukherjee and Arvind Kumar Chauhan, was apprehended in Kashmir. In response to the Saradha scandal, Mamata Banerjee announced a four-member judicial inquiry commission and established a USD 70 million relief fund for affected depositors. Additionally, a special investigation team (SIT) was convened to expedite the inquiry, culminating in a year-long investigation.

Subsequently, the Supreme Court intervened, directing federal investigative agencies to assume control of the probe. Despite initial resistance from West Bengal, prompted by similar case transfers in Assam and Tripura, the investigation was ultimately handed over to the Central Bureau of Investigation (CBI). As the CBI delved deeper into the scandal, startling revelations emerged, implicating several Trinamool Congress (TMC) politicians, including MPs Kunal Ghosh and Srinjoy Bose, as well as Transport Minister Madan Mitra, who allegedly received funds from Saradha and actively promoted the fraudulent scheme. Furthermore, Mamata Banerjee herself faced scrutiny when Sudipto Sen claimed to have purchased her artwork for a substantial sum. The scandal also extended to the central government, with Nalini Chidambaram, wife of former finance minister P. Chidambaram, facing charges of accepting a bribe of Rs. 1.4 crore.

Further investigation into the Saradha scam revealed discrepancies in the handling of evidence by the Special Investigation Team (SIT). The Central Bureau of Investigation (CBI) accused the SIT of failing to transfer all relevant evidence, some of which could have been crucial for the ongoing investigation. Despite making 18 attempts to question the SIT team, the CBI encountered obstacles in obtaining cooperation. Following Supreme Court intervention, the head of the SIT, Rajeev Kumar, eventually appeared for questioning. Meanwhile, Mamata Banerjee organized a three-day protest in Bengal under the banner of 'save democracy.'

Regarding the perpetrators of the scam, Sudipto Sen has spent approximately seven years in prison, with over 98 cases pending against him. He aims to expedite the trial process as he has already served the maximum prison sentence typically awarded in such cases. However, the CBI has been unsuccessful in tracing the money invested by the Saradha group and believes it to be irretrievably lost, including funds invested abroad.

The impact on victims of Ponzi schemes is significant and multifaceted:

Financial Impact:

- **Loss of Savings:** Victims lost their entire investments, impacting their financial security and retirement plans significantly.
- **Debt Accumulation:** Some victims resorted to borrowing money to recover their losses, exacerbating their financial distress.
- **Reduced Trust in Financial Institutions:** The experience undermined victims' confidence in the financial system, thus making them wary of future investments.

Emotional Impact:

- **Stress and Anxiety:** Victims experienced heightened levels of stress, anxiety, and depression due to financial losses.
- **Guilt and Shame:** Victims blamed themselves for falling prey to the scheme, leading to feelings of guilt and shame.
- **Strained Relationships:** Financial losses and emotional turmoil strained relationships with family and friends who have been affected or skeptical of the investment.

Physical Impact:

- **Health Problems:** Victims experienced various health issues stemming from the stress and anxiety caused by financial losses, including hypertension, sleep disturbances, and cardiovascular problems.
- **Social Withdrawal:** Feelings of shame and embarrassment led victims to withdraw from social interactions, exacerbating their sense of isolation.

Additional Considerations:

- **Impact Severity:** The extent of the impact depends on factors such as the amount of money lost, the victim's financial resilience, and their emotional fortitude.
- **Long-Term Effects:** Some victims may suffer long-term psychological consequences, necessitating professional assistance to cope with trauma.
- **Societal Impact:** The collapse of a Ponzi scheme can have broader societal implications, undermining public trust in financial institutions and deterring potential investors.

Importance of Support:

- Emotional Support: Victims require emotional support to navigate the aftermath of the scheme, including understanding and empathy from family, friends, and support groups.
- Financial Assistance: Some victims may need financial assistance to recover from their losses and rebuild their lives.
- Awareness and Education: Raising awareness about Ponzi schemes and educating the public about warning signs can help prevent similar scams in the future, protecting individuals from falling victim to fraudulent schemes.

6. DISCUSSION AND RECOMMENDATIONS

Responsibility for addressing the issue lies with investor awareness and grievance cells managed by SEBI and MCA. Despite their existence, large-scale scams persist in capital markets, possibly due to inadequate public knowledge about these governmental resources and their procedures. Although investments in primary and secondary markets constitute a small portion of household budgets, recent scams have severely impacted the economy and defrauded investors of significant sums. There's often hesitancy to discuss such investments, which should not be stigmatized or considered illicit. Thus, a public awareness and investor registration cell, supported by SEBI and MCA, should be established. This cell would:

- Register new investors
- Record the relevant company associated with the investor
- Address potential investors' inquiries
- Educate potential investors on proper investment mechanisms
- Manage investor complaints for further investigation by SEBI and the Ministry.

This initiative would help prevent incidents like the Saradha scam, an unregistered Collective Investment Scheme (CIS) in West Bengal, which caused substantial financial losses. The proposed system, Investor Duty Management (IDM), would include a toll-free hotline for potential or existing investors to seek assistance. Callers would navigate through an interactive voice response (IVR) system to select their inquiry department, ensuring prompt and targeted assistance.

The government must ensure that all investments adhere to official certification standards outlined by government regulations. A new legislation should be enacted to specify the required details for companies when soliciting funds from the public and issuing certificates with appropriate company identification and seals for such investments. Consistency in the collection process across all companies must be enforced to prevent illegal investments. The government can design a standardized certificate format to be integrated into the company registration process. Additionally, if callers seek information on specific companies to assess associated risks and benefits, a designated department should handle such inquiries separately from general investment queries.

Who stands to benefit? While all investors would reap the benefits, the most significant impact would be on lower-income and middle-class individuals, particularly those with limited education, who are often more vulnerable to fraudulent schemes. Wealthier individuals, typically more knowledgeable about investments, may not prioritize registration with the cell, often using such investments to conceal illicit funds. However, with companies registered and investor details provided to the Investor Database Management (IDM), regulatory bodies like SEBI and the Ministry can effectively monitor businesses and conduct regular audits.

Financial Aspect: Government funds allocated for investor awareness and grievance resolution, such as the Investor Grievance Management Cell and the Investor Education and Protection Fund, can be utilized for IDM implementation and operation.

Outreach Strategy: Advertising campaigns via television and newspapers serve as effective methods for mass awareness. Similar to initiatives promoting awareness of health issues like HIV/AIDS, raising consciousness about capital market investments is crucial. Outreach efforts for IDM could include

community campaigns, educational events, and street plays in rural areas to educate people about scams and the importance of investor protection.

7. CONCLUSION

The collapse of the Saradha Chit Fund in 2013 serves as a poignant reminder of the vulnerabilities inherent in informal financial systems and the devastating repercussions of Ponzi schemes. Numerous investors, many of whom were from low-income backgrounds, experienced irreversible losses, shattering their hopes for financial security. This event not only exposed the shortcomings in regulating chit funds but also underscored the urgent need for a stronger, more centralized oversight mechanism. Furthermore, it highlighted the critical role of financial literacy initiatives in empowering individuals to make informed investment decisions.

The Saradha Chit Fund debacle serves as a cautionary tale, illustrating the disastrous consequences of exploiting trust and social ties. It calls for collaboration among regulatory authorities, financial institutions, and communities to foster a transparent and secure financial environment. By enhancing regulations, promoting financial literacy, and holding wrongdoers accountable, we can strive to prevent similar tragedies in the future. Additionally, the case underscores the significance of ethical leadership within financial institutions; the charismatic personality of the Saradha Group leader played a significant role in luring investors. Promoting ethical behavior and transparency within financial entities can build trust and deter fraudulent activities.

The aftermath of the Saradha Chit Fund collapse is marked by fractured trust, financial adversity, and a call for increased vigilance. By learning from this experience, we can work towards a future where trust and transparency form the foundation of a more resilient and inclusive financial landscape.

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