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Corporate Scams and its Impact on Indian Economy: A Case on 'Saradha Chit Fund'

Prof. (Dr.) Sreekumar Ray

Vice-principal, Department of Commerce and Business Administration The Bhawanipur Education Society College 5, Lala Lajpat Rai Sarani, Kolkata - 700020

ABSTRACT

Scam and India are two sides of a coin. Since independence India has been attacked by few Indians having unholy nexus with Government machineries. It has been observed that always the high profile Government officials are involved hand in hand with the corrupt people who are engaged in scams. These include financial, political, or corporate scams. Few scams are 2G scam in 2008, Satyam scam in 2009, and Coal scam in 2012, Saradha Chit Fund scam in 2013. If the total amount of the scam would have been channelized in to the capital market, India would have been the permanent member of trillion dollar club long before 2007 and would have been the leader in the world capital market. In 2013 the Ministry of Corporate Affairs, Government of India, has published a list of bogus chit funds operating all over India. It is found that more than 80% (72 out of 86) are operating actively in West Bengal. So the state West Bengal has got the disgusting title of 'Ponzi capital of India'. Here an effort has been made to examine the details of Saradha Chit Fund scam.

KEYWORDS : Chit Fund, Ponzi scheme, Trillion dollar Club, Capital market, Money mobilizing, Collective Investment Scheme.

1. Introduction:

Before independence, India's enemy was British, but after independence India only, has got to be India's enemy. India being an "idiot" became the prey of scams again and again as foreign enemies attacked India as many times as they could. Now the enemies are within. The Saradha group, recently under the scanner of Central Bureau of Investigation (CBI), is a consortium of over 200 private companies running deposit mobilizing activities.

2. Objectives of the study

The objectives of study are;

1. To understand the volume of Scam in India since independence;
2. To know the effect on the Indian economy;
3. To know the modus operandi of Saradha chit fund;
4. To know the role of Securities and Exchange Board of India (SEBI);
5. To give some line of actions to curb this malpractices.

3. Reason to invest in Chit funds

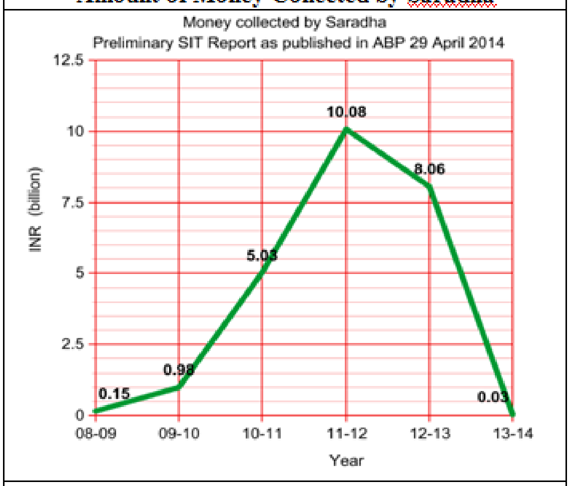
India has a large low-income rural population. According to the World Bank reviewed and proposed revisions in May 2014, to its poverty calculation methodology and purchasing power parity basis including India, the world has 872.3million people below the new poverty line, of which 179.6 million people live in India (Economic Times 10th May). These poor people do not have access to the formal banking facilities. Capital market is far behind of their knowledge due to their educational as well as financial literacy. A trap of parallel informal banking gets out of bed to fill the emptiness. Few corrupt people known as financial operators run Ponzi schemes in various disguises.

3.1 Impact on economy

The rural economy of our country is mostly relied on small savings schemes of Indian postal services. The low rate of interest in post offices encouraged the rise of various Ponzi schemes in 1980s, 1990s and later in 2008 like Sanchayita Investments, Overland Investment Company, Verona Credit and Commercial Investment Company and recently the Saradha chit fund. Naturally a major chunk of earnings of ordinary investors go to the speculative businessmen instead of being channelized either to the Bank, Post-office or to the Capital market. Thus the rural economy becomes a void since at the end of the day the investors are the losers. When the Saradha group was collapsed in April 2013 it is found that it eradicated an estimated amount of INR 200-300 billion (US $4-6 billion) and it collected money from 1.7 million depositors.

Exhibit 1

Amount of Money Collected by Saradha



Source: 2014 SIT Report

3.2 Fall in small savings

The activities of Saradha group had a direct hit on West Bengal's small savings post office deposits. In the year 2006-07, the net collection from small savings was Rs. 6,238.93 crore (Business Standard, 2nd March, 2013) and this increased to Rs. 8,985 crore in 2009-10. But in 2010-11 it marginally declined to Rs. 8,409 crore and afterwards in 2011-12 the amount of small savings had gone down to Rs.(-) 987.22 crore. This means in 2011-12, the whole amount of Rs.8409 crore plus Rs. 987.22 crore i.e. total Rs.9396.22 crores were eaten away by other financial instruments. The obvious question raises that where the money had gone? This money had certainly been invested in such financial instruments where the rate of interest was higher than the small savings rate of interest. The investors observably had a choice of investing money in Saradha like organization.

3.3 Impact on capital market

The total amount of scam since independence is accounted for an approximate amount of Rs.910, 603,234,300,000 which is equal to USD 20.23 trillion (Summary of all scams in India since 1947, Kundu, Paresh Ratan). The Indian capital market entered the trillion dollar club first time in June, 2007 but moved out in September 2008, during the worldwide economic recession. It again joined the elite league in May 2009 and had persisted there for a long time except for some phases, including once in 2012. On 5th august 2013, the total valuation (free-float market capitalization) of all listed stock in India stood at Rs. 61,55,448.63 crore ($ 1.011 trillion) , upgrading India to the elite global league of markets having a trillion-dollar valuation (business today- 6th august 2013). Across the world the economy of few countries like UK, Japan, China, Canada, Hong Kong, Germany, France, Switzerland, Australia, South Korea, Nordic region and Brazil are presently enjoy a trillion dollar status, led by the US (an estimates USD 20 trillion). This corroborates that if the total amount of the scam would have been channelized in to the capital market, our country, India would have been the permanent member of trillion dollar club long before and would have been the leader in the world capital market.

4. Birth of Saradha Chit fund

Saradha group of companies got birth in 2006. It is interesting to point out that when there was a global slowdown in the capital market and no difference in Indian stock market, the Saradha cheat fund took its larger shape in 2008 and it had collected nearly Rs. 30,000 crore from lakhs of people spreading its area from West Bengal to Assam, Orissa, Bihar, Jharkhand and Chhattisgarh. During the economic slowdown all over world, the cheat fund owner Mr.Sudipto Sen along with some influential people from political, social and administration had started to catch fish in troubled water. That time our Finance Minister, the Governor of RBI and the chairman of SEBI all of them were busy to protect our economy from external factors and they could not concentrate in internal economic factors. That chance was taken by those corrupt people. Had that moneybeen invested by our domestic investors in the capital market that would further strengthen our economy.From a low of 7697 in October 2008, Sensex has gone up nearly four times in 2014 (Sensex about 28000). The stock broking firm Karvy has predicted that the Sensex could touch Rs. 1,00,000 by 2020.(Goel, 2014)

4.1 Modus Operandi of Saradha

"Sarada" Devi was the wife of famous spiritual guru Sri Sri Ramkrishna Dev (Swami Vivekananda's spiritual guru) and she is a highly revered spiritual icon not only in West Bengal but also in whole of India and even world. The cheats have used the name of Mother Sarada so that by the name of Sarada the ordinary people will put faith on the fund. The group used to collect money through agents with high commissions ranging from 15 to 20 percent and even in some cases 40% of the funds mobilized by them. They agreed to pay back unusually high returns. If a person invests Rs.1 lakh for 14 years he/she might get Rs.10 lakh by 14 years which was next to impossible by normal any other deposits (observed from field investigation). The same could fetch maximum Rs.3.50 to 4.00 lakh in case of a Bank or Post office deposit. On the other hand, sometimes the investors had been allured by promising flat or land in return of their deposits. Due to the exorbitant commission the number of agents rose to thousands and even lakhs.

Saradha Group opened as many as 200 companies to create cross-holdings after getting a warning bell in 2009 from SEBI which created an extremely complex corporate structure. It made difficult to put blame on any one of the companies. It is learnt that the chief advisor of the company who was basically a chartered accountant cum top level administrator in police of the state government of West Bengal used to look after all these illicit games. After 2010 Saradha changed their way of collecting money rather started Collective Investment Schemes (CIS), such as package tourism, forward travel and hotel booking, motorcycle manufacturing, , real estate, infrastructure finance etc. In 2011 when SEBI had given further warning to Saradha Group it changed its modus operandi again. This time, it picked up and traded hefty number of shares of several listed companies, siphoning off the proceeds of the sale to accounts which are under the scanner of CBI, at present and have not been identified till date.

5 Role of SEBI

As per the Chit Fund Act of 1982 the chit funds are regulated by the state governments rather than the SEBI. Recently, the chairman of SEBI Mr. U.K.Sinha has stated that the State Governments have immense powers, if utilized well, to bring to book such entities (The Statesman, 15th September, 2014).

Exhibit 2
From the Desk of SEBI's Chairman

- Illicit money-pooling schemes sprout across nooks and corners of the country;

- State governments should provide the first line of defense against such activities and provide early warning systems for cases requiring action by the SEBI;

- There will be full support of SEBI in fighting this menace where fraudsters have collected thousands of crores of rupees through various Ponzi and other illegal schemes.

- The chairman has urged all state governments to pass the State Deposit Protection Act, which would allow the state governments to take stern action against illegal deposit taking activities within their jurisdictions. Many states have already passed this Act.

- The governor of RBI and the chairman of SEBI have already requested the chief secretaries of states to take action against those running illegal money-pooling schemes under the State Deposit Protection Act.

- Under a new law, SEBI has been authorized to take action against all unregulated money-pooling schemes with a corpus of Rs.100 crore or more.

6. Conclusions

As per the Securities regulations and the company's Act, 1956 (Section 67) no company can raise capital from more than 50 people without issuing prospectus. Also their accounts must be audited and Balance sheet of the company must be available to the public. Further, for raising capital any company should have explicit permission from SEBI. But in case of Saradha no legal formalities were followed. The state government was also apathetic although the market regulator SEBI informed the state government for a number of times. SEBI first defied Saradha Group in 2009. SEBI continued its investigation through 2010. SEBI warned the state government of West Bengal about Saradha Group's deceptive chit fund activities in 2011again. SEBI later in the year 2012 came to the conclusion that the group's activities were merely a Collective Investment Scheme (CIS), not chit fund, and claimed that it should instantaneously stop its operations. But Saradha Group ignored SEBI, and continued to operate in the similar modus till it collapsed in April 2013. It is observed that these companies are not chit funds. They are formed under The Companies Act, 1956, and are registered with the Ministry of Corporate Affairs.

The sorry state of affair is that many influential persons of high profile were involved in this illegal money mobilizing activities. Likewise in west Bengal, in Assam also one top level police officer was involved who committed suicide recently (The Statesman,18th September,2014) after his name got linked to the scam with other list of names by CBI. Many names from political and social arena are coming out which is very shocking not only to the state government but also to the younger generation of India. What world we are giving present to them. In 2013, Ministry of Corporate Affairs, Government of India, released the list of fake chit fund companies operating in India. As per the government's notification, all those companies were deceiving people in the name of investment. Out of them 5 are from Tamil Nadu and 5 from Delhi, 2 from Rajasthan, 1 from each Karnataka and Uttar Pradesh whereas 72 from West Bengal. Truly West Bengal has got the disgusting title of 'Ponzi capital of India'.

7. Road Ahead

The following line of actions can be taken at least to give a jerk to the dreadful problem of India:

1. The state government should play the role of a whistle blower.

2. The central as well as state government should try to make our people financially literate.

3. If the state government does not take action, SEBI without making any further delay should take immediate action so that the problem does not aggravate.

4. At the cost of common men's money the SEBI, RBI and the State government should stop blame game to each other.

5. State government should stop any kind of gimmick like imposing tax on cigarettes to collect money for distribution among the cheated people, rather should try to nip it in the bud so that it does not become ingrained.

6. Political patronage should be stopped.

7. Above all the Election Commissioner of India should see the political parties should not use any kind of illegal money for contesting elections.

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