International Journal of Business and Management Invention
ISSN (Online): 2319 – 8028, ISSN (Print): 2319 – 801X
www.ijbmi.org || Volume 5 Issue 8 || August. 2016 || PP—71-78

The Behavioural Finance Aspects of Chit-Fund Scams of Odisha: Loss is almost certain Profit is Not

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ABSTRACT: *The research in this paper has been conducted from within the theoretical framework of behavioural finance. The aim of this paper is to examine chit fund scams and its aftermath effect on Individuals & Households of Odisha. The study provides post-mortem analysis of changes in attitude investors towards chit funds. The data comprise a random sampling of 112 respondents drawn through a field survey. Different statistical tests were performed to assess support for the hypothesis.The results of data analysis reveals due to lack of financial literacy and sophistication, investors are simply more exposed to idiosyncrasies of the chit fund companies. Expectations of earnings high commission and high rate of return attracted investors to join chit funds. Someone known to investors or some of the family member or relative persuaded investors to join in chit funds. Majority of the respondents believe that the chit fund agent cheated them and they were unknown about the chit fund company and they believed the chit fund agents. The study shows that laxity in regulatory system and nexus between the politicians and chit fund companies paved way for the perpetrators to commit frauds. The study shows that investors are now more aware about these Chit Fund companies because of the relentless media coverage and would be more careful before investing next time.*

Keywords *Behavioural finance**,** Chit-fund scams, Financial literacy, Household savings, Investment*

I. INTRODUCTION

The economic theory of investment states that investors think and behave "rationally". However keeping in mind the recent trends in decline in ethical values and moral standards due to the detection and exposure of series of scams and frauds in all forms of businesses and in government organisations including the recent chit fund scams it is require to go for a behavioural explanation of investor's irrationality in a consistent and correlated manner. It is found that investors are not always rational; rather investor's emotion has a major role to play with the investment decision. Individuals and Households, by virtue of their relative immobility and lack of financial sophistication, are simply more exposed to idiosyncrasies of the chit fund companies, banks, financial institution and business houses. The recent chit-fund scams exposed the loopholes in the household financial investments and hence necessitate the study.

Odisha is a state located on the eastern coast of Indian peninsula. Nearly 85% of its population live in rural areas and depend mostly on agriculture for their livelihood. The state has abundant mineral resources including precious and semi-precious stones. It has also plentiful water resources. Cultivators and Agricultural labourers constitute 65% of the total workforce. Agriculture provides direct or indirect employment to 65% of the total work force and contributes 26% of the net state domestic product and it is also counted among the poorest states of the country.

The economy of Odisha is one the fastest growing state economies in India. According to 2014-15 economic survey, Odisha's gross state domestic product (GSDP) was expected to grow at 8.78% in the 2014-15 fiscal years. Odisha has an agriculture-based economy which is in transition towards an industry and service-based economy. According to Dun & Bradstreet, the GSDP is expected to grow at a rate of 8.1% during 2015-2020. Odisha is also one of the top FDI destinations in India. In the fiscal year 2011-12, Odisha received investment proposals worth Rs.49, 527 crores (US$9.296 billion). According to the Reserve Bank of India, Odisha received Rs.53, 000 crores (US$8.33 billion) worth of new FDI commitments in the 2012-13 fiscal.

However, in spite of all these developments the Individuals & Households of Odisha state has witnessed their hard earned money being siphoned by Chit funds companies. Although there are many avenues for savings and investment one's hard eared money. Chit funds and Ponzi schemes promises large returns on investments are very common avenues of parallel investment since long. But, in recent years a good number of frauds have been exposed involving thousands of crores rupees. A number of chit fund frauds in Odisha pressed the panic button and investors rushed to get back their invested money from such chit. These scams lead to domestic and social violence, harassment and even suicides.

As the bottom-of-the-pyramid population continues to fret about having lost one's life savings in the Odisha "chit funds". There is a necessity to analyze the determinants and rationale of frauds committed by chit funds in

Odisha. The lessons learned in recent chit fund scams and suggest remedial ways of proper managing of chit funds in Odisha.

II. OBJECTIVES OF THE STUDY

The objectives of the study are

- To analyze the determinants of investment in chit funds in Odisha.
- To study rationale of frauds committed by chit funds in Odisha.
- To suggest the remedial ways of proper managing of chit funds in Odisha.
- To study the lessons learned in recent chit fund scams in Odisha.

III. LITERATURE REVIEW

Chit funds are the Indian equivalent of the Rotating Savings and Credit Associations (ROSCA) that are famous throughout the world. [1]ROSCAs are a means to 'save and borrow' at the same time. It is considered one of the best instruments to cater to the needs of the poor.

There are numerous published literatures on Ponzi schemes. Ponzi schemes, which are another type of investment scam, because it promises large returns on investments that are unachievable because they are solely derived from new investor funds ([2]Blaylock, 1998; [3]Entombed Albania's Pyramids, 1997). Investors in a Ponzi scheme typically send their money to either a central investment house, or a person which is supposed to send the promised returns back to investors.

The fact that most investors are not told that they are destined to lose their money in these schemes is the reason why ponzi schemes are illegal. Motivating people into investment schemes is legal, and so is the giving of money to other people, but it is the deception of the investors about their expected financial returns that determines the illegality of pyramid schemes ([4]Caroll, 1998; Commerce Commission, 1997).

Fundamentally, deception exists because new investors are typically convinced on the promise that they will receive larger financial returns on their investments. The pyramid scheme that ran in Albania during 1995-1997 is a notable example of a pyramid scheme in which people invested and consequently suffered a financial loss. In this instance the scheme quickly spread through Albania and engulfed most of the populace. The debt incurred by Albanian citizens was estimated at one billion dollars, which if the Albanian government had reimbursed would have produced bankruptcy ([3]Entombed Albania's Pyramids, 1997). Investors in this scheme were promised returns of 50% per month on their investments and people were motivated to sell assets in order to invest cash for the expected monetary returns. For a short period of time the returns were achieved and a few people did well, but, as with all pyramid schemes, the supply of new investors ran out and consequently further payments were dishonoured, thus leaving investors in financial ruin.

The semantics surrounding deliberately misleading people includes such phrases as white lies, bluffs, and fibs, but essentially all equate to deception ([5]Hyman, 1989). The definition of deception encompasses all the previous terms, but here it is confined to the parameters of deliberate economic behaviour. Cheating and dislike of it display themselves cross culturally. People perceive it to be a socially unacceptable behaviour and react adversely to known cheaters ([6]Sigmund, 1993). Consequently, a cheater must assess the possible gains and risks associated with cheating before engaging in deceptive behaviour ([6]Sigmund, 1993; [7]Wokutch & Carson, 1999). As such, the outcomes associated with cheating influence both an individual's choice to engage in deceptive behaviour and the reactions of others if this behaviour is discovered ([5]Hyman, 1989; [8]Ridley, 1997). Arguably, either deliberate or unintentional deception is required for the successful recruitment of investors to pyramid schemes.

People who are closer and are deceived react more severely. This closely relates to the principle of evolutionary psychology that asserts people are more likely to act altruistically to people who are members of their kin group and are themselves more likely to reciprocate ([8]Ridley, 1997; [6]Sigmund, 1993). Therefore determining how these relationship factors affect people's economic behaviours is a worthwhile area to research, especially in respect to deception-based punzi schemes.

Furthermore, when people consider holding others responsible for acts of deception, they take into consideration the agent's intent and knowledge of the consequences ([9]DePaulo & Rosenthal, 1979). For example, a person who knowingly deceives others to invest their life savings in a fraudulent company is judged more harshly than someone who ignorantly advises someone to invest. Such distinctions about level of social undesirability are reflected in the law and are used to determine fraud.

[10]Bansal (2005) suggests that the international consensus in preserving the soundness of the banking system has highlighted a number of necessities including careful attention to the audit report prepared by the internal and external auditors.

[11]Sathye (2007) suggests that to prevent scams of chit funds Financial Intelligence Unit (FIU) should be formed.

[12]Hudon (2008) finds that under the veil of microfinance, the chit fund companies collect fund from the poor people and the research further shows that even though the chit funds are registered under Companies Act, Societies Act, RBI Act and SEBI Act, these are equally unsafe like their unregistered counterparts.
[13]Manniono (2009) concludes that Ponzi schemes' arrangement usually falls apart when a large number of investors want to withdraw their investments at the same time, especially during times when there is not enough new money being supplied by new investors.
[14]Rhee (2009) suggests that the informal credit market is vulnerable to the credit risk, interest rate risk, inflation risk, re-investment risk, market risk, operation risk etc. Once any of the risk materializes, the entire informal credit market collapses like anything.
[15]Eeckhout and Munshi (2010) finds that by bringing both, borrowers and lenders, in close proximity and by stimulating the competition, chit fund effectively created an informal credit market subject to different constraints.
[16]Ferri (2010) classified Ponzi agents as those who borrow more and more in order to repay their interest with the simplistic anticipation that profit and capital gain will be available to repay their commitments when they become due.
[17]Nielsen (2012) finds that whistle-blowers' appeals did not pay attention to the regulators. This can result in exposure of corporate's wrong doing, inaction by regulatory institutions and hindrance to institutional reform.
[18]Roy (2012) concluded that many chit fund companies are using the media business as a stepping stone by which they will be able to establish contacts with the political establishments, more so with people in power.
[19]Kapoor *et al.* (2013) concluded that the chit fund industry addresses the savings needs of people, is considered very safe and also offers loans at lower interest rates than money lenders.
[20]Sen (2013) suggests that all the banks should conduct random check to the accounts of the chit fund companies which collect money through collective investment schemes across the country.

IV. RESEARCH HYPOTHESIS

In addition to answering the research objectives the study tested the following hypothesis.
H_0: There is no significant relationship between chit fund investment and demographic characteristics.
Ha: There is significant relationship between chit fund investment and demographic characteristics.And
H_0: There is no relation between chit fund investments with awareness about frauds and scams, financial education, excessive greed to expect windfall gains aftermath of these scams.
Ha: There is relation between chit fund investments with awareness about frauds and scams, financial education aftermath of these scams

V. DATA AND RESEARCH METHODOLOGY

A. Data collection

The primary data to analyze the determinants and rationale of chit funds in Odisha was gathered from the investors through a questionnaire which signify the motivating factors and causes of frauds as well as their opinion regarding managing chit. The data comprised a sample survey of 112 investors covering observation for last 03 months. The primary data was collected through a well designed questionnaire. The main variables of interest related to individuals includes Gender, Age, Age group, Occupation, Education level, Religion, Caste, Tenure of investment in chit funds, Amount of investment in chit funds. The survey was entirely based on the information provided by the investors.

B. Research Methodology and Data analysis

The analysis of the determinants and rationale of chit funds in Odisha has been carried out in two steps. During the first stage of analysis, the data gathered was analyzed using descriptive statistics. Descriptive statistics explains the mean, median, minimum, maximum and standard deviation of the data. Examination of the characteristics of the sample was carried out which showed the level of investors all distinguished by Age group, Occupation, Education level, Religion, Caste, Tenure of investment in chit funds and Amount of investment in chit funds.
The data collected through questionnaire has been further processed through SPSS (Statistical Package for Social Sciences). Non-parametric tests mainly the chi-square test has been used to test the hypotheses. A Chi-square test for independence is applied when two categorical variables are generated from a single population. It is used to determine whether or not there is a significant association between the two variables.
The questionnaire with a 5 point Likert scale has been used for analyzing the behavioural attributes of the respondents. The 5 point scale in the questionnaire bears the corresponding prefix, e. g. 1 as agree, 2 as strongly agree, 3 as disagree, 4 as strongly disagree and 5 as do not know.
To test the reliability using Cronbach's Alpha score comes out as 0.958 hence it was accepted. To consolidate the data, factor analysis was carried out. Statistical tools like Descriptive Statistics, Chi-square (x^2) test, linear

regression and Principal Component Analysis (PCA) is used to test the hypotheses. The hypotheses for the aftermath effect and managing chit funds regulation which has been tested using Chi-square test. Finally, the data were processed through the use of SPSS.

Table 1: Reliability Statistics

Cronbach's alpha	Cronbach's alpha based on standardized items	No. of items
0.958	0.958	39

Source: SPSS Analysis Result

C. Demographics of the respondents

The descriptive analyses for demographics profile of respondents which indicated below-

Table 2: Demographics profile of respondents.

Demographic	**Frequency**	**Percent**	**Cumulative Percent**
Occupation			
housewife	16	14.29	14.29
business	16	14.29	28.57
service	48	42.86	71.43
Agriculture	32	28.57	100.00
Total	112	100	
Type of Job			
Govt.	22	19.64	19.64
Private	23	20.54	40.18
Self Employed	11	9.82	50.00
Others	56	50.00	100.00
Total	112	100.00	
Gender			
Female	33	29.46	29.46
Male	79	70.54	100.00
Total	112	100	
Age group:			
18-25 years	16	14.29	14.29
26-40 years	54	48.21	62.50
41-60 years	34	30.36	92.86
61 and above	8	7.14	100.00
Total	112	100	
Educational Qualification:			
Under Matriculation	45	40.18	40.18
Higher Secondary	23	20.54	60.71
Graduate	22	19.64	80.36
Post graduate	11	9.82	90.18
Any other	11	9.82	100.00
Total	112	100	
Religion:			
Hinduism	79	70.54	70.54
Muslim	22	19.64	90.18
Christian	11	9.82	100.00
Buddhism	0	0.00	
Jainism	0	0.00	
Any other	0	0.00	
Total	112	100.00	
Caste:			
General	45	40.18	40.18
Scheduled Caste	25	22.32	62.50
Scheduled Tribe	8	7.14	69.64
Other Backward Caste	34	30.36	100.00
Total	112	100.00	
Tenure of investment in chit funds			
0-2 years	42	37.50	37.50
2- 5 years	50	44.64	82.14
5 years and above	20	17.86	100.00
Total	112	100.00	
Amount of investment in chit funds:			
<= Rs. 10000	12	10.71	10.71
Rs.10001-	54	48.21	58.93

Rs.50000			
Rs.50001-Rs.100000	13	11.61	70.54
Rs.100001-Rs.500000	33	29.46	100.00
>Rs.500000	0	0.00	
Total	112	100.00	
Source: Compiled from questionnaires			

Table 3: Descriptive Statistics

Particulars	N	Minimum	Maximum	Mean	Std. Deviation
Type of Job	112	1	4	2.9018	1.22261
Gender	112	1	2	1.7054	0.45793
Age group	112	1	4	2.3036	0.80359
Educational Qualification	112	1	5	2.2857	1.34519
Religion	112	1	3	1.3929	0.66247
Caste	112	1	4	1.7321	1.01326
Tenure of investment in chit funds	112	1	3	1.8036	0.72085
Amount of investment in chit funds	112	1	4	2.3839	0.80813
Valid N (listwise)	112				

Hypothesis testing:

Here the researcher tests whether there is any relationship between chit fund investment and demographic characteristics.

Ho: There is no significant relationship between chit fund investment and demographic characteristics.

Ha: There is significant relationship between chit fund investment and demographic characteristics

Table 4: Chi-square test for independence result.

Demographic character	Value	df	Asymp. sig.(2 sided)
Job Type	86.576a	9	0
Gender	1.019a	3	0.397
Age	1.677a	9	0
Qualification	188.290a	12	0
Religion	176.270a	6	0
Caste	29.682a	9	0
Source: SPSS analysis result			

Since the P-value is <0.05 the null hypothesis is rejected that is there is significant relationship between chit fund investment and demographic characteristics. The result of the chi square independence result shows that there is relationship between chit fund investment and demographic characteristics, therefore the research hypothesis accepted.

D. Principal Component Analysis (PCA)

Principal Component Analysis (PCA) has been conducted to find and club the component under the suitable head. The result of the PCA is as follows:

Table 5: Component Transformation Matrix

Component	1	2	3	4
1	**.156**	**.733**	**.599**	**-.182**
2	**.950**	**.225**	**-.096**	**-.041**
3	**-.168**	**-.367**	**.631**	**.633**
4	**.134**	**.494**	**.412**	**.745**

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization

On the basis of Rotated Component Matrix, the 19 parameters in the questionnaire are segregated into four components. For each parameter, the highest factor loading has been taken for consideration for the under different components. Hence, the four components derived from PCA are as under:

Table 7: Components Derived from PCA

Component 1	Component 2	Component 3	Component 4
Laxity in regulatory system	Rigid banking formalities	High rate of return and high Commission	High rate of return and high Commission
Proper coordination among regulators	Stringent license norms and close monitoring	Stronger regulations	Present Chit Funds Act, 1982 is weak in its operation
Stringent license norms and close monitoring	Rationalized Banking norms	lack of Govt. sponsored small investment schemes	friends, family and relatives pressurize
Lack of financial literacy	Someone known and/or one of your family member or relative persuaded to join in chit funds	Financial iliteracy	Requirement of stringent Act
Encouragement of Investors education	nexus between some politicians and chit fund companies	A Bank in the locality	Scope of operation should be controlled and limited
Weak Chit Funds Act, 1982	Lack of financial literacy	Investors education	
	provision for caution/security deposit	provision for caution/security deposit	

E. Liner regression analysis

The researcher here also tests whether the recent chit fund scams has any impact on investors perception on their investments, where awareness about frauds and scams, financial education, excessive greed to expect windfall gains are considered independent variable and chit fund investments is dependent variables. For testing the hypothesis, a statistical test called liner regression analysis test was employed through the use of SPSS statistical package.

a) Statement of hypothesis

H0: There is no relation between chit fund investments with awareness about frauds and scams, financial education, excessive greed to expect windfall gains aftermath of these scams.

Ha: There is relation between chit fund investments with awareness about frauds and scams, financial education aftermath of these scams.

b) Dependent variable (D1): chit fund investments

c) Independent variables (I1, I2 and I3): awareness about frauds and scams, financial education, excessive greed to expect windfall gains.

Table 8: Model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.249[a]	0.062	0.036	0.7934	0.062	2.386	3	108	0.073

a. Predictors: (Constant), **I1,I2 and I3**

Table 9: ANOVA

Model 1	Sum of Squares	df	Mean Square	F	Sig.
Regression	4.507	3	1.502	2.39	.073[b]
Residual	67.984	108	0.629		
Total	72.491	111			
a. Dependent Variable: chit fund _investment					
b. Predictors: (Constant), I1,I2 and I3					

Table 10: Coefficients

Model 1	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations		
	B	Std. Error	Beta			Zero-order	Partial	Part
(Constant)	2.411	0.174		13.895	0			
I1	-0.084	0.054	-0.165	-1.536	0.127	-0.182	-0.146	-0.143
I2	0.13	0.075	0.221	1.717	0.089	0.131	0.163	0.16
I3	-0.056	0.078	-0.102	-0.713	0.477	-0.029	-0.068	-0.066
a. Dependent Variable: D1								

Table 11: Change in Perception of Investors after math of chit fund scams in Odisha

	Particulars	Agree	Strongly agree	Disagree	Strongly disagree	Undecided	Total
1	The chit fund agent cheated you	33.92	33.92	16.07	0	16.07	100
2	The chit fund company cheated you	25.89	50.00	8.03	8.03	8.03	100
3	You are now more confident not to invest in chit funds again	25.00	41.96	8.03	0	25.00	100
4	You won't be recommending this option to anyone else?	32.14	43.74	8.03	0	16.07	100
5	You now believe you would never receive the financial returns as promised by chit funds?	50.90	25	16.07	0	8.03	100
6	The Govt . is colluded with Chit funds and cheated you?	33.03	17.85	8.03	8.03	33.03	100
7	You believe you are more aware about frauds and scams now?	42.85	25.00	8.04	0.00	24.11	100
8	You now believe that the business models of chit funds are unsustainable in the long run?	58.03	8.04	8.04	0.00	25.89	100
9	You won't be excessive greed to expect windfall gains?	50.89	16.07	16.96	0.00	16.96	100
10	You should invest more on financial education?	33.93	41.07	8.04	0.00	16.96	100

From the above model summery R = **.249**[a] which shows there is a negative relationship between investments with awareness about frauds and scams, financial education, excessive greed to expect windfall, which means investors are more aware about frauds and scams, excessive greed to expect windfall and financial education.

VI. FINDINGS

As the determinants and rationale of chit funds in Odisha was gathered from the investors through a well developed questionnaire which signify the motivating factors and causes of frauds as well as their opinion regarding managing chits, the following information have been captured and summarized.

- Due to lack of financial literacy and sophistication, investors are simply more exposed to idiosyncrasies of the chit fund companies.
- Expectations of earning high commission and high rate of return attracted investors to join chit funds.
- Someone known to investors and/or some of the family member or relative persuaded investors to join in chit funds.
- Majority of the respondents believe that the chit fund agent cheated them.
- Majority of the respondents claim that they were unknown about the chit fund companies and they believed the chit fund agent.
- 86% of the respondents the current interest rate of banks and post office is low; 65% of the respondents believe that a bank in their locality would have avoided them to invest in chit funds; 48.4 % believe that due to lack of Govt. sponsored small investment schemes investors invested in chit funds; 42% believe that the present banking formalities are rigid and somewhat responsible for chit fund scams.
- The study shows that laxity in regulatory system and nexus between the political parties and chit fund companies paved way for the perpetrators to commit frauds.
- The respondents also believe that the business models of the chit funds are unsustainable in the long run and believe that the rate of interest offered by chit fund companies is unfeasible.
- The study further emphasizes the requirement of stringent Act is essential along with proper coordination is needed among the regulators.
- The study suggests that banking norms should be rationalized; investors education must be encouraged and stringent action must be taken against the perpetrators.
- The study shows that investors are now more aware about these Chit Fund companies because of the relentless media coverage and would be more careful before investing next time.

VII. CONCLUSION

The study empirically analyzes the determinants and rationale of chit funds in Odisha by constructing an econometric model to study the various factors of chit funds investments. The business of chit funds is running in India in various names and forms since many years. Recent Frauds have exposed these businesses of thousands of crores rupees because of laxity in regulation and financial illiteracy. Weak provisions of the Chit Fund Act, 1982 along with laxity in regulatory system and nexus between the politicians trembled the bottom-of-the-pyramid. Many small investors lost their life savings in chit fund scams. Rationalizing banking norms along with financial literacy and investors education must be encouraged to safeguard the interest of the investors .The regulators must tighten their Act with proper coordination among the various agencies so as to build investors confidence and to retain their faith.

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