Informal Credit Markets in India

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This paper deals with the non-bank urban informal credit market in India and, in specific, with how it contributes to finance in the Indian economy.

The Indian informal financial market, once far larger than the formal one, has both declined and changed its form in response to the expanding roles of the banks in recent years. But it remains an important force in the economy.

Two Banking Commissions in 1929-30 and 1911 surveyed important sectors of this market, but changed circumstances since 1969 (when the banks were nationalised) and some limits on the 1972 Banking Commission Reports' coverage have rendered a limited resurvey necessary for a full consideration of this informal market.

I

Introduction

CREDIT MARKETS develop almost in every case where extensive long-range trade or manufacture involving stocks and consumer credit exists. Those with surplus funds lend them to those who need funds to carry on their business, first for working capital and then for fixed capital assets as well. Soon intermediaries grow up which develop financial instruments which serve to reconcile the different terms (length of credit, type of security and so forth) desired by lenders and borrowers. After a period, governments attempt to regulate some of these intermediaries and instruments in order to protect all market participants, and often to direct funds preferentially in one direction or the other.[1] Other intermediaries and instruments remain outside of the regulatory net in the 'Informal market" Since the substance of both regulated and unregulated markets is the same mobile lendable funds, the markets interact and funds find their way back and forth between the two markets and go wherever the return is higher. To achieve their purposes of capital channeling, governments often try to repress the informal market, to increase the amount of regulated or channelled funds; but whether they will be successful or not depends on the external forces which drive the evolution of both markets. In particular, the increases in transaction costs occasioned by artificially channelling funds into the formal market may cause a net decrease in available funds, and retard economic activity, or repression may fuel "parallel" informal markets. "Stifling regulation by the Exchange Authorities can be one reason for the establishment of a parallel market. Other reasons are limitations on the Minimum transction or of amounts of each kind of security (instrument) and excessive commissions (transactions costs) charged by brokers on the original market."[3] The two markets — regulated and informal — may become disaggregated and all sorts of irrationalities occur in capital allocation because of the segmentation of what might naturally be a more integrated market.

On the other hand, the repression of informal markets could create space for the growth of a more integrated, rational set of financial institutions.

India has followed roughly the general pattern outlined here; old credit markets serving trade and traditional industry remain unregulated and coexist with regulated credit markets serving more modern industry and the state sector, Government policy aimed partially at channelling funds into the regulated financial sector — and partially at protecting savers and borrowers — has led to measures of control which have disaggregated this informal market from the regulated one. The questions that arise concern the countervailing gains and losses from such controls and the possibilities for future evolution of the two markets. This study is concerned with those questions.

DEFINITIONS

For the purpose of this study informal financial markets are any markets for cash finance (rather than credit in the form of goods) which do not involve directly the regular commercial banks, registered savings institutions, or equity and debentures traded in registered securities markets. The essential characteristic of these markets is that they are far more loosely monitored and regulated than 'formal' financial markets.

The earliest treatment of these financial markets by Bottomley and U Tun Wai in the IMF Staff Papers and elsewhere referred to them as 'unorganised markets', because in several cases they seemed highly segmented as compared to the 'organised' financial market dominated by the banks.[3] But at least in the Indian case (and the Korean one as well) several of these markets seem large and institutionalised enough to make the term 'unorganised' inappropriate.[4] Incidentally, to the extent the markets studied are less segmented the very high interest rates reported in studies like U Tun Wai's and Bottomley's seem less characteristic as well. Older Indian literature refers to the 'indigenous' market (elsewhere people talk about the bazaar financial market) to differentiate it from the more westernised forms of the regular commercial banks. But the invidious distinction seems hardly appropriate today when all institutions considered are thoroughly Indian.

The present study is not concerned with informal rural credit, except in so far as some of it finances trade and industry. Current estimates suggest that the rural informal sector in India accounts for almost Rs 3,000 crores of loans, lent at rates of 12-25 per cent per annum.[5] Nor is it concerned with the large market for 'black' money financed out of sums not reported to income tax. This study is also not concerned with the considerable market for consumption credit, especially to support the poorest members of society. This market is probably small in volume, but often characterised by high risks and interest rates.

The rural and consumption credit markets are not always easy to separate from the urban commercial and industrial finance market covered in this survey. Both rural and urban industry sometimes finance themselves out of these rural and consumption markets. Surveys particularly note this in the case of smaller artisans.[6] The Chettiars and Rastogi bankers and finance companies surveyed do considerable household finance — in the latter case especially of consumer durables.

The urban informal financial markets serve both the 'organised' and 'infor-

TABLE 1 : VOLUME AND RATES OF CREDIT IN ICMS

	Number of Firms	Credit Extended (Rs crores)	Rates of Interest Per Cent per Annum
(1) *Shikarpuri or Multani Bankers*[1]			
Members of local associations	550	60	21-37
Non-members	650	65	21-120 (high rates for film finance)
Brokers	550	125	21-120
Shikarpuri Submarkets			Maximum rates for Shikarpuris
Bombay members	238	24	30
Bombay non-members	350	33	NA
Madras members	126	15	37
Madras non-members	200	16	NA
South Indian cities			
Madurai members	20	3	21-25
Madurai non-members	10	NA	NA
Trichy members	30	NA	21-25
Trichy non-members	12	NA	NA
Tanjore	4	0.6	21-25
Salem	40	5	21-25
Calicut	20	1	27
Coimatore members	20	3	21-25
Coimbatore non-members	35	4	NA
Bangalore members	NA	4.5	NA
Bangalore non-members	NA	5.5	NA
Hyderabad members	NA	ε	NA
Hyderabad non-members	NA	4.5	NA
Vijayawada	NA	1	NA
Marwaris in Madras doing similar business	100	10.4	28-44
(2) *Gujarati Bankers*[2]			Average rates
Pure bankers	1500	860	18
Bankers and commission agents	3500 (at least)		18 (on finance in cotton plus ½ per cent commission on turnover; 3 per cent a month on powerloom cloth)
Gujarati Submarkets			
Kaira district	NA	26	
Bombay pure brokers	6	35	
Ahmedabad district	NA	16	
(3) *Chettiyars*[3]			
Bankers	2500	380	18-30
Pawnbrokers	40,000	1,250	18-30 plus
(4) *Rastogi bankers*[4]	500	100	18-24

(Ail rates are approximate—interest rates and numbers of firms are less so that the estimates of credit extended) \

Notes: (1) Multanis receive Rs 3 to 6 crore in bank refinance and have Rs 7.50 crores in deposits.

(2) Gujarati bankers may have as high as Rs 800 crore deposits, pay 7.5 per cent on current account (6 per cent in Bombay) and upto 12 per cent on longer term money. Gujarati annual hundi turnover in Bombay pure bankers, Rs 1,000 crore; and banker commission agents, Rs 600 crore.

(3) Chettiars who do secured lending are 25,000 pawnbrokers, 25 per cent of whose lending is for commercial purposes and who dispense a total credit of Rs 1,250 crores; and 2,500 bankers who extended Rs 380 crore of credit and hold perhaps Rs 250 crore deposits. The bankers, inter *alia,* refinance pawnbroker lending. Normal lending rates are 18-30 per cent per annum; deposits for over one year get 15 per cent per annum and less than a year get 12 per cent.

(4) Rastogi Bankers have roughly Rs35 crore in deposits on which they pay 12-15 per cent in Lucknow and 14-20 per cent in Benares. They lend on a secured basis at 18-24 per cent, and on an unsecured basis at higher rates. Effective rate on hire purchase finance is 36 per cent per annum

mal, unorganised' sectors of productive enterprises in trade, services, and industry. The informal enterprises among these productive enterprises are those whose economic activities are not closely monitored and regulated by the government. Specifically, informal enterprises' are those family and proprietary enterprises which do not come under the purview of the company and often the tax and labour laws. In general, less than half of small-scale industrial enterprises in India are probably registered as small-scale industries with the government, less than 20 per cent have bank credit, and even fewer pay income tax, Thus more than halt of all productive enterprises, even in the industrial sector, are 'informal'. But, as we shall see, most informal financial sector, credit goes to formal sector productive enterprises,

INFORMAL MARKETS AROUND THE WORLD

Informal and non-bank commercial credit markets exist in most market economies. These are markets not subjected to the close customary and legal regulation characteristic of commercial banking and its variants. In 1977, the volume of such finance in the US' alone was $ 70 billion. The volume of such lending has doubled since 1970.[7] These non-bank lenders provide working capital, generally at somewhat higher interest rates than the banks for those enterprises whose demands, procedures, and risks are deemed inappropriate by the commercial banks. The differential with the banks rates varies, though both in the American and Indian case it ranges between 2 and 8 per cent. These lenders serve a clientele which includes a disproportionate number of small-scale enterprises (SSE), whose size and instability make them unattractive to the commercial banks, normally the primary source of working capital. To the extent that the promotion of SSE is an important policy objective, the proper functioning or replacement of these markets is a critical concern of public policy; and to the extent that the activities the informal non-bank markets finance are necessary to the balanced growth of the economy, the finance markets are also necessary.

Further, in industrial economics the intermediaries in this non-bank market have often pioneered forms of credit later adopted by the regular hanking system. They form the cutting edge of banking innovation. These non-bank intermediaries have demonstrated the possibility of accommodating new categories of clients and business, The

financial institutions have then cither copied them or shared their returns by refinancing them. In LDGs where Western style banks often adjust poorly to indigenous market conditions these informal financial markets are likely to serve a larger and more crucial sector of the economy than in the industrialised, countries and to present a model of how the banks could adjust to serving the market's expressed needs.

The present study -estimates that the percentage of such non-bank finance in the Indian urban financial markets is at least 30 per cent of the total (not including 20 per cent accounted for by publicly held deposits with limited companies and call money, but not illegal monetary flows), Commercial Bank credit accounts for the bulk of the remaining borrowing by firms. By contrast, in the West Africa studies the proportion of informal finance is under 3 per cent.

Of course, the economies considered are quite different and at entirely different levels of financial development, but the figures are broadly indicative.

The countries surveyed indicate that there is a considerable span in the size and degree of integration of informal, unregulated credit markets in the countries concerned. As we will indicate toward the end of this survey, there seems to be a regular pattern in which the degree of integration normally increases with the industrial and commercial development of the countries concerned.

The existence of this informal 'indigenous' credit market has, of course, been no secret to the students of the Indian economy. References to it are made in the Vedas and the Buddhist Jatakas (7th to 2nd centuries BC) report bankers remitting cash and creating credit instruments, receiving deposits, and organised in guilds. Later sources refer to 15-80 per cent rates of interest varying with security and social standing., In the Mughal period (1525-1719) bankers managed the financial affairs of state and financed long range trade.[8]

II

Informal Credit Markets

Informal credit markets exist in a wide variety of forms in the Indian economy, largely complementary to but occasionally competitive with the 'organised' banking system. These credit markets provide credit to markets or firms which the 'organised' banking system cannot accommodate either because of explicit policy limitations or because the bank's requirements for borrowers are too onerous.

The data for this report came from a series of selected interviews with lenders, borrowers, intermediaries, and associations which represented them. Almost one thousand people were interviewed (not always singly) by the three investigators who submitted individual reports on their work; this monograph presents their results in integrated form.

The interviews were not rigidly structured though we did try to get data about costs, rates, and volumes of lending as well as a general sense of operating procedures from the intermediaries. From the borrowers, we tried to gain a sense of their criteria for choosing the informal sector, and the place its finance played in their operations.

Initially we had planned to concentrate on the traditional bankers alone (those who took deposits and made loans) — but it rapidly became apparent that it was necessary to study brokers, and new institutions like 'finance companies' which not only performed parallel functions in many markets, but actually formed part of the same informal market network.

The interviews were spread out in a variety of areas including Bombay, South Gujarat, Delhi, Amritsar, Kanpur, Calcutta, Benares, and Lucknow, and the major centres of South India, They do not represent any work in Central India, with an old banking network, nor in Eastern India outs de Calcutta. Even in Calcutta, the coverage is far lighter than we would have preferred; hut time was simply not available to establish the connections that would have been necessary for a more thorough study there.

TYPES OF AGENCY

The traditional informal credit market intermediaries were organised along lines of ethnic community. Their history can be and is recorded on communal lines.' The Shikarpuris, the Gujaratis, the Chettiars, the Rastogis, and so forth all had separate networks, with separate if similar procedures (Table 1). Some business was done across community lines, especially in port cities, and cli-entele was often gathered from different ethnic communities than that to which the intermediaries belonged. The Chettiars, for example, served almost all -economically active groups in South India; the Rastogis served the craftsmen and traders of all communities in the Oudh area of Uttar Pradesh. In the modem period, there has occurred a considerable blurring of lines both as to modes of doing business and to business partners, and a merging of the older modes with several non-traditional forms — intercorporate call money, hire purchase arrangements, finance "companies", etc. The informal intermediaries may not be classified on functional line. For the purpose of this study we shall be moving back and forth between the categories — communal and functional — but will try to organise the account on a functional basis.

There are four broad types of facilities available in informal credit markets defined in functional terms — indigenous style bankers, commercial financiers, finance brokers and commercial paper discounters. None of these are pure types. Agencies of all sorts, for example, discount commercial paper, and perform as brokers for their clients.

Indigenous Style Bankers: As the 1972 Banking Commission defined them, 'Indigenous Style Bankers' had both to take deposits and make loans. This had to constitute a major part of their business. Though their number has declined somewhat there are still thousands of family firms who continue business as traditional .style bankers. Continuously reorganised, many of these firms have continuous existences going back several hundred years. The Gujarati Shroffs do almost everything a commercial bank does — accepting deposits, making loans, and providing means of remittance and collection. The Gujarati firms themselves number well over 4,000. There is a continuum among these Gujarati bankers between those in Gujarat itself, who are often specialised in banking and 90 per cent of whose funds may be based on deposits, and the more numerous Marwari and Gujarati firms in Bombay and Calcutta which combine their banking with trade in cloth, grains, and other commodities and whose credit transactions are to a greater or lesser extent ancillary to that trade.

The indigenous style bankers, typically, perform a larger set of services for their clients than simply accepting their funds on deposit and reloaning them. They provide means of remittance (especially 'darshani hundis' — sight bills), discount commercial paper and checks, give commercial guidance, and often offer transient accommodation to their out of town clients and associates. Their offices are open both later and earlier than the commercial banks

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and they are far more flexible in serving their customers. They provide the only banking services in many areas of India and service firms with business interests there. This largely explains the preference of some Bihar and Assam cloth traders in Calcutta for dealing through Marwari indigenous banker since there are no commercial banks in the villages with which they trade. In other areas, especially Gujarat, indigenous bankers provide accommodation to "non-priority sector" trades not well financed by the banks — grains, cloth, "biri" tobacco etc. Deposits represent 30-90 per cent of the funds the fcujarati Shroffs use, and lower percentages for others.

Traditionally Gujarati Shroffs did not solicit new clients and restricted themselves to serving a local clientele whom they knew intimately. There are now a few Gujarati indigenous bankers who have taken a more aggressive pose and advertise for clients. One such banker has 93 branches, and Rs 20 crores as deposits.

Though the number of Gujarati Shroffs is relatively high and the range of their services particularly extensive, we found a wide variety of indigenous style bankers among other communities as well. Much of the Chettiar pawnbroking in South India is conducted, for example, on the basis of deposits.

By this 'deposit taking and lending' definition, the indigenous bankers ought to include as well a group of finance 'companies' (though they are rarely joint stock companies) who take and solicit deposits and lend them in turn to a commercial clientele. One of the authors surveyed two highly successful ami reputable firms of this sort. The firm run by Srinivasa Naidu in Coimbatore with Rs 1.80 crores in deposits kept Rs 60 lakhs in fixed deposit at 9 per cent and lent the rest out at 18 per cent against pawned sureties. The depositors are paid 9 per cent annum. The Gujarat Savings Unit runs a series of very successful savings and prise schemes for small savers. Over a million people are involved in these schemes, and 10,000 agents solicit, at least part-time, for them. The Unit has been especially successful in Andhra. 50 per cent of the money is invested at the 9 per cent fixed deposit rate and the rest is loaned to industry at rates ranging from 18 to 24 per cent per annum.

Many of these 'companies' are run by people from a traditional banking background. There were 50-150 of them in the various Southern centres surveyed — though most of our operational data is based on a survey of 20 such firms in Trichy. One estimate has it that there are 2,200 such companies with perhaps Rs 450' crores of working funds in the whole country. The 20 firms surveyed in Trichy who were members of the local finance company association had Rs 44 crores in working funds. In Trichy and Karur, 30 per cent of finance company advances went to retail trade and 10 per cent to wholesalers, 8 per cent to small scale industry and 12 per cent to agriculture. In the larger Cities, hire purchase finance of used vehicles seemed most important. In agricultural centres the credit went to finance trade in cash crops. In the case of Sugeshan in Madras about half the funds are invested in three month promissory notes and the rest in secured export finance. The largest of these finance companies have several crores of rupees, all of it based on deposits; own capitalisation is usually low. Peerless claims more, than Rs 100 crores in assets, Sugeshan Rs 100 million.

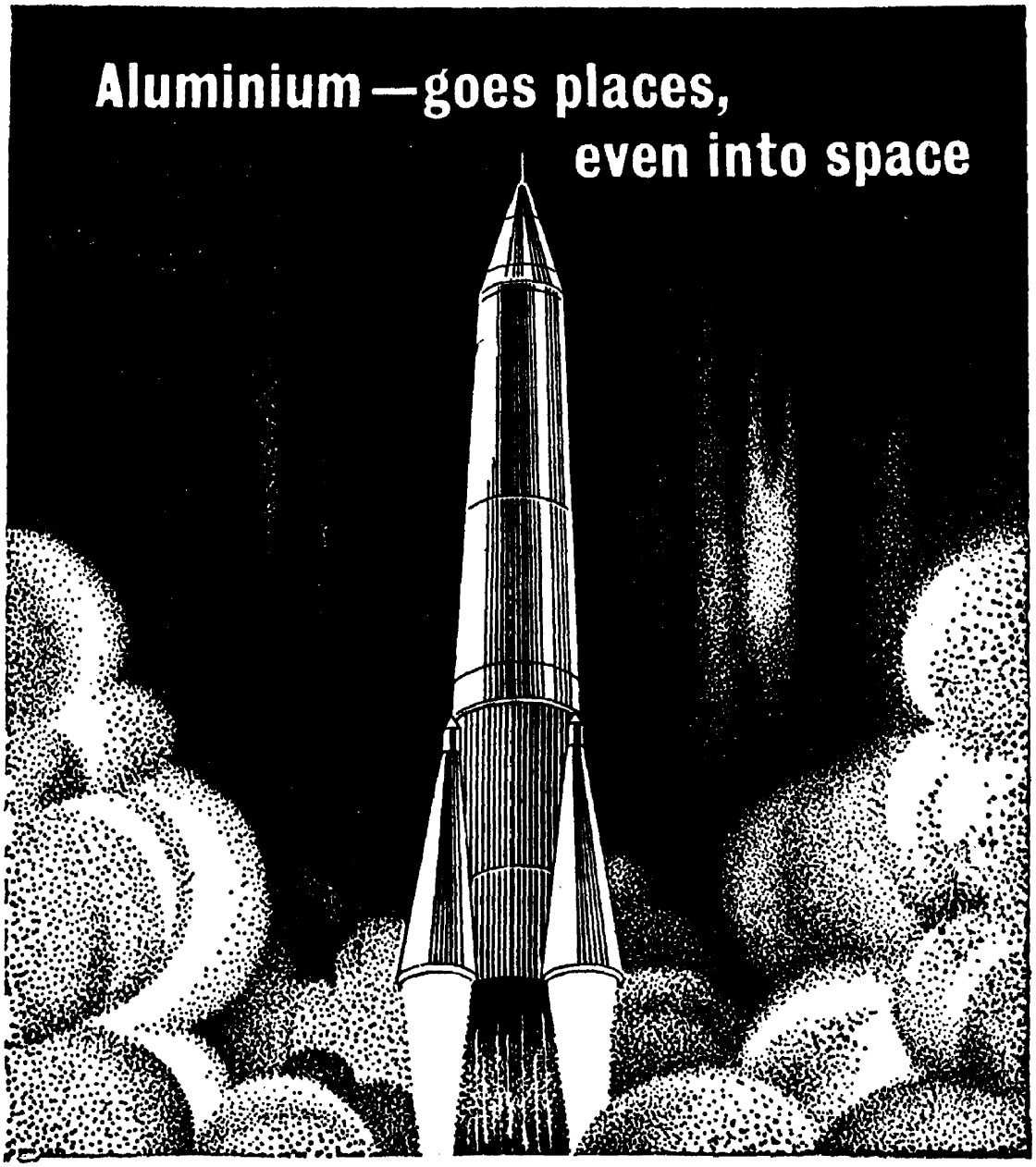
The few limited company finance companies are mostly involved in the hire purchase finance of vehicles less than three years old and enjoy considerable bank refinance. They had assets of Rs 26 crores.[10] The non-limited 'companies', in the larger centres specialise in the hire purchase finance of older vehicles, and to some extent of consumer durables. The Hire Purchase Association of India reports that 425 of its 500 members are not limited companies.

The finance 'companies' perform many bank functions — they discount and collect a variety of remittances and commercial paper, maintain deposit accounts, and sometimes provide cheque-like remittances. The non-limited company segment of these finance 'companies' is almost totally unregulated and some apprehensions are entertained about their soundness. The 1972 Banking Commission recommended that the government devise a scheme for their regulation. Since the RBI concluded that regulation was impossible, government has introduced a Bill in Parliament which would have the effect of banning these companies, as well as restricting a good deal of the rest of the indigenous banking community. No action has been taken as yet on this Bill,

A variant on these finance 'companies' is the commercially promoted Chit Fund (Kuri), a rotating credit arrangement characteristic of South India. Though not very profitable for those who invest in them, most include some lottery element and they are very popular. Again government has proceeded to ban 'prize chits'. It is estimated that there is an annual turnover of about 200-250 crores in Chit Funds.[11] Chit Funds are often run by traders who find that the funds help meet their working capital needs or by finance 'companies' but the bulk of chit finance is for non-business purposes. A variety of mutal loan funds (Nidhi) and commercial property mortage firms fill other credit needs, again primarily in South India. As much as a quarter of Chit Fund, Nidhi, and pawnbroking funds go for commercial purposes.

Commercial financiers: These are lenders who, in contrast with indigenous bankers, mostly employ their own funds and do not take significant amounts of deposits. In some cases, however, they may serve as intermediaries by discounting (i e, refinancing) their lendings with commercial banks or others. In this way they are similar to the Commercial Finance Companies in the US or other industrialised Companies. The large group of Shikarpuri (sometimes called Multani) financiers in Bombay and South India are the most widely known of these financiers. Originally indigenous bankers of the classic sort, they largely renounced deposits some time ago to rely on bank rediscount of their obligations. In recent years, this refinance has been reduced as a matter of bank policy, and they now largely rely on their own funds. The amount of bank funds made available to them is less than one tenth what it was in 1960.[12] There are roughly 600 firms which belong to the various local Shikarpuri Banker's Association with Rs 600 crores of capital according to one estimate. Other estimates would put the amount of capital at little more than half that figure. The average firm would have had a capital of roughly Rs one crore, though two or three firms may often be owned by the same family. In addition to the Shikarpuri firms who are members of the local associations there are probably an equal number who are not In the case of Madras, only those firms with refinance facilities at three banks are eligible for membership and membership at 127 is almost one half the number of non-member bankers. Incidentally the 127 members is up from 77 in 1970.

The Shikarpuris traditionally took what wore known as 'multani hundis', 90-day term notes in amounts between Rs 3,000 and Rs 5,000 (earlier much lower) and discounted these notes. With the decline of discount facilities,



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they have moved towards demand promissory notes (endorsed for a term) and instalment finance. Typically, a broker will arrange to break up a large loan into smaller notes which he will sell to a whole group of bankers; risks are thus spread throughout the Shikarpuri community.

Financiers of the Shikarpuri sort exist almost everywhere; that is there are in every major market people who make their living by lending their money to businessmen as do the Shikarpuris. One Rastogi 'Private Banker' in Kanpur indicated that he traded almost entirely on Rs 20 lakhs of his own capital A group of 100 Marwari bankers in Madras were found doing precisely this 'multani' business, Non-Shikarpuri commercial financiers, dealing through brokers, were found in all centres studied. They proved the shiest of the informal credit agencies, and in several cases I had to rely on second-hand reports on their activity. In general, the most difficult data to get for this study was that on the identity of lenders.

Finance Brokers : The typical commercial financier, unlike the typical indigenous banker, deals through brokers. But brokers go, as well to other, non-full time (i e, non-commercial lender) sources. In the Shikarpuri market, in particular, as the amount of bank funds in the hands of bankers has contracted and the brokers have emerged as an independent force, searching funds from any willing source. One broker gathered funds from 350 different .sources in amounts from Rs 10,000 to Rs 1,00,000, and re-lent them to 37 larger-sized public companies. There are full and part-time finance brokers in almost every commodity market, ranging from those who work the inter-corporate call money market (minimum of Rs 5 lakhs, at 8.5-10 per cent with 1/2 per cent brokerage) in Bombay for crores of rupees at a time, to the kind I interviewed in Kanpur and Amritsar who may carry back and forth as little as between Rs 5,000 and Rs 25,000 at a time between traders in the cloth market, or between the grain and. jute markets in Calcutta.[13] For certain purposes, it is necessary, however, to differentiate between the company broker who brokers deposits and call money in the corporate sector (in high volume and at low cost) and the smaller brokers who serve partnership and proprietary firms, The former are often stockbrokers and combine stock brokerage with the brokerage of other financial accommodations.

The brokers used by Shikarpuri financiers (accounting for almost all transactions in Bombay and 75 per cent in Madras, but very little in the smaller centres) often receive as high as 2 per cent commission. There are 85 association-member brokers in Madras and three times as many in Bombay, and many unregistered ones. Some of these brokers — members and non-member — deal with both Shikarpuri and non-Shikarpuri funds sources.

Gujarati indigenous bankers also use brokers, especially in the larger cities, but the brokers' role is less critical than among Shikarpuris and they do not syndicate loans among bankers. Rastogi bankers in Uttar Pradesh are beginning to use more brokers as they attempt to diversify their portfolio into new fields.

The smaller sort of brokers, providing intermarket or intramarket credit to proprietary firms, represent a considerable range. At the top there are those like the Amritsar broker who handled more than one to two crore rupees a year for 150 large clients in minimum amounts of Rs 50,000. By contrast a more typical broker has 15-25 clients and deals in a minimum unsecured transaction of Rs 5,000 or so in a small cloth or grain market.

Commercial Paper Discounters. There is also a considerable business in the discount of commercial paper, checques, post-dated cheques, truck receipts, etc. By and large, this financing is done as in the West; outstanding bills and accounts receivable are brought without recourse. An important part of the business is the discount of bank cheques, current and post-dated. Post-dated cheque finance was reported in large volume in Bangalore and Varanasi for hand and powerloom finance and in Madras for financing tanneries. Shikarpuri lending, particularly on an instalment basis, is now often done through the instrument of a post-dated cheque. In Calcutta, discounting is concentrated among Marwaris and capital of Rs ten crores to Rs fifteen crores is reported to be involved. Numerous firms do this kind of discount in the major centres including indigenous bankers and commercial financiers, trucking companies, commercial couriers *(angaria)* and others. In one variant, the cotton textile mills find firms to which they can sell their accounts receivable; textile purchasers find firms who will appear as the wholesaler of record in order to finance their transactions. The discounters typically charge what amounts to 18-24 per cent interest on an annual basis.

ORGANISATION AND REGULATION

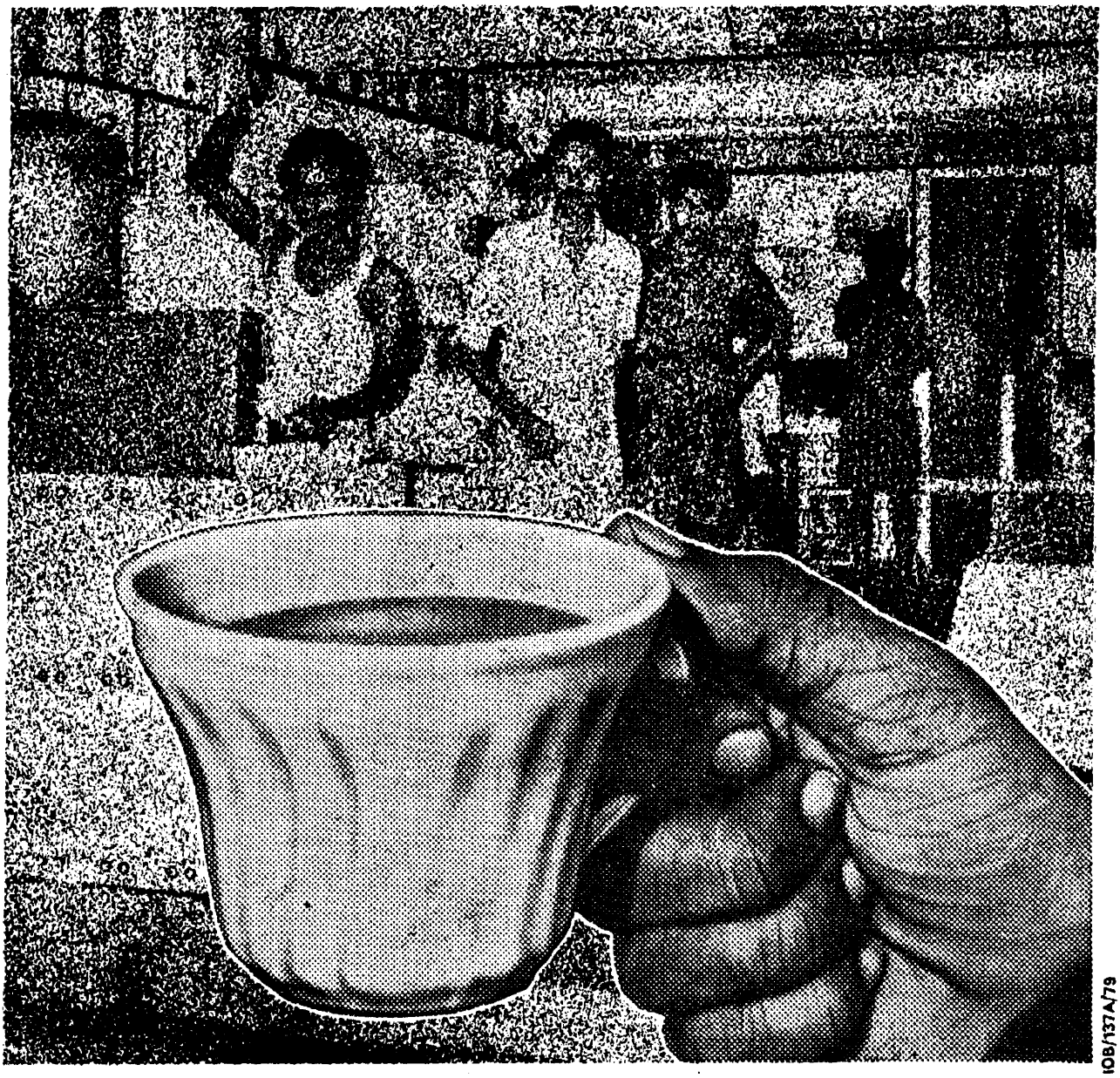
One characteristic of some of these informal credit markets worthy of note is their organisation for self-regulation. About half the Shikarpuri financiers belong to local associations which serve both as social centres and enable their members to be eligible for bank refinance. These usually do not have explicit disciplinary functions, though they may exercise informal control. The percentage of Gujarati bankers and market finance brokers of other communities who belong to such associations is often lower, but these associations serve key disciplinary functions such as certifying the dishonour of a hundi, and setting maximum interest rates, especially for transactions among members. These regulatory kinds of functions are especially pronounced in the organisations that run traditional markets like the wholesale cloth markets. The Hindustan Chamber of Commerce in Bombay, the Merchants Chamber of Commerce in Calcutta the Delhi Mercantile Chamber, and the Kanpur Cloth Committee all serve these functions. In these respects, these associations inherit the traditions of the commercial panchayats who have run such markets in India from time immemorial, and of the Nagar Seth (the hereditary head of the merchant community).

Newer markets — those in shares arid futures for example — which are populated by those from traditional trading backgrounds often preserve the old governing forms as well. On the other hand markets where a great deal of change of personnel has occurred, such as the wholesale markets of Delhi, are often characterised by looser control. The Bombay Shroff's Association, the organisation of the city's Gujarati bankers, has tried to create a national federation of these local bankers associations — the All Indian Shroffs Association — to represent the indigenous banking community in political matters and has achieved a modicum of success, at least within the Gujarati community.

III

Volume and Terms of Credit and Deposits

Hough estimates of the volume and rates charged for credit in various ICMs are found in Tables Land 2. In general, brokers and indigenous bankers provide money at an annual equivalent of 18-24 per cent to larger established traders — with 18 per cent the norm



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— and to smaller artisans and traders in a range sometimes as high as 24-36 per cent. Cheques and bills are discounted at 18-24 per cent. Call money loans in urban areas are sometimes provided at rates as low as 12 per cent. Black money also is normally available at slightly cheaper rates — 12-15 per cent in Bombay and 24 per cent in Madras. In general, South India has higher in formal rates and a wider variety of recently started informal institutions (nidhis, finance companies, and chit funds), possibly reflecting a greater capital stringency there, Shikarpuri banker's rates also seem high, though more so in Bombay and Madras where they are readjusting to a decline in bank refinance.

For purpose of comparison normal bank lending rates are between 13 and 16 per cent per annum, and most ICM clients might well have to pay the higher rates if they could get accommodation. The modal informal rate is thus only two to eight per cent higher than the bank rate, and probably even less if we look at the actual transactions costs to the borrower involved. The All-India Debt and Investment Survey, 1971-72 says that 75 per cent of households (accounting for 85 per cent of lending) in rural areas borrowed at rates under 25 per cent. Of course, trio relevant bank rate here is 11 per cent.[14]

Many of these interest rates are fixed in competitive markets. In some cases, there is some price leadership or institutional fixation — as by the cloth market committees — and in others the degree of association between lenders must lead to some co-ordination. The rates clearly move in some sympathy with bank lending rates as charted in some recent yet unpublished work by V V Bhatt and T R Venkatachalam.[15] The differences in interest rates from city to city are substantial and reflect the largely local and even sub-local nature of the markets surveyed. Even the Gujarati bankers who move freely back and forth between Bombay and Gujarat report money a percentage point or so cheaper in Bombay. Some of this difference may reflect the greater availability of bank credit in Bombay, or the greater liquidity of Bombay as a financial centre, it clearly does not reflect arbitrage costs which are less than 0.2 per cent or 0.3 per cent if one assumes a need to cover double the remittance costs. The differences between Madras and Bombay Shikarpuris are equally hard to explain because the firms are related, though money *is* not so mobile. Perhaps the risk level is perceived higher in Madras; perhaps the lower Bombay figure is a reflection of the inelasticity of demand in the Madras market within the ranges the Shikarpuris charge.

As to the persisting difference between the inter-market and Gujarati rates and those charged by Shikarpuris and finance companies, we must assume that the Shikarpuris and finance companies deal with people who do not have access to sufficient lower priced finance from either informal sources or the banks; and that seems largely the case.

Normally interest is paid when the 'note' is paid off, or on current account for credits from Gujarati bankers. It is collected when the account is brought into balance. Shikarpuris and some other lenders take their interest in advance, and that has been taken account of in reporting their rates on a basis comparable to the others. Penal interest is not common except among hire purchase companies; overdues are rare and usually rolled or negotiated. In some situations, interest is paid every quarter or month, independently of principal repayment — this was reported in the Kanpur cloth market. In other circumstances, particularly in South India, instalment pay offs, usually concealing higher interest rates, are becoming common. (In these cases, actual rates are sometimes in the 36-40 per cent range — an increase of 20-50 per cent.) In the case of advances to small traders and artisans, again high annual rates are sometimes hidden by quick repayment.[16]

In each case there may be some incidental fees — brokerage, charity charges, 'shigriti' (speed money), and stamp taxes — but I have tried to consolidate these in the reported rates. These exist in different forms for bank lending and sometimes raise the .cost of lending as much as 6 per cent.

Normal brokerage is less than 1/2 per cent annually of the loan principal, but Shikarpuri brokers charge 2 per cent. In no case, that we know of, does the broker guarantee the loan, but his business is obviously based on his track record in finding good borrowers who repay on schedule.

Short of a total survey it is hard to determine what percentage of total capital employed in trade and industry is accounted for by informal lending — and what relation informal capital employed has to that provided by the commercial banks who are the prime other urban credit source. Urban co-operatives are relatively small and weak; development finance is available elsewhere but usually not for working capital purposes (from State Finance Corporations, Industrial Development Corporations, and Small Scale Industry Corporations).

There are several definitional problems connected with the 'concept' of informal money. On the one hand, reported figures include a considerable amount of money from friends and relatives that might well be counted in equity. On the other hand, it includes a certain amount of money which might well be considered simple trade credit and outside our terms of reference. By and large the figures contain, today, very little agricultural credit (less than 5 per cent). The figures also could include — but this is more easily separable — deposits and call money lent to joint stock companies, which really belong to the organised sector of the economy.

Just as relatively accurate figures are available showing that 70 per cent of all debt in the rural sector was owed to 'non-institutional creditors' from the RBI's Rural Credit Survey in 1971, similar data should become available in the next two years from the RBI's Urban Household Sector Survey (which includes non-limited company enterprises) and the Economic Census. With the rapid increase in commercial bank credit to agriculture since bank nationalisation, this figure should have declined yet further. Nonetheless one has reasons to be apprehensive about the accuracy of the returns that will be made on financial matters to these two surveys.

Still some estimates can be attempted and are in Tables 1 and 2. The total amount of informal credit is at least half that of bank credit — not counting trade credit, 'Finance Companies', or black money. Counting these and uncovered markets, it is certainly higher.

Tables 1 and 2 also deal with the volume of deposits and the rates paid on them. Our overall estimate says that the Gujarati bankers have Rs 800 crores of deposits. In the small town centre of Anand, the typical firm had 200-300 depositors in amounts ranging from Rs 1,000 to Rs 1,00,000. Demand deposits got 7-1/4 per cent as contrasted to 6 per cent in Bombay, three-month deposits got 9 per cent and one-year deposits got 12 per cent. More than half the total was in these one-year deposits. The one larger firm had well over 1,000 depositors. Though depositors are primarily businessmen who

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often borrow as well, they also include agriculturalists and professionals. The Bombay Shroffs had roughly the same number of depositors each, but the deposit amounts were much larger and bulk of the depositors were in current account, but were still traders.

Though the proportions are lower, Rastogis and Chettiars covered in C V Aiyar's survey work *(op cit,* Note 4) reported considerable deposits; Shikarpuds had very little in the way of deposits and most of that from close associates. Finance companies were entirely dependent on deposits, mostly for three-year terms, at 15 per cent per annum. One has the impression that finance company depositors include a large number of salaried middle-class members. The sources of non-owned funds in other sectors of the informal credit market is less clear. Shikarpuris operated on their own funds, plus a modicum of bank credit, Shikarpuri brokers used these funds, but like other brokers went out in the market and sought deposits from traders professionals, and others with excess funds. The intra-market brokers said most of their funds came from cash surplus firms in the market itself — such was clearly the case in Amritsar and Kanpur — though others, even rich farmers, were occasionally mentioned. Typically, the capital deposit ratio is 1:6, fairly close to that reported by a number of Gujarati firms though the average among Gujaratis would appear higher (and lower among Chettiars and Rastogis).

TRANSACTION COSTS

Table 3 presents transactions costs as percentage of working funds. Transactions costs in those markets not covered in Table 2 where brokers predominate as intermediaries may be as little as 0.5 per cent on an annual basis though they do go as high as 1.2 per cent of turnover. Shikarpuri brokers charge 2 per cent on each transaction, usually a three-month loan. Indigenous bankers and commercial financiers typically have higher costs. One large Gujarati firm had costs equal to 2 per cent of its total worth or 2.2 per cent of its deposits. The Bombay Gujarati pure bankers had yet higher costs. The actual costs of the Shikarpuris are yet higher. They work out to Rs 30,000 to Rs 45,000 a firm. However, the expenses may be spread over several allied firms.

The Gujarati firms are often larger than the Shikarpuris and do a considerable business in collecting remittances around town and often house their visiting clients. The average Bombay firm has 12-15 employees. One large firm in a small town employed one manager, nine clerks and two messengers. The clerks are usually not college educated, and start at salaries of lis 150-200 a month plus annual bonus. The employees are recruited on recommendation from friends of the banker, and experience a low turnover. Overheads of tins small town firm are roughly 2 per cent of its net worth or roughly Rs 400,000 a year. Smaller rural firms have as few as one or two employees.

The average cost for a small indigenous banker with Rs one crore turnover should be Rs 34,000 a year and the increase with volume is slight. One Bombay banker with a 80 crore rupee turnover had administrative expenses of Rs 100,000 and another with a turnover of Rs 360 crores had only Rs 150,000 expenses. The Bombay backers' expenses were probably lower than the small town banker's because they had fewer clients. 45 per cent of the total administrative costs went toward wages and salaries.

The basic unit of a Gujarati banker is the branch; most firms have one, but the largest surveyed had 93 branches and Rs 20 crores in deposits. The branch is headed by a manager who is paid Rs 600-1,000 a month plus prerequisites and bonus. The staff is largely occupied with keeping the books of the firm. Table 4 presents the workload reported by a large Gujarati firm.

In a general survey of Benares and Lucknow, Rastogi firms the largest firms had an average of eight employees and Rs 40,000 annual expenses and the smallest ones had two employees and annual expense of Rs 15,000.[17] Chettiar offices normally employ one to three assistants, usually from the Chettiar community, and pay them Rs 150-250 a month plus bonus. With a telephone and rental the total cost of the establishment is usually under Rs 15,000 a year. The finance companies surveyed employ 5-15 persons (though the figure is far higher for the giants like Peerless, Sugeshan, or the Gujarat Savings Unit). Some of the larger firms have larger buildings of their own, and in this respect contrast with the general pattern of low overhead accommodation by Informal Credit Market intermediaries. Costs may run as high as 30 per cent of gross income.

In all brokered loans, the difference between what is paid lenders and taken from borrowers *is* obviously the brokerage alone. In the case of the indigenous bankers, the spread is larger and the profit element considerable.

The employees, if any, of informal credit agencies are typically less well paid (and educated), the establishment less elaborate, and the paper work less complex than in commercial banks. Operations are smaller and typically under the personal supervision of the owner; so numerous cross-checks against fraud are not .needed. Not surprisingly, costs are usually somewhat lower than those reported by the Indian commercial banks on their relatively high cost small-scale lending operations (see Table 2).

The brokers in the informal market have a limited span of lenders and borrowers. The largest in Kanpur and Ainritsar dealt with 15-30 firms each, on both the lending and borrowing side. The Shikarpuri brokers in Bombay deal with a clientele that changes but may be no larger at any given time. Shikarpuri market borrowers are usually expected to deal with only one broker, but lenders may deal with many and thus they constitute the market. Indigenous style bankers rarely have more than 200 clients in a single branch, for a!! purposes.

By contrast, commercial banks deal with larger and more rapidly changing clienteles who are moreover far more varied in terms of the markets in which they deal. While this gives them a flexibility in adjusting the market fluctuations they loose in the detailed knowledge of their clients, and thus have increased 'information' costs.

BAD DEBTS AND RESERVES

Beside administrative costs a major transaction cost is typically occasioned by bad debts. Bad debt figures, as reported, are particularly questionable because of the obvious opportunities to use non-paid bills to 'whiten' otherwise unaccounted money. The five to ten per cent of profits reported as bad debt may thus be an underestimate, since it is understood that income tax authorities will rarely allow more.[18]

Informal intermediaries avoid legal proceedings. They find them too costly and the resulting judgments often hard to collect. For some, the fact that non-prosecuted bad debts can be marked as paid and used to 'whiten' black money on which income tax has not been paid is also an incentive not to pursue debts through the courts. In any case, bad debts are usually compromised or re-scheduled.

Whatever the precise figures it is clear bad debts are few, and relatively

TABLE 2 : OTHER INFORMAL CREDIT MARKETS

(1) *Discount facilities* (for checks, postdated checks, bills, truck receipts, etc)

The Bombay Gujarati and Marwari Indigenous Bankers discount current paper at 2-2.5 per cent with an estimated volume of Rs 1,500 crore for the Gujaratis and Rs 500 crore with the Marwaris.

In Benares there are 500 discounters, plus many part-timers; capital involved is Rs 50 crore. Annual rates would be equivalent to 18-24 per cent.

Finance 'Companies' in Madurai discount paper for an annual equivalent of 20-24 per cent.

(2) *Intra-market and Intermarket Lending*	Rates (Per Cent)	Volume (Rs Crore)
To Cloth Commission Agents in Amritsar	9-18	NA
To Cloth Commission Agents in Delhi	15	NA
To Cloth Commission Agents in Kanpur	13-16	NA
Yarn Traders' Advances to Powerlooms, Kanpur	18	NA
Yarn Traders' Advances to Powerlooms, Amritsar	14-22	NA
BOMBAY		All Foodgrains
To Bombay Rice and Dal Traders	15	900
To Bombay Dried Fruit Traders	18	10-12
To Bombay Jute Traders	18	1
To Bombay Iron and Steel Traders	18	80
To Bombay Share Trading ('Badla')	15-16	NA
CALCUTTA		
To Cloth Commission Agents	16.2	NA
To Yarn Traders	15	NA
To Grain Traders	15.2	4
To Oil Seeds Dealers	15-18	NA
To Gunny Dealers	18	NA
Deposits with Small Pharmaceuticals Firms	14.5-15	NA

(3) *Finance 'Companies'*

One source estimates 2,200 companies with Rs 450 crore

One Madras Finance Company had Rs 5 crore some in Multani-type bills at 26-29 per cent and some in secured export finance at 24-30 per cent.

There are 60 in Trichy, 40 in Kothamangalam, and 100 in Karur. Twenty firms in Trichy had assets of Rs 44 crore. They pay 7-15 per cent on deposits and charge 21-24 per cent.

(4) *Miscellaneous—mostly involved in Consumer Finance*

	Number	Credit Extended (Rs crore)	Percentage of Loans to Business
Chit Funds	Annual Turnover	300-250 annually	NA
Pownbroking	—	1.200	35
Nidhi	63	30	28

easy to allow for. In fact, they are roughly comparable or slightly higher than those reported for small enterprise lending by the commercial banks, but the commercial banks are widely granted to seriously understate their losses on these small enterprise loans.

One cost advantage of the informal agencies is their exemption from the large idle reserve requirements imposed on the organised sector — over 30 per cent of 'total deposits. The larger proportion of their own capital they use, however, achieves a somewhat similar anti-inflationary effect to compulsory reserves (deposits in Reserve Bank and holdings of low interest government secruities). Only the most advanced Gujarati firms had as high a deposit-capital ratio as ten or twelve to one. Three to one and two to one were more common, and many firms used little outside money. One large Gujarati banker kept 12,5 per cent of his money as reserves — 2.5 per cent in cash and 5 per cent each in a bank fixed deposit (against which a large overdraft could be taken.) and with other indigenous bankers. He never lent more than 80 per cent of his funds in peak periods. Two large Bombay Gujarati bankers keep 10 per cent of their resources in cash and 20 per cent in fixed deposit. The Anand indigenous bankers had 5-15 per cent of their resources in readily cashable form while Bombay bankers kept up to 30 per cent in cash because they did a considerable business cashing and discounting for cash hundis, cheque and other commercial instruments.

How ONE CHECKS UP

The borrowers in the informal market are 'known' parties, under continuous survellance in the closely packed lanes of the urban wholesale markets. Each bale of cloth that comes in and out is observed by neighbours, the finance brokers among them; an expensive night on the town is reported and judged the next morning in market gossip. In contrast to the relatively anonymous world of Western businessmen, even in the larger metropolitan centres, Indian businessmen live their lives in a narrow social ambit. Most of the brokers interviewed seemed incredulous that they would have to ask formal questions of borrowers whose shops they visited each day, and with whose business confreres they were in continual contact. Still, one Shikarpuri in Bombay said he asked to see income tax returns in about 10 per cent of his transactions and one in Madras indicated that he, too occasionally asked for income and wealth tax forms. These requirements are common, and some Shikarpuris in Bombay and Salem will only lend to income tax assessees. But the Shikarpuris deal with a more diffuse clientele than the typical informal market lender — a fact .reflected as well in their higher than average interest rates.

In fact the people in the market not only have a twenty-four hour relationship; they typically have one that extends over generations. We asked one broker how he evaluated 'new borrowers' and were told that he never took them; all his clients were children and grandchildren of businessmen with whom he and his father and grandfather had done business.

Informal financial agencies, by and large, concern themselves with the overall credit standing of the borrowing party rather than the specific enterprise or project for which credit is taken. They, thus, do not do any close check of the specific use of their funds but are generally content with monitoring the party's total activity.

The brokers in the informal market watch closely the level of business activity not only in their borrower's main establishment but in any others he may have. They watch his personal expenditure, They talk with his competitors and especially his employees. They then judge what sort of margin he is operating on and how likely he is to pay them. Most especially they watch his payments record to see if he may be faltering on any of his market obligations.

CRTIERA FOR CREDIT

It was somewhat difficult to get informal market lenders and brokers to

TABLE 3 : TRANSACTIONS COSTS AS PERCENTAGE OF WORKING FUNDS

Type	Administration	Default Loss	Total
Multani	4.5	1.0	5.5
Gujarati	2.5	0.5	3.0
Chettiars	3.1	1.5	4.6
Rastogi	3.5	1.5	5.0
Pawnbroker	2.5	1.0	3.5
Financial Corporation	4.0	1.0	5.0
Nidhi (Mutual Loan Fund)	3.1	0.5	3.6
Hire Purchase Companies	4.0	1.0	5.0
Banks, commercial	3.4 (1976) (4 per cent on intermediation alone)†		

† According to Paul Mampilly, "Innovations in Banking: The Indian Experience, Part II", IBRD, pp 36, 41-42, 148, 185, 195-6). This is an average figure. For small loans the cost works out to several multiples of this figure. Mampilly estimates that the commercial banks lose 34.99 per cent on full cost basis on cash credit loans under Rs 10,000. They break-even at Rs 45,506. The modal loan at least for Gujarati, Chettiars and Rastogis is well under this figure.

TABLE 4 : DISTRIBUTION OF MAN HOURS AMONG FUNCTIONS

Function	No of Persons	No of Hours Per Person Per Workday	Total Hours of Work
Book-keeping	12	8	96
Dealing with public	2	2-1/2	5
Remittances	1	1	1
Bills collection and purchase	2	3	6
Cash payment and receipt	2	8	16
Advances	2	4	8
			132 hrs a day

specify their criteria for lending. The key elements were clearly the overall prosperity, wealth, and cash position of the borrower and an evaluation of his commercial integrity. Most important seemed to be a reputation for punctiliousness in meeting debts. In reverse, borrowers, potential and actual, felt that they had to have a reputation for the prompt meeting of market dues.

One explicit criteria for lending which seemed common was some target relationship between total borrowings and net worth. Two Shikarpuris (one each in Bombay and Madras) and the private banker in Kanpur mentioned 25 per cent of net worth as their normal limit. A third Shikarpuri in Bombay set 33 per cent, though he clearly bad a relatively adventurous financing posture. In Amritsar, there seemed to be an informal 'one-third rule' — one-third from banks, one-third from the market, one-third from own capital — in financing at least larger borrowers. On the other hand, an informant who audits the books of larger trading firms in Calcutta says most of them try to limit their own equity to 25 per cent of gross, but much of the rest must be trade as distinguished from financial credit. The Gujarati firms in particular seemed reluctant to commit themselves to any net worth figure perhaps because their concern is more focused on the cash and stock position of their clientele than their net worth.

In general, urban informal intermediaries try to avoid coming under the restrictive money lending acts and do not lend in amounts less than Rs 3,000 or to agriculturists precisely for that reason. They usually provide working capital accommodation to prosperous enterprises in well known markets. Their major risk is either of a wave which sweeps under all the firms in their market or of the mala fide non-payment of their dues. They reduce risks of the latter sort by lending only to those with strong roots in the community.

Many lenders also have informal limits on their maximum lending to any one party. These were as low as Rs 10,000 for one Shikarpuri interviewed. But because of the practice of breaking up each loan in the Shikarpuri market among many different bankers this is entirely understandable. Two of the larger non-Shikarpuri firms — one a Gujarati indigenous banker, the other an Amritsar broker — had a singly debtor with a limit of Rs 1,500,000 at one time or another representing in one case 5 per cent of net lending. One Gujarati indigenous banker arranged Rs 10,000,000 of finance for a contractor in Bombay, recently. Except for the Shikarpuris, most lenders and brokers were too specialised in one or another commodity market to limit their exposure in it.

Third party guarantees are often required especially by Gujarati Shroffs, but rarely by Shikarpuris except when a limited liability company is involved. On the other hand the standardised Shikarpuri bill docs require two co-signers.

Several lenders expressed particular scepticism about borrowers who were too well off or had access to low cost credit markets (such as Joint Stock companies who could advertise for deposits). It was felt they were up to no good if they came into more costly informal markets.

PURPOSES OF LENDING — WHERE THE MONEY GOES

The bulk of informal lending goes to finance trade and industry, mostly the former (Table 5). 'Badla' financing of stock market speculation is a large and important exception which flows through specialised channels. Essentially it involves short term lending at rates about 14 per cent plus 1.2-2.4 per cent brokerage on the security of shares and with no margin requirement. Gujarati credit goes almost entirely to funding trade, especially wholesale trade in agricultural and craftwork commodities. The Shikarpuri loan to a wide variety of small, and occasionally large enterprises, as do the finance 'companies'. Rastogis and Chettiars finance smaller traders and artisans.

The credit provided by brokers in wholesale markets for cloth and grain is obviously solely trade credit. Brokers providing money to industrial firms in the form of deposits, call money, or promissory notes obviously serve industry. Special demands on the informal market come from exporters who need quick money, and builders and restauranteurs who have no physical security to give. Certain industries — tanneries in Madras, "zari" cloth manufacturers in Surat and "biri" tobacco merchants in Anand — have needs which banks are unable to meet.

The report of the 1972 Banking Commission noted that informal finance was particularly important in chemicals dyes. But that is the kind of fact which increased bank credit for small scale industry should have affected. Madras Shikarpuri bankers themselves mentioned building, leather tanneries, cashew nut and government and forest contractors, hotel and restaurant owners, biri tobacco merchants and sea-food exporters as especially numerous among their clientele. Engineering, chemicals and pharmaceuticals were mentioned by one Bombay Shikarpuri. The grain and cloth traders, and powerloom owners seemed to have their own informal credit markets

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everywhere. The Gujarati indigenous bankers in Anand were especially involved in biri tobacco finance and those in Ahmedabad and Surat in financing textile manufacture and trade. Rastogis finance traders and to some extent artisans. Chettiars financed traders execpt in Coimbatore where they primarily finance small-scale industries. The finance companies do a lot in hire purchase finance of commercial vehicles and consumer durables in larger cities and cash crop trade finance in smaller places.

None of the groups we study now do much finance of agriculture — even those like the Chettiars and Hastogis who formerly did so — because restrictive legislation makes it unprofitable. Less than 5 per cent of indigenous bank finance now goes to agriculture.

Speculative activities and even high risk ones are eschewed by normal operators in the legal informal credit market. Film finance, a high risk proposition, is normally done by a separate set of financiers, and in any case is mostly in 'black money'. It is estimated that of Rs 750 crores involved in film finance, Rs 500 crores is such 'black money'. There are more than 500 brokers involved in arranging film finance. They lend money at rates ranging from 36 to 60 per cent but occasionally as high as 120 per cent.

Informal money is in fact, generally only available for working capital purposes, precisely because new ventures are seen as too risky. To accommodate demands for credit in risky fields — speculation and the cinema, and the needs for illegal 'black' money — there exist two parallel sets of informal financial institutions, the former (high risk ones) taking much higher interest and the latter ('black' ones) taking lower interest than the legal, normal, informal market. In Bombay alone there are a number of firms which discount fictitious hundis (with an estimated annual flow of Rs 450 crores) and provide fictitious book entries (havalas) at a rate of 2 per cent a month. These firms enable businessmen to move a sum in and out of their white books at will. Direct lending of black money is usually done at rates of 12-15 per cent in Bombay (24 per cent in Madras), with all kinds of coded receipts given in exchange. At least 200 remittance facilities for unaccounted black money at a rate of 1-1/2 per cent exist in Bombay. A set of overlapping firms car perform the same functions for illegal foreign exchange.

In the urban markets surveyed, observers estimated and cross-checks confirmed that perhaps 50 per cent of the capital employed in the wholesale cloth trade in Calcutta and 20 per cent of the capital in the grain trade came from the informal market. The percentages in Kanpur and Amritsar were probably lower. These are markets in which little if any bank finance is available. Small industrial units in the Amritsar powerloom industry got 5-10 per cent of their capital in peak season from the informal market. The Anand tobacco trade receives 15-30 per cent of its finance from Gujarati indigenous bankers. Calcutta pharmaceutical firms were dependent for 25-30 per cent cf their working capital on deposits.

The typical borrower in informal markets has well over Rs 1,00,000 in assets but does not belong to the big business category we studied. Of those lenders who would give estimates one broker in the Kanpur cloth market guessed his average client was worth from Rs five lakh to Rs ten lakh. Another Kanpur financier and an Amritsar broker said their mean client was worth Rs 20 lakh. While one of the Anand indigenous bankers said that his minimum advance was Rs 25,000 (his maximum, was Rs 1,000,000), others would loan as little as Rs 5,000 and one had some Rs 100 clients, presumably small shopkeepers. Bombay Gujarati Shroffs said their modal credit was Rs 50-1,00,000. Among industrial firms, the smallest capitals normally encountered among borrowers in the informal market were about Rs 1,00,000. One Shikarpuri banker said that his modal debtor was worth Rs 8 lakh to Rs 10 lakh. The modal credit in the Madras Shikarpuri market is perhaps Rs 1,00,000 and rising, though the amounts go up to Rs 15 lakh.

While it is clear that the bulk of informal finance is provided directly to trading enterprises and very little is provided directly to very small units (under Rs 1,00,000 capitalisation), it is an error to assume that the borrowers are the ultimate beneficiaries of the credit. The working capital needs that are financed are typically for advances to trading partners and manufacturers, large and small, who demand cash payment. The advances fund as well as the 30-90 day credit on which the smaller retail shops subsist. India's largest category of small enterprise — handlooms — are funded by master weavers who may in turn borrow on local informal markets. And the pattern is repeated for shoemakers and other smaller artisan units. Thus, indirectly, the entire economy is dependent on informal sector advances.

ADVANTAGES: WHY THE BORROWER CHOOSES

At times, the advantage of the informal financial sector for the borrower is the rapidity with which it can provide money, or the cheapness of the money provided, though neither of these is the norm.

Generally, informal money is slower to arrange and more expensive for the borrower than money from the organised sector. The exceptions to this slowness and expensiveness are found especially in the larger metropolitan markets where indigenous bankers and commercial financiers provide money far more quickly than the banks, and brokers in markets like the cloth market or the inter-corporate call money market provide finance more cheaply than the banks.

The informal money market has some other advantages from the point of view of the borrower. Informal lending is almost all unsecured. Many borrowers do not have or want to tie-up stocks as collateral. Even where collateral is available the restrictions on the collateral and the procedures for checking it are often onerous. Indian bank credit to SSE is almost always secured, and the procedures for checking and conserving the collateral often appreciably increase the cost of the loan. On the other hand, there are forms of secured lending on the informal market — firms that buy up Bombay textile market accounts receivable fall in this category-; we can also point to the 'financier' in Amritsar (one of a number) who did roughly the same thing, but this time as an accommodation to the purchaser, rather than the mill. In other cases, guarantees were demanded. One Gujarati indigenous banker noted that 60 per cent of his lending was against third party guarantees.

Informal finance is generally provided without having to fill up forms or spend much time in the intermediary's office, is not tied-in to all sorts of formal requirements like compliance with municipal land use regulations. In these respects, its costs to the borrower is not higher than face interest cost in contrast to most 'organised' bank lending. In fact, in many informal credit markets the broker visits the client's place of business and does all the preparatory work for teh loan as part of his service.

On the other hand, there are some

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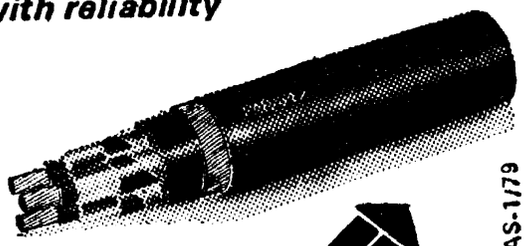

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TABLE 5 : DESTINATION OF INFORMAL CREDIT MARKET FUNDS (PERCENTAGE)

	Trade	Exports	Small Scale Industry	Large Industry	Others
Multani	32	20	16	7	25
Gujarati	60	10	5	10	15
Chettiar	45	10	5	20	20
Rastogi	55	12	—	—	33
Pawnbrokers	22	—	5	—	73
Nidhi (Mutual Loan Fund)	20	—	5	—	75
Finance Companies in Trichy and Karur	40	—	8	—	52

negative aspects to informal sector lending from the borrowers point of view. Much informal credit is call money and in any case may have to be paid on some precise due date, whereas bank Credit is seen as more flexible and easier to delay payment on. There is also a feeling that informal credit is less reputably than bank credit, and that informal market transactions are more likely to be challenged by the tax man.

Almost half the units surveyed even in markets in which informal finance is important denied using it, often because they were either too rich or too poor to be accommodated. Some of them may simply have been reluctant to discuss the issue. On the other hand, over 90 per cent of Kanpur and Amritsar cloth firms were reported to use some informal sector credit in the busy season. Several power and handloom owners indicated that they used 'market' money for peak periods. A larger shoddy blanket manufacturer in Amritsar (one of 120 such) got 10 per cent of his money through a broker during the peak season. The money, at the premium rate of 15 per cent plus 1.2 per cent brokerage, cost him no more than his 12 per cent bank credit with all its onerous conditions.

None of the numerous art-silk powerloom owners we interviewed in Atmritsar (where there are 1,200 such enterprises) admitted themselves to taking bazaar or informal credit though all assured that it was the norm in the industry. One association official estimated that 20 per cent of the capital in the industry came from the informal market as compared to 25 per cent from the banks. A cotton powerloom owner in Kanpur estimated that he got 50 per cent of his yarn on credit at 18 per cent from yarn brokers to whom he also paid 1-2 per cent yarn brokerage. There are about 2,000 powerlooms and 10,000 handlooms in Kanpur.

The large Anand biri tobacco dealers have enormous needs for capital since they have to finance the trade from the time they pay the peasant till they receive their money from the manufacturers, an average of 1-1/2 years later. One of the largest indicated that he held an average stock of Rs 28 lakh worth of tobacco and handled an annual turnover of Rs 1.5 crores. The lines of credit of the larger tobacco traders with the indigenous bankers ran to Rs one crore. The larger traders typically reported some bank credit as well.

A recent RBI study (of firms with bank credit) shows that 28 per cent of firms with bank credit report using non-institutional finance, and the Shikarpuri bankers report that almost every sizeable firm in Bombay comes into their market at one time or another. Very recently a group of textile mills borrowed large sums to meet pressing payroll demands. As a general pattern, much of trade on a routine basis including exports and many industrial firms on a sporadic basis, go into the informal market. Usually they treat the informal market as a residual for working capital needs the banks cannot accommodate.

INSTRUMENTS

The instruments for borrowing in the informal market vary. One of the most common is the demand note, often 'informally' endorsed for a term and rate on the back. As a demand bill the instrument avoids the stamp tax on term bills such as those traditionally used by the Shikarpuris. The Shikarpuris clearly feel that even with the added cost the stamp gives their notes greater authority and it makes possible their discount with the bank. As discount has become loss possible they have largely abandoned this term note. In the smaller centres in the South where bank refinance is unavailable, 90 per cent of Shikarpuri advances are done on demand notes, Shikarpuris have in any case been moving from 90 days promissory notes to instalment credit,, and such credit now accounts for 45 per cent of their advances in the South, the instalment notes, especially in the South are commonly supported by post-dated cheques, one for each instalment payment

30 to 40 per cent of Gujarati banker-finance is done by direct cash advance and 60-70 per cent through the issue of hundis, The Chettiars do obtain both promissory notes and security from their clients, or hire purchase agreements when appropriate. Inter-market lending is most usually done on promissory notes. Finance companies often loan on a term bill. Deposits are often given on a simple receipt now universal because of income tax: traditional- receipts, however, 'ruka' or 'chilka' simply bore an amount and occasionally a name and date. Such receipts often in code are still common in black money markets.

IV

Some Issues

COMPETITION WITH BANKS

Despite their advantage in their lower transactions and reserve maintenance costs the informal agencies are almost totally noncompetitive with the organised banking sector in the giving of loans and only somewhat so in attracting deposits. There is certainly some diversion of deposits from- the organised banking sectors, but most lenders/depositors in the informal market have higher earning possibilities than the bank interest rates available to them if they are not tempted by the rates informal credit intermediaries offer them. This is not so much the case of those who are attracted to the elaborate savings schemes organised by some of the more aggressive finance companies; in fact such schemes have been widely copied by banks to mobilise deposits.

The informal agencies do evade some of the credit and monetary control measures which the banking system promotes. Their merit lies partly in providing an escape hatch from the losses in efficiency which too tightly controlled administrative allocation of credit might cause.

MONEY CREATION

Some of the agencies in the informal credit market edeate money by issuing sight drafts (darshani hundis) or activating idle balances by brokering them. But most informal credit agencies do not create significant amounts of money in the normal sense, For each rupee they lend in one

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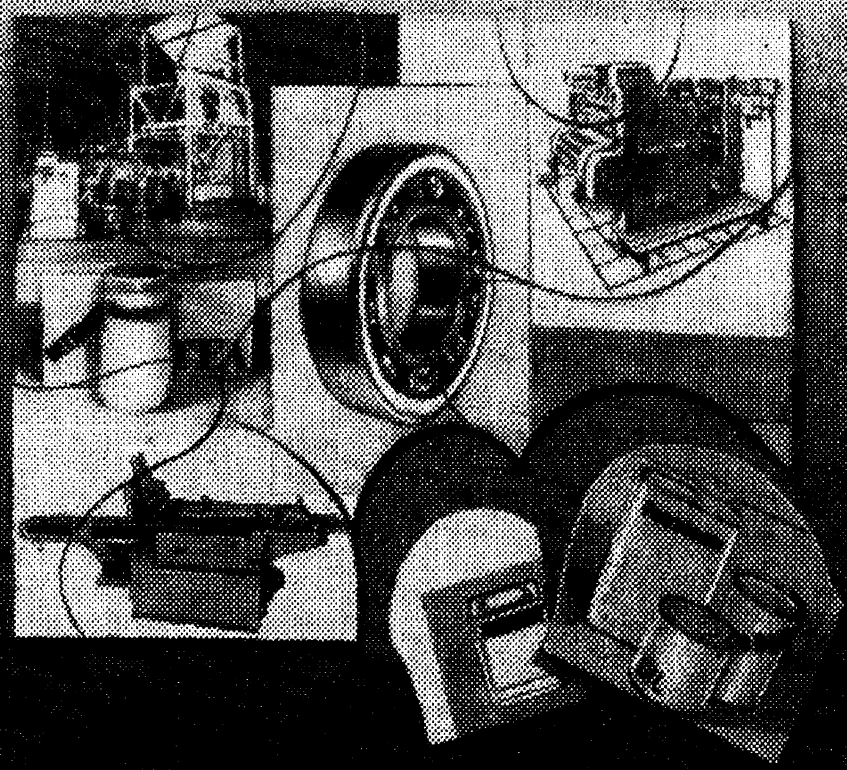

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market, they borrow a rupee of active money from another market. The funds that these informal credit agencies use — in addition to a high proportion of own funds — are attracted from lenders by higher interest rates than are available elsewhere and occasionally by the assurance of access to credit in time of need and other services, The lenders often, but not always, are cash rich market traders. In several cases, they include a number of prosperous farmers and even professional men. Thus, though the informal credit agencies include those who perform all of the banker's essential functions, their major function is as a channeller of credit from those with excess money to those who need it.

The Shikarpuri bankers are able to discount or borrow on the security of their own bills from some commercial banks, though the total amount has declined rapidly in recent years and is now a small fraction of their own lending. Other indigenous bankers of any size maintain considerable sums in term deposits and on current account with the commercial banks against which they do borrow, and many of their payments are made by cheque. To this extent they serve to support the commercial banks own money creation but their relations with the banks are relatively distant though largely complementary.

The one form of money creation of particular interest is the issuance of 'darshani hundis' — sight drafts. These differ from cheques in that the person to whom they may be paid is usually far more constrained; at the same time that they are more transferable among the class of eligible payees. Darshani hundis can be cashed at any time of the day or night. Unlike cheques in India which rarely pass through more than one set of hands before deposit, darshani hundis are typically negotiated several times before ultimate encashment. Darshani hundis are also preferred because they often cost less and are cheaper to negotiate a settlement on if dishonoured. But they are clearly a declining institution, and are largely used for remittance to areas which are not yet heavily banked. The Merchants Chamber of Commerce in Calcutta reports a sharp drop in the number of hundi cases it handles; the Hindustan Chamber in Bombay, reports the same.

But the volume of hundi transactions is still considerable. A study of five leading Bombay pure indigenous bankers (Gujarati) shows that their annual turnover of hundis was between Rs 150 crores and Rs 360 crores each. It is estimated that the total annual turnover in Gujarati hundis in Bombay is Rs 1,600 crore of which Rs 1,000 crore is accounted for by the Six pure, non-commission agent, shroffs. Marwaris in Bombay are estimated to have a Rs 500 crore turnover in hundis. These are two way figures, though the flow is usually one-sided, depending on season. The bankers also discount bank cheques and commercial bills, in an amount roughly equivalent to the hundis they handle. The rates charged are generally cheaper than the commercial banks, since the indigenous bankers can remit the cheque or hundi back to the issuing area by cheap couriers ('angaria') and redeem them for face value. The commission on Hundi issue is Rs 7 to Rs 15 for Rs 1,00,000 face value. Marwari indigenous bankers also provide a large number of demand darshani hundis for remittance through Calcutta to traders throughout Assam and Eastern India; but there, too, despite the hundi's cheapness, they report the increasing popularity of the bank, cheque. The major advantage of bank cheques is clearly their greater acceptability to income tax authorities as the records of a transaction. Other groups of indigenous bankers appear to have almost ceased using darshani hundis, except in connection with trade bills or what are called 'hill-ti' hundis.

SEGMENTATION

Over time there is a strong tendency for the different categories of lenders in the market to merge their forms and to some extent overlap in the markets they serve. The rigid community differentiation in which Gujaratis served only Gujaratis. and Multanis worked only through Multani brokers (but never lent exclusively to Multani clienteles) breaks .down. On the other hand, the market remains local, and rates differ systematically between different markets within the same town. All rates seem to move in some sense sympathetically with bank and organised sector interest rates, but the spread and particularly what seems higher rates and greater' supply stringency in South India remains.

This market segmentation partially represents the cost of the advantage informal credit intermediaries have. They lend to a couple of hundred well known local parties and borrow usually from the same sort of constituency. The obligations are imperfectly subject to discount — though discount is available to a greater extent among Gujarati and Marwari Shroffs which explains the somewhat greater uniformity of their rates. But the reasons for the lack of movement of funds among centres, particularly among the Multanis who have a national network is not clear.

The segmentation of the market means, of course, that money does not go to the most eligible use, and is relatively immobile among centres. Again, the Gujarati and Marwari networks which are especially concerned with financing long range trade are exceptions. Perhaps someone might argue that the relative allocation of funds in the first place to local market serving systems may reflect the overall relative returns in local and extra-local lending. Further, segmentation means that the risks of lenders are not spread and increases market risk though, for reasons dealt with earlier, this seems less of an issue in the stable markets, informal credit markets serve.

One of the most difficult cases of segmentation to explain is that which has Shikarpuri bankers in Bombay charging almost double the rates that Gujaratis do. Some of this difference may be connected with the greater risks. Gujaratis finance the accounts and stocks of established traders in what has traditionally been a sellers market. Much of Shikarpuri finance goes to finance export enterprise and construction which are inherently more risky. Further, the clients of the Gujarati Shroff are tied to him through a myriad of social channels as fellow Gujarati traders; the Shikarpuris deal with a more mixed, cosmopolitan clientele. Nonetheless, the Shikarpuris bad debt experience at 10 per cent (at the highest) of profit (representing 1-2 per cent of turnover) hardly justifies the difference in rates charged.

One can only partially credit a situation where the clientele in the Shikarpuri market remains constant. They neither secure commercial bank accommodation nor gain admittance to other informal markets, while the relative amount of money in the market declines, because of declining bank refinance. Perhaps over time, some adjustment will occur and the rates will move closer together.

Another facet of segmentation is the fact that South Indian markets are consistently so much tighter — at least higher interest rate — than North Indian ones. This is a difference noticeable in the organised sector as well, but it is again far higher in informal markets than arbitrage costs should indicate.

Even more dramatic is the situation within the Gujarati Shroffs system where funds are continuously remitted between branches and firms according to market needs. The reigning lending rates and borrowing rates are 1-1½ per cent lower in Bombay than in the smaller Gujarati centres. Some of this does reflect arbitrage costs and the greater looseness of the Bombay markets, and some the larger average size of the Bombay clients which may increase their credit standing. Our data did not permit us to draw any conclusions about an interest differential between East and West India to parallel that observed in the organised money market, but one could wager that such a differential could be established.

The pattern of evolution of the informal markets seems to be driven by three factors; (1) The demands of the traditional trading groups in Gujarat and South India whom they have served for hundreds of years, and of whose trading system they are an essential ancillary: (2) the availability of surplus funds with some members of the investing public looking for higher yield returns; and (3) the pressure of regulatory and repressive measures which affect the form and direction of credit, in particular channelling it to activities and firms who cannot get lower interest bank credit.

Government measures of control have at the same time interrupted the integration of markets that might have proceeded and was foreseen in the two Banking Commission Reports of 1929-31, and 1972, and thus increased the separation of informal and regulated markets; at the same time that there appears to be some integration of informal markets themselves as regards forms and personnel. Geographically, the markets remain largely segmented despite the presence of links and intermarket flows at least in the Multani and Gujarati cases.

DYNAMIC

One of the hardest issues to determine in the case of the informal market is the extent to which its growth is a response to credit needs, and the extent to which it has an inherent institutional logic which may in fact form those credit needs. The empirical evidence available to us does not provide clear answers. On the one hand, many of the informal credit markets serve traditional markets and respond to their needs. This applies as much to the Gujarati and Shikarpuri indigenous style bankers as to the market credit provided through brokers. Even the movements into more modern activities often simply represent the service of old clients who have entered new lines. In this sense the development seems demand-led. The rapid development of informal sources of credit to meet the demands cut off by bank selective credit controls again shows a response to demand. On the other hand, the very dominance of certain communities in trade and industrial lines partially responds to their possession of access to an established informal credit system — a supply factor; and to that extent the existence of a credit supply enables, if it does not drive, the process of informal intermediation. In addition, at least in the case of the Shikarpuris and probably to some extent for the other traditional banking communities, their possession of excess funds searching for investment, the existence of supply, is what brought them into the banking business.

We have one case of the suppression of a market in our data; Rastogi; and Chettiyar financiers who once lent extensively to agriculturists now no longer do so. This is partly due to the onerous regulations of the various moneylending Acts, and partly because of measures obstructing debt collection from agriculturists, including partial or total moratorium on repayments.

PUBLIC POLICY

The history of the public policy involvement with the indigenous market has two aspects. One is sporadic efforts to regulate the market directly by trying to label some of the agents in it as 'monneylenders' and controlling their rates and recourse for collection. The results of these efforts are embodied in the various Moneylenders' Acts. The other aspect is, an attempt to link at least indigenous bankers and perhaps Shroffs as well to the formal market, subjecting them to, RBI control and using their abilities to get funds to productive sectors in the economy. In a number of cases, in reverse, indigenous style bankers have reincorporated themselves as modern commercial banks.

The policy concerns have led to some research and policy interest in the informal credit area. The two Banking Commissions (1929-30 and 1972) both studied the indigenous market in some detail, spoke highly of its merits and recommended a linkage scheme — in 1930 directly with the RBI and in 1972 through the commercial banks. On the ground, the RBI and the indigenous bankers found themselves unable to agree on a level of control that would be appropriate to such a link and the issue may be considered dead.

The RBI did have, from 1941 to 1975, a concessional remittance facility for those indigenous bankers who conformed to its standards, which put them on a par with the non-scheduled banks. This facility was withdrawn because it was not sufficiently used, though the organised indigenous bankers made some effort to have it reinstated.[19]

Since it contains the most recent public consideration perhaps a review of the 1971 Study Group's report is particularly in order. The Group concluded : The indigenous bankers continue to play an important role in the Indian financial system in that they look after the credit needs of numerous small industrialists and retail traders" (p 99).

The key recommendations of the Study Group were for a licensing of indigenous bankers with a requirement that they submit "a summary statement of the volume and nature of business", maintain "books of account in the usual recognised manner" and have them certified by outside auditors and observe some constraints oil overlending (pp 102-8). In return the RBI would refinance commercial bank lending to indigenous bankers who would in turn charge reasonable rates, (pp 103-4). Some licensing of financial brokers in the informal market was also recommended,, (p 109).

For the future, the Study Group saw a possibility for the indigenous bankers to evolve in the direction of private bankers in Europe, merchant bankers in the UK, and commercial finance companies in the US, or broker commercial bills and function like discount and acceptance houses in London.

After the report was largely endorsed by the whole Banking Commission,

some efforts were made to carry out these recommendations. But the Banking Commission introduced several qualifications in its endorsement which toned-down its effect. Efforts to implement the recommendation floundered on the issue of the precise controls to be implemented and have largely been dropped, and the Community of indigenous bankers have limited themselves to fending off specific regulatory inroads on their business.

Meanwhile, the one segment of the informal credit market which was linked to and supervised by the commercial banks has been declining. Despite a positive recommendation in the 1972 Banking Commission Report, the 600 or so Shikarpuri or Multani bankers have seen their links with the bonking system become progressively more tenuous.[20] With bank funds running dry, demand push has driven up their rates by 100 per cent; but they remain an important lender for small' and medium-scale enterprises in Bombay and South India, Of course, bank rates have increased almost as rapidly over the period; but the point is that the gap has widened.

FUTURE OF THE MARKET

It is clear that sections of the informal financial market are in decline as the organised sector expands its activities. Bias by income tax officers, moneylending Acts, bank credit officers, and the expanding credit from the banks all have taken their toll. Darshani Hundis are less and less used. Kanpur private bankers no longer take deposits. Shikarpuri bankers get 10 per cent of the bank accommodation they used to; their numbers and assets in Bombay are static in the face of an inflationary expanding economy. Call money has vanished from the Amritsar market. In several cases the sons of indigenous bankers have chosen other professions.

There is now a proposed law to limit radically the taking of deposits or of unsecured loans by non-banks. The immediate result would be to end the entire indigenous style banking category, the similar finance companies, and corporate deposits. Brokered lending would be limited in scope. The results would include the wiping out of the bulk of the 20-30 per cent of the present credit in the urban areas provided by informal agencies. Much of the money would undoubtedly then flow to the banks, though there should be significant leakage; and the sectors now receiving finance are unlikely to receive the same amount from the banks. The result would be a considerable decrease in and reallocation of the working capital funds in the economy.

On the other hand, the Gujarati indigenous bankers operating in some sense competitively with the organised banking sector have been expanding their operations at a par with the rest of the economy. Inter and intra-money continues to be available to traders and at rates that compare favourably with the banks.

There should be no difficulty with this apparent contradiction. Activities like trade in cloth, grain, and biri tobacco are Essential and related in a relatively automatic way to the overall growth of the economy. The organised banking sector's rejection of them has preserved a growing role for indigenous informal agents in serving them. The organised banking sector will not for the foreseeable future be able to fill all the pressing if not 'priority' needs of the Indian economy, and an informal market will necessarily exist to do so. The excessive contraction of the informal financial markets would lead to a rigidity in the economy whose costs will be apparent in reduced economic activity, higher overheads, and lessened efficiency.

SUMMING UP

Informal financial markets exist legally and provide perhaps up to 30 per cent of all capital in Indian urban markets (50 per cent if interest bearing corporate deposits by private investors are included). They finance half of wholesale trade in certain commodities and 10-30 per cent of the capital needs of small-scale producers like powerloom owners and pharmaceutical manufacturers. Despite the rapidly increasing bank credit for small-scale industrial units, most of these units find it necessary to go into the informal market, at least during their busy season. The rates in this informal market are generally 2-4 per cent higher than the bank lending rates, but there is enormous variance in rates, and forms of lending. Very small enterprises when served by these markets directly may pay nominal rates as much as 10 per cent higher than normal bank rates, but they normally are financed through trade credit refinanced with the informal market and increasingly by discount facilities. In Southern Gujarat, a parallel system of indigenous-style bankers successfully serves much of the urban economy. Elsewhere informal markets are conducted by commercial financiers like the Shikarpuris, brokers, and discounters of commercial paper.

This informal market is used because it provides funds for purposes like trade which the banks do not finance, provides them more rapidly than the banks for those who require speed like exporters and without security for those including restaurants and contractors for whom security is a big stumbling block.

The operating margins — the transaction costs and bad debt experience of these markets — are by and large superior to those of the banks. The Shikarpuri bankers of Bombay and South India might be presumed to be an exception since their margins and rates are considerably higher than the banks, but some of this is due to the limited funds in their market due to the banks cutting them off since 1970 and the resulting pressures of demand. One might as well consider that their borrowers represent relatively high risks, and perhaps increasingly so as banks accommodate their safer clients.

Though some informal markets may be in some decline, due in part to explicit restrictive government action, they still perform important roles in providing finance to trade and industry. Others expand in response to new needs of growing trade and industry.

V
Conclusions

> The "Capital market... does get progressively integrated, widened and deepend with economic and financial evolution. The crucial variable in this context seems to be transactions costs (both administrative costs and default risk). Financial innovations reduce these costs and thus lower the costs of lending and borrowing (not completely represented by the interest rate) and narrow the interest rate differentials".

The above (Bhatt and Roe, *op* cit*)* represents a schematic description of financial development as an ancillary and prerequisite of overall economic development. Roe and Bhatt deal in another part of the same working paper with the relations of Informal Credit Market to these developments (pp 78-82). They posit three characteristics of these markets: (1) Lower transactions costs because of well known clienteles entailing low information costs; (2) avoidance of controls on lending

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and borrowing rates; and (3) avoidance of tax—in the forms of idle reserves or reserves in the form of low interest government obligations.

It is the absence of these three characteristics which often lead to a sub-optimal level of intermediation in the Organised Credit Market, To the extent that the Informal Credit Market has these characteristics, it increases the volume of intermediation and, in particular, distributes credit to the traditional sectors of the economy. The overall level of intermediation is higher and more economic activity is funded particularly in traditional sectors.

But informal credit markets are typically highly localised and segmented and do not necessarily distribute funds to the best users from an overall point of view. The small markets may permit an undue amount of monopoly power to lenders and intermediaries. And society may wish to use credit channelling to favour sectors with low financinl but high social returns.

Indian ICMs do have relatively low transactions costs, particularly for small loans—and their rates reflect relatively low monopoly power and relative integration — though both are certainly present in some submarkets. Indian ICMs certainly do serve traditional and other sectors who would otherwise be unserved. The volume of intermediation is certainly higher than it would be without the ICM (because of its higher lenders rates) and the allocation of credit difference. The existence of large informal markets have not kept the commercial banking system from rapidly expanding.

There is clearly a dynamic reduction in segmentation in Indian ICMs over time as traditional groups merge and overlap in their clientele and modus operandi. It is still the case, however, that rates differ systematically among markets — particularly contrast the difference in Shikarpuri and Gujarati lending rates in Bombay — and the systematic differences between capital scarce South India and better endowed North India.

Dynamically as the Banks have expanded dramatically in the years since Bank Nationalisation in 1969 and legal restrictions on the ICM have tightened, some segments and activities of the ICM have declined while others have expanded to serve needs the Banks now refuse to serve. This reflects the dominant demand push aspect of the Indian ICMs. In fact, in many of these demand led markets, the needs for funds are so high that rates can go up drastically. In the Shikarpuri market, the cut in the amount of bank funds available for relending has contributed to a considerable hike in lending rates — unless we presume that the bankers increased their rates, in the face of existing slack, to achieve a constant income on the basis of a reduced volume. In the South Indian agricultural markets where debt payments moratoria have caused a decline in informal lending, large-scale asset sales by impoverished agriculturists have occurred.

On the other hand, Rastogi and Chettiar funds, no longer employable in their traditional fields, have poured into hire purchase and commercial financing. Gujarati bankers have ventured into those fields which their long-time clientele have moved into. In these supply led cases, the direction and volume of lending in different markets have been affected by government regulation and other outside causes.

Notes

[The data end opinions are solely those of the authors, and not of the institutions to which they are attached. We wish to thank T N Srinivasan, U Tun Wai, V V Bhatt, Shahid Yusuf, Promodh Malhotra, B S Minhas, Gary Hyde, Raymond Goldsmith. Arnand Pinell-Siles, Wolfgang Schaefer, Avishay Braverman. Michael Lipton, Dale Adams, B B King, J C Sandesara and Jack Revell for their comments — though they are, of course, not responsible for the final product.]

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8 See Bibliography at end of article,

9 Raman Mahadevan, 'Immigrant Entrepreneurs in Colonial Burma — An Exploratory Study of the Role of Nattukottai Chettian of Tamil Nadu. 1980-1930', *The Indian Economic and Social History Review* XV, 1978, pp 329-358; 'Pattern of Enterprise of Immigrant Entrepreneurs: A Study of Chettiars in Malaya, 1880-1930', *EPW* Jan 28-Feb 4, 1978. pp 146-52; The Development of Modern Entrepreneurship in the Chettiar Community of Tamil Nadu, 1900-1930", Indian History Conference; Thomas A Timberg, "The Marwaris", Vikas, Delhi. 1078.

10 'Performance of Financial and Divestment Companies, 1974-75' *RBI Bulletin*, July 1977; 'Census of

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11 Radhakrishnan *et al,* "Chit Funds", Institute for Financial Management and Research, Madras, 1978, P 37.

12 OF course, a certain amount of other bank lending finds its way into informal markets. Lenders report occasional borrowings on the security of shares or fixed deposits — and those sums may be re-lent. There is certainly spine circulation of bank funds from bank borrowers to their business fellows who may be net lender in informal markets; but in contrast to the situation in Iran several years ago these flows are clearly peripheral. See Richard E Benedick, "The Money Market in Iran', *Pakistan Development Review,* II. 1962, pp 406-21.

13 The inter-corporate call market cantains Rs five crores to Rs ten crores on average terms of six months. The company deposits market in which private demand and term depositors are recruited by brokers to help finance joint stock companies in amounts as small as Rs 1,000 already contained Rs 1,000 crores in 1973-74. ('Growth of Deposits with Non-Ranking Companies, 1973-74', *RBI bulletin,* XXXII, January 1978, pp 39-54) but it expanded rapidly in the credit crunches alter 1974 and is now as high as Rs 3,500 crores. A succession of recent regulations limiting the proportion of finance that can be obtained through these deposits has considerably constrained the growth of this market, and there is a proposal for its total prohibition. One large Bombay firm dealing in the company deposits market reported 500 brokers working for it full time on 0.6 to 1 per cent commission. (The firm gets 1/4 per cent on the transaction as manager). Another firm handled Rs five crores of deposits a year.

Corporate depositors get up to 13.5 per cent interest (the rates are also regulated by the RBI), though the rate is going down, which is several points higher than the rate on the longest term savings accounts. Their money usually is tied tip for a year or less. From the borrowing company's point of view, however, deposit interest is not fully deductible from tax and the real cost is somewhat higher than the reported face cost.

14 Indebtedness of Rural Households and Availability of Insitutional Finance", RBI, 1977, p 146.

15 See also S Ghatak, "Rural Money Markets in India" MacMillan, Delhi, 1976. pp 98-101.

16 A N Bose, "Calcutta and Rural Bengal: Small Sector Symbiosis", Minerva Associates, Calcutta, 1978.

17 The one private banker in Kanpur had two clerks (paid Rs 300-500 a month) 15 collectors (Taqqadgirs) Rs 150 a month plus a 01-02 per cent commission on collections, totalling a probably monthly payroll of Rs 3-4.000. The firm also pays rent on a one room office in Kanpur and another in Farrukhabad and retains a full-time lawyer. The total worth of the firm is Rs 20 lakh to Rs 30 lakh and its costs should not be more than 3-4 per cent of its outstanding credit. But even then a good deal of the collection expense is probably connected with the small-scale consumer lending the firm does, rather than its commercial finance.

18 One Bombay Shikarpuri found that 10 per cent of his profits are accounted for by arrearage, of which half is eventually recovered; he went to court twice during the previous year to secure payment on his credits. A Madras Shikarpuri reported that 5 per cent of his profits went to cover bad debts. This 5 per cent seems to be the big city norm, though, small town Shikarpuris report as high as 7-10 per cent of profits accounted for by bad debts. One Kanpur broker has about one failure a year among his 20-30 clients (meaning an arrearage, not a loss), another two. A private banker in Kanpur reports bad debts equal to 10-15 per cent of profits, though he could not tell how much was on commercial accounts. The figure was echoed by other Rastogi bankers.

19 Proceedings of the 4th All India Shroff's Conference, October 9. 1976.

20 R*eport of the Banking Commission.* Goveroment of India, Delhi, 1972, P 462.

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