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Financing Patterns of the Unorganised Sector in India: A Survey of the National Capital Region

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Abstract – This paper is based on the major research project sponsored by UGC completed by the author in the capacity of the principal investigator. Various field surveys were conducted as part of the project to study the importance and relevance of the formal financial sector in meeting the financial needs of the unincorporated sector. The growth of the Indian economy is largely driven by the informal sector. It plays a crucial role in our economy in terms of employment and its contribution to national income, savings, and capital formation. Notwithstanding its importance in the economy, the unfortunate state of affairs is that it remains starved of capital. Since it fails to get access to the organized sources of finance, it is forced to fall upon the unorganized credit market, getting funds often at exorbitant interest rates. The major results presented here help to explore and understand the intricacies in the working of the Indian financial system, with particular reference to financing the requirements of the so-called informal sector. The position of the national capital region in this context has been separately analyzed.

Keywords – Unincorporated Sector, Financial Institutions, Questionnaire, Field Survey, NCR.

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1. INTRODUCTION

Most textbooks on finance and money matters give the impression that India today takes pride in having a sound financial system capable of meeting the needs of the various sectors and segments of the economy, and that we have been able to almost eliminate the moneylenders and their exploitative strategies. It has often been claimed that dependence on informal sources of finance is marginal and limited to rural India. Recent research by the author as part of UGC sponsored major research project however reveals serious facts about the ineffectiveness of the financial system in India and its failure to penetrate the economy to meet the financial needs of its various constituent segments.

The next section describes the unincorporated or the informal sector of the economy and brings out its relevance in the growth process of our economy. Section 3 describes the methodology and coverage of the field survey together with the aggregative results. Section 4 presents the analysis for the national capital region. Section 5 summarizes and concludes.

2. THE UNINCORPORATED SECTOR

As per National Accounts Statistics, all unincorporated enterprises and household industries which are not regulated by any acts and which do not maintain any annual accounts showing the profit and loss and balance sheets, are classified as unorganized. All economic systems contain an unorganized or the so-called informal economy in some proportion, the proportion being substantially greater for the developing or underdeveloped economies, in comparison to the developed ones. This sector plays a significant role in the economy in terms of employment opportunities and poverty alleviation as it generates income-earning opportunities for a large number of people.

The growth of the Indian economy is largely driven by the informal sector. The agricultural sector is wholly unorganized. In the industrial sector, proprietorship and partnership firms, self-employed businessmen form a large part of the entire industrial output. The service sector in India is dominated by traders, self-employed professionals, other service providers (e.g., boutiques, parlors, tour operators, hotels, rickshaw pullers, hawkers….), etc. operating at individual or non-corporate levels.

As per the report of the Unorganized Sector Statistics Committee, National Statistical Commission, Government of India, the informal or the unincorporated sector accounted for more than 90 percent of the workforce and 50 percent of national production, as in February 2012. Over the past two decades, India's high economic growth has been associated with an ever-increasing proportion of output and employment being associated with the informal sector. The analysis of this sector is thus crucial in understanding any aspect related to the growth of the economy.

3. THE FIELD SURVEY

The survey was conducted in the year 2013 in the states of Delhi, Bihar, Haryana, and Rajasthan - in both rural and urban areas. Data from more than 3000 respondents from various parts of these states was collected based on the random sample principle. A bilingual questionnaire was prepared for the indigenous non-corporate sector. This sector includes indigenous entrepreneurs, self-employed workers, proprietary and partnership firms, traders (retailers, wholesalers, and exporters), and other service providers like tour operators, boutiques, hotels, parlors, rickshaw pullers, dealers, and so on. The focus of the research has been on the extent of reliance on formal versus informal sources of finance, the impact of financial constraints on production and expansion plans of the entrepreneurs, problems faced in obtaining institutional finance, studying the bias of the banks if any, reasons for going to money lenders.

It was found in the study that less than a third of the respondents in aggregate, were able to receive institutional funding. An equal fraction met their financial needs from their savings or borrowed from friends and relatives. About a fifth of the respondents had to sell their property or jewellery to raise funds, and one-fourth received it from other sources including creditors in trade, business clients, chit funds, and committees. The majority of traders reported a high dependency on trade credit. More than 10% of respondents were unable to obtain funds from any source. (As more than one source was used by most respondents, the totals do not add up to 100 percent).

In rural areas, the situation is even more worrisome where a very small percentage (19.2%) reported obtaining institutional funds. The percentage of respondents depending on relatives and friends was higher (45.1%) as compared to the urban counterparts (28.3%). Surprisingly Bihar reported the highest percentage (55%) of people who got loans from financial institutions. A special feature witnessed in Bihar was that commercial loans were designed to be taken in the form of personal loans. This was followed by Rajasthan (43.2%), Haryana (26.6%), and Delhi (24.1%) in that order. In Haryana and Delhi, most of the funding is obtained from relatives, friends, savings, or the sale of ancestral property in their villages. Classified on basis of income, about 58% of high-income respondents got funds from financial institutions whereas, for the low-income category, the corresponding proportion was just about 22%.

More than half of the respondents did not even consider going to financial institutions. The main underlying reasons reported were(i) long-time involved in the processing of loan (30.9%), (ii) inadequate security or required documents (28.9%), (iii) fear of procedural formalities (25.1%). Further, those who required a small loan or short-term finance preferred other sources rather than going to the financial institutions. Some of the respondents from the high-income category did not approach the financial institutions because they felt that these institutions charge high interest rates while they could arrange funds from their relatives and friends at lower interest rates or, at times, without paying interest. Many respondents reflected the idea of simply not wanting to take out a loan and expand their business to the extent permitted by their own resources only.

Of the respondents who chose to go to financial institutions, 7.2% were denied credit, most of them from the middle- and lower-income class, together with the retirees (irrespective of their income category). About 35% of the respondents who initially chose to apply to the financial institutions for a loan, later gave up. The quoted reasons had been (i) unavailability of security and documents required (16.7%), (ii)lengthy process (12%), (iii) multiple visits and tedious formalities (11.1%), and (iv) expected unofficial payments and favors (6.0%).

About 11% of the surveyed respondents were compelled to abandon the idea of starting a new business or expanding their existing business due to the inability to arrange funding, nearly 19.3%arranged finance by selling their jewellery or property. This situation is particularly evident in Delhi, where immigrants are in high proportion. As they lack the required documents, guarantees, securities, and proof they could not arrange institutional finance and had to sell off their land/ properties in their respective villages to arrange finance.

Low-income respondents needed to visit the financial institutions multiple times, even before they could apply for a loan; but the high-income people with established businesses, depending on their previous credit rating, could promptly obtain funds for their new projects. They had access to facilities like trade credit, bank overdraft, and bill discounting that helped them easily arrange loans for short durations and small amounts.

A lot of the low-income category respondents were also relatively less qualified, and belonging to urban slums or rural areas and hardly knew about the options of obtaining finance from banks, etc., and the loan procedures thereon. Some of them however ventured to find about these and apply for finance. They met with varying degrees of success depending on various factors related to the satisfaction of the loan requirements. Servicing the loan like regular EMI payments was a problem for many.

Trade credit was found to be the major source of credit for the small-scale indigenous traders dealing in FMCGs (fast-moving consumer goods). Own funds were used for big expenses and renovation activities. Further, for expansion activities, institutional financing was accessed, but preference was for NBFCs rather than bank loans due to relatively easy availability of the same and also greater flexibility. Besides these sources, the traders selling items like timber, marble, accessories, hardware products, clothing, etc. also arranged funding from chit funds and committees. Over a fourth of the responding traders had to sell off their ancestral property like jewellery or agricultural land in their village to fund their business.

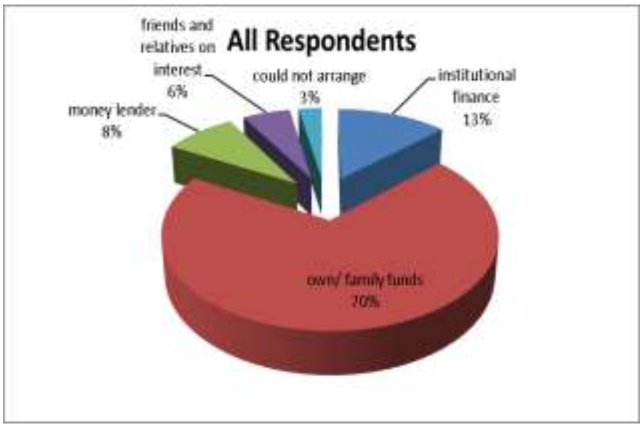
Several new entrants to the service sector such as real estate agents, tours and tourism agents, boutiques, cyber cafes, investment services, beauty and gym facilities, couriers and supplies, etc. start at the beginning with a commission or charge a fee. This keeps their setup costs to low levels. Many of them reported working from a place in their home or in an area obtained by selling off their property. Nearly a third of these were in partnerships, while a little less than half had obtained a working space on rent with their own funds. Tour operators used schemes like hire purchase for arranging vehicles and also took auto loans.

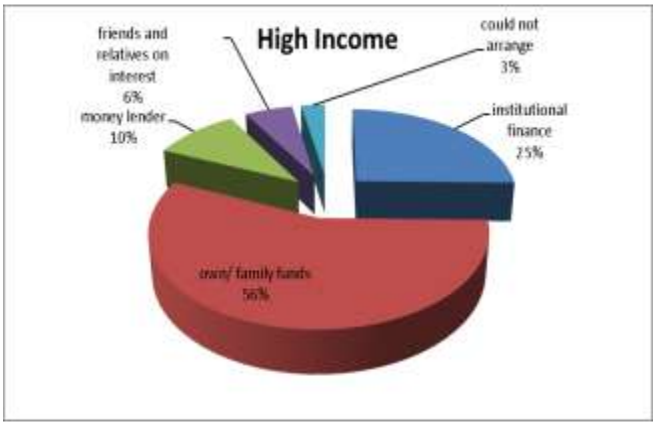
Many practicing lawyers, self-employed doctors, C.A., and the like also reported to be operating similarly. They often operated in their own premises or a property that they could easily afford on their own. About a little over one-fourth of these respondents took to banks for financing small proportions of their expansion/modernization requirements. Majorly it was done using owned funds or borrowings from relatives and friends at low interest rates.

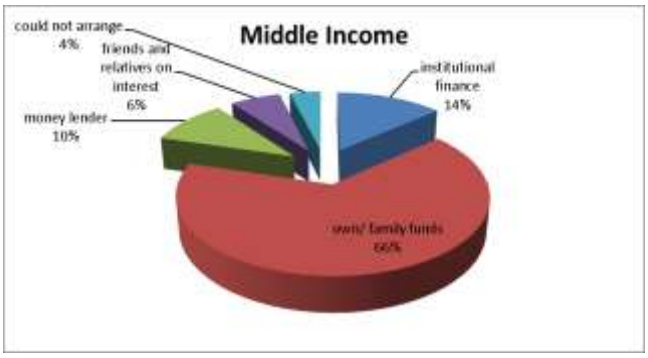
4. NATIONAL CAPITAL REGION

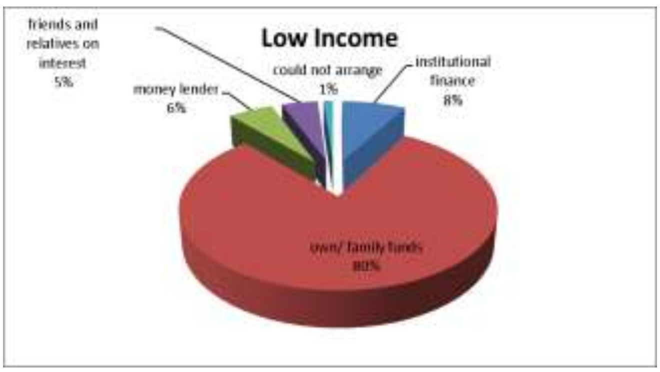
Surveys have been conducted in Delhi and surrounding areas of Gurgaon, Sonepat, Ghaziabad, Noida, and the Delhi-Faridabad border. In Delhi, the major market clusters and commercial centers like Connaught Place, Karol Bagh, Paharganj, Daryaganj, Khan Market, Lajpat Nagar, South Extension, Greater Kailash, Sarojini Nagar, Nehru Place, Okhla, Rajouri Garden, Sadar, Asaf Ali Road, Chandni Chowk, Khari baoli, Bhajanpura, Kamla Nagar, Rajendra Palace… together with several local units of Rohini, Mehrauli, Munirka, Yusuf Sarai, Mayapuri, Naraina, Tilak Nagar, Jwala Heri, Mayur Vihar, etc. have been surveyed. Small traders operating in the vicinity of various residential colonies have also been covered by the survey.

Surprising results have been obtained from the survey. It can be seen from the figures below, more than two-thirds of the respondents are dependent on owned or family funds. They are mostly content to operate on a scale permitted by their own funds and do not want to get into hassles and risks associated with borrowed funds. Institutional finance forms a small proportion even for the high-income class. A somewhat lower proportion meets financial requirements from money lenders. There is a small percentage in each income class that gets funds from relatives and friends on interest and a further smaller percentage that could not obtain the required funds.





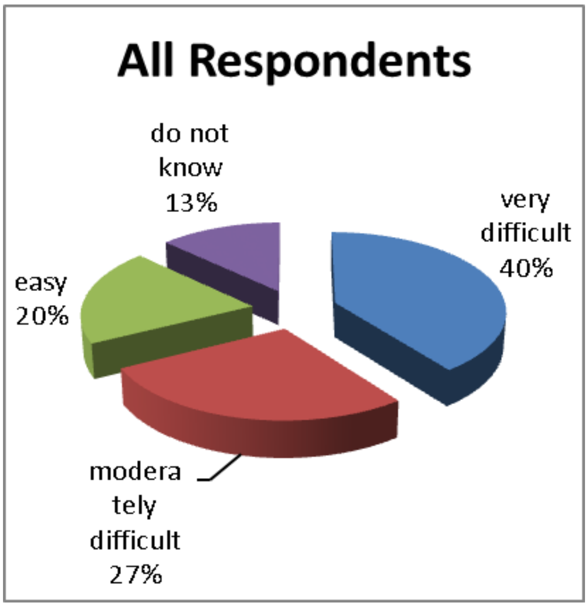


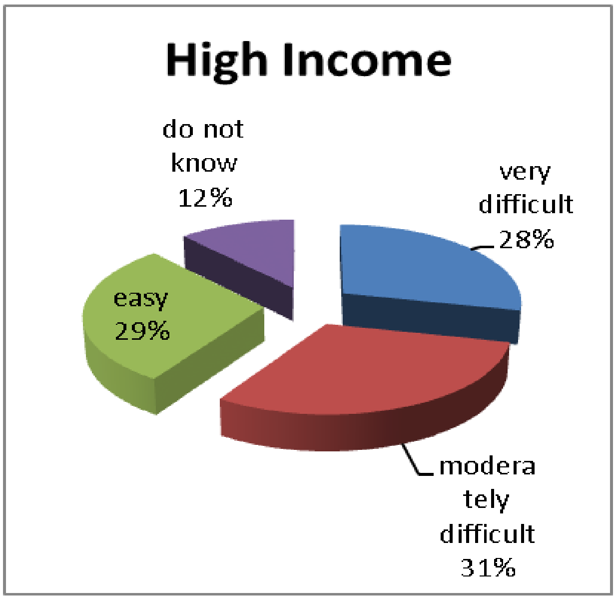


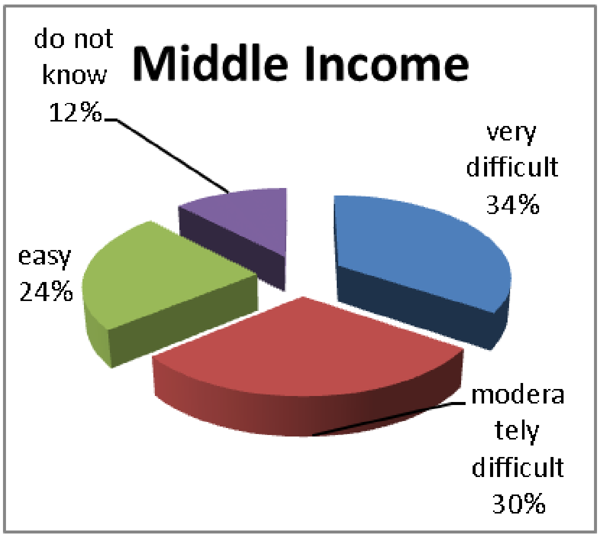
It is clearly seen that reliance on owned funds is sharply increasing with a fall in the income level. This is balanced by a reverse pattern of institutional finance. Even in the high-income category, only 25% of the total requirements are met out of institutional finance. Surprisingly, money lenders meet 10% of the finance requirements for this category too. The middle-income category has a somewhat greater reliance on owned funds and correspondingly lesser reliance on institutional finance. The trend noted for high and middle-income categories further accentuates for the low-income category. This trend implies that the use of owned funds is more a matter of compulsion than of choice.

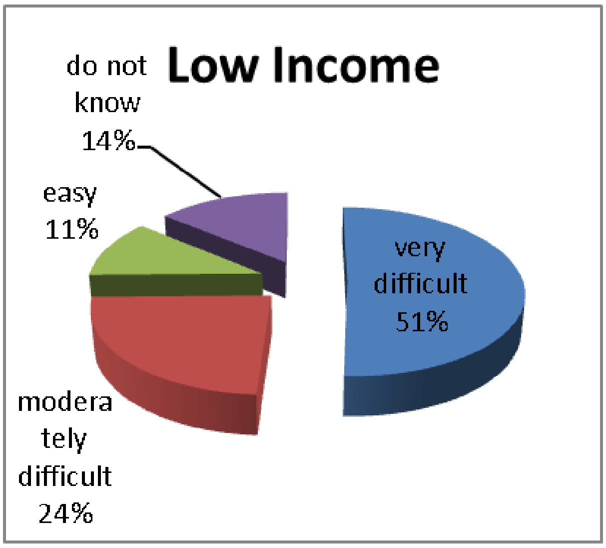
The reason behind low percentages of institutional finance is not that finance was denied but that the banks/ institutions were sparingly approached. This does not mean that people had enough funds and were not inclined to borrow but in a majority of cases this decision was made to avoid a highly probable denial. Many of the respondents, especially the low-income category or the migrants did not have the required security or the required levels of "declared" income to obtain institutional finance. A huge proportion also feared the lengthy procedural formalities and paperwork and preferred to operate on a smaller scale with owned funds or approach a money lender. A very small percentage of respondents reported giving up for a loan after making an application due to delaying tactics of the banks.

The next set of graphs depict the difficulty levels in obtaining finance in the economy for various income classes. It shows that more than half of the respondents in all income categories find obtaining finance a difficult task. Nearly the same percentage of respondents in all categories reported ignorance on the matter. So, the relative percentages for easy and difficult are broadly comparable. As expected, the percentage of respondents reporting difficulty fall with an increase in the level of income. The reverse pattern then follows for 'easy'.



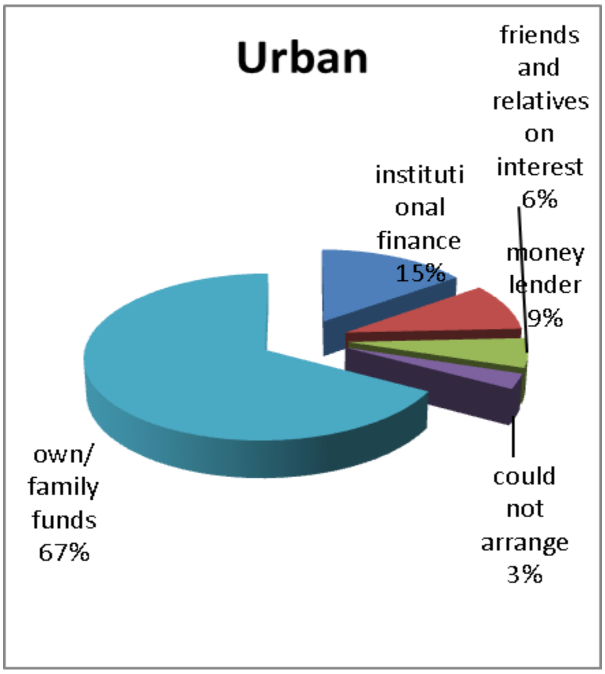


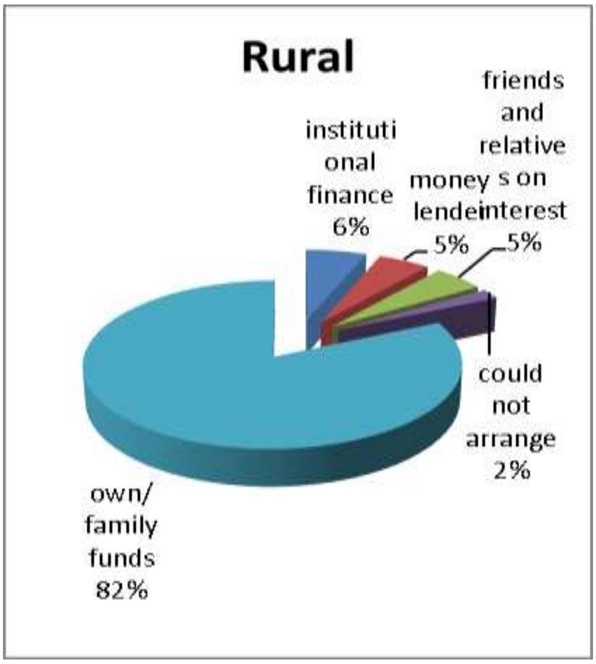




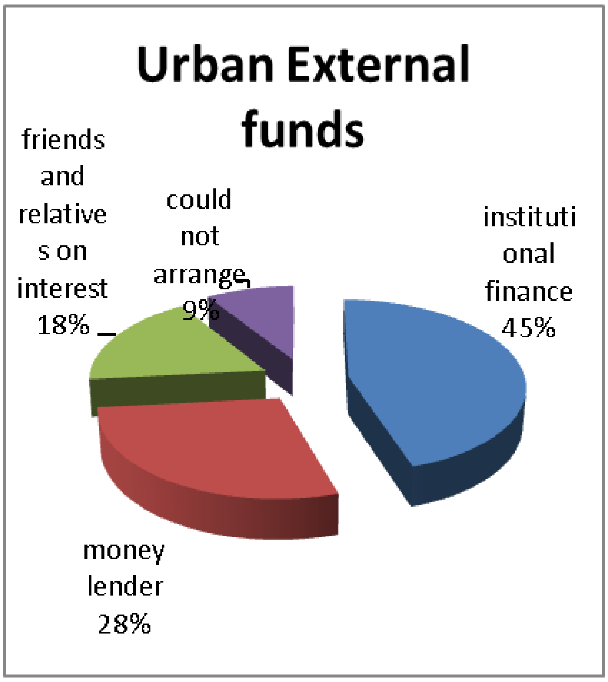
The reported pattern makes it clear that the banking system of the country operates in a way as to leave out the disadvantaged section. Although there are huge claims of financial inclusion being made it does not seem to be reflected in practice. Nearly 80% of the respondents from all income categories stated a bias in the operation of banks. They strongly favor the upper-income classes and castes and those who are ready to bribe or grant unofficial favors. There is thus a lack of transparency reflected in the operations of the Indian banking system.

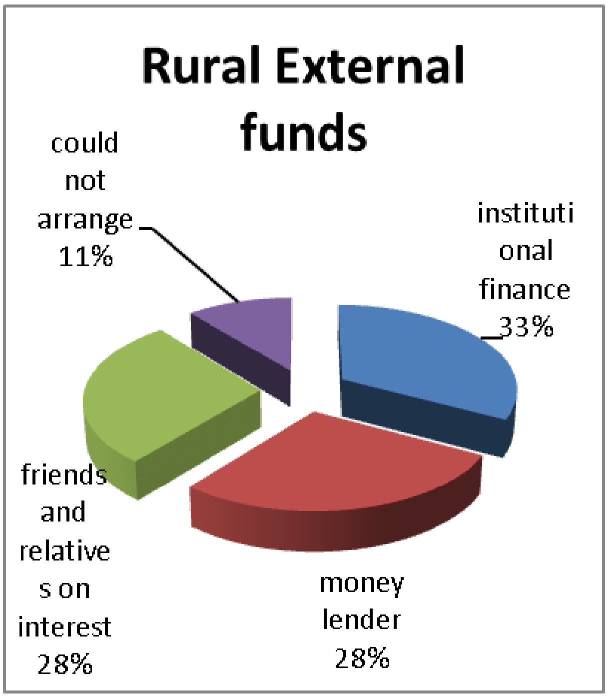
The analysis for Delhi NCR has also been done on the basis of rural-urban categorization of the respondents. The graphs below bring out the picture in this regard. The reliance on owned funds is much greater in the case of urban respondents. The relative division of external funds between rural and urban respondents, therefore, becomes non-comparable.





To make a meaningful comparison only external funds are now considered. It is found that while somewhat less than half of the urban respondents using external funds can obtain institutional finance the corresponding magnitude for rural respondents is nearly one-third. Greater reliance is seen on friends and relatives in rural areas. This is possibly because they are unable to obtain it from institutional sources. Highly surprisingly the percentage obtaining finance from money lenders is the same in rural and urban areas. There is not much difference between rural and urban areas in the percentage of those who wanted external funds but could not arrange them.





5. SUMMARY AND CONCLUSIONS

A study of the Indian indigenous producers and service providers reveal that they still rely a lot on the informal sources of finance. Small and medium size entrepreneurs tend to run away from institutional funding due to personal taboos or difficult challenges and lengthy processes involved. Some of them initiate the process but take a retreat. Banks favor larger loans thus leaving behind the smaller ones, in particular the unorganised sector. This forces them to return to their creditors, especially if they do not have property or jewellery to sell, or friends and relatives who can help them in times of need. This reflects the dire situation in the Indian financial system that needs to be addressed immediately.

Just as any research, this one too has its share of problems. First of all, not all respondents could be interviewed personally. In a large-scale survey as this, where respondents are approached in thousands, it becomes inevitable to take the help of hired surveyors. The results will largely depend on their reliability in conducting these surveys and being able to effectively communicate the questions to the respondents. Their understanding of the questions is very important in this context. To address this problem as much as possible the majority of the investigators included economics students. Overall, it has been possible to draw important and somewhat shocking insights into the dismal realities of the Indian financial system. These have important implications for policy, in particular towards the efforts of obtaining financial inclusion. These goals are far from being achieved.

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