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Comparative study between organized and unorganized loan provider

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Abstract
This research paper includes perpetual study on organized and unorganized market of loan providers. In this research paper the both organized and unorganized loan providers are studied to understand the development of loan market. Previous the personal loan and gold loan was dominated by unorganized loan providers. But recent time have changed various organized loan providers are available. It also includes research on financial system.

Keywords: financial market, financial structure, public and private banks

Introduction
The economic development of any country depends upon the existence of a well-organised financial system**.** Financial System plays a very crucial role in the functioning of the economy because it allows transfer of resources from savers to investors**.** This chapter deals with an overview of financial system which will support the research to understand much better**.** In order to understand the classification of organised and unorganised financial institution, it is necessary to take a start of this chapter from Indian financial system. The Indian Financial System in detail as follows:

Indian Financial System
The word "system" in terms of "financial system" [1], implies a set of complex and closely connected or interlinked institution, agent practice, market, transactions, claims, and liabilities in the economy. The financial system is concerned about money, credit and finance-the three terms are intimately related yet are somewhat different from each other.
Financial System is a broader term which brings under its fold the financial markets and financial institutions which support the system. Financial System provides the intermediation between savers and investors and promotes faster economic development. The researcher has used short forms as follows:

FS = FI + FM + FI + FS

The Financial System (FS) is set of Financial Institutions (FI), Financial Markets (FM), and Financial Instruments (FI) and Financial Services (FS) which help in the formation of capital and meet the short term and long term financial needs of households and corporate houses. The study is mainly of financial needs of the households and business (i.e. short term loans or short term borrowing). The major assets traded in the Financial System are money or monetary assets. So, the responsibility of Financial System is to mobilize the savings in the form of money and invest them in to productive venture. The financial system can be easily expressed through financial structure [2]. The financial structure is mainly classified as follows in diagram 1.

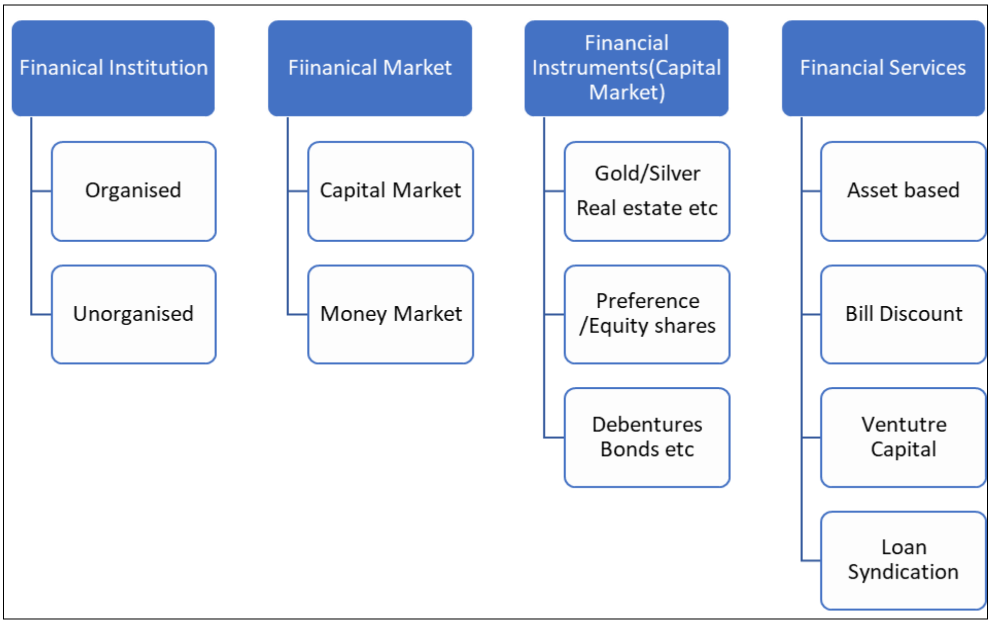


Diagram 1: Financial Structure

The diagram 1 indicates the Structure of Financial System. Depending upon this structure the Loan Market is further classified into organised and unorganised lenders. The study covers financial institution, which deals in Financial Asset that is Gold /Silver. The financial Institution provides fees based services that are loan Syndicate. The researcher has studied only the loan syndication in this study.

Types of loans granted by Financial Institution

- Secured loan and
- Unsecured Loan

Secured Loan

A secured loan is a loan in which the borrower pledges some asset (e.g. Gold, a Car or Property) as collateral for the loan, which then becomes a secured debt owed to the creditor who gives the loan. The debt is thus secured against the collateral — in the event that the borrower defaults, the creditor takes possession of the asset used as collateral and may sell it to regain some or all of the amount originally lent to the borrower, for example, foreclose is a portion of the bundle of rights to specified property. If the sale of the collateral does not raise enough money to pay off the debt, the creditor can often obtain a deficiency judgment against the borrower for the remaining amount. The opposite of secured debt/loan is unsecured debt, which is not connected to any specific piece of property and instead the creditor may only satisfy the debt against the borrower rather than the borrower's collateral and the borrower.

Unsecured loan

Unsecured loans are monetary loans that are not secured against the borrower's assets (no collateral is involved). There are small business unsecured loans such as credit cards and credit lines to large corporate credit lines. These may be available from financial institutions under many different guises or marketing packages:

- Personal Loans
- Bank overdrafts
- corporate bonds
- credit card debt
- credit facilities or lines of credit

The researcher has included the detail about the Personal Loans provided by the financial intuitions. The financial institution for both secured and unsecured loan is further classified into organised loan lender and unorganised loan lenders.

Overview of Organised and Unorganised Loan Lenders of the study or Financial Institutions

In financial economics, a financial institution is an institution that provides financial services for its clients or members. Probably the greatest important financial service provided by financial institutions is acting as financial intermediaries. Most financial institutions are regulated by the government. Broadly, there are three major types of financial institutions:

1. **Depositary Institutions:** Deposit-taking institutions that accept and manage deposits and make loans, including banks, building societies, credit unions, trust companies, and mortgage loan companies.
2. **Contractual Institutions:** Insurance companies and pension funds; and
3. **Investment Institutions:** Investment Banks, underwriters, brokerage firms.

(The researcher has mainly studied the Depositary financial Institution in organised and unorganised form in formal and informal financial sector in India.) There are various types of loan granted by Financial Institution.

The financial institution can be classified in to organised and unorganised loan lenders. Where organised loan lenders have to follow certain norms and policy formulated by RBI. There is differentiation in the functioning of organised and unorganised loan lenders. Traditionally, there was unorganised loan lenders were only option for borrowing. But now along with Personal loan, even gold loan has been provided by organised loan lenders. The organised and unorganised loan lenders follow different procedures to lend the loan. The researcher had studied certain loan lender. These loan lenders are being classified as follows in Diagram 2 in the next page.

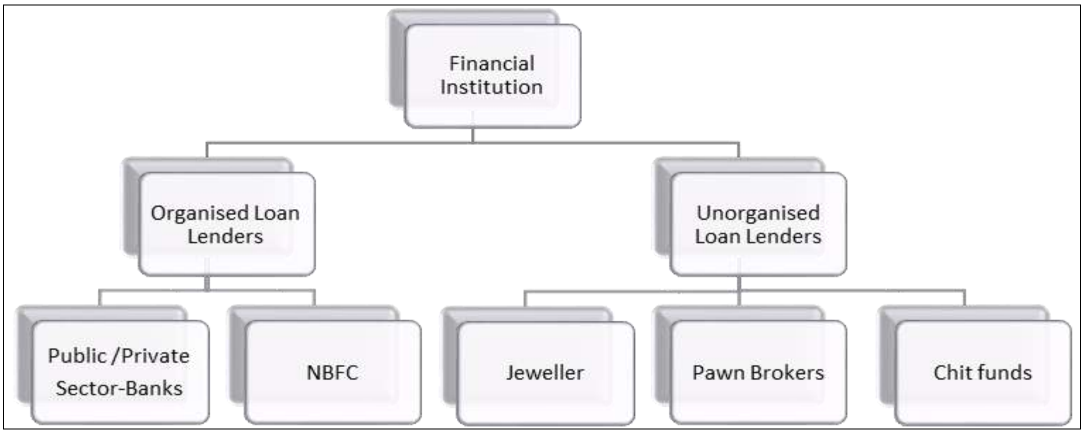


Diagram 2: Financial Institution for the study

The Researcher has classified the loan lenders i.e.
- Organised loan lenders – Public /Private Banks and NBFCs
- Unorganised Loan Lenders – Chit funds and Pawn Brokers includes Jeweller for the study.

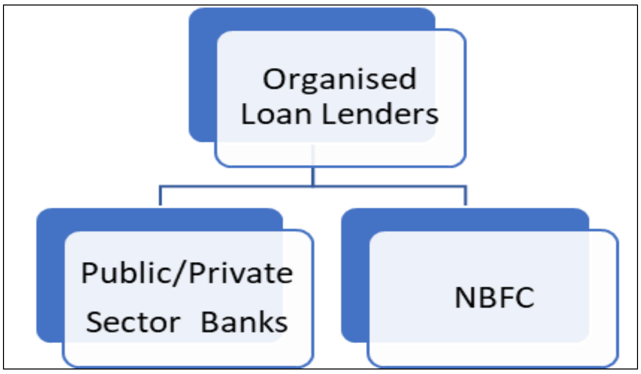
Public/Private Sector Banks, NBFCs, Jeweller, Pawn Broker, Chit-funds, these are the types of loan lenders (lenders) studied in this research study. A detail explanation of these terms has been included in this chapter. (List of the Public/Private bank, NBFCs, and Pawn Broker, Chit funds, Jewellers interviewed are in Annexure 1on Page No. 314-315. The detail explanation of Organised and Unorganised Loan lenders are given next.

(a) Organised Financial Sector

Organised sector comprises of Banks, Financial and Investment Institutions, Short term funds are mainly provided by Commercial and Co-operative Banks.The organised financial system comprises the following sub-system:

1. Banking System
2. Commercial System
3. Co-operative System
4. Development System
5. Public Sector
6. Private sector

The research has only included Public Banks and NBFCs to study Gold Loan Market and Personal Loan Market. Diagram no. 3.



(The Researcher has classified the loan lenders i.e. Organised loan lenders which include lenders like Public/Private Sector Banks and NBFCs)

Diagram 3: Organised Loan lenders

(a1) The Private Bank" is ban k where greater parts of stake or equity are held by the private shareholders and not by government. Private banking is banking, investment and other financial services provided by banks to high-net-worth individuals who enjoy high levels of income or invest sizable assets. The term "private" refers to customer service rendered on a more personal basis than in mass-market retail banking, usually via dedicated bank advisers. It does not refer to a private bank, which is a non-incorporated banking institution. Private banking forms an important, high-level and more exclusive (for the especially affluent) subset of wealth management. At least until recently, it largely consisted of banking services (deposit taking and payments), discretionary asset management, brokerage, limited tax advisory services and some basic concierge-type services, offered by a single designated relationship manager. The banks, which were not nationalized at the time of bank nationalization that took place during 1969 and 1980, are known to be the old private-sector banks. These were not nationalized, because of their small size and regional focus. Most of the old private-sector banks are closely held by certain communities their operations are mostly restricted to the areas in and around their place of origin. Their Board of Directors mainly consists of locally prominent personalities from trade and business circles. One of the positive points of these banks is that, they concentrate more on service and technology and as such, they are likely to attract more business in days to come with the restructuring.

Unorganised Financial Sectors

The term Unorganised sector when used in the Indian context is defined by the National Commission for Enterprises in the Unorganised Sector, Government of India in their Report on Conditions of Work and Promotion of Livelihoods in the Unorganised Sector thus:

- The unorganised sector consists of all unincorporated private enterprises owned by individuals or households engaged in the sale or production of goods and services operated on a proprietary or partnership basis and with less than ten total workers.
- Amongst the characteristic features of this sector are ease of entry, smaller scale of operation, local ownership, uncertain legal status, labor intensive and operating using lower technology based methods, flexible pricing, less sophisticated packing, absence of a brand name, unavailability of good storage facilities and an effective distribution network, inadequate access

to government schemes, finance and government aid, lower entry barriers for employees, a higher proportion of migrants with a lower rate of compensation. The researched have studied Money lender, Pawn broker, Jeweller and chit fund as unorganised financial money lender. The details of

1. Money Lender
2. Pawnbroker
3. Chit funds as follows:

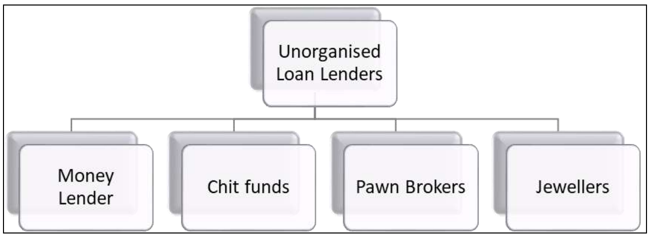


Diagram 4: Unorgansied Loan Lenders

The details of above terms like Money lender, Chit fund, Pawn broker, Jewellers are as follows:

(b1) Money Lenders [3]

A moneylender is a person or group who offers small personal loans at high rates of interest. Most of the time the borrower prefers to take loan without any collateral. An Act respecting Loans from Money-lenders This Act may be cited as the Money-lenders Act [4].

Interpretation

In this Act,

a. "Interest" includes discount and also includes charges in respect of which the Legislature has not power in this behalf;
b. "Loan" includes money advanced on account of a person in any transaction which, whatever form it takes, is substantially a loan to such person, or one securing the repayment by such person of the money advanced;
c. "Money-lender" includes any person carrying on a loaning business, and any person who engages in any transaction referred to in clause (b) and any person who carries on the business of money-lending, or advertises or announces himself or holds himself out in any way as carrying on that business, and who makes a practice of lending money at a higher rate than ten per cent per annum, but does not include a registered pawnbroker or a bank;
d. "Rate permitted" means a rate that is a legal and valid rate in respect of the loan and is not in contravention of any Act heretofore or hereafter enacted by the Parliament.

Application of Act

This Act shall apply in respect of any loan made after the enactment of this Act and to any loan whenever made not wholly discharged before the enactment of this Act.

Relief where action already pending

Where in any action or proceeding in the Supreme Court or in the county court in respect of any loan from a money-lender, the court finds that the amount of the charges for commission, expenses, inquiries, fines, bonus and renewals in respect of which the Legislature has power in this behalf, and any other such charges, together with the amount of the interest, exceeds the amount of the interest calculated at the rate permitted, or that any convincing in connection therewith was unnecessary, or the charges therefore excessive, or that insurance other than that reasonably proper for security for the loan was required by the money-lender, the court shall have jurisdiction and power to:

a. Reopen the transaction and take an account between the creditor and the debtor;
b. notwithstanding any statement or settlement of account or any agreement purporting to close previous dealings and create a new obligation, reopen any account already taken and relieve the debtor from payment of either the whole or any part of any sum in excess of the sum adjudged by the court to be due for principal and interest;
c. order the creditor to repay any such excess if the same has been paid or allowed on account by the debtor; or
d. Except in respect of interest, set aside, either wholly or in part, or revise or alter any security given or agreement made in respect of the loan and, if the creditor has parted with the security, order him to indemnify the debtor.

Relief where action not pending

Where no such action or proceeding is pending, or where such action or proceeding is pending before any other court or before a justice or justices of the peace, any debtor who would be entitled to relief under Section 4 if such action or proceeding were pending in the Supreme Court or in the county court, may apply in a summary way to the Trial Division of the Supreme Court or a judge thereof, or to the county court or a judge thereof, on such notice as the court or a judge directs, for any of the relief provided by Section 4 and such court or judge shall have jurisdiction and power to grant any or all of such relief.

Effect of Act

Nothing in this Act shall affect the rights of a *bona fide* assignee or holder for value without notice, and the jurisdiction and power given or conferred by this Act is in addition to the existing jurisdiction and powers of the Supreme Court and of a judge thereof and of the county court and of a judge.

(b2) Pawn Broker [5]

Pawnbroker is an individual or business (pawnshop or pawn shop) that offers secured loans to people, with items of personal property used as collateral. The word pawn is derived from the Latin pignus, for pledge, and the items having been pawned to the broker are themselves called pledges or pawns, or simply the collateral. In simple words a pawn broker is a person who lends money to people in exchange for personal property that can be sold if the money is not returned within a certain time.

If an item is pawned for a loan, within a certain contractual period of time the pawner may redeem it for the amount of the loan plus some agreed-upon amount for interest. The amount of time, and rate of interest, is governed by law or by the pawnbroker's policies. If the loan is not paid (or extended, if applicable) within the time period, the pawned item will be offered for sale by the pawnbroker. Unlike other lenders, the pawnbroker does not report the defaulted loan on the customer's credit report, since the pawnbroker has physical possession of the item and may recoup the loan value through outright sale of the item. The pawnbroker also sells items that have been sold outright to them by customers. Business model of Pawn Broker

The pawning process begins:

- When a customer brings an item into a pawn shop. Common items pawned (or, in some instances, sold outright) by customers include jewelry, electronics, collectibles, musical instruments, and tools.
- In some states in the U.S., pawnshops with firearms licenses sell pistols and rifles to customers who meet state and federal acquisition criteria. In other states and other countries, such as Canada, Ireland and the UK, pawnshops do not sell firearms. Gold, silver, and platinum are popular items—which are often purchased, even if in the form of broken jewelry of little value. Metal can still be sold in bulk to a bullion dealer or smelter for the value by weight of the component metals. Similarly, jewelry that contains genuine gemstones, even if broken or missing pieces, have value.
- The pawnbroker assumes the risk that an item might have been stolen. However, laws in many jurisdictions protect both the community and broker from unknowingly handling (also known as fencing).
- These laws often require that the pawnbroker establish positive identification of the seller through photo identification (such as a driver's license or government-issued identity document), as well as a holding period placed on an item purchased by a pawnbroker (to allow time for local law enforcement authorities to track stolen items).
- In some jurisdictions, pawnshops must give a list of all newly pawned items and any associated serial number to police, so the police can determine if any the items have been reported stolen. Many police departments advise burglary or robbery victims to visit local pawnshops to see if they can locate stolen items. Some pawnshops set up their own screening criteria to avoid buying stolen property.

Assessment of items

- The pawnbroker assesses an item for its condition and marketability by testing the item (in the case of electronics or instruments) and examining it for flaws, scratches or other damage.
- Another aspect that affects marketability is the supply and demand for the item in the community or region. In some markets, the used goods market is so flooded with used stereos and car stereos, for example, that pawnshops will only accept the higher-quality brand names.
- Alternatively, a customer may offer to pawn an item that is difficult to sell, such as a surfboard in an inland region, or a pair of snowshoes in tropical or sub-tropical regions.
- The pawnshop owner either turns down hard-to-sell items, or offers a low price. While some items never get outdated, such as hammers and hand saws, electronics and computer items quickly become obsolete and unsalable.

Steps in Assessment

- To assess value of different items, pawnbrokers use guidebooks ("blue books"), catalogs, Internet search engines, and their own experience.
- Some pawnbrokers have trained in identification of gems, or employ a specialist to assess jewelry. One of the risks of accepting secondhand goods is that the item may be counterfeit. If the item is counterfeit, such as a fake Rolex watch, it may have only a fraction of the value of the genuine item.
- Once the pawnbroker determines the item is genuine and not likely stolen, and that it is marketable, the pawnbroker offers the customer an amount for it. The customer can either sell the item outright if (as in most cases) the pawnbroker is also a licensed secondhand dealer, or offer the item as collateral on a loan.

(b3) Chit Funds

Chit Fund means a transaction whether called chit [6]", chit fund, chitty, kuree or by any other name by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of grain instead) by way of periodical installments over a definite period and that each such subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount". Chit fund is a kind of savings scheme practiced in India. A *chit fund company* is a company that manages, conducts, or supervises a chit scheme—as defined in Section of the Chit Funds Act, 1982. According to Section 2(b) of the Chit Fund Act, 1982:

Such chit fund schemes may be conducted by organised financial institutions, or may be unorganised schemes conducted between friends or relatives. In some variations of chit funds, the savings are for a specific purpose. Chit funds also played an important role in the financial development of people of south Indian state of Kerala, by providing easier access to credit. In Kerala, chitty (chit fund) is a common phenomenon practiced by all sections of the society. A company named Kerala State Financial Enterprise exists under the Kerala State Government, whose main business activity is the chitty.

(b4) Jewellers

The term 'Jeweller' refer to a person whose business is selling jewellery or setting of gemstone or making or repairing, polishing as well as giving loan against gold jewellery on the bases of prevailing rate of gold. Borrower may go to jeweller only for Gold loan. Traditionally Indian gold market was dominated by Jewellers. It was the gold loan market where there was no fixed rate of interest and tenure, no documentation required. The procedure was as follows:

- Any needed person (borrower) will go with the jewellery to the Jewellers. It can be local or from any areas.
- Jeweller would verify and inspect the authencity of the Jewellery in his own way. There was no transparency. No certification was issued for pledging the gold.
- Jeweller then will decide the rate of interest and amount to be disbursed to the borrowers.
- If the Borrowers agrees with the transaction that is rate of interest and Loan to Value. Than the Jeweller would keep the jewellery and disburse the Loan amount.
- The Transaction would be verbally. No written

agreement exchanged between Lender and Borrower.

- It will be decided to pay the interest monthly on a day agreed**.** Failing to do so, after certain period of time the jewellery would be taken away by the jeweller without any notification.

Conclusion

As understanding the both organised as well as unorganised loan lender is necessary to analyse the gold loan as well as personal loan business in Mumbai metro region**.** This has further helped the researcher to analyse the preference, procedure differences of both the loan lenders. The researcher had interviewed some of them to analyses the market reality of gold loan and personal loan from organisedor unorganised loan lenders.

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