

Investigated Study on Shaping the System of Personal Loans in India: With Special Reference to Informal Workers of Madras Province (Chennai)

Abstract

The study aimed to bridge information gaps and unravel the complexities of asymmetric information in personal loans among Madras's informal workers. A field survey was conducted among informal sector workers in Madras, revealing that 76.9% had obtained a personal loan in the last decade. Of these, 63.06% were employed in the private sector, while the remaining 36.4% were engaged in public-private partnerships or government sectors. The study was primarily located in Madras (now Chennai), leveraging its rich history of trade and commerce and its status as a major industrial and commercial centre. The research findings are expected to contribute valuable insights to the discourse on personal loans in the informal sector, particularly in the context of customer satisfaction, micro borrowing, loan defaults, and the impact of personal micro credit. Based on the findings, the study proposes suitable policy recommendations to address the identified challenges and improve access to personal loans for informal workers in Madras. These recommendations aim to enhance transparency, reduce information asymmetry, and foster a more inclusive and equitable financial ecosystem.

Introduction

The intricate challenges posed by asymmetric information and adverse selection in the domain of financial services, particularly personal loans, have been a critical area of focus in recent years. This is especially relevant within India's vast informal sector, which constitutes a substantial portion of Madras's population. These workers often face barriers in accessing financial resources due to a lack of transparency and information asymmetry. The motivation for our research stemmed from the need to address these challenges, uncover the underlying dynamics, understand the implications, and contribute viable solutions that can propel the development trajectory of the country.

Purpose of the study

The purpose of the study stems from the critical need to address the intricate challenges posed by asymmetric information and adverse selection in the domain of financial services, particularly personal loans within India's vast informal sector. The informal workforce, constituting a substantial portion of Madras's population, faces barriers in accessing financial resources due to a lack of transparency and information asymmetry. This research is driven by the imperative to uncover the underlying dynamics, understand the implications, and contribute viable solutions that can propel the development trajectory of the country.

Review of related literature

Ch. L. Hymavathi, K. Kalpana (2014) Customer satisfaction towards housing loan, car loan, and personal loan schemes in state banks of India, andhra bank, and axis bank, Guntur varies, with some banks providing better services than others. The South and Western regions in India have the highest share of personal loans disbursed by commercial banks, with high regional disparity and growth rates. **Abhijit Sinha, D. Kundu (2018)** Micro borrowing in India is driven by a combination of structure, strategy, and personal effects, with men borrowing larger sums and structural constraints affecting default rates. **Padmavathi Koride (2022)** Micro borrowing in India is driven by a combination of structure, strategy, and personal effects, with men borrowing larger sums and structural constraints affecting default rates. **Saha A Et.al (2022)** Housing loan default in India is driven by factors such as employment, gender, socio-religious category, and age, with interest rate, repayment frequency, prepayment options, and loan period also playing a role. **Rais Ahmad Itloo, A Selvarasu and J Filipe (2015)** Commercial banks in India offer various loan products and credit scoring techniques, categorized into advanced and traditional categories, to classify risks and grant credit to applicants. Personal Micro Credit, a small loan extended to impoverished women, can improve their socio-economic status and enable them to become self-employed. Personal Micro Credit, a small loan extended to impoverished women, can improve their socio-economic status and enable them to become self-employed. **Ninad J, Panchakshari, S. P. Huddedar (2012) & Atanu Sengupta, Sanjoy De (2019).**

Research Gap for the study

Based on the above literature, the research gap found for "Bridging Information Gaps: Unravelling Asymmetric Information in Personal Loans for Madras's Informal Workers".

While there is extensive research on customer satisfaction, micro borrowing, loan defaults, and the impact of personal micro credit, there seems to be a lack of comprehensive studies specifically focusing on the informal workers in Madras and their experiences with personal loans. The existing literature does not delve deeply into the issue of asymmetric information in the context of personal loans among informal workers in Madras. This could be an area of exploration, understanding how information asymmetry affects the borrowing and lending process in this specific demographic. Loan Products and Credit Scoring Techniques. There is a need to study how various loan products and credit scoring techniques used by commercial banks affect informal workers in Madras. This could help understand if these methods are effective or if they contribute to information asymmetry. While structural constraints and their impact on default rates have been studied in the context of micro borrowing, similar studies for personal loans among informal workers in Madras seem to be lacking. Customer Satisfaction. Studies on customer satisfaction have been conducted for state banks, but there is a gap in understanding customer satisfaction among informal workers in Madras who avail personal loans from private banks and NBFCs.

To full fill these lacuna present opportunities for further research to unravel the complexities of asymmetric information in personal loans for Madras's informal workers.

Profile of the Study area and Reason for Choosing Madras (Chennai)

Madras, now Chennai, is a prime location for studying the dynamics of personal loans among Madras's informal workers due to several factors. Firstly, Historical Significance: Madras has a rich history of trade and commerce, dating back to the East India Company era. This economic history provides a strong foundation for studying financial phenomena. Secondly, As the capital city of Madras, Madras is the second-largest industrial and commercial center in South India. In 2022, it had an estimated Purchasing Power Parity (PPP) GDP of US\$78.6 billion, with recent estimates around US\$128.3 billion. Thirdly, Informal Sector: The informal sector plays a significant role in India's economy, with Madras

being no exception. A study shows that the state, far from being absent, played a fundamental role in creating the dichotomy between the formal and informal sectors. Fourth, Financial Sector: Madras has a vibrant financial sector, with a mix of traditional banking institutions and emerging fintech companies. This makes it a fertile ground for studying personal loans.

What is the present status of financial and informal sectors in Madras

Madras has an economic base anchored by the automobile, software services, medical tourism, hardware manufacturing, and financial services. It is also home to the Chennai Port, one of the biggest in South Asia. The informal sector and informal employment relations occupy a prominent place in India's economy. This sector is characterized by the absence of official protection and recognition, non-coverage by minimum wage legislation and social security system, predominance of own-account and self-employment work, absence of trade union organization, low income and wages, little job security, and no fringe benefits from institutional sources. In 2022, Chennai had an estimated PPP GDP of US\$78.6 billion. Recent estimates of the economy of Chennai are around US\$128.3 billion PPP GDP.

Research Methodology for the study

Primary data was collected through field surveys and interviews with informal workers in Madras who had availed personal loans. This provided first-hand information about their experiences, challenges, and perceptions. Secondary data was gathered from various sources such as research papers, reports, articles, and official statistics related to personal loans, informal sector, and financial institutions in Madras. The collected data was analyzed using simple percentage analysis. This method was chosen for its simplicity and effectiveness in presenting the distribution and proportion of responses for each question or variable. The research adopted an analytical approach, critically examining the data and findings to unravel the complexities of asymmetric information in personal loans among Madras's informal workers. While the methodology was primarily data-driven, it maintained a holistic perspective, considering various factors such as socio-economic conditions, financial practices, and institutional policies that influenced the dynamics of personal loans in the informal sector.

Results and Discussion

For this study field survey was conducted in informal sector workers in Tamilnadu. Out of total 76.9 percent of the workers working in informal sector was got personal loan in during this last 10 years. that is noted that 63.06 percent of the customers were woking in a

private sector. Remaining 36.4 percent of the customers were working in public private partnership or government sector as a contract worker or wage labourers.

They revealed that 60 percent of the workers got the personal loan in the private sector banks and remaining 40 percent of the customers were got the personal loan in the non banking financial intermediaries.

Based on these information questions was asked with them that is EMI's able to pay I the right time? They said that 60 percents of the respondents said that they able to pay the EMI's on time. And remaining 40 percent of the respondents said that they unable to pay the EMI's on time.

What it reveals?

Of the workers who were employed, 60 percent were receiving their salaries on time from their respective companies. These companies had fostered good relationships with their workers. Among these punctual workers, 23 percent reported that they felt pressured to make their payments on time, particularly around the Equated Monthly Installment (EMI) due dates. How were they pressured? If the EMI due date was the 5th of every month, they would start receiving frequent calls from the last day of the previous month. These customers reported that such calls were causing them psychological distress. The remaining 40 percent of the respondents, who were typically unable to pay their EMIs on time, cited a lack of job security as the primary reason for their predicament.

Reserve bank of India guidelines on personal loan and NBFIs says that After full repayment or settlement of the loan, all original movable/immovable property documents must be released by the lending institution within 30 days. The borrower can choose to collect these documents from the branch where the loan was serviced or any other office of the lending institution. If there's a delay in releasing the original property documents or in filing the charge satisfaction form with the relevant registry beyond 30 days after full repayment, the lending institution must compensate the borrower at the rate of ₹ 5,000/- for each day of delay. The RBI has tightened norms for unsecured personal loans by increasing the risk weights by 25 percentage points. This is aimed at making lenders more cautious about such advances. The revised norms with increased risk weights do not apply to certain consumer loans, including housing, education, and vehicle loans. Basic Rules: All banks, lenders, and NBFCs need to follow a basic set of rules by RBI for personal loans. These include a minimum credit score requirement and meeting eligibility criteria.

In reality, the survey had revealed that approximately 70 percent of the respondents had not read the regulations and were unaware of them. If the remaining 30 percent of the respondents were aware of the regulations, they had not read the Reserve Bank of India's regulations for various reasons. These reasons included an urgent need for money to meet current demands, indifference towards interest rates, and a lack of time to read the regulations. These factors led to consequences such as facing high-interest rate problems. If they did not pay their Equated Monthly Installments (EMIs) on time, there would be additional charges.

The field data indicated that 60 percent of the people were paying 75 percent of the repayment amount as interest. This was not a problem originating from the Reserve Bank of India, Banks, or Non-Banking Financial Companies, but rather a problem from the customers and agents of personal loans.

The issue with the agents was that, in their eagerness to show performance to the bankers, they were not spending much time explaining the rules and regulations of personal loans to the customers. This lack of communication led to misunderstandings and dissatisfaction among customers towards the Government, the Reserve Bank of India, and Banks.

According to **Finezza India (2024) and HDFC**, it was found that 5% of all loan application documents submitted through an online channel had been tampered with. Furthermore, loans obtained with fake documents resulted in a 60% loan write-off rate. Fraudsters often modified existing documents or created new ones to deceive lenders. They might have added a false signature or stamp to the original document and a photograph. Blank, stolen documents could also be classified as modified documents, in which blank documents were replaced with incorrect information. The question arose on how to overcome this problem to maintain a good relationship with the customer and the Government of India, especially for RBI, Bankers, and NBFC's.

Was there a need to implement anything new?

No, “symmetric information with no adverse selection” was all that is needed. RBI had perfect rules and regulations on personal loans. Banks were also functioning with the guidelines of RBI. Some kind actions needed to regulate the personal loan from the customer side and mediators, that is, agents.

How can it be?

The study by **Douglas W. Diamond and R. Rajan (1991)** stated that loans were illiquid when a lender needed relationship-specific skills to collect them. Consequently, if the relationship lender needed funds before the loan matured, she might have demanded to liquidate early, or required a return premium, when she lent directly. Borrowers also risked losing funding. The costs of illiquidity were avoided if the relationship lender was a bank with a fragile capital structure, subject to runs. Fragility committed banks to creating liquidity, enabling depositors to withdraw when needed, while buffering borrowers from depositors' liquidity needs. Stabilization policies, such as capital requirements, narrow banking, and suspension of convertibility, might have reduced liquidity creation.

Policy Suggestions and Recommendations:

To the agents:

With the available resources, the monitoring system should have been effective. It already existed but it should have been effective in the following aspects: verification of applications, official documents of the customers. Secondly, it was important to provide the exact information to the customers which was available in the banks and RBI. Time had to be spent more to explain the rules and regulations than sanctioning of loans.

To the customers, especially who needed personal loans:

Before going to apply for the personal loan, customers were recommended to read all the related rules and regulations available in the application form. As well as on the website, all the information was available. All the advertisements on television and newspapers advised customers to read the information carefully.

Conclusion

The study highlighted the critical role of information asymmetry and adverse selection in the domain of personal loans within the informal sector. The findings underscored the need for greater transparency, improved communication, and enhanced financial literacy among borrowers. Furthermore, it pointed to the need for stricter regulation and monitoring of loan agents to ensure adherence to RBI guidelines and fair practices. The

study thus provided valuable insights that could inform policy interventions and strategies to improve access to personal loans for informal workers in Madras.

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