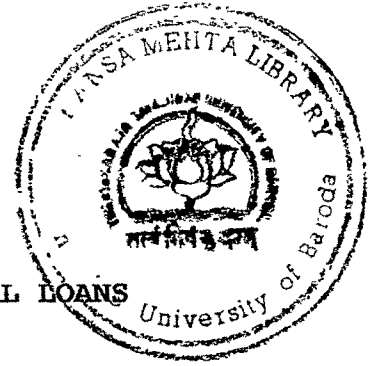


## CHAPTER FOUR

### CHARACTERISTICS AND ANALYSIS OF FORMAL LOANS



This chapter is devoted to the analysis of the financial assistance provided by formal financial institutions.

Finance is an essential requirement for almost every activity. If the required finance is not available out of one's own income, then one needs credit. In the rural areas of India credit requirements are more pressing. Rural population comprises of agricultural producers, tenant cultivators, village artisans, landless labourers, etc. All these categories are in need of credit. The main purpose of financing by institutional agencies is not merely to advance more and more money to rural producers for replacing the traditional money lenders but to provide credit at cheaper interest rates with less cost and in a convenient way. Provision of adequate credit to agricultural producers on right time, and on easy terms had attracted the attention of the policy makers even before the independence. Up to 1960s, rural credit was considered to be the exclusive domain of cooperative system. The history of cooperative movement in India started with the passing of the first cooperative societies Act in 1904 by the Government of India. A number of committees and commissions at the union and the state levels have made recommendations for improving

agricultural credit and strengthening co-operative credit structure. In spite of the phenomenal expansion of cooperative credit, it could not meet the growing credit requirements of the fast developing rural sector in general and agriculture in particular. The report of the Study Group of the National Credit Council (1968) recommended the participation of commercial banks for financing agricultural sector. The credit gap in the agricultural sector was highlighted in the rural Credit Review Committee; Report of 1969 (Shri B. Venkatappaiah's Committee). The committee laid emphasis both on increasing the amount of agricultural and rural credit by cooperatives and a change over to a multi-agency approach for meeting the growing credit requirements of the rural sector. While, recommending the increasing role of commercial banks in the rural areas, it observed, "progressive and far sighted commercial banking should ordinarily be able to see the wisdom of stepping in boldly to serve the rural areas with the services of banking and credit". The Government of India directed commercial banks in 1967 to take up rural banking. The Nationalisation of 28 major banks in July 1969, paved the way for a major thrust in rural areas. The multi-agency approach to agricultural credit evolved through the suggestions of several expert committees that studied the rural credit requirement. In 1975, regional rural banks were setup with the task of introducing social banking at

low cost in the rural areas. This was followed by the establishment of the National Bank for Agricultural and Rural Development (NABARD) in 1982, with a mandate for promoting banking facilities in rural areas.

The total priority sector advances provided by commercial banks amounted to 10281 crores in the year 1994-95.

The multi-agency approach to rural credit has yielded a mixed harvest. The availability of credit to rural sector has certainly increased considerably during the past couple of decades and the weaker sections of the society have received a growing share of rural credit. But the quality and quantity of credit has been far from satisfactory. Credit activities in rural areas are still dominated by private money lenders continuing the practices for which they are notorious. For the country as a whole, nearly 50 percent of the rural households are still outside the ambit of formal credit system, and are thus dependent on informal credit sources for meeting their credit needs.

The role of credit in agricultural development has quantitative and qualitative dimensions. While the quantitative aspect of credit is, in itself an important factor, it is not the whole. The qualitative character of credit is equally important. The qualitative aspect involves the terms, policies and considerations of agencies supplying credit, the rates at which credit is being

supplied and the purposes for which credit is being made available. To put stress on the quantitative aspect of credit, without reference to the qualitative aspect is as much foredoomed to failure as the consideration of the qualitative aspect without reference to the quantum of credit. A proper blending of both the quantitative and qualitative aspects of credit alone can help agriculture and other rural activities develop and diversify at a rapid pace.

The objective of this chapter is to analyse the characteristics of credit provided by the formal banking institutions. The chapter examines several dimensions of formal credit, listed below :

- Size of loan and activities financed
- Source
- Tenure
- Security
- Interest rate structure
- Repayment performance and
- Gender analysis

The analysis in this chapter is based on sample data. As stated earlier, a primary survey was conducted and credit data and information were collected for 319 loan cases.

#### 4.1 Size of Loans and Activities Financed

The size of a loan given to a borrower depend upon his credit worthiness as it reflects his repaying capacity, and the purpose of borrowing.

Resource endowment and the scope of technology determine the scope for different activities. The main four purposes for which credit is given are :

- (a) short-term loans for production inputs like seeds, fertilizer, pesticides, animal feed, raw materials, etc.,
- (b) long-term loans for purchasing assets like farm machinery, livestock, irrigation, wells, land improvement, etc.,
- (c) consumption credit to support the farm household during the intervening period of production and consumption and also for meeting contingencies like illness, and
- (d) repayment of past debt obligations.

Farm families are simultaneously units of production and consumption and both these components affect one another closely. Formal institutions normally try to restrict credit to the first two purposes. There was a national policy directive for diverting growing share of total credit to non-farm activities, with a view to increasing employment opportunities in rural areas. But the data shows that

borrowers had considerable access to consumption loans also, which was indicated also by the share of miscellaneous loans.

Data on loan cases and credit disbursed for various types of economic activity is given in table 4.1.

**Table 4.1 : Distribution of Loans According to the Activities Financed.**

(Amount in rupees)					
Activities	No. of loan cases	Percent	Loan amount	Percent	Average loan
1	2	3	4	5	6
Agricultural operations	188	58.93	1281800	52.68	6818.09
Animal husbandry	47	14.73	265950	10.91	5658.51
Self employment	4	1.25	155600	6.80	38900.00
Business	15	4.70	198200	7.64	13213.33
Housing	19	5.96	247900	10.17	13047.37
Repayment of old loan	7	2.19	89000	3.65	12714.29
Miscellaneous	39	12.23	198500	8.15	5089.74
Total	319	100.00	2436950	100.00	7639.34

(Figures in columns 3&5 are percentages to the totals of columns 2&4 respectively)

Note: Miscellaneous include all types of consumption loans.

Table 4.1 shows that there were 319 sample loan cases and the total credit disbursed amounted to Rs. 24,36,950. The average amount of the loans received was Rs. 7639 per loan case. Activity wise distribution shows that more than half of the loans was agricultural loans. The average amount of farm loan was Rs. 6818. Out of the remaining half of the total loans, animal husbandry and housing had more than 10 percent each. In spite of the efforts to reduce consumption loans, they still accounted for more than eight percent. The average amount of consumption loan was Rs. 5089. Further, although data is not available it was observed from personal discussions with the borrowers that considerable amount of the credit obtained for productive purposes was diverted towards consumption purposes. Small business and self-employment accounted for 7 and 8 percent of the total loans respectively. Whereas, repayment of old debts, attracted less than 4 percent.

The IRDP introduced on national level to improve the economic and social conditions of the poorest sections of the rural society consisting of small and marginal farmers, agricultural labourers, rural artisans and craftsmen, scheduled castes and scheduled tribes gained very little momentum in the areas of our study.

There were 26 loan cases of IRDP, of which, 24 were for animal husbandry and two for small business. The

average amounts of loan for animal husbandry, and small business were Rs.5977 and 7000, respectively. In sum, credit still continued to be largely agricultural.

#### 4.2 Sourcewise Distribution

With the multi-agency approach to rural credit, the co-operatives, nationalised and other commercial banks, specially established institutions like regional rural banks are all playing a vital role in the rural credit scene. The table 4.2 presents distribution of credit according to the source.

**Table 4.2 : Institution wise Distribution of Formal Loans**

(Amount in rupees)

Institution	No.of loan cases	Percent	Loan amount	Percent	Average
1	2	3	4	5	6
Commercial banks	107	33.54	1053800	43.24	9848.6
Regional rural banks	197	61.76	1096850	45.01	5567.77
Co-operative banks	5	1.57	38600	1.58	7720.00
Land mortgage banks	9	02.82	197700	8.11	21966.67
Housing board	1	00.31	50000	2.05	50000.00
Total	319	100.00	2436950	100.00	7639.34

(Figures in columns 3&5 are percentages to the totals of columns 2&4 respectively)



It can be observed from table 4.2 that commercial banks and regional rural banks together contributed 88 percent of the formal loans. In spite of the considerable progress in the cooperative credit since independence, the cooperative societies along with the land mortgage banks met less than 10 percent of the rural credit in the study area. Further, there was only one loan case (provided by the Housing Board) which constituted 2 percent of the total amount financed. RRB's had a predominant share in loan cases (62 percent) and the highest share in the total credit. Thus, the major characteristics of the sample loans was their small size and their large share given to the poor.

#### 4.3 Tenurewise Classification

Loans are typically classified according to the period of loan into three categories : short-term, medium-term and long-term. Short-term loans are usually for a period upto 15 months, and are usually given for the purchase of farm inputs and raw materials, payment of wages, etc. Agriculturists are given medium-term credit for purchasing agricultural tools and implements, livestock, to dig or deepen wells etc. Medium-term loans are given for a period of 15 months to 5 years. For long-term loans the period is more than 5 years and it may be as long as 15 to 20 years if required for the purchase of costly agricultural machineries or land, etc. Table 4.3 given tenurewise distribution of credit.

**Table 4.3 : Tenurewise Classification of Formal Loans**

(Amount in rupees)					
Tenure	No. of loan cases	percent	Loan amount	Percent	Average loan
1	2	3	4	5	6
Short-term	298	93.42	1980450	81.27	6645.81
Medium-term	2	00.63	41200	1.69	20600.00
Long - term	19	05.96	415300	17.04	21857.89
Total	319	100.00	2436950	100.00	7639.34

(Figures in columns 3&5 are percentages to the totals of columns 2 & 4 respectively)

Tenurewise classifications of the loan shows that 93.42 percent of the loan cases were short-term loans. Medium-term and long-term loans together constituted around 6 percent only. From a total of Rs. 2436950 disbursed during the two years 1992-94, 81.27% were short term loans having an average amount of Rs. 6645. Long-term loans came a low second in importance. The total amount of long-term loans was Rs. 4,15,300 which is 17 percent of the total loan disbursed and the average amount was Rs. 21,857. Medium term loans were negligible.

#### 4.4 Securitywise Classification

Banks try to reduce the risks in making loans by insisting that a borrower gives security which can be sold in the case of default for loan recovery. This means, to

obtain credit the client has to prove his/her credit worthiness. Insistence on security has been the legacy of traditional commercial banking. Loans backed by personal assets like land give a feeling of safety to the lender. However, such a stipulation made formal institutions inaccessible to marginal farmers and land-less agricultural labourers. Table 4.4 gives data for secured and unsecured advances covered by the sample.

**Table 4.4 : Securitywise Classification of Formal Loans**

(Amount in rupees)					
Category	No. of loan cases	percent	Loan amount	Percent	Average loan
1	2	3	4	5	6
Secured	267	83.7	2107300	86.47	7892.50
Unsecured	52	16.3	329650	13.53	6339.42
Total	319	100.00	2436950	100.00	7639.34

(Figures in columns 3&5 are percentages to the totals of columns 2 & 4 respectively)

A perusal of the table shows that nearly 86 percent of the loans was secured. The average amount of secured loans was much higher compared to unsecured loans. Only 13.53 percent of the loans was unsecured. Loans were granted mainly against securities like land and gold. Only a small number of loans was sanctioned against third party personal guarantee by non-borrowers, bank deposits, salary

certificate, license of the shop owned, etc. In a few cases both security and personal guarantee were demanded.

#### 4.5 Interest Rate Structure

Interest rate is a crucial factor in borrowing decisions as it contributes the bulk of borrowing costs. Demand for credit by rural people is assumed to be inelastic. The cost of borrowing from formal sources is less compared to informal sources. This fact is confirmed by the considerable increase in formal credit during the last few decades. The priority sector also received a fair share of the credit assistance at lower than the commercial rate of interest.

**Table 4.5 : Interest Rate Structure of Formal Loans**  
(In percentages)

Category of loan	CB	SIB	RRB	SBI	LMB	Co. B	HB
1	2	3	4	5	6	7	8
DRI	--	--	--	4	--	--	--
IRDP	12.5	12.5	12.5	--	--	--	--
Loan amt. upto Rs. 25000	12.5	12.5	12	12.5	12.5	12	--
25000 to 2 lakhs	14	15.5	15.5	--	15.5	--	15.2

(-) denotes nil)

Note :	CB	=	Canara Bank
	SIB	=	South Indian Bank
	RRB	=	Regional Rural Bank
	SBI	=	State Bank of India
	LMB	=	Land Mortgage Bank
	HB	=	Housing Board
	Co.B	=	Co-operative Bank
	DRI	=	Differential Rate of Interest

An observation of the above table shows that the interest rate charged by all the above types of financial institutions were almost the same during the study period. Around 12.5 percent for amount upto Rs. 25,000 and 15.5 percent for bigger loans.

For personal loans (loan for unproductive purposes) interest rate charged by the South Indian Bank was high, ranging from 18 to 22 percent. No other bank charged such a high rate of interest for personal loans. There was no tenurewise difference in the interest rates. The interest rate of IRDP loan remained the same irrespective of the institution. S.B.I provided the DRI Scheme financial assistance to the weaker sections of the society for productive purposes and charged a very low interest rate (4 percent).

#### **4.6 Repayment Performance**

Repayment is an important aspect of financing. Our literature review shows that repayment performance of rural borrowers had been far from satisfactory. As a rule repayment should synchronise with the generation of cash flow from the production process. Commercial banks have normally inflexible repayment schedules. Financial institutions usually have little or no control over technological developments, market prices, and timeliness of input supply, all of which are key factors in ensuring the success of farm operations and in turn, high loan repayment

rates. Generally, the short-term loans are repaid immediately after the harvesting of the crops, i.e. within a year or so. The medium-term and long-term loans are repaid in a number of installments spread over a fairly long period.

**Table 4.6 : Repayment Performance of Formal Loans**

(Amount in rupees)				
Repayment Performance	No. of loan cases	Percent	Loan amount	Percent
1	2	3	4	5
Fully repaid	89	27.9	621300	25.49
Overdue	219	68.65	1632150	66.98
Ongoing	11	03.45	183500	7.53
Total	319	100.00	2436950	100.00

(Figures in columns 3&5 are percentages to the totals of columns 2&4 respectively)

Note : Ongoing loans are those which are not due for repayment at the time of data collection.

It is observed from table 4.6 that more than two-thirds of the total number of loan disbursed during the study period were overdue. Only 25 percent of the total loan amount was fully repaid. The study confirms the poor repayment performance of rural borrowers noted by other studies.

#### 4.7 Gender Analysis

Traditionally monetary transactions in a household are mostly handled by men. However, during the last two decades, at the institutional level, several policy and institutional changes were made for bringing a greater proportion of women into the economic mainstream. In India, since the beginning of the Sixth Five Year plan (1980) gender issues have received attention of the planners and since then, several measures have been taken for drawing women into productive work. Several reports on economic status and guidelines for development were published for gender sensitisation and guiding planners and credit delivery institutions. The concerted efforts, has resulted in increasing the proportion of total credit delivered to women as shown by some research studies. Just two decades ago women hardly received institutional loans and had to solely depend on private money lenders for meeting their credit needs.

Presently, there is very little data available on the credit given to women. Gender wise data on loans outstanding by banks are available only from 1996 March. However, in our department of the M.S. University some pioneering work has been done in generating data on genderwise distribution on formal loans and their impact on borrowers at the household level in Gujarat. Although these

data represent small samples they do provide some insight into the gender issues of credit analysis. Elavia and Chellani (1994) found that women received 13 percent of the total credit and contributed 26 percent of the bank deposits in 1992-93.<sup>1</sup> Hema Chavan (1994) found that women's share in the total IRDP loans increased from 20.96 in 1986-87 to 45.27 in 1991-92.<sup>2</sup> Zafar Alam (1996) found women accounted for only 4 percent of loans and increased their income by 4.40 percent.<sup>3</sup> Hema Chavan reported much higher proportion of women among borrowers compared to other studies because their study focussed on IRDP borrower, where women were despecially targetted. All these studies relate to the state of Gujarat only. However, the present study is the first one exploring women's access to credit outside Gujarat i.e. in the state of Kerala which boasts of hundred percent literacy.

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1 Ealvia and Chellani. 1995. Women's Participation in Banking Operations: Some Evidences from Gujarat. IBA Bulletin.

2 Hema Chavan. 1993. Socio economic impact of rural credit on women under IRDP programme: a study of Vadodara District. Unpublished doctoral dissertation.

3 Zafar Alam. 1996. Economic impact of rural credit at the household level : A study of Vadodara District. Unpublished doctoral dissertation



Comparing the access to formal and informal credit Elavia and Zafar Alam (1993) found that women's access to former improved and that to the latter decreased. For the 3 years of the study period taken together, female borrower ratio was much higher in the case of formal sector (19 percent) compared to that in the informal sector (11 percent). Among the informal borrowers the proportion of women decreased from 16 to 13 percent over the study period. On the other hand among the formal sector borrowers, there was a rise in the women's participation ratio from 5 to 17 percent.<sup>4</sup> On the other hand there are some studies which show that, the characteristics of formal credit are often inappropriate for the needs of women and they do not even attempt to borrow from financial institutions. In this study gender aspect of rural credit is examined using the following three indicators:

- Loan size
- Activities financed and
- Repayment performance

#### Loan size

The table 4.7 compares the loan size of male and female borrowers in our sample data.

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4 Elavia. and Zafar, Alam. 1993. Rural Households and Credit : Some Evidence from Gujarat. Working Paper, WHODSIC, MSU, Baroda. PP. 8-24.

**Table 4.7 : Genderwise Distribution of Sample Loans.**

Gender	No. of loan cases	Percent	Loan amount	(Amount in rupees)	
				Percent	Average
1	2	3	4	5	6
Male	213	66.77	1798300	73.79	8442.72
Female	106	33.23	638650	26.21	6025.00
Total	319	100.00	2436950	100.00	7639.34

(Figures in columns 3&5 are percentages to the totals of columns 2&4 respectively)

Table 4.7 indicates that out of 319 loan cases around two-thirds were male's and one-thirds were female's.

Further, out of the total loan of Rs. 24.37 lacs around three-fourth was received by male borrowers, and only one-fourth went to females. Further, even the average size of loan disbursed to women was much smaller compared to men. The sample amount of loan per borrower was Rs. 7639. It was Rs 8858 for men and Rs. 6025 for women. Our analysis revealed that women received much lesser proportion of credit than men and ore importantly their loan size was also smaller. Hence, though women constituted one-third of the borrowers, their share in the total credit was around one-fourth only.

### Activities financed

The majority of women in rural areas are engaged in agriculture and constitute a vast human resource. The farm operation of women include application of manure, sowing, planting, irrigating field, fertilizer application, plant protection, weeding, thimming, harvesting, handling winnowing, cleaning, and storing, of food grains, feeding cattle, taking care of livestock, looking after poultry, kitchen garden, marketing vegetable, etc. The nature of functions performed by women in rural families varies from region to region and from one social group to another. Women are not only engaged in farm activities and animal husbandry but also in activities like small business, handicrafts etc. The credit needs of women are for farm activities, self-employment, consumption purposes and stabilizing cash in-flow during slack season. Table 4.8 presents the comparative data on loans given for different activities, separately for men and women.

Table 4.8 : Gender Comparison of Activity Financed

(Amount in rupees)

Gender	Agricultural operations		Animal husbandry		Self employment		Business		Housing		Repayment of old loan		Miscellaneous	
	1	2	3	4	5	6	7	8	9	10	11	12	13	14
	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)
Male	140	999200	22	119700	2	150000	14	195500	9	118000	3	51000	23	164900
	(74.47)	(77.95)	(46.81)	(45.00)	(50)	(96.4)	(93.33)	(98.64)	(47.37)	(47.6)	(42.86)	(57.3)	(58.97)	(83.07)
Female	48	282600	25	146250	2	5600	1	2700	10	129900	4	38000	16	33600
	(25.53)	(22.05)	(53.19)	(55.00)	(50)	(03.6)	(06.67)	(01.36)	(52.63)	(52.4)	(57.14)	(42.7)	(41.02)	(16.93)
Total	188	1281800	47	265950	4	155600	15	198200	19	247900	7	89000	39	198500
	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)

(Figures in parenthesis denote percentage to the total)

- Note : (1) Loans for agricultural operations include loans for fertilizer, farming, seeds, fencing, land improvements and purchasing of new land, etc.  
 (2) (a) is for loan cases and (b) for loan amount.

Table 4.8 shows that animal husbandry and housing were the two purposes for which women had received more number of loan cases and received a bigger share of the loan amount than men. It can be seen that in small business only a single woman has taken loan. Women's share of credit is significantly low in self-employment, agricultural operations and consumption purposes.

#### Repayment performance

There is a popular view that women's repayment performance is better than men's. Two of the best savings and credit programmes in India, the Self Employed Women's Association and the Working Women's Forum, both with 90

percent and 95 percent repayment rates are womens programmes. The following table depicts the gender comparison of repayment performance. Most of the research findings point out that women are better than men in repayment of loans.

The following table depicts the gender comparison of the repayment performance, of the sample borrowers of our study.

Table 4.9 : Gender Comparison of Repayment Performance

Repayment	(Amount in rupees)			
	Male		Female	
	No.	Amount	No.	Amount
1	2	3	4	5
Fully repaid	62	454400 (25.27)	27	166900 (26.13)
Overdue	142	1168400 (64.97)	77	463750 (72.62)
On going	9	175500 (9.76)	2	8000 (1.25)
Total	213	1798300 (100)	106	638650 (100)

(Figures in parenthesis denote percentage to the total)

Note : On going loans - not due at the time of data collection

An appraisal of the table 4.9 shows that 25 percent of the total credit disbursed to men and 26 percent of the

total credit disbursed to women were fully repaid. Overdues were more in the case of women than men. This finding thus differs from other researches, and requires further research for identifying this typical situation. The factors leading to higher overdues need to be identified for ensuring smooth flow of credit in future.

#### 4.8. Conclusion

Our analysis shows that each loan case received an average loan of Rs. 7639. The loans for self employment were five times bigger than that of the sample average. The loans for business, housing, repayment of old debts were much bigger than that for activities like farming, animal husbandry and consumption loans.

It also shows that around 59 percent of the loan cases was for agriculture. Further 53 percent of the loan amount was for the same, followed by animal husbandry (10.91 percent) and consumption, (8.15 percent). The loans for repayment of the old loans received least share (3.65 percent).

Sourcewise distribution shows that the regional rural banks provided 45 percent of loan, followed by the commercial banks with 43.24 percent share. Whereas the loans provided by the co-operative banks were the least, (1.58

percent). This analysis shows that co-operative banks falling behind are RRBs and commercial banks.

Tenurewise classification shows that, 93.42 percent of the loan cases and 81.27 percent of loan amount were short-term loans. 17.04 percent of the total loan amount was long-term loans. Medium-term loan were negligible.

Securitywise classification showed that around 83 percent of the loan cases were secured, amounting to 86.47 percent of the total credit.

The interest ratewise classification showed that interest rate of all the loans except DRI loan were between 12.5 percent to 15.5 percent. The interest rate of DRI loans was only 4 percent.

Analysis of the repayment performance shows that around 25 percent of the total amount was fully repaid and around 67 percent of the loans outstanding were overdue.

Gender analysis shows that as expected male borrowers received major share in the number of loan cases and amount of loan. Male borrowers received 73.79 percent of the total amount as against women who received 26.21 percent of the total. Activitywise analysis shows that for animal husbandry and housing women received major share of loan, 55 percent and 52.4 percent respectively. Women's share in the total loan amount was the least in case of

business loans. Analysis of the repayment performance shows that 64.97 percent of male loans and 72.62 percent of female loans were overdue. But no conclusion can be drawn about women's poor repayment performance. It was observed that majority of female loans were just fronts for their male counterparts, who could not get any more loans from the financial institutions as they had defaulted earlier in loan repayment.



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