CHAPTER ONE

INTRODUCTION

1.1 Rationale

Finance is the life blood of economic development. All over the world it is a scarce commodity and scarcity adds to its value. Development planners believe in the myth that "by providing finance development follows". But the reality is that for finance to be productive all other goods and services must be available. The concept of finance being the "missing link" of development, is at best a half truth. When all other real factors are present, finance does work as a catalyst of development. But in most of the developing countries supportive services are hardly available and finance is provided under pressure for achieving targets under state or donor plans and programmes. Such supply-leading credit creates several problems. Firstly, it leads to insufficient allocation of resources and poor investments. Secondly, it distorts the financial market mechanism and gives wrong signals to the economy. Thirdly, it leads to political patronage and corruption. Fourthly, the elements of interests and investment subsidies and credit quotas and targets attract the rich and powerful who receive large proportion of credit, while weaker sections of society and poor are bypassed. Lastly, it ruins the financial health of institutions in the long run by undermining their economic viability and performance efficiency. Evidence for supporting all this is available all over the world, including India.

What is required for rapid rural development is an efficient dependable and permanent source of finance so that, credit is available to all who need it for turning any and every opportunity into productive and profitable economic activity. It is important that the lender and borrower have an all time relationship based on mutual trust in each other. Profitable performance, of both lender and borrower is important for sustained development.

In India, formal rural credit has grown at a phenomenal rate over the last two decades. It is pertinent to understand the process of access to credit at the household level for answering some vital questions. What is the role of various lending institutions in credit supply ? What is the extent of informal credit and does it compete or complement formal credit ? What activities are financed ? Has the policy of diversification of credit succeeded ? Does the credit reach women in informal sector ? What policy reforms are required for providing adequate and timely credit to all in need of credit and having adequate debt capacity for repaying the loan? This study makes a humble attempt to answer all such questions.

The preference for household as a unit of economic analysis has been growing in the last two decades. Several models are put forth in the international literature for explaining the behaviour of household as producers and consumers. As the predominant activity in the case of rural households is farming and the majority of rural people are poor or marginally better off with no saving, they need credit both for meeting both production and consumption expenses.

Realising the importance of credit for rapid rural development most of the developing countries have implemented plans and programmes for increasing the supply of institutional credit to rural households over the last four decades. Inspite of this, various studies show that the flow of formal credit has not been adequate for realising the optimum benefits from technological revolution in farm and non-farm sectors.

Inspite of the phenomenal growth of formal credit, informal credit continues to play a significant role in the rural credit system. This fact needs to be recognized and it should no longer be tolerated as a necessary evil. It needs to be encouraged for supplementing the functioning of the formal credit sector, so as, together they make the rural financial system a vibrant force for supporting rapid rural development.

Since the international conference at Mexico city in 1975, the international community has recognized the importance of bringing women to the centre of development process. Women's access to credit is one of the most pressing problems of the developing countries. Various studies show that women's access to formal credit is limited. Facing restricted access to formal credit, women are forced to rely heavily on informal sources of credit.

Since 1991, India has chosen the path of economic liberalisation and globalisation. These new policies require credit flows for supporting the rapid rural development for meeting the growing demand of inputs by the fast growing industries. The countryside will also be a big market for the consumer goods industries, only if the rural income increases at a faster rate. Thus, credit which serves as a catalyst for rapid rural development is a pre-requisite for success of the economic policy reforms. The need of the present time is to have a quantitative and qualitative expansion of rural credit so that all who need credit gets it in time. Further, the poor classes of society and women who are discriminated against by the lending institutions need to be cultivated as credit worthy customers with bankable schemes of development, by undertaking special policy reforms.

1.2 Theoretical Background

Rural credit performs two major functions. Firstly, it enables investment to go beyond the meagre savings of the ruralites for the purpose of economic development. Secondly, it provides for survival needs of the poor. Prof. Yunus of Bangladesh emphasising the importance of the second function calls access to credit as a fundamental human right.

Almost all developing countries have attempted to increase the flow of formal rural credit in the last four decades. Most of them implemented programmes of substantial credit directed to specific borrowers groups, areas, sectors and economic activities by state policy. It was felt that this was the best way to provide credit for rural development. This is known as the view point held by the "traditional school of thought" on rural credit.

On the other hand, over the last decade a consensus is emerging in western countries, popularly known as modern school of thought, which advocates, delivery of rural credit at commercial rates of interest, in response to effective demand, following dictates of the market economy.

In India, since the last five decades of independence, a massive rural credit system was developed and nurtured with the help of state policy implemented under the five year plans. Multi-agency approach was adopted, which terminated the monopoly of co-operatives and inducted the commercial banks in the field of rural finance. Though the policy favoured " credit plus" approach, in practice "credit alone" prevailed. By the decade of eighties, however, several problems emerged , viz., large number of defunct lending institutions, huge and growing proportion non-performing assets, very poor customer service and inadequate credit support for rapid rural development. Hence, at the present juncture, it is pertinent to undertake take an in-depth examination and analysis of rural finance system and process, with a view to suggest changes and explore the possibility of shifting to demand oriented and market dictated credit system from the supply leading system. The aim should be to adopt the former system, including a "credit net" for the poor.

The second issue of concern, is gender sensitising of rural credit system. The myth that " women are higher risks than men", needs to be explored and the lenders need to be convinced about the fact that women are better at loan repayment than men. The strength of the inside/outside dichotomy varies considerably by region and household socio-economic status. On the whole the barriers to women's access to resources and markets are greater in the north than in the south. They are stronger among caste Hindus than among scheduled castes and tribes and stronger among landowning cultivators than among landless labourers or marginal farm families (The World Bank, 1991).

In view of the above, it is pertinent to examine the access of rural credit at the household level, for generating first hand data for understanding and revealing the complexities of credit process and recommending reforms for guiding policy reforms in future. This is precisely the objective of this study.

1.3 Hypotheses

Based on our literature review, we have developed the following set of working hypotheses ,which are tested in this study.

1 Formal rural credit continues to be predominantly farm credit, inspite of the policy to encourage non-farm credit.

2 Informal credit plays a useful role in complementing formal credit, for increasing the overall credit flow.

3 Interest rates charged by informal sources are extremely high and unjustified.

4 Women receive lesser share in formal credit and smaller size loans, compared to men.

5 Informal credit is more responsive to the credit needs of women compared to formal credit.

6 Female headed households have much lesser access and smaller size loans compared to male headed households.

1.4 Objectives

The primary objective of this study is to examine and measure the flow of credit to rural households and its distribution pattern.

The specific objectives are :

1 to identify the major characteristics of sample households and borrowers;

2 to measure the total amount of rural credit deployed at the household level and examine its purposewise distribution;

3 to study the distribution pattern of credit with respect to formal and informal credit sources;

4 to examine the characteristics of formal and informal loans with a view to understand the complexities of the credit delivery system;

5 to examine the gender distribution of formal, informal and overall credit flows and undertake gender analysis of credit;

6 to examine the characteristics of female headed households and their access to credit.

1.5 Chapter Scheme

1 Introduction

- Rationale of the study
- Theoretical background
- Hypothesis
- Objectives
- Chapter scheme
- Methodology
- Importance of the study.

2 Literature Review

3 Profiles of Sample district, Villages, Households and Borrowers

4 Characteristics and Analysis of Formal Loans

- Size of loan and activites financed
- Source
- Tenure
- Security
- Interest rate
- Repayment
- Gender analysis

5 Characteristics and Analysis of Informal Loans

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

6 Loan Analysis : Overview

7 Conclusion, Observations and Recommendations

1.6 Methodology

The preference for household as a unit of economic analysis has been growing in the last two decades. Several models are put forth in the international literature for exploring the behaviour of households as producers and consumers. However, models explaining the lender-borrower behaviour for credit delivery systems need continuous updating for developing a comprehensive approach.

Our literature review revealed that most of the studies of access to credit at the household level relates to institutional credit. Informal credit considered as a necessary evil, is usually excluded. Further, the gender issues in credit are hardly considered, even in major studies. Hence, there is a virtual absence of data base on these two vital dimensions of credit. This study makes an attempt to fill up this void.

This study has developed a conceptual framework for generating The data which bring out the close relationship between borrowers and loans. It is a comprehensive study which analyses the borrower characteristics and relates them to loan features which is considered as a proxy for lenders behaviour. The study analyses the problem of access to credit with reference to borrowers in the sample households, as it is the focal point within the household, from financial / banking point of view. The primary data on access to credit was collected from 300 sample households, from two villages namely, Puduppadi and Kodenchery in Calicut District (now known as Kozhikode), of the state of Kerala. The data and information used for developing the sample district and village profiles were collected from census and village level records of government and development block offices. The sample households were selected by using the purposive sampling method. The primary data were collected from sample households by the questionnaire cum interview method. All the 300 respondents were personally contacted for data collection and drawing out relevant information on the process of access to credit.

The borrowers were stratified into eight categories : i) borrowers from formal source of credit; (ii) informal loan borrowers; (iii) female borrowers; (iv) male borrowers; (v) backward class borrowers (vi) higher caste borrowers; (vii) borrowers under IRDP; and (viii) non-IRDP borrowers.

The survey data relate to the period 1992-94. The data on credit received by various categories of borrowers were used to analyse the different types of credit. For this, two parameters were used. First, the percentage share of each borrower category in the specific type of credit. Second, the average loan size in each borrower category. Majority of population in sample villages belonged to the small and marginal farmers category or were agricultural labourers. As it is not possible to cover a very big sample, in a single handed study like this, two adjoining villages were purposively selected from the district under reference for sampling. While selecting the sample villages consideration was given to existence of adequate number of formal and informal loan cases and women borrowers and reasonable degree of success achieved in implementing IRDP.

The loans in different borrower categories are compared by using simple statistical techniques like percentages, averages, etc. for the purpose of analysis.

1.7 Importance of the Study

This study follows grass-root level approach to credit analysis. Such studies are far and few, as data have to be painstakingly collected by personal, door-to-door visit of rural households. The primary importance of this study lies in generation of useful primary data sets which throw light on some important dimensions of rural credit policy and issues. The essence of this study lies in the typical combinations of the holistic view of rural credit, with indepth analysis of various components of credit for capturing the complexities of the credit delivery system.

The first important issue addressed by this study is the role of the informal credit sector in providing access to credit at the household level. The informal credit data provided by this study explore the myth that informal credit is only for consumption purpose, exploitative, results in increasing debt burden of borrowers and thus, needs to be discouraged. This study points out the important role played by credit market and provides comparative picture of informal and formal loans.

We have enough evidence in the literature to prove that the formal credit delivery system has bypassed women. From 1980, credit flows to women are encouraged by policy directives. Hence, what is required at this juncture is the data on women's access to credit, which can serve as a bench mark for measuring the success and efficiency of the policy for enhancing credit to women. Secondly, comparison between the credit received by men and women will help in throwing light on factors which enhance and restrict women's access to credit. Further, the methodology developed for gender analysis for credit in this work will facilitate further research in this important area.

Besides the two dimensions discussed above, our credit analysis explores the borrower loan relationships in depth. It provides relevant data on the loan size per borrower,purposewise distribution of loans to the backward classes, loans under the Integrated Rural Development Programme (IRDP) and other important facets of loans. The evaluation of the loans given under the IRDP helps in assessing the efficacy of this important poverty alleviation programme of our country, which is one of the biggest of its kind in the developing world. Besides this, it answers vital questions on the characteristics of the IRDP loans which have policy implications.

In sum, the study provides scientific evidence on rural households access to credit by examining the credit flow at the grass-root level. Secondly, it provides comparative data and analysis of formal and informal credit, credit to men, women and women headed households and credit under poverty alleviation programmes. Such data obviously have useful policy implications. The analysis also provides clues for improvising lending policy in future, with a view to increasing credit flow and improving its efficiency in achieving the goals set forth.

References

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