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COMPARATIVE STUDY OF INSTITUTIONAL CREDIT VS NON-INSTITUTIONAL CREDIT FOR AGRICULTURAL FINANCE IN INDIA

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ABSTRACT

Agriculture credit is very essential for poor and marginal farmers. Farmers use the credit amount for crop production and for the ancillary activities. Before independence almost all the farm borrowers used to take loans/credit from non-institutional sources. After that government emphasized more on institutional credit schemes. The objective of present study was to understand different institutional and non-institutional credit sources and to compare their merits and demerits. It is observed that the interest rate of non-institutional sources is much higher than that of institutional sources. The study also aimed to give suggestions on how to motivate farmers to take credit from institutional sources instead of non-institutional sources.

KEYWORDS*: Agriculture Credit, Marginal Farmers, Institutional Credit, Non-Institutional Credit, Liquidity.*

Introduction

Meaning of Agricultural Finance: Agricultural finance is the financing and liquidity services provided to farm borrowers. It is the provision of multiple types of services dedicated to supporting both on- and off-farm agricultural activities and businesses including input provision, production, and distribution, wholesale, processing and marketing.

Most of the times farmers suffer from the problem of inadequate financial state. This situation leads to borrowing from an easy and comfortable source. Professional money lenders were the only source of credit to agriculture till 1935. They used to charge unduly exorbitant rates of interest and follow serious practices while giving loans and recovering them. As a result, farmers were heavily burdened with debts and many of them are left with perpetuated debts. There were widespread discontents among farmers against these practices and there were instances of riots also. With the passing of Reserve Bank of India Act 1934, District Central Cooperative Banks and Land Development Banks, agricultural credit received impetus and there were improvements in agricultural credit. A powerful alternative agency came into being through the initiative of the government. Large-scale credit was available with reasonable rates of interest at easy terms, both in terms of granting loans and recovery of them. The cooperative banks advance credit mostly to agriculture. Till 14 major commercial banks were nationalized in 1969, cooperative banks were the main institutional agencies providing finance to agriculture. After nationalization, it was made mandatory for these banks to provide finance to agriculture as a priority sector. These banks undertook special programs of branch expansion and created a network of banking services throughout the country and started financing agriculture on large scale. Thus agriculture credit acquired multi-agency dimension. In bringing "Green Revolution", "White Revolution" and now "Yellow Revolution" finance has played a crucial role.

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Institutional Credit

Agriculture credits provided by government institutions are called institutional credit. RRBs, Commercial Banks, Cooperative Banks, Micro Finance Institutions are those Institutions who provide agriculture credit.

Sources of Institutional Credit

The general policy on agricultural credit emphasizes better access to institutional credit for the small and marginal farmers and other weaker sections to enable them to adopt modern technology and improved agricultural practices. National Bank for Agriculture and Rural Development (NABARD) is an apex institution established in 1982 for rural credit in India. It doesn't directly finance farmers and other rural people. It grants assistance to them through the institutions described below:

- **Regional Rural Banks:** RRBs came into existence in 1975, on the basis of the recommendations of the working group headed by Mr. M. Narasimham with a view to provide banking facilities to the rural masses and extending wide variety of financial assistance to the weaker and poorer sections. They have been active participants in programs designed to provide credit assistance to identified beneficiaries under the new 20 point programme, IRDP and other special programs for rural development. The main objectives of these RRBs is Granting loans and advances to small and marginal farmers and agricultural labourers whether individually or in groups, and to cooperative societies, including agricultural marketing societies, cooperative farming societies, primary agricultural credit societies, agricultural processing societies or farmers' service societies, primary agricultural purposes or agricultural operations.
- **Cooperative Banks:** A co-operative bank is a financial entity which belongs to its members, who are at the same time the owners and the customers of their bank. Co-operative banks are often created by persons belonging to the same local or professional community or sharing a common interest. Co-operative banks generally provide their members with a wide range of banking and financial services (loans, deposits, banking accounts etc.). Co-operative banks differ from stockholder banks by their organization, their goals, their values and their governance. Co-operative banking is retail and commercial banking organized on a co-operative basis. Co-operative banking institutions take deposits and lend money. Co-operative banking, includes retail banking, as carried out by credit unions, mutual savings and loan associations, building societies and co-operatives, as well as commercial banking services provided by manual organizations (such as co-operative federations) to co-operative businesses.
- **Commercial Banks:** A commercial bank is a financial institution which performs the functions of accepting deposits from the general public and giving loans for investment with the aim of earning profit. In fact, commercial banks, as their name suggests, axe profit-seeking institutions, i.e., they do banking business to earn profit. They generally finance trade and commerce with short-term loans. Commercial banks are the most important credit institutions in the country in the business of lending and borrowing of money and credit creation.
- **Microfinance Institutions:** Microfinance is a general term to describe financial services to low-income individuals or to those who do not have access to typical banking services. In other words, microfinance is a term used to refer to the activity of provision of financial services to clients who are excluded from the traditional financial systems on account of their lower economic status. Usually rural people depend on non-institutional agencies for their financial requirements. Micro financing has been successful in taking institutionalized credit to the door step of poor and have made them economically and socially sound.

Non-Institutional Credit

Money lenders, Traders, Relatives, Friends and Landlord are those persons who provide non-institutional credit. Agricultural credits given by these sources are called non-institutional credit.

Sources of Non-Institutional Credit

The non-institutional finance forms an important source of rural credit in India, constituting around 36 percent of total credit in India. The interest charged by the non-institutional lenders is usually very high. The land or other assets are kept as collateral. The important sources of non-institutional credit are following:

- **Money-Lenders:** Money-lending has been the widely prevalent profession in the rural areas. The money-lenders charge huge rate of interest and mortgage the property of the cultivators and in some cases even the peasants and members of his family are kept as collateral.

- **Traders, Landlords and Commission Agents:** The agents give credit on the hypothecation of crops which when harvested is used to repay loans.
- **Credit from Relatives:** These credits are generally used for meeting personal expenditure. Some these credits are available without interest but the amount of credit is very small.

Objectives of Study

- To study the various Sources of Agricultural Credit.
- To analyze the performance of Institutional Sources and Non-Institutional Sources.
- To find out merits and demerits of Institutional Sources and Non-Institutional Sources.

Review of Literature

- **Ashok Gulati and Seema Bathla** in **Institutional Credit to Indian Agriculture: Defaults and Policy Options** studied the issues that prevent fast mobilization of formal credit in the rural areas. It was found that the formal sources of credit are paralysed with high levels of non-performing assets (NPAs).
- **Mohan** (2006) studied the overall growth of agriculture simultaneously with institutional credit. Agreeing that the overall supply of credit to agriculture as a percentage of total disbursal of credit is decreasing, he argued that this should not be a cause for worry as the share of formal credit as a part of the agricultural GDP is growing. This established the fact that while credit is increasing, it has not really made an impact on value of output figures. Thus, it pointed out the limitations of credit.
- In another study, **evaluating the impact of agricultural credit: A matching approach, Sunil Mitra Kumar** showed the importance of credit for farmers. Improved credit policies show a positive impact on the living standards of the farmers thus impacting the nation's economy positively. In the present study, we re-look at the problem by quantitatively assessing the impact and execution of institutional credit expansion on agriculture.

Hypothesis

A hypothesis is an idea or explanation that can be tested through study and experimentation. It is a proposal intended to describe certain facts and observations.

H_0 : Institutional credits are much better than non-institutional credits.

Research Methodology

Data Collection

The proposed study was conducted based on primary data as well as secondary data. Primary data was collected through interviews, meetings and structured questionnaire. Primary data has been collected from the farmers of Jaipur, Ajmer, Bhilwara, Nagaur and Chittorgarh district. There were 250 respondents within categories of marginal, small and large farmers. Secondary data were collected from finance ministry report, NABARD and RBI annual report, published papers and other secondary data sources. Both kinds of collected data were analysed on percentage basis.

Data Analysis

Primary Data Analysis and Interpretation

Table 1: Need Loans to Meet Agricultural Requirements

S.No.	Particulars	Farmers	%
1	**Yes**	**218**	**87.20**
2	**No**	**32**	**12.80**

Interpretation

The farmers were asked if they need monetary aid to meet their agricultural requirements. Out of the 108 respondents, ~ 86 % accepted the requirement of loans. This shows that there is vast untapped potential in the agricultural sector which needs to be covered by providing credit via formalized sources.

Table 2: Loan Taken in the Past for Agricultural Necessities

S.No.	Particulars	Farmers	%
1	Yes	93	37.20
2	No	157	62.80

Interpretation

When asked if they have taken any loan to meet their agricultural requirements, 38.9 % said yes while 61% answered no. The loan would have been taken from any source. This shows that the farmers are uneasy to take loans and thus they are not able to reap benefits from the various schemes and policies introduced by the Government from time to time.

Table 3: Source of Loan

S.NO.	Particulars	No. of farmers	%
1	Institutional	62	66.67
2	Non-institutional	31	33.33

Interpretation

This shows that about 38% people are not able to take loan from government institutions. Either farmers are not aware of institutional credits or they are not able to take loan from these institutions due to time consuming documentation process.

Table 4: Rate of Interest of Non-Institutional Lenders

S.No.	Rate of interest	No. of farmers	%
1	<12%	0	0
2	12% - 18%	0	0
3	18% - 24%	5	16.13
4	24% - 36%	26	83.87

Interpretation

It is clear from above table that non-institutional credit interest rates are much higher than interest rates of institutional credit. Due to higher interest rates many farmers are unable to repay loans and thus they are trapped in hands of money lenders etc.

Secondary Data Analysis and Interpretation

Unrated Borrowers with Aggregate Credit Limits below Rs. 25 Lacs

Table 1: Working Capital Loans: KCC/ACC/CC/OD

(For both direct agri and indirect agri advances falling under Priority Sector lending category)

S.No.	Limit	Fixed/Floating	Spread (One Year MCLR +)	Effective Rate% p.a.	Reset #
1	Upto Rs.3.00 lacs**	Floating	8.90 + 3.10 = 12.00	12.00	1 year
2	Rs.3 lacs–upto Rs.25 lacs	Floating	8.90 + 3.10 = 12.00	12.00	1 year

Sources: https://www.sbi.co.in/portal/web/interest-rates/agricultural-segment

Interpretation

Above data shows that interest rates for working capital loan are 12% p.a. but government provides subsidy for these loans and effective rate of interest is 7% p.a. or even lesser for loans upto Rs.3.00 lacs. This helps small and marginal borrowers to take loan on concessional interest rates and to repay loan easily.

Table 2: Crop Loans/Investment Loans Sanctioned Against the Pledge of Gold Ornaments

S.No.	Limit	Fixed/Floating	Spread (One Year MCLR +)	Effective Rate % p.a.	Reset #
1	Upto Rs.3.00 lacs**	Floating	8.90 + 0.80 = 9.70	9.70	1 year
2	Rs.3 lacs – upto Rs.25 lacs	Floating	9.05 + 0.80 = 9.85	9.70	1 year
3	Multi purpose gold loans	Floating	8.90 + 1.10 = 10.00	10.00	1 year

Sources: https://www.sbi.co.in/portal/web/interest-rates/agricultural-segment

reset frequency in case of floating rate of interest

** Short term crop loan up to Rs.3.00 lacs will be charged 7% p.a. (fixed) as per Government of India (GOI) directives. It is subject to GOI providing 2% p.a. interest subvention to Banks on such advances. Otherwise, as per Bank's norms.

Interpretation

It is clear from above table that interest rate on loan taken against pledge of ornaments is 9.70% to 10.00% p.a. For loans upto Rs.3.00 lacs only 7% p.a. interest rate is charged. These loans can be used for multipurpose such as investment in equipment or land development.

Table 3: Tractor Loans

S. No.	Facility	Fixed/ Floating	Linked referral rate (ie. MCLR maturity)	Spread	Effective interest rate	Reset frequency in case of floating rate of interest
1	SSTL (with collateral)	Fixed	8.90	2.10	11.00	Fixed
2	SSTL (without collateral)	Fixed	8.90	2.35	11.25	Fixed
3	MNTL	Fixed	8.90	3.10	12.00	Fixed
4	TTL					
	TTL With 25% margin	Fixed	8.90	2.35	11.25	Fixed
	TTL With 35% margin	Fixed	8.90	2.10	11.00	Fixed
	TTL With 50% margin	Fixed	8.90	1.70	10.60	Fixed

Sources: https://www.sbi.co.in/portal/web/interest-rates/agricultural-segment

SSTL = Stree Shakti Tractor Loan

MNTL = Modified New Tractor Loan

TTL = Tatkal Tractor Loan

Interpretation

Above data shows that there are various schemes for tractor loans. Under SSTL scheme loan is taken with women as co-borrower. The effective rate of interest for loans without collateral is 0.25% higher than loan with collateral. The rate of interest under MNTL scheme is 12% p.a. which is highest in all tractor loan schemes. The interest rate on loans taken under TTL scheme increases from 10.60% to 11.25% p.a. as the margin amount decrease from 50% to 25%.

Table 4: Term Loans (Investment Loans)

		Repayment				
		Effective Interest Rates % p.a.				
S.No.	Activity	Less than 5 years	Floating/ Fixed	More than 5 years	Floating/ Fixed	Reset #
1	Plantation & Horticulture	8.90 + 3.35 = 12.25	Fixed	8.90 + 3.05 = 11.95	Floating	1 year
2	Dairy*	8.90 + 3.35 = 12.25	Fixed	8.90 + 3.05 = 11.95	Floating	1 year
3	Poultry*	8.90 + 3.35 = 12.25	Fixed	8.90 + 3.05 = 11.95	Floating	1 year
4	Irrigation*	8.90 + 3.35 = 12.25	Fixed	8.90 + 3.05 = 11.95	Floating	1 year
5	Storage & Marketing	8.90 + 3.35 = 12.25	Fixed	8.90 + 3.05 = 11.95	Floating	1 year
6	Self Help Groups	8.90 + 3.35 = 12.25	Fixed	8.90 + 3.05 = 11.95	Floating	1 year
7	Land Development	8.90 + 3.35 = 12.25	Fixed	8.90 + 3.05 = 11.95	Floating	1 year
8	Others	8.90 + 3.35 = 12.25	Fixed	8.90 + 3.05 = 11.95	Floating	1 year

Sources: https://www.sbi.co.in/portal/web/interest-rates/agricultural-segment

* Wherever concessions were provided at present, they will be protected by allowing an option for decrement in CBs.

Interpretation

Above table shows that the rate of interest on loans taken for investment purposes for various activities remains fixed if repayment period is less than 5 years and it is floating if the repayment period is more than 5 years. The effective rate of interest for more than 5 year duration is 11.95% p.a. for all the activities while for less than 5 year duration it is 12.25% p.a.

Rated Borrowers With Aggregate Credit Limits Above Rs.25 Lacs

Table 5: Rated Borrowers with Aggregate Credit Limits Between (Rs.25 lacs & upto Rs.100 crores)

S. No.	Facility	Fixed/Floating	Linked referral rate (i.e. MCLR maturity)	Spread	Effective interest rate	Reset frequency in case of floating rate of interest
1	**Working Capital Loans**					
	SB1 & SB2	Floating	8.90	2.00	10.90	1 year
	SB3 to SB5	Floating	8.90	2.25	11.15	1 year
	SB6 & SB7	Floating	8.90	2.50	11.40	1 year
	SB8 & Above	Floating	8.90	3.00	11.90	1 year
2	**Term Loans (Repayment less than 5 years)**					
	SB1 & SB2	Fixed	8.90	2.60	11.50	Fixed
	SB3 to SB5	Fixed	8.90	3.10	12.00	Fixed
	SB6 & SB7	Fixed	8.90	3.35	12.25	Fixed
	SB8 & Above	Fixed	8.90	3.60	12.50	Fixed
3	**Term Loans (Repayment more than 5 years)**					
	SB1 & SB2	Floating	8.90	2.00	10.90	1 year
	SB3 to SB5	Floating	8.90	2.25	11.15	1 year
	SB6 & SB7	Floating	8.90	2.50	11.40	1 year
	SB8 & Above	Floating	8.90	3.00	11.90	1 year

Sources: https://www.sbi.co.in/portal/web/interest-rates/agricultural-segment

Interpretation

Above table shows that more than 25 lacs loan amount is sanctioned only to the rated borrowers. These loans are given as working capital loan and term loan. The rate of interest for working capital loan range from 10.90% to 11.90% p.a. for different facilities and it is floating. The rate of interest for term loan ranges from 11.50% to 12.50% p.a. for different facilities which is fixed if repayment period is less than 5 years. The rate of interest for term loan ranges from 10.90% to 11.90% p.a. for different facilities which is floating if repayment period is more than 5 years.

Table 6: Agency-Wise Institutional Credit Flow

(Amount in Crores)

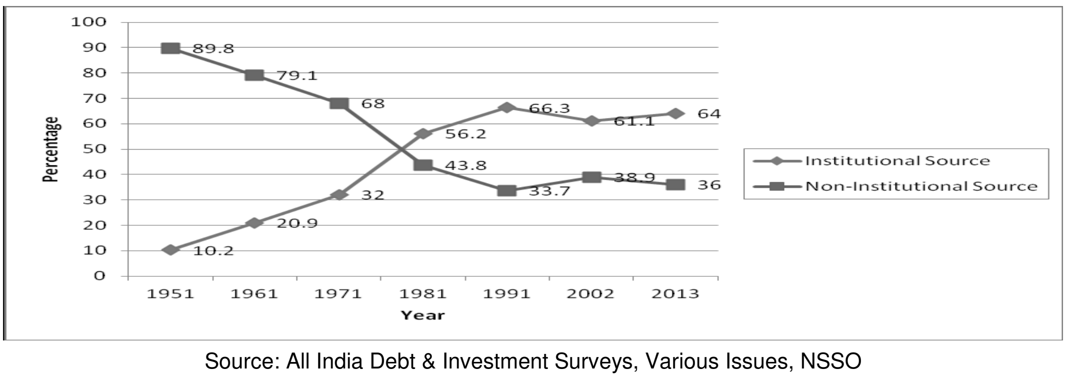
Agency	2011-12	2012-13	2013-14	2014-15	2015-16*
Commercial Banks	3,68,616	4,32,491	5,27,506	6,04,376	6,04,668
Regional Rural Banks	54,450	63,681	82,653	1,02,483	1,19,261
Cooperative Banks	87,963	1,11,203	1,19,964	1,38,469	1,53,295
Total	5,11,029	6,07,375	7,30,123	8,45,328	8,77,224

Source: (1) NABARD (based on reporting by RRBs and cooperative banks) (2) Indian Banks Association (IBA) (for commercial banks, as reported to NABARD). Note: *Provisional.

Interpretation

The above data shows that over the years loan given by various institutional agencies is increasing continuously. It seems that borrowers are taking more and more loans from institutional sources and their dependency on non-institutional sources is decreasing.

Table 7: Share of Agriculture Credit From Institutional and Non-Institutional Sources



Source: All India Debt & Investment Surveys, Various Issues, NSSO

Interpretation

It is clear from above graph that non-institutional credit dropped from about 90% in 1951 to 36% in 2013 while institutional credit has increased from about 10% in 1951 to 64% in 2013. It is also clear that the shift from non-institutional credit to institutional credit was very fast from 1951 to 1978. After that this rate of shift has slowed down and now it is shifting very slightly. There is much to be done to encourage farmers for institutional loans so that they can be brought out of the cage of money lenders. This will improve the financial status of the farmers.

Comparison of Institutional Credit and Non-Institutional Credit

S.No.	Basis of Difference	Institutional Credit	Non-institutional Credit
1.	Rate of interest	Lower (7% to 12.5% p.a.)	Higher (18% to 36% p.a.)
2.	Transparency	Transparent procedure	No transparency. Illiterate farmers do not know the rate of interest and the duration of repayment mentioned in agreement by money lenders.
3.	Mortgage	Smaller loans are available without mortgage	No loans are available without mortgage
4.	Repayment	Flexible repayment facility	No flexibility
5.	Exploitation	No exploitation	Borrowers are exploited through free labour.
6.	Malpractices	No malpractices. All loans are sanctioned as per government norms	No norms are followed
7.	Loss of land	No loss of land	If loan is not repaid borrowers loose their land to money lenders
8.	Bonded labour	Does not exist	Money lenders exploit borrowers through bonded labour if loan is not repaid within time
9.	Government subsidy/waiver of loan	Government give subsidy on interest rates and in case of natural calamities full loan is waived off	No waiver of loan and no benefit of subsidy
10.	Loan amount	Large amount of investment loan (upto 100 crore) are available	Large amount of loans are not available
11.	Insurance benefits	Personal and crop insurance benefit is available	No insurance benefit is available
12.	Procedure	Typical	Simple
13.	Restrictions	Have to fulfil qualifying conditions	No restrictions
14.	Time taken	Take more time	Take lesser time
15.	Limitations	Loan to be consumed for particular use	No limitations

Testing of Hypothesis

As per above analysis given in various tables, it is clear that for working capital loan as well as investment loan–Institutional credit sources are much better and flexible than non-institutional credit sources with some limitations. Hence the hypothesis, i.e. institutional credits are much better than non-institutional credits, is proved.

Suggestions and Recommendations

Though, institutional credit is an effective tool for providing credit to farmers, but for further improvement, some changes are required in operation process. Following are few suggestions regarding coverage, credit limit, cost of operation, flexibility, publicity, education to farmers etc.

Coverage

Facility of institutional credit should be extended to more and more small and marginal farmers and it should be monitored regularly.

Credit Limit

The Scale of Finance has to be more realistic and flexible. It should be made higher for irrigated land.

Flexibility

The institutional credit schemes should be made flexible. It is suggested that drawl may be allowed on the aggregate credit limit without insisting on the seasonality to allow the farmer to have sufficient flexibility in purchase of inputs at the beginning of the year in advance, wherever possible. This will enable the farmers to avail of lean season input-price advantage. Due to this farmers will avoid taking loan from money lenders.

Cost of Operation

Institutional credit sources should take a liberal view of levying various charges for issue of loans and should keep these charges to the minimum. Documentation charges should be minimised. Levy of stamp duty may be rationalized.

Awareness

The farmers should be made fully aware of all the procedures and benefits of institutional credit schemes. This can be done by educating farmers through awareness camps organised time to time at gram-panchayat level. All the schemes should be published in local and simple language with merits and demerits of institutional credit and non-institutional credit.

Waiver of Loan

In case of natural calamities the farmers will not be able to repay loan amount within stipulated time period. In such cases the government should waive off the amount of loan or the interest on loan. He should not be denied further loan without repayment. This will encourage more and more farmers to take loan from institutional sources instead of non-institutional sources.

Fixation of due Dates

The “due date” concept need to make more user friendly and simple to align with overall spirit of institutional credit.

Conclusion

It is clear from primary and secondary data analysis that more and more farmers are taking loan from institutional sources. The rate of interest of institutional sources is much lesser than the rate of interest of non-institutional sources, and it becomes even lower after government subsidy. Institutional sources are also providing long term loans for working capital and for investment purposes. Large amount of loans are only given by institutional sources with fixed rate of interest as well as floating rate of interest as per customer requirement. Non-institutional sources neither can provide long term loans nor large amount of loans. Farmers cannot repay loans of non-institutional sources due to their higher rate of interest. It is the need of time that farmers should be motivated to take loan from institutional credit instead of non-institutional credit.

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