Chapter 3

Literature Survey

3.1. Introduction

The discussions in economics related to credit market revolved around its certain puzzling features. These are that (a) informal credit market coexists with formal credit market in spite of low interest rate in the formal sector. (b) Huge gap remains between supply and demand for credit. In number of cases, credit rationing needs to be done and during bad harvests, credit may just not be available. (c) The number of moneylenders does not increase sharply in spite of high interest rates and high profit margins. (d) Linkages between credit market and other markets are common in informal sector. (e) Formal credit agencies specialize in areas where collateral is available.

3.2. Credit Market Imperfections

In the developing countries, imperfections exist in the capital market. These imperfections have drawn attention of a number of economists like Griffin (1979; Ladman and Adams, 1978; Lipton, 1976; Rutton, 1986; Braverman and Guasch, 1986; Eswaran and Kotwal, 1986). Because of these imperfections access to credit has been difficult for some whereas it has been easier for others. To ease the access, institutional agricultural credit has been assigned a pivotal role. With the adoption of high yielding technology, the requirements for credit, especially for small farms has increased. It has been realized that productive credit is required not only for bringing in growth in production but also for changing the composition of production in favour of deficit producers (Lipton, 1976). Lipton argues that credit facilitates the liquidity needs of peasant farmers in addition to providing command over resources. Donald (1976), Sarap (1990) say that
an improved access to formal credit market shifts rural borrowing from informal market to formal institutions, which, in turn, leads to a greater use of high yielding inputs and technology and thereby improve production and income of rural poor.

Broadly, there are two sources of credit available to the farmers in a less developed country like India–institutional and non-institutional. Non-institutional sources include moneylenders, traders, landlords, friends and relatives while institutional sources consist of cooperatives, commercial banks, agricultural credit societies (PACS), regional rural banks, land development banks, etc.

Institutional credit helps shifting rural borrowing from informal lenders to formal institutions. Institutional credit encourages enhanced borrowing and thereby encourages adoption of HYV technology, improved inputs. Formal credit, thus, provides the mechanism for income transfer leading to increased production and income for rural poor (Donald, 1976, Sinha, 1976). Economists (Ghatak, 1975, 1977, 1983; Bottomley, 1975; Bottomley and Nudds, 1969) suggest that the growth of agricultural output and productivity would increase per capita income, reduce the risk premium and thereby reduce the rural rates of interest.

Based on the theories and arguments of economists describing the role of institutional credit, there has been a great widening of the network of formal financial institutions in the rural areas. However, empirical studies have shown that only the quantitative aspects of credit have been taken care of at the cost of qualitative aspects. Sarap (1990) argues that there exist a large gap between supply of credit to and its requirement of small and marginal farmers. This supports the findings of empirical studies of Rao (1975), Lipton (1976), Adam and Vogel (1986) that the beneficiaries of these rural credit extension policies and programmes are wealthy farmers and not

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the poorer ones. It has been found that not only a small proportion of farmers obtain credit from financial Institutions but also a small group captures the lion’s share of total credit disbursed.

The incident of inadequate access of small farmers to institutional credit has been explained in a number of ways.

Basu (1983) observes informal credit continues to be important in less developed countries because the landless labourers and marginal farmers mainly depend on informal sources of credit. Large farmers are offered better terms than the small farmers if the implicit charges are taken into account. The probable reasons for the large farmers to get a much better access to formal credit is that they are having more power and influence. Basu mentions about a gift exchange which exhibits a triadic character for instance, a bank worker might appear helpful to a wealthy farmer. Basu observes that although because of the absence of a legal machinery, certain risks of default are there in rural credit market, actual default is very less there as the moneylenders lends money only to those over whom he has control.

Bhaduri (1973) comments that the existing production relations in Indian villages, exhibits the characteristics of semi-feudalism featuring sharecropping, perpetual indebtedness of small tenants, concentration of two modes of exploitation, namely usury and landownership in the hands of some economic class and inaccessibility of poor farmers to the market. Bhaduri observes that a substantial portion of Kishan’s (the least privileged category) share of the harvest is taken away immediately after the harvest as repayment of past debt with interest. Hence, the Kishan is usually left with insufficient food and is compelled to borrow for consumption.

Binswanger and Khandekar (1992), in their macro study of 85 districts for the period 1972-73 to 1980-81, observe that formal finance helped non-farm sector growth, employment growth and increase in real wages but had a modest impact on agricultural output.
Haque and Verma (1988) studied the regional and class disparities in the flow of agricultural credit for the country. They studied the extent of temporal variations in the relative contribution of institutional and non-institutional credit. They found out the nature and extent of regional and class bias. The authors suggested that disbursement of loans to states by NABARD should be made in accordance with their relative weightage in total borrowing members and on the basis of medium and long term loans covered by the states.

Dadibhabi (1988) in his study found that there has been an increase in concentration in institutional credit to agriculture for some regions between 1972-'85. He also found that short term credit distribution is more uneven among small land holders than large land holders. He suggested that commercial banks can play a complementary role in those areas where cooperatives are strong.

Agarwal et. al. (1997) analysed the rural credit system in India in the context of changing economic scenario consequent upon the financial sector reforms. They argued for strengthening the credit structure either by nursing the existing system or by reinforcing with new entities like SHGs. They felt that increasing the outreach of credit and maintaining the viability standard of the institutions should be emphasized for strengthening the credit delivery mechanism.

There has been a contention that availability of adequate and timely rural credit is important than its cost (Dandekar, 1994). Hence, even a hike in interest rate is justified. This contention is opposite to the contention, which prompted institutionalisation of rural credit. It has been argued by Agarwal et. al. (1997) that raising interest is not a sustainable method for bringing in viability of rural financial institutions.
Shah (1995), Rudra, (1990) opined that in the situation of rural-urban divide, inter regional disparities and income inequality, cooperatives constitute the only alternative to solve agrarian problems.

It has been realized that because of the subtle differences in agro climatic conditions and socioeconomic structures influencing ground reality, situation at the micro level might not be revealed from the macro studies. Several micro studies have also been conducted to look into inter regional differences in the credit situation.

Sarap (1986) has analyzed the actual access of small and marginal farmers to formal credit. He has identified factors responsible for the inadequate access to formal credit. To know the extent of extra price paid by farmers of different size classes for formal credit, he has estimated the transaction costs associated with formal credit. He has also measured the credit gap from formal institutions for small and marginal farmers. Sarap has commented that existence of credit institutions does not guarantee that poor farmers will benefit from these institutions. He has observed that lower bargaining strength of small farmers, the bureaucratic and procedural formalities, collateral based lending policies and the corrupt practices of officials work against the access of poor farmers to formal credit institutions. Some other factors for inadequate access are small landholding, the oral nature of tenancy contracts, illiteracy and lower caste. These factors also lead to higher transaction costs for small loan, which, in turn, leads to an increase in effective rate of interest and prohibit small farmers to approach formal credit institutions. Sarap has also found that large farmers dominate in the decision making of formal credit institutions and tilt institutional credit to their favour. Because of their dominant socio- economic status, the large farmers become willful defaulters in many cases.
Sarap (1991) has pointed out that the time taken for obtaining a loan from the formal credit agency is negatively associated with the farm size. He has found that large farmers, in general, can obtain formal credit (short term) more or less at the time they need it while small and marginal farmers face a substantial delay in getting formal credit. This, along with some other factors, leads to a highly unequal distribution of formal credit against small and marginal farmers.

It has been found that formal loan as a percentage of total loan is much higher for large farmers than for small and marginal farmers (Sarap, 1991). Among the factors inhibiting the small farmers from securing formal credit in time, Sarap has emphasized the lower bargaining strength of small farmers vis-à-vis large farmers, the bureaucratic and procedural formalities required, patronage, arbitrariness and corrupt practices of the officials, especially in the cooperatives. Again, Sarap (1991) has pointed out, the real costs of borrowing including tips and opportunity costs of time spent (of the borrowers) are inversely related to the farm size. It has been found that the effective rate of interest paid by the smaller group of borrowers is almost twice the nominal rate of interest charged by the formal credit institutions. This further limits small farmers’ accessibility to formal credit. Besides, because of the corruption in the distribution of formal credit, a credit or price subsidy policy, leads to a rise in the interest rate in the informal credit market and thereby low productivity (Chaudhuri and Gupta, 1996 and Gupta and Chaudhuri, 1997).

3.3. Interlinked Credit Transactions

The existing literature shows that the relatively backward regions have less access to credit than the developed regions (Reddy, 2001). Hence, the farmers are compelled to depend on informal or non-institutional sources of credit, the causes for this dependence being insufficient credit, inadequate access to credit and hidden costs of credit. In order to get rid of these hidden
costs of borrowing farmers very often take recourse to tied lending. The tied lending, in many cases, may lead to undervaluation of either labour or output of the borrower or overvaluation of inputs provided by lender. In other words, the unequal bargaining power of lender and borrower leads to distress sale of land, labour or output of borrower.

A number of studies have been undertaken on interlinked credit transactions. Interlinked transactions are said to exist if individuals are involved in at least two markets on the condition that the terms of all trade between them are jointly determined (Bardhan, 1980, Bell, 1988, Bell and Srinivasan 1989). Without an understanding of the nature of interlinkage of factor markets, many of the key issues related to the inadequate access to credit cannot be analyzed.

Gangopadhyay and Sengupta (1987) observe that pure credit transactions i.e., loan taken in the form of cash and repaid in cash, take place very rarely in rural India. A borrower, in many cases, takes loan in the form of kind and returns by transferring his crop to the lender at a price lower than the market price. The explanation for these phenomena lies in inadequate access of farmer either to the product market or to the institutional credit market or to both. Farmers remain more and more in disadvantageous position if his access to credit is very inadequate and his demand for credit is inelastic in nature.

Economists differ in their opinion regarding the effects of interlinkage. Some economists opine that the interlinkages are utilized as an exploitative device by the stronger party to extract surplus from the weaker party (Bhaduri 1973, 1983, 1986, Bhardwaj, 1974). Others have rejected the view that interlinkage is necessarily exploitative. They explain the rationale of interlinkage in terms of information asymmetry and uncertainty (Braverman and Stiglitz, 1982, Mitra, 1983)

Avishay Braverman and Joseph, E. Stiglitz (1982) have shown how the landlord can induce the tenants to borrow more by altering the terms of lending of poor farmers. They can even
induce the tenants to work harder and even to undertake the projects which are dear to the landlord. It is possible for the landlord to make credit less expensive to induce the tenant to borrow more. Under somewhat more restrictive conditions, the tenant would be induced to increase his borrowing to such an extent that the amount which he is supposed to repay, increases. Under such circumstances if penalties are associated with default, the tenants would be required to work harder to pay for the loan. The landlord can restrict the borrowing of his tenants from some other sources by charging a higher rate of interest than the market rate. Here, he can offer his tenants an otherwise attractive tenancy contract.

Similarly, in the case of interlinkage with product market, if the landlord observes that the tenant is purchasing less of inputs, such as fertilizer than the landlord desires, a portion of the increased return to the inputs may be appropriated by the landlord.

In the case of consumption credit, the landlord's observation of the fact that consumption of certain commodity may increase the work effort and the consumption of certain others may reduce it, leads landlords to subsidize the consumption of the former goods.

The fact that the worker has considerable discretion over his actions and the workers actions have an important effect on the landlord's expected profits because of the nature of contracts have further important implications in terms of screening and incentive problems. As for example some economists say that interlinkage acts as a screening device for selection of customers (Braverman and Guasch, 1984) which can also be utilized as an enforcement device for execution of contracts and reduce transaction costs (Bardhan 1984, Ray 1980).

The underlying implication is that the landlord has an incentive to attempt to induce workers to behave in certain manner which he desires. Secondly, the behaviour of the worker is affected by the amount and the term of borrowing, by the goods he purchases with the loan and the price he
pays. Hence, the observations of the authors provide an economic rationale for interlinking contracts to get rid of moral hazard problem.

Bell and Srinivasan (1989) in their study of 34 villages (chosen purposely) from Andhra Pradesh, Bihar and Punjab on interlinked transactions have shown that they occupy a prominent position in India’s rural economy. They observe that interlinked transactions, contrary to the popular belief, are flourishing and are most pervasive in the most commercialized agricultural region like Punjab. Credit-marketing interlinkage is the most dominant form in more developed areas and credit-tenancy and credit-labour linkage are more prevalent in relatively backward agricultural region. The extensiveness of interlinked transactions does not bear any proof that usury is the dominant form of exploitation in interlinked contractual arrangements.

Empirical studies on prevailing form of production relations or the institutional characteristics of agriculture have also focused on interlinkage. This phenomenon of interlinkage or interrelationship among different factor markets and output market tends to reinforce imperfections in different markets. The interlinkage between land, labour and credit market has been a widely discussed issue by the economists. Bardhan and Rudra’s large scale survey of 275 randomly chosen villages in West Bengal, Bihar and some of the eastern districts of Uttar Pradesh (1976), have brought out the terms and conditions of land, labour and credit markets. However, the survey suggests that in spite of the dominance of tenancy and attached labour contract, feudalistic characteristics of production relations are not revealed in Eastern India. The employers’ need for readily available and dependable source of labour supply and the employees need for job security provide the explanation for attached labour contracts. In Eastern India, the landlord or the employer is an important source of credit to the tenant or wage labourer. The majority of loan- giving employers are self- cultivators who use HYV- seeds, fertilizers, pumps
and tube wells or undertake modern techniques and use technologically improved implements. They often give production loans, shares in cost of production, participates in the decision taking regarding the use of inputs. In nutshell, they take lot of interest in productive investment.

Consumption loans are also given by landlords to tenants and wage laborers which are, occasionally interest free and sometimes, interest is charged in the form of wage costs. The labourers usually pay loan either in the form of labour or in the form of grain at the time of harvest period. The study suggests that incidence of usury is not the main mode of exploitation and bonded labour is also a rare phenomenon. On the whole, it has been observed that tenancy is decreasing and self- cultivation with the help of casual labourers (not leading to bonded labour) is increasing in Eastern India.

Sahu, Madheswaran and Rajashekhar (2004) surveyed the credit situation in Kalahandi district of Orissa where they have discussed about credit constraints and distress sale. They have examined the determinants of access to institutional credit and distress sale in Kalahandi district of Orissa. They suggested that inadequate and poor access to formal credit compel these small farmers to depend on informal market which, in turn, leads to interlocked transactions and distress sale. This distress sale (of paddy) results in substantial income loss to small peasants. However, the principal factor contributing to the income loss by small peasants through distress sale due to the interlinked credit and product market is itself a consequence of the inadequate access to small farmers to institutional credit. Hence, their analysis confirms that the iniquitous agrarian structure and interlinked markets are the main problems faced by poor farmers.

A number of other empirical studies have established the existence of interlinked contracts. In micro empirical study of two villages- Kanpur and Gokilaparam in the Madurai district of Tamil Nadu, Swaminathan (1991) finds interlinkage with other market, especially, the labour market.
Anita Gill (2004) conducted a survey in 12 villages in two districts of Punjab. It reveals the dominant position of the moneylender in the form of a commission agent where interlinkage takes place between credit market and output market. In villages, credit is given on the collateral sale of crop to the commission agent, who further sells it to government agencies. Payment on sale of crops to the cultivators is also made through these commission agents. The commission agents deducted the amount for their loan before making the final payment to the cultivators. The commission agents are preferred to the formal institutions by the cultivators as they do not insist on collaterals. Although the rate of interest charged by the commission agents is very high but the cultivators are compelled to pay it as the institutional finances are inadequate. The cultivators do not approach the commercial or cooperative banks because of the cumbersome procedures in obtaining loans. As a result, the cultivators are constantly exploited even in Punjab, agriculturally the most advanced state of India.

3.4. Transaction Costs and Group Lending

Some studies have also been made on the role of transaction costs and group lending. The role of Transaction Costs in credit delivery which has been conceptualized as non financial costs incurred by lenders and borrowers during pre- loan disbursement and post-loan disbursement has also been widely discussed by economists. For lenders, this may include costs associated with searching for loanable funds, designing credit contracts, engaging in screening borrowers, assessing project feasibility, evaluating loan applications providing credit training to staff and borrowers, monitoring and enforcing loan contracts.

For borrowers, this include concession with screening potential group members, group formation, agreeing on formal or informal group rules, negotiating with the lenders, filling out
necessary paper work, transportation to and from the lending agency, time spent on project appraisal and meetings, monitoring group activities and enforcing group rules.

A critical factor in designing group lending initiatives is to ensure that it should economize transaction costs for both lenders and borrowers. In traditional, informal credit markets, lenders are seldom interested in the kind of project for which a loan is requested. Instead, they estimate the risk of a loan by their personal knowledge about the potential borrowers' reputation in the community and past behaviours on various occasions (Von Pischke et al, 1983). The money lending trade is viable in many settings, because both lenders and borrowers are able to save on Transaction Costs (Ladman 1984).

Although moneylenders and their operations stood the test of time and remained an important source of credit for the poor and micro entrepreneurs in many countries (Adams & Fitchelt, 1992, Tang 1995), it suffers from many abuses: like extreme and inhuman methods to recover loans. In order to get rid of these abuses of money lending, recourse has been taken to group lending arrangements.

There are three types of group lending arrangements:

1. Group loans, joint liability
2. Individual loan, Joint liability
3. Individual loan, individual liability

Arrangement 1 is highly beneficial from a lender's perspective as most of the activities & related transaction burdens with regard to credit delivery are shifted to group members. The lender's administrative cost is reduced as he needs to interact with only one group representative for record keeping and collection. However, in order for this area to work group members need to be able to reduce the transaction costs arising from their joint
responsibilities & liabilities. This depends on borrowers’ environment. Group members tend to be more cooperative if all of them are strongly identified with same set of social norms and conventions & members trust each other due to previous society interactions. (Coleman 1990, Putman 1993, Neutan 1996).

Economists have observed that intervention of Self-Help Groups and Non Government Organisations might help reduce transaction costs in micro finance. (Puhazhendi,1995 and Srinivasan and Satish, 2000). The costs for reduction in group formation, group training, conveyance expenses by the field workers have also been identified. (Tankha, 2002). It has been said that monthly meeting instead of weekly group meeting may reduce transaction costs (Karduck and Stebel, 2004).

Llanto and Chua (1996) commented that there is an inverse relationship between an organisation’s transaction costs and its number of years in existence. Gonzalez Vega et. al. (1997) studied the transformation of an NGO Micro Finance Institution named BascoSol to a licensed commercial bank. They commented that the increased investment in infrastructure, monitoring and communication systems and additional staff did not immediately generate sufficient number of loans. BancoSal compensated by increasing the revenue generating capacity of each loan by increasing loan sizes and increasing maturities.

Under the micro finance model, the micro finance institutions go to self help groups or to individuals to lend as well as to collect deposits. Some micro finance institutions even offer extension services and marketing support to their clients. Hence, in spite of high interest rate, credit outstanding offered by micro finance institutions has been of the order of 30 to 40 per cent.
Ghate (2006) in his study, recommended that quality of SHG programme should be improved. He argued that the programme should grow organically with respect to need and capabilities. He commented that in order to strengthen the focus on quality, and to monitor progress in increasing it, the SHG movement needs to devise an annual or biannual sample survey, representative at the national level, designed to assess changing (and hopefully improving) SHG quality.

Nanda (1996) in his studies recommended some performance indicators for SHGs like recovery performance at the bank level and as well as the SHG level, transaction cost of lending to the banks and ultimate borrower, shift in pattern of purposes for which loans are taken by the members from the SHGs, increase/decrease in the rate of savings of the group members of SHGs, creation of assets by SHGs/members.

In a qualitative study by Nirantar, a centre for Gender and Education, revealed a huge gap between the claims of women’s empowerment and poverty alleviation and the ground level realities. They observed that although the SHGs may provide women with access to money, they certainly do not ensure women’s entitlement to the use of the resources or assets that the money provides. This finding reveals a disturbing fact in a context where the primary burden of repayment is on women. In addition to this, the promoters of the SHGs focus only on micro enterprise at the expense of non-cash resources such as common property resources and public services. The options for micro enterprise are most often unviable and lack support from the promoters for backward and forward linkages, related in particular to marketing. The study recommended to provide educational inputs to improve women’s empowerment. Saibel and Dave mentioned about direct and indirect effects of SHG-Bank linkage. The indirect effects identified are an increase in the bank’s overall repayment rate, due to the influence of the SHG
men members increased overall vibrancy in branch business, due to the economic activities of SHGs in the villages, very much welcomed by the branches where “large underutilized capacities” exist, lead to substantial decrease in the reliance on moneylenders, many of whom have reportedly gone out of business, while the remaining ones have tended to lower their interest rate (from 5% to 3% on the declining balance). The direct effects of the linkage are the spreading of thrift among members and nonmembers, excellent credit culture, with SHG members fully observing their loan obligations, higher economic activities and family income of SHG members, asset creation, such as cows, agricultural implements and land among SHG members, access to credit by non-members (at 3% interest per month, compared to 2% to members and 5% charged by moneylenders). The study has also mentioned about some intangible effects which improved adult literacy, drastic increase in school enrolment, better health, family planning, support for government programmes, and a decline in adherence to the extremist movement.

According to Chavan and Ramakumar (2005), the cost of borrowing for SHG members across the country is in the range of 24 to 36 per cent per annum. Most studies like Harper (1998), Harper (2002), Gaiha (2001), Puhazhendi and Satyasai (2000) and Puhazhendi and Badatya (2002) come to the same conclusions. Only in exceptional cases, the cost of borrowing may be as high as 50 to 60 per cent per annum.

In their study by Puhazhendi and Satyasai (2000) and Puhazhendi and Badatya (2002) the authors noted positive changes in the development of the value of physical capital in sample SHG member households. The value of assets increased on average in more than 50% of all sample SHG member households when comparing the pre- with the post- SHG situation. This
development indicated that poor households also participated in the accumulation of physical capital.

In the study on SHG-Bank linkage programme on rural poor, Puhazhendi and Badatya observed that the net income, mean savings of SHG members have increased, amount of formal loan has also increased whereas amount of informal loan has decreased. There has been an increase in the repayment rate by SHG member households.

In a study by Harper (2002), the author observed that the banks, particularly co-operatives, are likely in the medium term to be the main SHPIs. They should support, and eventually be replaced by, SHG members' own initiatives. The extent and quality of member-promoted SHGs should be monitored, a regular national SHG sample survey should be put in place, to enable NABARD to monitor SHG quality and to delegate the management of SHG promotion to banks, RRB and Co-operative Bank management who believe that SHG business is unprofitable should be encouraged to consider interest rate increases in order to make it profitable.

In a study conducted by Mahila Abhivruddhi Society, Andhra Pradesh (APMAS) and Centre for Micro Finance, Andhra Pradesh (CMF) in 2006 it was observed that there was no significant variation between GO promoted and NGO promoted groups in terms of quality and coverage of the poor and vulnerable sections. Quality and performance of groups was not found to be significantly influenced by infrastructure such as bus points, distance to bank or distance to block headquarters. Cultural factors, zeal and interest of individual members of SHPIs seemed to play an important role in the quality and functioning of the groups.
3.5. A Review of Literature Related to the Studies Conducted in the Context of West Bengal

Some studies have been made on the credit situation of West Bengal which shows that along with a high rate of growth of productivity of agriculture, demand for credit has also increased in the state since the mid '70s. Higher demand for credit arising out of higher working capital needs increases the dependence of poor farmers on informal credit market.

In his study (2002), Samal reviewed the flow of institutional credit to agriculture in West Bengal. The study, which has been conducted in the district of North 24 Parganas, is based on micro data. The inadequacy of production credit to meet the working capital requirements of small and marginal farmers has been confirmed by the findings of the author. It was revealed that overall production credit received by small and marginal farms could meet about 26 per cent of the working capital required per hectare. The author suggested formation and financing of Kisan SHGs for meeting the credit needs of sharecroppers, marginal and small farmers.

It has been shown by Saha and Swaminathan (1994) and Sanyal et al (1998) that the recent strides in agriculture in West Bengal have proved that agriculture come out of the Boycian impasse. The study by Saha and Swaminathan has dealt with the growth performance in agriculture in West Bengal for the years 1981-82 to 1990-91. The study by Sanyal et al concentrated on the growth performance for the period 1977-78 to 1995-96. They found that the growth in value addition in agriculture during the 80s was better (6.22 per cent exponential growth per annum than that first half of the 90s (5.62 per cent exponential growth per annum). Sanyal has shown that the share of operational holdings of marginal size class (both in number and in area) has increased during the period 1980-81 to 1990-91.
A survey by Meenakshi Rajeev and Sharmistha Dev (1998) on the households of Hooghly district of West Bengal shows high dependence of small and marginal farmers on informal credit market comprising traders, a new lending class. Regarding formal finance, they observed that in the case of cooperative societies, both service as well as repayment is better than that of commercial banks, the reason being involvement of local people. The survey also reveals a significant presence of traders as a non-institutional source of credit. Village money lenders and landlords (who are non-traders) also remained a source of credit. The study also reveals a striking fact that 90 per cent of these credits are non agricultural, mainly consumption loans for marriage. However, the study has revealed per capita cooperative loan is positively related with landholdings whereas loans from the non-institutional sources consisting of fertilizers and seed dealers have been found biased towards small and marginal farmers, the highest share being taken by the cultivators with smallest landholdings (0-2 bighas). The percentage of loan kept on decreasing as the landholding size increases.

The authors also studied the sources of credit through a field survey (2007) in Hooghly district. They found that marginal farmers rely on the trader class as a major source of credit for working capital in stead of depending on moneylenders. They also observed that the repayment rates by these marginal farmers are better than the relatively better off farmers.

Datta and Chakrabarti (1997) observed a decline in the access to credit during 1984-86 to 1996-97. They also found that households having access to credit have an increase in the average size of ownership holding during the period but those without access to formal credit have a fall in the average size of ownership holding. In a later study of the same regions they commented that there can be no denial of the prime role played by rural credit for the growth and development of agricultural activities in developing countries. Datta and Chakraborty looked into
the changing perspective in rural credit scenario by mid 80s and mid 90s. They dealt with the issues necessary to be tackled to enhance the capability of the credit delivery system in rural West Bengal to sustain the growth performance of 80s. They found that the credit scenario in the study area have deteriorated in real terms over the years leading to insufficient investment in agriculture. This has resulted in decline in cropping intensity and increase in default rate- both for formal and informal finance.

A study by Bhattacharya (2003) on rural credit in West Bengal has stated indebtedness of peasantry as the root cause of backwardness in agriculture, which, in its turn, leads to class differentiation. Dependence on usury capital has been cited as one of the most important reasons for indebtedness by the author. The author has tried to relate the role of institutional credit in a different structure characterized by the inequality in the structure of asset, irrigation, output and marketed product. The author has tried to assess whether the agricultural credit flow assisted the process of agriculture led development in West Bengal. The author has observed that West Bengal has shown an egalitarian pattern of distribution of agricultural credit. The rural credit flow in the State has been found to be positively related with agriculture led development in the state. However, the author has found that although there has been substantial improvement in institutional credit, this has been reaped by the labour hiring class while the exploited class is still largely dependent on the non-institutional credit and the private money lending class is still alive in the State. It has also been found that the labour hiring class obtains the major share of loan at lower rates of interest. It has been observed that wealthy labour hiring classes having the ability to provide high value collateral can get loan at low rates of interest. They use this loan mainly for unproductive purposes. The poorer class, because of their inability to provide collateral do not get institutional loan and become dependent on moneylenders for their survival.
Hence the method of usurious exploitation is used against the small and marginal farmers. It has been shown by the author that labour-hiring classes mostly belong to the recorded tenants and corner a higher proportion of both institutional and non-institutional credit. The author also commented that although institutional credit has been able to lift the landless class above the poverty line, it has benefited labour hiring class more than the marginal farmers.

Bhaumik and Rahim (2004) have attempted to give a broad idea about the structure and actual nature of operation of rural credit markets in their recent study on West Bengal. On the basis of primary survey of eight villages in Hooghly and Bankura district, the authors observed that the rate of participation of the rural households in formal as well as informal credit markets has been extremely high. About 90 per cent of all households are borrowing households reflecting their dire need for credit. Informal sector contributes about two-thirds of total loan taken. It has been observed by the authors that formal credit is not only inadequate but is unequally distributed also. It has been seen that in their study villages, agricultural labourers are completely dependent on informal credit sources. Although the percentage of households borrowing from the formal financial institutions has been the highest for small farmers, the amount of borrowing per household for the small farmers category has been far less than large and medium category of farmers. Hence, because of inadequate formal loan, small and marginal farmers are forced to borrow from informal lenders. It has been observed in the villages of study that while formal loans are obtained almost exclusively for production purposes, informal loans are obtained for consumption purposes as well leading to segmentation in rural credit markets. The authors recommended that for attaining and sustaining better agricultural performance, institutional credit should be supplied in sufficient amounts and without delay in disbursement to small and marginal farmers category.
It is quite understandable that the formal credit institutions, in spite of expansion of network and extension of branches, play a limited role in meeting production and consumption credit requirement. The major concerns of the present day are to expand institutional sources of credit, especially for marginal and small farmers, to increase the credit base in the underdeveloped pockets of the country and thereby to tackle the problem of financial exclusion\(^6\).

It requires to address the problem of agricultural credit both from the demand and supply side. Along with other factors, demand for credit depends on the awareness and credit worthiness of farmers. The procedural formalities of formal financial institutions like documentation etc., timings, distance of the institutions from the villages, expenses and time of travel are some of the hindering factors affecting demand for formal credit. Inadequate information, lack of awareness, absence of collateral security (Sarap, 1986) and cultural gap are the factors which affect demand for formal loan adversely.

From the supply side there are several constraints. One of the most important factors of these, is the willingness of the bankers and assessment of risks for lending. According to the so called perception of the bankers, the credit risks are high for the poor borrowers. The amount of loan is also too small to attract banks as the transaction costs for smaller loans are high. Besides this, large transaction costs\(^7\) for smaller loans, huge recovery costs are also having negative impact on supply of loan. Even if the terms of lending are acceptable, it is difficult to supervise the end-use. Operational problems also might arise because of large number of small accounts. (Roy, D. 2007). The bankers do not have enough confidence in poor borrowers because they do not possess adequate marketable collaterals. Because of the asymmetry of information and absence of credit history, the banks cannot monitor cash flows. Inadequate personnel, lack of orientation

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6 lack of access of the poor to basic financial services.
7 Transaction costs may be conceptualised as non financial costs incurred by borrowers and lenders at the time of pre loan and post loan disbursement.
and expertise of staff also act as constraints for supply of loan. The extension services of banks are totally inadequate. These factors lead to restrictive practices of banks. Moreover, it need not be mentioned that most of the assets of the small and marginal farmers are not liquid. Hence, they need short-term loans before a sowing period or before a harvesting period or to cover the running cost of agricultural operation. When the course of development progresses, with the change in the form of production, they need long-term loans. Thus the farmer graduates from short term loans to long term loans. Hence the rural/agricultural money market is dependent on informal sector credit for short-term production and then on, formal sector for longer term loans. The existing formal sector credit agencies do not provide an appropriate substitute for the informal sources. The credit source substitution process is the decision making process⁸ of the borrowers. It is influenced by the incremental gains perceived by them. Incremental gains are the opportunity gains expected to occur as a result of substitution of one source of credit for the other. This incremental gain is affected by the interest rates, the cost of borrowing from other source, instant availability of money and flexible recovery method. Among these, the most dominating influence in opting for formal sector loans is the rate of interest. But the poor farmers do not prefer this substitution due to easier and timely availability of informal credit, although they are costlier than formal credit. Hence, the farmers, especially belonging to the category of marginal, small, semi-medium and the agricultural labourers largely depend on trader-cum-moneylender credit of the informal sector. In this context, the role of micro finance institutions and self help groups are worth mentioning. These micro finance institutions and self help groups play a crucial role as financial intermediary or facilitator. But the sustainability and suitability of micro finance institutions and the access to credit depend on risk management,

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⁸ Patrick George, F ,Managing Risk in Agriculture, NCR 406, Cooperative extension service, Purdue University, IN 47907.
4.3. The District Profile of Bardhaman

Geographic Location and Area

The district Burdwan lies between 22° 56' -23° 55' north latitude and between 86°48'-88° 25' east longitude. The total land surface area of the district is 7034 sq. kms. The district is bounded on the north by Dumka of Bihar, Birbhum and Murshidabad district, on the east by the district Nadia, on the south by Hugli and Bankura district and on the west by Dhanbad district of Jharkhand. The land of eastern part of the district has been formed by silts from Bhagirathi river. The area is plain and sloppy towards east-south direction. The land of this area is very fertile and is very suitable for paddy cultivation. The land of the western part of the district has been
formed by Chhotanagpur plateau of Bihar. There is no important hill in the district. The main rivers of the district are Damodar, Barakar, Ajoy and Bhagirathi or Hugli.

**Rainfall and Temperature**

The rainfall in Bardhaman is 1442 millimetre and temperature varies from 43 degree celsius to 5 degree celsius.

**Population and Sex Ratio**

According to 2001 census, the total population of the district is 6919698. The density of population is 98 per square km. The sex ratio in Bardhaman is 921 females per 1000 male population.

**Agriculture and Irrigation**

The net cropped area of Bardhaman district is 466630 hectares. The eastern, northern, southern and central parts of the district are extensively cultivated but the western part of the district is unfit for cultivation as the soil here is of extreme lateritic type. With the implementation of the irrigation projects undertaken by the Damodar Valley Corporation in 1953, the cultivation of the district has improved. The yield rate of rice in this district is 3063 kgs. per hectare and that of wheat is 2447 kgs. per hectare. On an average, 58.5 per cent of the total population belongs to agricultural population.

The net irrigated area in Bardhaman district is 4454.52 square kms. The gross irrigated area as a percentage of gross cropped area of the district is almost 63 per cent (62.98 %).

The district of Bardhaman has been regarded as the Granary of Bengal. In spite of some changes, the district still heads the list in connection with production of crops. Rice is the main crop of the district. Three types of rice, the Aus or Autumn, the Aman or Winter and the Boro or
the Summer rice, are cultivated here. Potato is also an important crop of the district. The other crops of the district are sugarcane, jute, pulses, mesta and oilseeds.

The information regarding the general profile of the district is presented in the following table:

**Table 4.1 : General Information about Bardhaman**

<table>
<thead>
<tr>
<th>Items</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Population (number)</td>
<td>6919698</td>
</tr>
<tr>
<td>Population Density (per sq. km.)</td>
<td>98</td>
</tr>
<tr>
<td>Sex Ratio (per 1000 male population)</td>
<td>921</td>
</tr>
<tr>
<td>Rainfall (mm.)</td>
<td>1442</td>
</tr>
<tr>
<td>Temperature (celsius)</td>
<td></td>
</tr>
<tr>
<td>Maximum</td>
<td>43 degree</td>
</tr>
<tr>
<td>Minimum</td>
<td>5 degree</td>
</tr>
<tr>
<td>Net cropped area (hectares)</td>
<td>466630</td>
</tr>
<tr>
<td>Net irrigated area</td>
<td>4454.52 sq.km.</td>
</tr>
<tr>
<td>Yield rate of rice (kgs. Per hect.)</td>
<td>3063</td>
</tr>
<tr>
<td>Yield rate of wheat (kgs. Per hect).</td>
<td>2447</td>
</tr>
<tr>
<td>Cropping intensity</td>
<td>183%</td>
</tr>
</tbody>
</table>

Source: District Statistical Officer, Burdwan.
reduction in proper transaction costs, exploration of new credit channels, dissemination of information and the utilization of modern techniques.

3.6. Need for the Present Study

Available literature suggests various alternative strategies for improvement of accessibility of farmers to institutional finance. But macro studies offering certain general observations contradict with the observations at the micro level. Some district level studies have been conducted in different parts of the country including West Bengal, which have found that production credit supply meets only a small percentage of requirement of small farmers (Samal, 2002). The existing literature has given the evidence that the share of marginal farmers in operational holdings has increased in terms of area and number (Sanyal et al, 1998). Still, they are highly dependent on informal sources of credit (Rajeev and Dev, 1998). Some economists have also dealt with the issues which should be emphasized upon to enhance the capability of the delivery mechanism of institutional credit in rural Bengal. However, the intricacies of credit market, in general and certain peculiar characteristics of the credit situation of West Bengal, in particular, leaves scope for further exploration and research.

West Bengal presents a paradoxical situation because although cooperative movement has remained prime force of all development initiatives, it has not been able to solve the problem of credit market. This fact deserves a special mention here because agricultural credit cooperative societies have the advantage of collecting local level information to combat the problem of adverse selection and moral hazard.

The explanations might be that information assumed to be available to the cooperatives easily, is not forthcoming and hence cannot be used for peer monitoring. Cooperatives suffer from the problem of nonrepayment and nonrecovery. There can also be massive misutilisation of funds
provided by outside lender (the government) because of a collusion between the monitor and the monitored. This could be a widespread problem because of large scale politicization in the rural areas (Dutta and Chakravarty).

3.7. Conclusion

In this backdrop, need has arisen to understand the behaviour of farm households and their pattern and nature of participation in the credit market. To understand the extremely complex and heterogenous character of the credit market, it is essential to understand the micro situation under which a farm household interacts. The study has tried to focus on the problem of accessibility of marginal and small farmers to formal credit market of West Bengal. The present micro level study is an attempt to capture the dynamics of rural credit market and to reflect upon some of the complications and intricacies in the background of diverse agroclimatic and socioeconomic conditions of West Bengal.