Cost of borrowing and financial feasibility of credit for small and marginal farmers in district Lakhimpur Kheri, Uttar Pradesh

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ABSTRACT

The study was conducted on the cost of borrowing and financial viability of credit for small and marginal farmers in the Lakhimpur Kheri district of Uttar Pradesh. The cost of borrowing of small and marginal farmers was very high and for them credit for productive purpose was financially unviable (return on credit being less than the cost of credit). Credit was studied for specified classes namely the small and marginal farmers, artisans etc in rural areas. Cost of borrowing included the interest paid by the farmers for credit as well as processing fee borne by them. The total cost of borrowing differed from what source the farmers had taken the credit. Interest paid by the farmers was always less for institutional sources as compared to non-institutional sources.

Keywords: Cost; financial viability; institutional sources; non-institutional sources

INTRODUCTION

Credit is an important key to livelihood expansion and poverty alleviation and enhances the business and management skills of the farmers. Since long the policy makers have been expressing concern for transforming the credit delivery mechanism to enhance the rural households' access to institutional credit (Kumar et al 2015). Agriculture and its allied sectors contributed around 20.2 per cent to the total GDP of India in the financial year 2020-21 (Anon 2021). Agricultural exports also constituted a sixth of the total exports of the country in the same year. In sync with this situation, it has become very urgent for the government to ensure that the farmers get the right access to credit.

The commercial banks receive deposits from customers and lend to borrowers. They provide credit for specified classes namely the small and marginal farmers, artisans etc in rural areas.

The bulk of the credits for agriculture in the developing countries originates in the informal sector and probably is not less than five times the outstanding institutional credit. The percentage of farmers receiving institutional credit varies widely in different parts of the developing world (Ramanjulu and Jayachandra 2015). Imperfections in the agricultural credit market are omnipresent and more pronounced. Large farmers have been the main beneficiaries of institutional credit. It is common to find that 70 to 80 per cent of small farmers in the developing world are with virtually no access to such credit.

The supply of credit to all farmers however is heavily unfair and in favor of short-term credit particularly in the case of credit for small farmers. Institutionalization of agricultural credit is usually necessary though not sufficient for increase in agricultural productivity and income. This applies especially to small farmers who have neither savings nor ready access to institutional sources (Ramanjulu and Jayachandra 2015). The policy makers in almost all developing countries have realizedthe role of institutional credit in agricultural and rural development. Organization of agricultural credit especially institutional credit poses several problems in developing economies.

Financial intermediaries are underdeveloped and operate mostly in the metropolitan and urban areas.

But in recent times they are either introduced or directed to extend their credit operations to the rural sector mostly due to the operation of development plans with an objective of growth with equity. Types of sources of agricultural credit are given in Fig 1.

All India Rural Credit Review Committee scrutinized the progress made by institutional agencies in respect of short-term credit, medium-term credit and long-term credit. It examined the implementation of the integrated credit scheme which was recommended by the All India Rural Credit Survey Committee, 1954. The committee after taking into account the nature and dimensions of the demand for agricultural credit felt that a single agency like cooperative alone cannot meet the changes in agriculture. The committee suggested the entry of commercial banks into agricultural credit because of the inability of the cooperatives in meeting the challenges of agriculture. The committee recommended that an attempt should be made to plan the entire business of the borrowers.

METHODOLOGY

The universe of the present study was Lakhimpur Kheri district and the variables were small and marginal farmers. Based on the nature of the landholdings, the respondents were classified as small and marginal farmers. The different criteria such as rural and urban, age groups, education, marital status etc were considered while selecting the samples. In all the selected villages, the list of the farmers who had any credit need and took credit from any source was obtained with the help of Gram Pradhan. These farmers were classified on the basis of landholding in the following categories: Group 1: marginal farmers (landholding less than 1 hectare) and Group 2: small farmers (landholding between 1-4 hectares). From each selected village, 10 farmers were chosen using random sampling method. This made the total sample size of 150 farmers. Tools for analysis of data and benefit-cost ratio were applied for data analysis.

It is the ratio of discounted cash inflows and outflows which must be unity or more for an enterprise to be considered worthwhile. The minimum ratio required is 1:1 which indicates the coverage of costs without any surplus benefits. However the ratio should be more than unity in order to provide some additional returns over the costs for clear decision.

The benefit-cost ratio can be stated both verbally and mathematically as:

$$\text{B:C} = \frac{\text{Present worth of benefits}}{\text{Present worth of costs}}$$

$$BC = \frac{\sum_{t=1}^{n} B_n /(1+r)^n}{\sum_{t=1}^{n} C_n /(1+r)^n}$$

where B_n = Benefit in each year, C_n = Cost in each year, n= Number of years, r= Discount rate

The internal rate of return is the rate of return which equates the present worth of benefits to present worth of costs ie the net present worth is zero. This represents the average earning capacity of an investment from the projects. The mathematical form is:

$$IRR = \frac{\sum_{t=1}^{n} B_n - C_n}{\sum_{t=1}^{n} (1+d)^n} = 0$$

RESULTS and DISCUSSION

On average, effective cost of credit as compared with the commercial banks and regional rural banks, cost of credit of commercial banks 13.40 per cent was higher than the regional rural banks 8.90 per cent (Tables 1, 2). Thus the motto of eradicate the poverty of government programmes is also supported.

Average effective cost of credit from commercial banks (KCC)

Table 1 shows the calculation of effective cost of credit from commercial banks (KCC). The financial cost (interest cost) from this source was 7.00 per cent. Additional cost in the form of transaction cost was 5.20 per cent and opportunity cost amounted to1.20 per cent. Thus the effective cost of credit from this source was 13.40 per cent.

Average effective cost of credit from RRBs (KCC)

Effective cost of credit from RRBs (KCC) is given in Table 2. The Financial cost (interest cost) from this source was 4.00 per cent. Additional cost in the form of transaction cost was 3.70 per cent and opportunity cost amounted to 1.20 per cent. Thus the effective cost of credit from this source was 8.90 per cent which was higher so that most of the farmers were unable to borrow in every farming season.

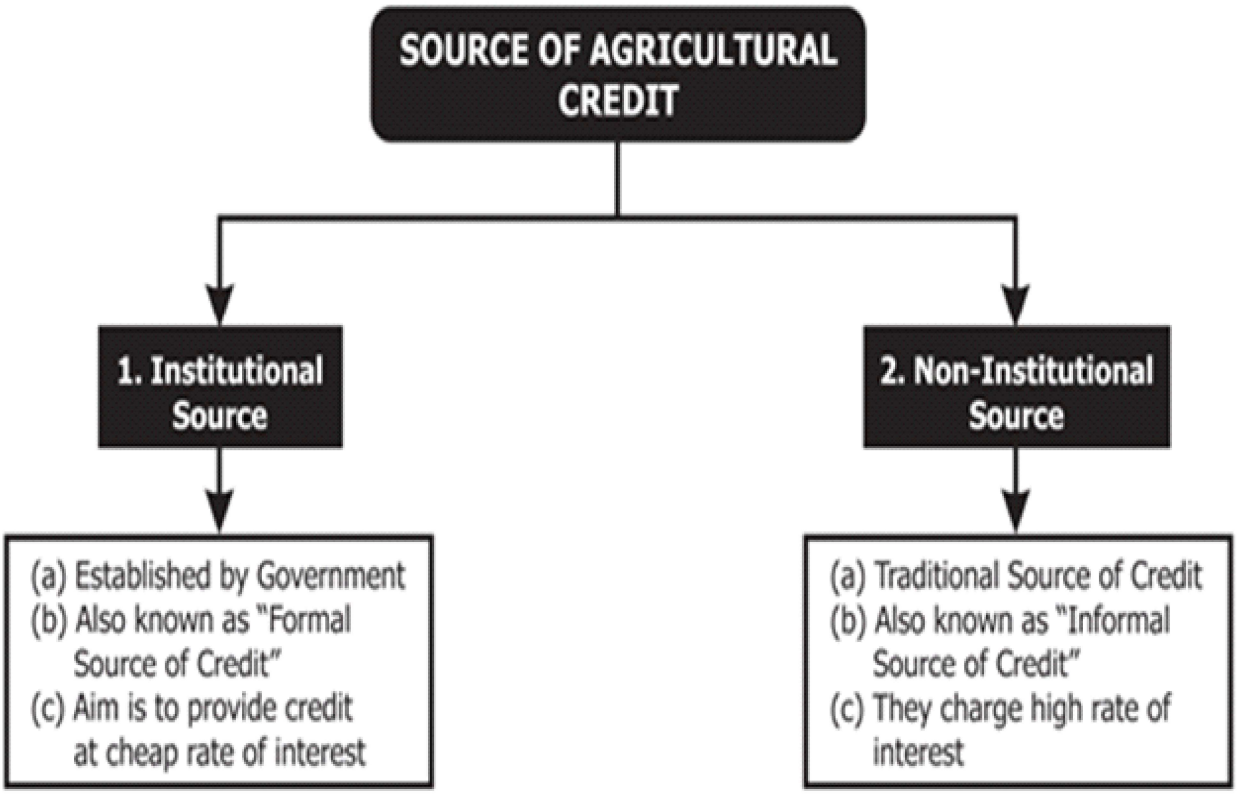

Fig 1. Types of sources of agricultural credit

Table 1. Average effective cost of credit from commercial banks (KCC)

Cost of credit	Cost component	Average effective cost (%)	Total (%)
Financial cost	Interest rate	7.00	7.00
Transaction cost	Processing charges	0.60	
	Premium paid on life insurance	1.50	
	Premium paid on crop insurance	1.50	
	Membership	0.40	
	Inspection fee	0.42	
	Photo	0.78	5.20
Opportunity cost	Loss of wages	1.20	1.20
Total		20.43	13.40

Table 2. Average effective cost of credit from RRBs (KCC)

Cost of credit	Cost component	Average effective cost (%)	Total (%)
Financial cost	Interest rate	4.00	4.00
Transaction cost	Processing charges	0.60	
	Premium paid on crop insurance	1.50	
	Membership	0.40	
	Inspection fee	0.42	
	Miscellaneous	0.78	3.70
Opportunity cost	Loss of wages	1.20	1.20
Total		8.90	8.90

CONCLUSION

The interest rate on loan provided by the institutional sources of credit was lower than the non-institutional sources. There is no denying that a farmer has to pay more than interest for getting credit from institutional sources. The farmers are again in need of credit for day to day expenses for inputs and various crop production operations. This is a vicious cycle which forces them to be in debt and sometime may cause ill-fated consequences such as farmers' suicides. This makes the credit taken for production purposes financially unviable to marginal and small farmers.

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