Policy Brief #01

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Willing, but unable? Insights on Agricultural Borrowing from rural Tamil Nadu

Nearly 49 percent of India's population depends on agriculture as their primary source of livelihood. However, agriculture's share in GDP has been declining over the years[1]. While there has been an impressive growth in agricultural credit flows in the last decade or so, ensuring timely and adequate institutional credit to farmers on the ground remains a challenge for policymakers and financial institutions. This trend is corroborated by the dominance of non-institutional sources, which continue to account for a significant share of borrowings among agricultural households (Mor Committee Report, 2013). Thus, a more refined understanding of farmer's credit requirements across agricultural seasons and factors that explain the dominance of informal sources is vital.

In an ongoing IFMR LEAD- Harvard- Duke University study on access to finance in rural areas of Tamil Nadu, researchers surveyed 353 farmers during the Samba/Thaladi2 cropping season of 2014-2015 (September to March), to gain insight into their usage of financial services. The study undertakes a long-term impact evaluation of the Kshetriya Gramin Financial Services (KGFS) portfolio- a financial services delivery model promoted by IFMR Trust with an aim to ensure that every individual and enterprise has complete access to financial services. While a detailed analysis of the data from the study is forthcoming, this brief captures insights on the access and usage of financial services among farmers in the sample.

Box 1: Willing, but unable?

Seasonality: Majority of borrowings at the beginning of the farming season are from formal sources (72 percent of volume). This drops to 35 percent during the course of the season.

Information and Access: Limited information about sources of formal credit, as well as poor access to them are still major constraints for farmers.

Convenience is Key: The quick approval of loans from informal sources, coupled with the ease of access to these loans work in favour of informal lenders.

[1] Economic Survey of India, 2014-15

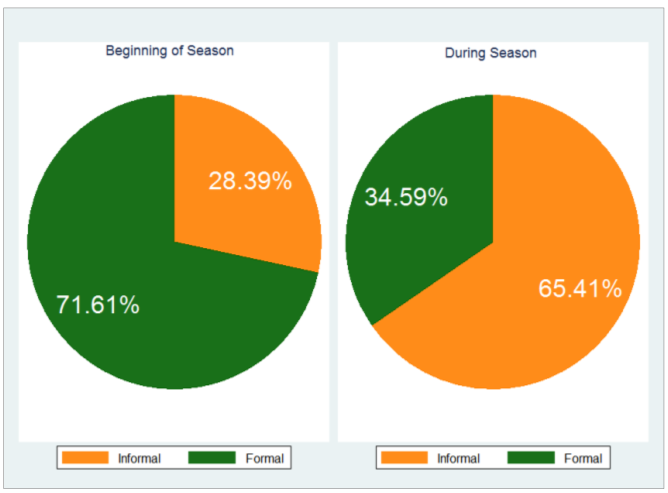
[2] Samba and Thaladi are rice growing seasons in the state of Tamil Nadu, India. The broad definitions of the seasons are: planting undertaken in the August-October period is counted as Samba rice, while planting undertaken in the September-November period is counted as Thaladi.

Key Observations

1. Borrowing from formal sources appears to be time sensitive

By collecting weekly data on agricultural borrowings from the households in our sample over an entire season, we are able to disaggregate borrowing behavior accordingly. We classified agricultural borrowings as any borrowings that were undertaken with the purpose of financing agricultural expenses.

Figure 1: Borrowing by source – across season



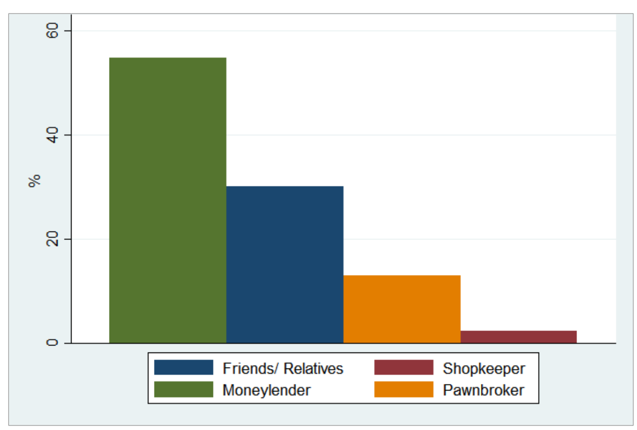
An interesting trend emerges from this – ***72% of the total volume of borrowings reported at the beginning of the season– before cultivation begins – is from formal sources (~40% of the total number of reported loans)***. However, when we examine the borrowing behavior ***during the course of the farming season, it emerges that only 35% of the total volume of borrowing is from formal sources[3] (~10% of the total number of reported loans)***.

Farmers often require credit at very short notices during a farming season. For instance, given the uncertainty in the arrival of rains in the 2014-15 cropping season in India, even a slight delay in rainfall would have been enough to prompt farmers to rent a pump-set for irrigation – a situation that requires unforeseen expenses. In such a scenario, it would be most convenient for farmers, especially small and marginal holders, to borrow from informal sources, given the speed in availing these funds – in spite of their exorbitant interest rates[4]. While larger loan amounts are taken by farmers pre-season, the potential losses of not being able to access credit during the season are the highest. In the above scenario, failure to procure the required funds could affect the harvest adversely – creating a situation for the farmer that is potentially more damaging than not having farmed at all due to lack of access to credit. While further analysis is required to draw firm conclusions regarding this trend, nevertheless, ***our analysis suggests that farmers are willing to borrow from formal sources. However, they appear to be unable to do so at crucial times***.

2. The persistence of informal lending –a warning sign?

66% of our sample reported having taken at least one loan, with the primary purpose meeting farming expenses. ***77% of all such reported loans were from an informal source[5]*** *(Figure 2)*.

Figure 2: Informal sources of credit



[3] See Appendix for breakup of loans by provider

[4] An ongoing survey of the informal lending market in the same geographic regions by the same team of researchers estimates an average annualized interest rate of at least 55%, charged by financiers.

[5] Formal loans are defined as loans from formal providers, including private banks, NGO/MFIs, nationalized banks, cooperative banks and SHGs. Informal loans are defined as loans from friends/neighbors/relatives, shopkeepers, employers, moneylenders, pawnbrokers and landlords.

Nearly 68% of all informal loans came from either moneylenders or pawnbrokers. Friends, neighbors and relatives provided an additional 30% of informal loans.

Moreover, the level of indebtedness among farmers in the sample is high, with *95%* of the informal loans outstanding. These observations reiterate the findings of a NABARD study on the situation of agricultural households, conducted using NSSO data (70th round) – the ***importance of non-institutional sources has not declined over the last decade.***

Marginal farmers continue to remain the largest borrowers of loans from informal sources among all categories - a troubling observation, given the recent and ongoing efforts to bridge last mile gaps between formal institutions and the most financially excluded[6] (Table 1).

Table 1: Landholding size and loan source

(%)	Marginal	Small	Semi-Medium	Medium
Informal	82.2	70.4	73.5	46.2
Formal	17.8	29.6	26.5	53.9

82% of the agricultural loans taken out by marginal farmers in our sample were availed from informal sources; this number drops to 46% for medium-landholding farmers.

As seen in Table2 the average loan taken by a marginal farmer in our sample from an informal source is Rs. 8,650. Farmers are not required to provide any collateral while availing loans up to Rs. 1 Lakh[7] – a policy measure that is intended to allow easy access to credit for small loan amounts. However, marginal farmers still seem to borrow small amounts from informal sources despite the much higher interest rates of these loans.

Table 2: Mean borrowing by loan source

(Rs.)	Marginal	Small	Semi-Medium	Medium
Formal	20,538	29,868	24,904	75,000
Informal	8,643	15,555	26,083	22,833

It appears to be the case that higher interest rates of informal loans are offset by a) the ability of informal lenders to provide funds at very short notice, b) the lack of collateral and document requirements, and most importantly, doorstep delivery of credit and collection of repayment. At the same time, disbursement of a regular crop loan from a nationalized bank can take up to two weeks. Thus, when funds are required at very short notice as illustrated earlier, informal lenders are favorably placed to meet this demand.

These findings are substantiated by additional data[8] collected for this sample, which shows that distance from formal sources of finance, lack of information, and most worryingly, a lack of interest in interacting with formal institutions are important factors that determine farmers' preference for informal sources.

Thus, there are clear indications that solely improving access to formal institutions in the vicinity may not increase uptake among farmers. Bridging this last mile gap in access as well as usage of institutional credit is important and requires concerted focus by policymakers and practitioners.

Looking Ahead

Preliminary findings from the study suggest that while farmers in the study areas are indeed borrowing from formal sources, there is a lack of access to formal credit during periods when they need it the most. This highlights the need for innovative and well-designed products that account for the uncertainties a farmer faces over

[6] https://www.nabard.org/Publication/How_Indian_farmers_borrow_produce_and_earn_h.pdf
[7] http://agricoop.nic.in/imagedefault/credit/agriculture-credit-overview.pdf

[8] Data collected during July-November 2015 (Household Survey) – 266 valid responses.

the course of a season. Moreover, the persistence of informal lending is a warning sign that formal sources of credit are still not meeting the needs of farmers timely, especially those of small and marginal holders. Unless institutional credit products are designed to meet the seasonal nature of farmers' requirements, decline in borrowing from informal sources is unlikely.

Thus, there is considerable scope for banks and other financial institutions to create awareness about their products among farmers, while also thinking of the design of their products critically. From a policy perspective, an increase in credit flow to the agricultural sector needs to be accompanied with robust systems to implement credit policies and schemes, and better targeting towards the most needy sections- in line with the Central government's recently adopted mantra of "more from less" for the agricultural sector. Innovatively designed products that address the credit requirements of farmers' in a timely manner, coupled with adequate measures to mitigate agricultural risk can go a long way in easing the burden of informal loans.

Appendix

During the Samba/Thaladi cropping season of 2014-2015 (September to March), we followed a sample of 353 farming households in Ariyalur and Pudukkottai districts across the entire season – collecting weekly data on their farming expenses, and agricultural borrowing*. The sample consisted of marginal, small, small-medium and medium sized farming households cultivating groundnut, sesame or rice. (Samba/ Late Samba)** Every household was visited at the time it commenced cultivation, and at the time of harvest. During the period of cultivation, data was collected through weekly phone surveys.

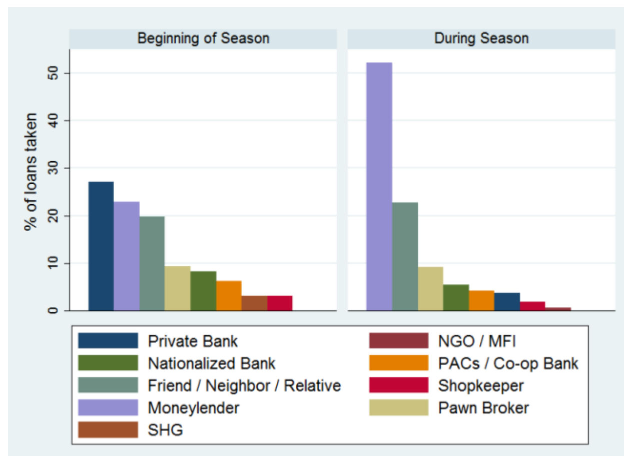
*We define 'agricultural borrowing' as any borrowing whose main purpose is for expenditure on agricultural inputs/ purposes.

** Classification as per Agricultural Census of India; see http://www.iasri.res.in/ebook/TEFCPI_sampling/AGRICULTURE%20CENSUS%20IN%20INDIA.pdf.

A. Sample Distribution – Landholding

	Frequency	%
Marginal	244	69.12
Small	63	17.85
Semi-Medium	37	10.48
Medium	9	2.55
Total	353	100

B. Loans taken, by provider – beginning of season v/s during season



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