AEC 401 AGRICULTURAL FINANCE, BANKING AND COOPERATION (1+1)

(2015 SYLLABUS)

Lecture Notes

by

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Objectives

This course aims at imparting knowledge on principles of finance, banking and co – operation, and farm financial analyses. This course will also help the Under Graduate students in understanding the functions of various institutions involved in farm financing and different crop insurance products implemented in India.

Theory

Unit 1: Agricultural Finance – Nature and Scope

Agricultural Finance: Definition, Importance, Nature and Scope - Agricultural credit: Meaning, Definition, Need and Classification - Sources of credit – Role of institutional and non - institutional agencies: Advantages and Disadvantages - Rural indebtedness: Consequences of rural indebtedness - History and Development of rural credit in India.

Unit 2: Farm Financial Analysis

Principles of Credit - 5C's, 3R's and 7 P's of Credit – Project Cycle and Management - Preparation of bankable projects / Farm credit proposals - Feasibility - Time value of money: Compounding and Discounting - Appraisal of farm credit proposals - Undiscounted and Discounted measures - Repayment plans - Farm Financial Statements: Balance Sheet, Income Statement and Cash Flow Statement – Financial Ratio Analysis.

Unit 3: Financial Institutions

Institutional Lending Agencies – Commercial banks: Nationalization, Agricultural Development Branches – Area Approach – Priority Sector Lending - Regional Rural Banks, Lead bank, Scale of finance - Higher financial institutions: RBI, NABARD, AFC, ADB, World Bank and Deposit Insurance and Credit Guarantee Corporation of India – Microfinance and Its role in poverty alleviation – Self-Help Groups – Non-Governmental Organizations - Rural credit policies followed by State and Central Government – Subsidized farm credit, Differential Interest Rate (DIR), Kisan Credit Card (KCC) Scheme.– Relief Measures and Loan Waiver Scheme and Know Your Customer (KYC).

Unit 4: Co-operation

Co-operation: Philosophy and Principles - History of Indian Co-operative credit movement: Pre and Post - Independence periods and Co-operation in different plan periods - Co-operative credit institutions: Two tier and three tier structure, Functions: provision of short term and long term credit, Strength and weakness of co-operative credit system, Policies for revitalizing co-operative credit: Salient features of Vaithiyanathan Committee Report on revival of rural co-operative credit institutions, Reorganization of Co-operative credit structure in Andhra Pradesh and single window system and Successful co-operative credit systems in Gujarat, Maharashtra, Punjab, etc. - Special Co-operatives: LAMPS and FSS: Objectives, role and functions - National Cooperative Development Corporation (NCDC) and National Federation of State Cooperative Banks Ltd. (NAFSCOB): Objectives and functions.

Unit 5: Banking and Insurance

Negotiable Instruments: Meaning, Importance and Types - Central bank: RBI – functions - Credit control – Objectives and Methods: CRR, SLR and Repo rate - Credit rationing - Dear money and cheap money - Financial Inclusion and Exclusion: credit widening and credit deepening monetary policies. Credit gap: Factors influencing credit gap - Non- Banking Financial Institutions (NBFI) - Assessment of crop losses, Determination of compensation - Crop Insurance: Schemes, Coverage, Advantages and Limitations in Implementation - Estimation of Crop Yields - Livestock Insurance Schemes - Agricultural Insurance Company of India Ltd (AIC): Objectives and functions.

Lecture Schedule

1. Agricultural Finance: Definition, Importance, Nature and Scope –- Agricultural credit: Meaning, Definition, Need and Classification.

2. Sources of credit – Role of institutional and non - institutional agencies: Types, Roles, Advantages and Disadvantages - Rural indebtedness: Consequences and Control measures of rural indebtedness - History and Development of rural credit in India.
3. Principles of Credit - 5C's, 3R's and 7 P's of Credit – Project Cycle and Management - Preparation and Appraisal of Bankable Projects / Farm Credit Proposals – Preparation of Feasibility Report of Project.
4. Time value of money: Compounding and Discounting Techniques – Project Appraisal: Undiscounted and Discounted measures.
5. Repayment plans - Farm Financial Statements: Balance Sheet, Income Statement and Cash Flow Statement – Financial Ratio Analysis.
6. Institutional Lending Agencies – Commercial banks: Nationalization, Agricultural Development Branches – Area Approach – Priority Sector Lending - Regional Rural Banks.
7. Lead bank: Role and Functions, Preparation of District Annual Credit Plan and Scale of finance, Kisan Credit Card (KCC) Scheme and Know Your Customer (KYC) - Rural credit policies followed by State and Central Government – Subsidized farm credit, Differential Interest Rate (DIR) Scheme – Relief Measures and Loan Waiver Scheme.
8. Higher financial institutions: RBI, NABARD, AFC, ADB, World Bank and Deposit Insurance and Credit Guarantee Corporation of India: Role and their functions in rural credit.
9. **Mid Semester Examination**
10. Microfinance: Definition and Its role in poverty alleviation – Self-Help Groups: Characteristics, role, functions, growth and development in India – Role of Non-Governmental Organizations in promoting SHGs.
11. Co-operation: Philosophy and Principles - History of Indian Co-operative credit movement: Pre and Post - Independence periods and Co-operation in different plan periods.
12. Co-operative credit institutions: Two tier and three tier structure, Functions: Provision of short term and long term credit and Strength and weakness of co-operative credit system.
13. Policies for revitalizing co-operative credit: Salient features of Vaithiyanathan Committee Report on revival of rural co-operative credit institutions, Reorganization of Co-operative credit structure in Andhra Pradesh and single window system and Successful co-operative credit systems in Gujarat, Maharashtra, Punjab, etc.
14. Special Co-operatives: LAMPS and FSS: Objectives, role and functions - National Cooperative Development Corporation (NCDC) and National Federation of State Cooperative Banks Ltd. (NAFSCOB): Objectives and functions.
15. Negotiable Instruments: Meaning, Importance and Types - Central bank: RBI: functions - Credit control – Objectives and Methods: CRR, SLR and Repo rate - Credit rationing - Dear money and cheap money.
16. Financial Inclusion: credit widening and credit deepening monetary policies. Credit gap: Factors influencing credit gap - Non- Banking Financial Institutions (NBFI).
17. Assessment of crop losses, Determination of compensation - Crop Insurance: Schemes, Coverage, Advantages and Limitations in Implementation - Estimation of Crop Yields - Livestock Insurance Schemes - Agricultural Insurance Company of India Ltd (AIC): Objectives and functions.

Practical Schedule

1. Visit to a farm to study the credit needs, problems and suggestions in the use of farm credit.
2. Preparation of Bankable Projects / Farm Credit Proposals.
3. Project preparation and appraisal – Undiscounted methods.
4. Project preparation and appraisal – Discounted methods.
5. Preparation of Balance Sheet and Income Statement.
6. Preparation of Cash flow Statement and Exercise on preparation of Repayment plans.

7. Exercise on Financial Ratio Analysis.
8. Appraisal of farm credit proposals.
9. Guest lecture on Role and functions of Commercial Bank and Lead Bank.
10. Guest lecture on NABARD and its Role and Functions.
11. Visit to Regional Rural Bank to study its role and functions.
12. Visit to Primary Agricultural Co-operative Bank (PACB) to study its role, functions and procedures for availing loan.
13. Visit to District Central Co-operative Bank (DCCB) to study its role, functions and procedures for availing loan – Fixation of Scale of Finance.
14. Visit to Cooperative Agricultural and Rural Development Bank **(**Land Development Bank) to study procedures for availing long term credit.
15. Visit to Self-Help Group to study its characteristics, roles and functions.
16. Analysis of Different Crop Insurance Products / Visit to crop insurance implementing agency.
17. **Practical Examination**

References

1. Muniraj, R. 1987. Farm Finance for Development. Oxford & IBH. New Delhi.
2. Subba Reddy, S and P. Raghu Ram. 2011. Agricultural Finance and Management. Oxford & IBH. New Delhi.
3. Lee, W.F., M.D. Boehlje, A.G. Nelson and W.G. Murray. 1998. Agricultural Finance. Kalyani Publishers. New Delhi.
4. Mammoria, C.B. and R.D. Saxena. 1973. Cooperation in India. Kitab Mahal. Allahabad.
5. Patnaik, V.E. and A.K. Roy. 1988. Cooperation and Cooperative Management. Kalyani Publishers. Ludhiana.

Lecture No.1. Agricultural finance: definition, importance, nature and scope. Agricultural credit: definition, need, classification.

Farm finance has become an important input due to the advent of capital intensive agricultural technologies. Farmers require capital in order to enhance the productivities of various farm resources. Indian agriculture, in general, is characterized by low and uncertain returns. In order to break the vicious cycle of low returns → low savings → low investment → low returns, provision of external finance to farmers becomes inevitable.

The existence of both organized and unorganized credit agencies in the agricultural credit system, different banking system followed by bankers, changing government credit policies regarding institutional credit set-up, credit rationing, rates of interest, subsidy and the functioning of markets and other developmental agencies which would influence the extent of credit available to farmer-borrower ultimately have a bearing on farm returns. Hence, problems regarding agricultural finance could be well understood, if one could realise the theoretical basis of agricultural credit system in India, different banking systems, bottlenecks faced by bankers and borrowers, and the governments' efforts in solving the problems involved in the agricultural credit system in India.

Importance of Agricultural Finance

Credit is essential for agricultural development and also for the development of the economy as a whole. The agricultural finance is required for the following reasons:

i) The scope for extensive agriculture in India is limited. Therefore, increase in agricultural production is possible only by intensification and diversification of farming. Intensive agriculture needs huge capital.

ii) Extreme inequalities exist in the distribution of operational holdings and operational area. 85 per cent of the total numbers of farm households which own less than 2 hectares operate only 44 per cent of the total operated area whereas only 15 per cent of total number of farm households which own more than 2 hectares operate 56 percent of the total operated area in 2010-11. (In India, there were 88.88 million farm households which operated 163.79 million hectares in 1980-81 But in 2010-11 there were 137.76 million farm households which operated 159.18 million hectares).

The purchasing power of these small and marginal farmers is limited to their subsistence farming. Hence, they have to depend on the external financial assistance to use the costlier (modern) inputs.

iii) Farmers economic condition is subject to frequent onslaught of flood, drought, famine etc. Therefore, either the continuance of cultivation of crops or making improvements on the farms depends on the nature and availability of finance.

iv) In recent years, more area is brought under irrigation which in turn would increase the use of inputs like fertilizer and plant protection chemicals. In order to accomplish this, external finance is needed.

v) In order to sustain the development of agro-based industries, there should be a substantial increase in the supply of raw materials needed for such industries. Therefore, for the development of farm sector, a constant flow of credit is essential and it would enhance overall growth of the economy.

vi) In agriculture, fixed capital is locked up in permanent investments like land, well, buildings, etc. Moreover, it takes a long time to get returns from farm. Hence, farmers need finance to continue their farm operations.

vii) The weaker sections of the farming community should be motivated to participate in development programmes by giving financial assistance to acquire productive assets.

viii) Small and marginal farmer's are trapped in the vicious cycle of poverty i.e., low returns → low saving → low investment → low return. To break this cycle, credit has to be injected in agricultural sector.

Differences between Financing of Agricultural and Other Sectors

Financing agriculture requires a thorough understanding of farming conditions as it is different from lending to other sectors. The important factors which differentiate farm finance from other lending are as follows:

Financing Agriculture	Financing other sectors
(i) Farmers are not aware of credit policies and procedures	They are aware of banking procedures.
(ii) Difficult to estimate the efficiency of farming in the absence of farm records.	Efficiency can be assessed as all returns are recorded.
(iii) Farming is exposed to natural calamities and uncertainties.	Risk and uncertainties involved in an enterprise can be foreseen and managed.
(iv) Frequent supervision and follow-up after loan disbursement are difficult as farms are scattered.	Monitoring is easy and less time consuming.
(v) Land as major security being immovable is not highly liquid.	Apart from immovable assets, movable assets are also taken as security which can be easily liquidated.
(vi) Ownership of land is difficult to verify as land records are not updated.	Identification of ownership can be easily done by verifying records.
(vii) As farm products are perishable, they are subjected to distress sales.	As industrial products are non-perishable, producers can fix prices.
(viii) Long gestation period between investment and returns.	Very short gestation period.
(ix) Since income is seasonal, repayment schedule is drawn in accordance with income generation from investment.	As income generation is a continuous process, repayments will be made continuously.
(x) Adequate infrastructural facilities are not available to implement new technologies.	Sufficient infrastructure is available to implement their schemes.
(xi) Farmers are susceptible to external influence and hence some vested interests exploit them and guide them in wrong direction.	Entrepreneurs are not usually misled by external influence as they are well organized.

Definition

Credit is obtaining control over the use of money at the present time in exchange for a promise to repay it at some future time.

Agricultural Credit is the amount of investment funds made available for agricultural production from resources outside the farm sector.

Hopkin et al referred agricultural finance as the means of acquiring and control of assets, ownership by cash purchase or borrowing or leasing or custom-hiring.

Warren F.Lee et al defined Agricultural Finance as the economic study of the acquisition and use of capital in agriculture. It deals with the supply of and demand for funds in the agricultural sector of an economy.

According to William G. Murray, agricultural finance is the economic study of borrowing of funds by farmers; of the organization and operation of farm lending agencies; and of society's interest in credit for agriculture.

Farm Finance is a branch of agricultural economics which deals with the provision and management of services of financial resources related to the individual farm units.

Farm finance can also be defined as the amount of funds obtained from off-farm sources for use on the farm, repayable in future with an interest agreed to either explicitly or implicitly.

Nature and Scope of Farm Finance

i. is not meant merely for more production but also to raise the productivity of farm resources;
ii. not a mere loan or advance , but it is an instrument to promote the well being of the farming community;
iii. is not just a science to manage the money, but is an applied science of allocating scarce resources to derive optimum output; and
iv. is not a mere social obligation on the society; but it is a lever with backward and forward linkages to the economic development both at the micro and macro level.

At macro level, farm finance may be defined as the study of impact of finance (extended to the farmers by the intermediaries) on agricultural sector and also on the economy as a whole. At micro level, farm finance may be defined as the study of these intermediaries who extend finance to the farming sector and obtain their loanable funds from financial markets.

Thus, farm finance should have the following features:

i. Finance should be extended to farmers for farm activities;
ii. Finance should stimulate tie productivities of farm resources resulting in higher economic returns for the investment;
iii. Finance should promote economic development of farm households; and
iv. Finance should be provided by an external agency for strengthening the backward and forward linkages with country's economic development.

Classification of Agricultural credit

Agricultural credit can be classified based on purpose, time (repayment period), security, generation of surplus funds, creditor and number of activities for which credit is provided.

***i) Purpose*:** Based on the purpose for which loan is granted, agricultural credit is categorized into:

1) Development credit or Investment Credit: This is provided for acquiring durable assets or for improving the existing assets. Under this, credit is extended for: purchase of land and land reclamation, purchase of farm machineries and implements, development of irrigation facilities, construction of farm structures, development of plantation and orchards, development of dairy, poultry, sheep/goat, fisheries, sericulture, etc.

2) Production credit: is given for crop, production. Here, the loan amount is used for purchasing inputs and for paying wages.

3) Marketing credit: It is essential to carry out the marketing functions and to get higher prices for the produce.

4) Consumption credit: It is the credit required by the farmer to meet his family expenses.

ii) Repayment Period: Based on the period for which the borrower requires credit, it is divided into:
1) Short-Term Credit: It is given to farmers for periods ranging from 6 to 18 months and is primarily meant to meet cultivation expenses viz., purchase of seed, fertilizer, pesticides and payment of wages to labourers. It serves as the working capital to operate the farm efficiently and is expected to be repaid at the time of harvesting / marketing of crops. It. should be repaid in one installment.

2) Medium-Term Credit: Repayment is for the period of 2 to 5 years, It is for the purchase of pump-sets, farm machineries and implements, bullocks, dairy animals and to carry out minor improvement in the farm. It can be repaid either in half yearly or annual installments.
3) Long-Term Credit: It is advanced for periods more than 5 years and extends even unto twenty five years against mortgage of immovable property for undertaking development works viz., sinking wells, purchase of tractor, and making permanent improvements in the farm. It has to be repaid in half-yearly or annual installments.

iii) Security: Credit is provided to farmers based on the security offered by them.
1) Farm Mortgage Credit: It is secured against mortgage of land.
2) Collateral Credit or Chattel Credit: It is given against the security of livestock, crop or warehouse receipt.
3) Personal Credit: It is given based on the character and repaying capacity of the person and not on any tangible assets. In general, LT credit is usually advanced against security of land while MT and ST loans are sanctioned against personal and. collateral security.

***iv) Generation of Surplus Funds*:** Based on generation of surplus funds, credit can be classified as self-liquidating and non-self -liquidating credit.
1) Self Liquidating Credit: In this case, loan amount gets absorbed in the production process-in one year or production period and the additional income generated is sufficient to repay the entire loan amount.
2) Non-Self Liquidating Credit: Here the resources acquired with the borrowed funds are not consumed in the production process during the project period. The investment is spread over a period of several years. The additional income generated in one year is not sufficient to repay the entire loan amount and hence the repayment is spread over to number of years.

v) Creditor or Lender wise Credit: Credit can be classified from the point of view of creditor.
1) Non - Institutional Agencies: They include money lenders, traders, commission agents, friends and relatives. This kind of loan is generally exploitative.
2) Institutional Agencies: They include co-operatives, commercial bank and regional rural bank.

vi) Number of Activities Served: Based on the number of activities for which amount the loan can be used, credit can be categorized into a) single purpose loan and b) composite loan.

Lecture No.2: Rural indebtedness. Source of credit – Institutional and Non-institutional agencies: types, roles, advantages and disadvantages. History and development of rural credit in India

Rural Indebtedness

Farmers require finance not only to cultivate their lands in time but also to switch over to modern techniques of agricultural production. They also require loan to meet out their family expenditure, expenses for social functions like marriage, birth and death and litigation. Indian farmers especially, the small and marginal farmers are severely affected by poverty by generations. Hence, it is almost impossible for them to save and .invest money on farm production. The ultimate way to do farming is to borrow from external agencies. Since these loans contribute nothing to production, it becomes difficult to provide for repayment. As a result, such debts go on increasing from generation to generation and the borrowers are trapped in indebtedness. Thus, it is rightly pointed out that the Indian farmer is born in debt, lives in debt and dies in debt.

Extent of Rural Indebtedness

The NSSO 59th round (2003) indicates that the average amount of debt outstanding per household which stood at Rs. 406 in 1961 rose to Rs.653 in 1981 to Rs.10000 in 2002. Thus, the rural indebtedness has increased during 1961 to 2002. As per 70th survey conducted on 2013, the rural indebtedness has increased to Rs.32,522 per rural household.

Causes of Rural indebtedness:

Rural indebtedness is caused mostly by economic and social factors. The following are the causes of rural indebtedness:

i) Poverty: Marginal and small farmers have to borrow both for production and consumption purposes, as they do not have past savings, i.e., they are severely suffering from poverty (poverty is a situation in which people are not having enough income even to have a subsistence living.) for generations. Moreover, farmers are also often affected by flood, drought etc. and hence, they are forced to borrow. Just as poverty forces him to borrow, it is this poverty again forces him to have so little far repaying his debt.

ii) Use of Traditional Production Techniques: Most of the Indian farmers do not use high yielding varieties, fertilizers and modern techniques of cultivation. They do not have assured irrigation also. Consequently, the farm productivity is extremely low and it does not allow them to get out of indebtedness.

iii) Uncertainty of Income: The farmer is unable to get stable income either due to uncertain output or due to price fluctuation (low prices).

iv) Defective Agricultural Credit System: The exploitative practices adopted by money lenders are responsible for continued indebtedness of rural poor. The government also has failed to effectively control these anti-social activities of money lenders. The co-operatives and commercial banks could not be strengthened to challenge the existence of money lenders.

v) Pressure of Population on Land and Ineffective Land Reforms: The rapid population growth and the failure of industrial development to absorb the surplus rural population have increased the pressure of population on land and this had led to further sub-division of holdings. These two factors, small size of holdings and disguised unemployment, have kept the income of these farmers low and they had to suffer from indebtedness. The land reforms like regulation of rent, consolidation of holdings, prevention of sub-division and fragmentation, distribution of surplus land to landless labourers were not effectively and seriously followed.

vi) Inherited Debt: A larger part of the present debt consisted of debts inherited from the past and it increased with the passage of time.

vii) Social and Religious Needs: The expenditures on various social and religious needs are high. As the loan is used for these unproductive purposes, the borrowers are trapped in indebtedness.

viii) Litigation: Various kinds of disputes often force the farmers to go to court of law. This increases their unproductive expenditure, reduces income and increases the need for loan.

Consequences of Rural Indebtedness

i) Economic consequences

a. Incentive to efficient farming and increase of agricultural production is curtailed.
b. Farmers mortgage their properties to the money lenders and ultimately lose it to the latter.
c. Farmer is hit hard through the adverse terms of trade, i.e., he has low bargaining power as he has to sell his produces to the money lender from whom he has borrowed.

ii) Social Consequences

a. Social group split into two classes, viz., exploited and exploiting and this leads to social tension in rural areas.
b. Because of deprivation of land, the cultivators not only suffer economically but also they are pushed down in the social hierarchy.

iii) Political Consequences Money lenders have fraudulently deprived the simple and illiterate villagers of their land ownership. This has been the direct cause of Naxalite movements in these areas. This creates intense political activities in the villages and this has been encashed by all the politicians.

Remedies for Rural Indebtedness

The problem of rural indebtedness has to be tackled in two ways: i) the burden of present indebtedness should be reduced, and ii) indebtedness in future should be controlled.

i) Reducing the Burden of Present Indebtedness

Since the major cause of continued indebtedness of rural poor is the malpractices adopted by money lenders, many states have taken steps like prescribing maximum rates of interest and compulsory registration and licensing of money lenders. Many states enacted laws according to which the borrower cannot be asked to pay more than twice the loan amount taken by him. In many states, Debt Conciliation Boards were set up and these boards could review the debt repaying capacity of the borrower and reduce the debt compulsorily if it found excessive.

ii) Control of New Loans

The initiation of co-operative movement in 1904 and nationalization of commercial banks in 1969 have strengthened the institutional credit network in the country. These institutions have the objective of extending financial support to the weaker sections of the rural community. Lower interest rate, subsidy, and technical support offered by institutional agencies would reduce indebtedness. Farmers should avoid the diversion of production credit into consumption credit. For achieving this, consumption loans (for marriage, medical expenses, etc) can be provided by institutional agencies. Land reforms should be strengthened. Transfer of lands from farmers to money lenders should be prevented by enacting suitable laws.

Agricultural Credit System in India

Farmers get external financial assistance from two sources namely, i) non-institutional or unorganized agencies, and ii) institutional or organized agencies. It is a fact that agriculture has been financed by non-institutional agencies for a long time and institutional agencies were started functioning only during the early part of twenth century.

Non-Institutional Sources of Finance in India

Non-institutional sources include money lenders, land lords, traders, commission agents, friends and relatives.

Table 1. Borrowing by Farmers from Organized and Unorganized Agencies

Lending Agencies	1951	1961	1971	1981	2002
I Organized Agencies					
1.Government	3.3	6.7	7.1	4.0	1.7
2. Co-operatives	3.1	11.4	22.0	29.0	30.2
3.Commercial banks	0.9	0.3	2.4	28.0	26.3
4. Insurance and Provident Fund	-	-	0.2	-	0.5
5. Other institutional agencies	-	-	-	-	2.4
Sub-Total	7.3	18.4	31.7	61.0	61.1
II Unorganized Agencies					
1. Land Lord	1.5	0.9	8.1	4.0	0.9
2. Agricultural Money lender	24.9	48.1	23.0	9.0	9.9
3. Professional money lender	44.8	15.8	13.1	8.0	16.9
4. Trader	5.5	7.1	8.4	3.0	2.6
5. Friends and Relatives	14.2	5.2	13.1	9.0	6.2
6. Others	1.8	6.5	2.6	6.0	2.4
Sub-Total	92.7	81.6	68.3	39.0	**38.9**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100**

Sources: NSS 48th Round, Report No. 420, Indebtedness of Rural Households as on 30.06.91, Debt and Investment Survey, 1992; NSS 59th Round, Report No. 501, Household Indebtedness in India as on 30.06.2002, All India Debt and Investment Survey, 2003.

i) Money Lenders

There are two types of money lenders in rural areas namely agricultural money lenders and professional money lender. Agricultural money lender's main occupation is farming and money lending is secondary one. Professional money lender's main profession is money lending. Although the reliance on money lender by rural poor declined over the years, the credit disbursed by money lenders still forms a major portion of the total credit obtained by the farmers.

Advantages

i. Unrestricted supply of credit for any purpose.
ii. As money lenders maintain close relationship with rural families, easy access.
iii. Methods of business adopted are simple and flexible.
iv. Timely availability of credit without much formality.
v. Knowledge on local conditions and experience of money lender facilitate his business.
vi. Money lenders do not insist upon any particular type of security for the grant of loans.

Disadvantages /Unfair Practices of Money Lenders

Money lenders deceive the farmers through many ways such as:

a. They manipulate bonds and promissory notes obtained from debtors and enter large sum than actually lent.

b. They give no receipt for repayments and often they deny such repayments.

c. They charge very high rate of interest.

d. They give loans for both productive and unproductive purposes which results in indebtedness

ii) Land Lords

Small farmers and tenants rely on land lords for finance to meet out their productive and unproductive expenses. This source of finance has all the defects associated with money lenders. Interest rates are exorbitant. Often small farmers are forced to sell out their lands to these land lords and they become land less labourers and bonded labourers.

iii) Traders and Commission Agents

They are functioning either to get regular supply of products for their trade or to have a control over the provision of credit by other creditors. Though the rate of interest charged by them is not as high as charged by the money lenders, they charge more in the form of concessions and service changes. They mostly finance for the cultivation of commercial crops like sugarcane, cotton, ground-nut, tobacco, onion, etc.

iv) Relatives

Farmers borrow from their relatives for temporary exigencies. It is simply a mutual help. Since all farmers are living under similar conditions, they cannot lend large sums as loans. Normally, no interest is paid on such loans.

Need for Institutional Credit Agencies

Although, the private agencies satisfied some of the criteria of a good system of credit, their loan were not related to production purposes, they never cared for the end use of the loan extended and the loan is often used for wasteful purposes. However, institutions adopt a productive and purpose oriented credit policy while providing credit. So this policy made the institutions to discourage the provision of credit to consumption purpose. But it is evident that the need for consumption loan in rural households continues to persist. As the institutions deny consumption loans to farmers, the non-institutional agencies continue to dominate the rural credit system. Moreover, the institutional agencies could not provide more than 60-65 per cent of the total credit needs of the farmers. Therefore, the private credit agencies should be brought under a more realistic system of state regulation. Otherwise, the rural people would continue to suffer from indebtedness in spite of various efforts taken by the government to uplift their economic conditions.

Institutional Credit Agencies

As compared to the quantum of credit requirement and the capacity of institutions to meet these credit demands under multi-agency system, it is impossible to completely wipe out the private agencies from the rural scene. The Banking committee, (1931) and the Banking Commission (1972) offered suggestions to get over the evil aspects of private lending agencies and bring them under sound credit system. These suggestions may be adopted till the institutional agencies attain the capacity to meet the full demand for credit. The initiation of co-operative movement in 1904 and nationalization of commercial banks in 1969 have strengthened the institutional credit network in the country.

The major institutions supplying credit to agricultural sector are : i) Government, ii) Co-operatives, iii) Commercial Banks, iv) Regional Rural Banks, v) Reserve Bank of India (RBI) (National Bank for Agricultural and Rural Development- NABARD)

i) Government

The Government provides both direct and indirect finance to farming sector.

a) Direct Finance

The government provides taccavi loans in times of distress like famine, flood, drought etc. Land Improvement Loans Act of 1883 and the Agriculturists Loans Act of 1884 were enacted to extend long and short term financial assistance to farmers for agricultural development and also as relief measures during distress times.

Merits

1. They are granted for long period of time.
2. Low interest is charged.
3. The repayment plan is convenient, i.e., repayment in equal annual installments.

Demerits

1. Quantum of loan is determined on the basis of value of security offered, by which, large farmers receive more credit than small and marginal farmers.
2. As these loans are not production oriented, they do not satisfy the standard needed for sound system of form credit.
3. The loan amount is inadequate.
4. The land less labourers were left out in the lurch at the time of distress.
5. The taccavi loans are not popular among farmers due to inordinate delay in sanctioning of loan, imposition of irrelevant conditions, incompetent supervision and in convenient recovery methods.

In view of these demerits, it was recommended to channelize these loans through co-operatives.

b) Indirect Finance to Agriculture by Government

1) It allocates subsidized fertilizer to states according to their needs.
2) It provides technical assistance to farmers through Tamil Nadu Agricultural Development Program.
3) It implements price stabilization schemes for various crops.
4) In consultation with the RBI, the government prescribes the rates of interest to be charged on loans granted to weaker sections of rural areas.
5) It contributes to the share capital and debentures of co-operatives.

Instead of playing direct role in providing farm credit, the government may play a vital role in creating conditions or infra-structural facilities to the promotion of institutional credit.

Lecture No 3: Principles of Credit - 5C's, 3R's and 7 P's of Credit – Project Cycle and Management - Preparation and Appraisal of Bankable Projects / Farm Credit Proposals – Preparation of Feasibility Report of Project.

PRINCIPLES OF FARM FINANCE

When you apply for a loan, the lender will evaluate your request in order to determine whether or not it is a good decision to lend you and your business money. A common evaluation framework is the Five C's of Credit: capacity, capital, collateral, conditions and character.

Capacity refers to your ability to meet the loan payments. The prospective lender will want to know exactly how you intend to repay the loan. The lender will consider the cash flow from the business, the timing of repayment, and the probability of successful repayment of the loan. Lenders will also consider payment history as an indicator of future payment potential. For example, if you have a history of not paying back loans then it becomes more difficult to obtain additional loans.

Capital is the money invested in the business and is an indicator of how much is at risk should the business fail. Lenders will generally consider the company's debt-to-equity ratio to understand how much money the lender is being asked to lend (debt) in relation to how much the owners have invested (equity). A high debt-to-equity ratio also indicates that the company already has a high level of loans and could be a higher financial risk.

Collateral is a form of security for the lender. Banks usually require collateral as a type of insurance in case you cannot repay the loan. If you default on the loan, then the lender takes possession of the collateral in place of the debt. The loan agreement should carefully specify all items serving as collateral. Equipment, buildings, accounts receivable, and inventory are all potential forms of collateral. A lender will normally want the term of the loan to match the useful life of the asset used as collateral. For example, if equipment with a five-year expected life span is used as collateral, then the term of the loan will generally be five years or less. In some cases, the lender may ask for a third-party guarantee where someone else signs a document promising to repay the loan if you cannot.

Conditions refer to the intended purpose of the loan, for example working capital, additional equipment, or new offices. The size of loan in relation to the specific use will help the lender evaluate your loan request. Conditions also include the national, industry level, and local economic situation. A volatile or unstable economic situation can negatively impact the evaluation. However, positive expectations can increase the likelihood of obtaining the loan.

Character is the obligation that a borrower feels to repay the loan. Since there is not an accurate way to judge character, the lender will decide subjectively whether or not you are sufficiently trustworthy to repay the loan. The lender will investigate your payment history, review a credit bureau report, and consider your educational background and experience in business. The quality of your references and the background and experience of your employees will also be considered.

The application of these principles facilitates largely the lending agencies, in the sense that the character of the borrower is a dominant factor for consideration before a lending agency decides to advance loan. Although the farm more net income, create good finance extended to a farmer may yield repaying capacity and buildup risk bearing ability he will not repay the loan unless he has good character. The second principle deals with the capacity of the borrower who not only produce more but also has to repay the loan in time.

The third principle is intended to safeguard the interest of the lending agency. When the first two intangible assets prove inadequate during distress periods, the third, asset or capital will come to the rescue of the lending agency.

The principles of farm credit can also be stated as ‘three Rs'. They are:
i) Returns from the proposed investment,
ii) Repaying capacity
iii) Risk-bearing ability of the borrower

To find out the feasibility of a project or a scheme or a farm plan, these principles can the applied as economic feasibility tests.

i) Returns

The economic viability of a project indicates whether the proposed project is likely to contribute reasonable returns on the investment which in turn will lead to economic development of the farmer.

The economic viability can be measured by
1) Net Present Worth (NPW)
2) Benefit-Cost Ratio (BCR)
3) Internal Rate of Return (IRR)

1. Net Present Worth

The NPW of the project can be estimated using formula as given below:

$$NPW = \sum_{t=1}^{n} \frac{Bn - Cn}{(1+i)^n}$$

Where,

Bn = Benefits in n'th Year.
Cn = Costs in n'th Year.
n = life span of the project
i = interest or discount rate.

If the NPW of a project is positive, then it is considered that the project is economically feasible.

2. Benefit-Cost Ratio (BCR)

The BCR can be calculated using the following formula:

$$BCR = \frac{\sum_{t=1}^{n} \frac{Bn}{(1+r)^n}}{\sum_{t=1}^{n} \frac{Cn}{(1+r)^n}}$$

To compute the NPW and BCR, the opportunity cost of capital (normal/market lending rate) may be used as a discount rate. If the BCR is greater than 1, then it is worth wile to invest on the project.

$$IRR = r \left| \sum_{t=1}^{n} \frac{Bn - Cn}{(i+r)^n} = 0 \right.$$

IRR is that rate of discount which makes the present worth of benefits and costs equal or the net present worth of cash flow equal to zero. If IRR is greater than the opportunity cost of capital, the project is feasible.

ii) Repaying capacity

The repayment of loan depends on the amount of surplus income available with the farm household after providing some amount for the family expenses and pre-existing liabilities, besides keeping a margin for the risk factor. As the farming family is likely to get income from the farm business as well as from off-farm activities, the repaying capacity of the borrower should be judged by taking into account their total income.

The concept of repaying capacity can be expressed symbolically as:

$Rc = ((Y2\text{-}rf) + (Y_1\text{-}rf) + Y) - ((X_2\text{-}X_1) + Fe+OL)) \geq I+i$

Where,

Rc = Repaying capacity
Y = Income from other sources.
Fe = Family expenses
OL = Other liabilities
rf = risk factor margin
I = Loan installment
i = interest on investment and working capital.

If the surplus is greater than or equal to loan installment plus interest, the borrower may be judged as having the capacity to repay the loan. If the surplus is more, the repayment period of loan may be reduced and it is less than (I+i) either the period for the repayment of loan may be extended or the project can be modified.

iii) Risk Bearing Ability

The beneficiaries of the project should have risk bearing ability (for repaying the loan amount promptly), ie., they should withstand the shocks of probable financial losses irrespective of the fact that the project appraisal has taken care of all precautions to prevent such losses. While the technical feasibility test reveals the productivity of the investment, the economic viability test indicated the returns to the investment. How far the beneficiaries of the project are having the capacity to repay the loan promptly is revealed by repaying capacity test. However, the farm income is subject to variations and it is essential to account for this variations in farm income. The output and price are the factors which determine the farm income fluctuations in output may be due to:

1) Natural causes like floods, droughts, pests and diseases etc.
2) Technical causes like break down of machinery, non-availability of inputs, availability of defective inputs etc.
3) Social causes like theft, labour strike etc.

Fluctuation in prices is due to demand and supply factors besides lack of storage, transport and communication facilities, failure of government to control/regulate prices etc. The variation in farm income over a period of years is measured by coefficient of variation. The coefficient of variation is measured by the formula:

$$C.V = \frac{Standard\ Deviation}{Mean}$$

Where,

$$\text{Standard Deviation (SD)} = \sqrt{\frac{\sum_{t=1}^{n} (Xi - \bar{X})^2}{n}}$$

Table 2. Estimation of Standard Deviation

Year	Farm Income (Rs.000'./year) (X_i)	(X_i - $\bar{X}$)	(X_i - $\bar{X}$)^2
2008-09	4,600	-3,646	132,93,316
2009-10	6,150	-2,096	43,93,216
2010-11	7,900	-346	1,19,716
2011-12	9,880	1,634	26,69,956
2012-13	12,700	454	198,38,116
Total	41,230	0	403,14,320

$$SD = \sqrt{\frac{40314320}{5}} = 2839.518269$$

$$CV = \frac{2839.518269}{8246}$$

= 0.34 (or) 34.44%

Since the coefficient of variation is 34 percent for this farm, to determine the repaying capacity of the farmer, the gross income should be deflated by 34 percent. Suppose, if the farm income is Rs.10,000 and the coefficient of variation is 34 per cent, the real farm income is Rs.6,600 only.

The modern rural financing institutions have to follow principles of farm finance not only to achieve commercial gains but also to bring about social benefits. By the combination of principles of economics, banking and farm management along with the existing principles, the following principles of farm finance have been evolved, on the basis of the definition adopted for the concept of farm finance for development:

1) Principle of Productive Purpose,
2) Principle of Personality,
3) Principle of Productivity,
4) Principle of Phased disbursement,
5) Principle of Proper utilization,
6) Principle of repayment, and
7) Principle of protection

1. Principle of Productive Purpose

While there is encouragement for production finance, consumption credit is discouraged at all levels. The CRAFICARD (1981) recommended consumption credit if it is meant to increase family labour productivity. Only the unproductive consumption credit needs such as loan for litigation, social functions, etc., of the farmers may be excluded from the purview of farm finance. The resource being scarce even for productive purposes, the most important and indispensable purpose should be served first. Though a scheme may be technically feasible, the economic viability, repaying capacity and risk bearing ability of the farmer should also be taken into consideration before accepting the scheme. Therefore, even among the productive purposes, the most important one like sinking of well or installation of pumpset may be considered on a priority basis for providing finance.

2. Principle of personality

This emphasizes that the criteria to extend farm finance is not only credit worthiness, but also trust-worthiness of the borrower. The farmer should be a man of character having entrepreneurship, capable of keeping up his promises, agreeable to adopt modern technology in farming and inclined to co-operate with the financing institutions in all aspects. One of the reasons attributed for the mounting overdues is the willful default of the borrowers, majority of whom are credit worthy-affluent farmers.

3. Principle of Productivity

In short, productivity can be defined as output per unit of input. Farm finance is used by a farmer to increase the 'marginal efficiency of capital' which is a ratio between increase in expected future returns of the investment and increase in the cost of investment. Farm finance aims not only at mere production, but also intends to increase the productivity of farm resources, viz., land, labour, capital and management. Apart from productive purpose for which the loan is disbursed and good character as emphasized under principle of personality, the economic returns that would be generated by the scheme is also very important. The economic viability of the scheme is measured by Benefit-cost ratio, Internal Rate of Return and Net Present Worth.

4. Principle of phased disbursement

The finance should be disbursed not only in time but also in a phased manner, because no project needs the entire finance at the initial stage itself. Phased disbursement enables the borrower to make use of the finance far the purpose far which it is granted and aids the financing institution to ensure the end-use of it. Disbursement has three facets, viz., i) disbursement in cash, ii) disbursement in kind and iii) disbursement to suppliers of inputs directly. The institution itself may supply the needed inputs such as seeds, fertilizers, pesticides, etc., to the farmers as is being done by co-operatives. A portion of the finance may also be disbursed to the farmer in cash to meet out labour expenses. In case of machinery the institution may directly make payments to the suppliers after receiving the margin money from the borrowers.

5. Principle of Proper Utilization

The finance so extended to a farmer should be utilized far the purpose far which it is granted. The finance should be put into optimum use through backward and forward linkages which need basic infrastructure and supervision. When finance is provided for the cultivation of crops, inputs like seeds, fertilizers, pesticides, labour, etc., must be made available to him in time. Apart from technical guidance for production, marketing facilities will help him to realise mare returns.

Farmers also divert the finance to meet their urgent needs, as a result they could not generate adequate returns for loan repayment. Thus, proper appraisal of the overall financial needs of the farmer and adoption of supervisory credit system in farm financing operations will bring the desired results.

6. Principle of payments

This helps to draw proper repayment schedule and emphasizes how and when the finance extended to the farmer should be repaid. Unrealistic repayment plan makes the farmer become a defaulter, even though he may have good repaying capacity. The repayment schedule should synchronize with the time of generation of income from the project. The repayment should be drawn in such a way that the principle and interest can be repaid out of the incremental income generated from the project, after setting aside a portion to meet his family expenses.

7. Principle of protection

This emphasis is that all possible precautions should be taken to safeguard the funds which the financing institutions lend to the farmers. Some of the safety measures taken are:

i) Insurance cover

Insurance cover is available for machines, animal husbandry projects and crops to some extent.

ii) Linking credit with marketing

Linking credit with marketing enables the financing institutions to ensure the end use of credit and to receive repayments regularly. A few examples are given below to indicate agencies with whom marketing arrangements can be made.

Finance for	**Tie-up arrangements with**
a) Growing sugarcane	Sugar factories
b) Growing crops	Co-operative Marketing Societies.
c) Growing coffee, tea, cardomom, rubber, etc.	Respective commodity boards. Co-Operative Milk Producers' Societies
d) Establishment of dairy unit	Poultry Development Corporation.

iii) Provision of infrastructure

One of the factors for the success of farm finance is the availability of infrastructural facilities like input supply, storage facilities, transport and communication facilities, good marketing system, availability of technical guidance, etc.

iv) Covering credit under small Loans Guarantee Scheme of DI and CGC

The loans extended to the weaker sections can be covered under small Loans Guarantee Scheme of Deposit Insurance and credit Guarantee Corporation (DI and CGC).

v) Taking Securities

Neither the secured loans are invariably repaid, nor the unsecured loans completely remain unpaid. However, as a measure of caution, the loans maybe secured by mortgage / hypothecation of assets. But no project need be rejected merely for want of security, if it is considered feasible.

Knowledge of these principles enables the lending agencies to arrive at a correct judgment of the project/ scheme, to assess the financial requirements of the farmers, to determine the risk involved in such financing and to evaluate the extent of benefit that accrues to the farmers.

Project Appraisal and Evaluation – an Overview

Project appraisal and evaluation are often referred to together as *project assessment*. *Project appraisal* is concerned with assessing, in advance, whether a project is worthwhile and therefore if it should be proceeded with.

The process of *project evaluation* is concerned with assessing, in a retrospective sense, the performance of a project after it has been implemented and completed. Such a process of policy assessment occupies a central place in public policy and management. Many of the issues of public policy and management are about resource allocation, the trade-offs between different policy measures and the impacts of those policy measures on the economy and on society. Management in the public sector is subject to budgetary constraints and often to political pressures; project appraisal techniques may help in the decision process and obtain a more efficient allocation of resources.

What is a Project?

Gittinger (1982) defines a ‘project’ as ... an investment activity upon which resources – costs – are expended to create capital assets that will produce benefits over an extended period of time and which logically lends itself to planning, financing, and implementing as a Unit. A specific activity, with specific starting point and specific ending point, intended to accomplish a specific objective.

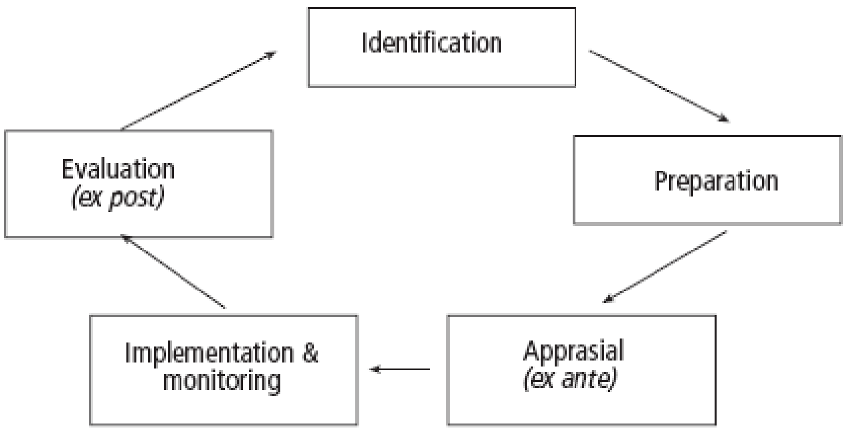
The smallest operational element prepared and implemented as a separate entity in a national plan or program. Generally unique in that it is not a segment of an ongoing program, although it may be a ‘time slice’ a portion lasting several years – of a long-term program.

The Project Cycle

The appraisal and evaluation of projects, programmes and policies is best seen in the context of the project cycle, the stages of which are shown in Figure 1.1. The process begins with *project identification* and ends with *project evaluation*. To ensure that projects meet their original objectives, it is usual to set up an evaluation framework, which allows project finance agencies, policy makers and other stakeholders to assess the success of the project through *the monitoring and evaluation process*. The project cycle consists of the following stages:

- Project identification
- Project preparation
- *ex ante* project appraisal
- Implementation and monitoring
- *ex post* project evaluation.

Figure 1.1 The Project Cycle



The idea behind the project cycle is that there are a number of sequential processes from the identification of a project through to the completion of the project. It is important that *ex-post* project evaluation is carried out in order to assess the impacts of the project and whether it achieved its original objectives. There are a number of different tools you will learn later in this course which are used at different stages in the project cycle. They include:

- Financial and economic analysis (*ex ante* project appraisal)
- Impact analysis (monitoring and evaluation and ex-post project evaluation)
- Risk analysis (project preparation, *ex ante* project appraisal)

The identification stage

This is the conception stage in a project's life cycle. In the past, the procedure that led national governments and other borrowers to generate proposals for external financing was fairly ad hoc (meaning that proposals were generated in isolation, as and when they were considered necessary, and with no reference to other potential projects). In recent years, major donor agencies (such as the World Bank) place much emphasis on project identification as an important element in the overall success of the project. Defined priority areas within broad development strategies are used to encourage project generation, for instance, or to screen incoming projects. **In-depth knowledge** and **experience of local conditions** can be an important source of suggestions for project formulation, as can occasional field missions and technical surveys aimed at identifying potential projects. Domestically, public sector projects are usually derived from the planning process or from political imperatives of national governments and their agencies, whereas private sector projects usually result from the identification of an opportunity for profit. Factors that complicate project identification in practice are numerous and include such issues as conflicting interests between involved parties (local and regional bodies, sectoral ministries, national governments and external donors) and varying levels of capability in project formulation.

Preparation

Projects that survive the early stage of successful identification need to be prepared and analysed before money is allocated to them. Although this is formally a borrower responsibility, in practice it is common for donor agencies to extend technical and financial assistance to borrowing countries to assist them in the preparation and analysis of projects. A 'project brief' is used to describe the project's objectives, its main issues and the timetable within which its implementation and processing are conceived. The length of time taken for preparation and analysis is not fixed: it will almost certainly be a function of the nature of the project (its size, borrower experience, whether it is a new project or the extension of an existing one, *etc*). Often it may also involve a feasibility study (or a sequence of them) to establish at an early stage which projects are worth pursuing further. Consideration of alternatives is important at this stage as another 'early signalling' mechanism for deciding worthwhile projects.

Through careful and detailed analysis, projects are likely to be shaped and redefined (sometimes to the point where they do not look anything like their original form) to take them a step closer to the realistic conditions under which they may be implemented. This is required for detailed planning, which should take account of the full range of technical, institutional, social, environmental, commercial, financial and economic aspects of the project that we introduced earlier (see the last section).

Appraisal

The purpose of project appraisal is to establish whether a project is worthwhile in the light of its costs in terms of resource commitments and the project's expected benefits. That is, appraisal is an *ex ante assessment* of a project and is the key element in the decision as to whether or not to proceed with a project. This will involve the consideration of alternative projects (the *with* option[s]), or alternatively, by comparison with the status quo (that is, the *do-nothing* option). In practice, this is an intricate and sophisticated process of enquiry, with substantial data requirements. Examination of the viability of the project may require the specialised services of appraisal missions and appointed consultants. Appraisal covers four major aspects of the project: technical, institutional, financial and economic.

The project appraisal is the process of critical examination and analysis of the proposal in totality. The appraisal goes beyond the analysis presented in the feasibility report. At this stage, if required compilation of additional information and further analysis of project dimensions are undertaken. At the end of the process an appraisal note is prepared for facilitating decision on the project implementation.

The appraisal process generally concentrates on the following aspects.

• **Market Appraisal**: Focusing on demand projections, adequacy of marketing infrastructure and competence of the key marketing personnel.

• **Technical Appraisal**: Covering product mix, Capacity, Process of manufacture engineering know-how and technical collaboration, Raw materials and consumables, Location and site, Building, Plant and equipments, Manpower requirements and Breakeven point.

• **Environmental Appraisal**: Impact on land use and micro-environment, commitment of natural resources, and Government policy.

• **Financial Appraisal**: Capital, rate of return, specifications, contingencies, cost projection, capacity utilization, and financing pattern.

• **Economic Appraisal**: Considered as a supportive appraisal it reviews economic rate of return, effective rate of protection and domestic resource cost.

• **Managerial Appraisal**: Focuses on promoters, organization structure, managerial personnel, and HR management.

• **Social Cost Benefit Analysis (SCBA):** Social Cost Benefit Analysis is a methodology for evaluating projects from the social point of view and focuses on social cost and benefits of a project. There often tend to differ from the costs incurred in monetary terms and benefits earned in monetary terms by the project SCBA may be based on UNIDO method or the Little-Mirriles (L-M) approach. Under UNIDO method the net benefits of the project are considered in terms of economic (efficiency) prices also
referred to as shadow prices. As per the L-M approach the outputs and inputs of a project are classified into (1) traded goods and services (2) Non traded goods and services; and (3) Labor. All over the world including India currently the focus is on Economic Rate of Return (ERR) based on SCBA assume importance in project formulation and investment decisions.

Detailed Project Report (DPR)

Once the projects are appraised and the investment decisions are made a Detailed Project Report (DPR) is prepared. It provides all the relevant details including design drawings, specifications, detailed cost estimates etc. and this would act as a blue print for project implementation.

Contents of a project report

The following are the contents of a project report:

1. Objective and scope of the project
2. Product characteristics (specifications, prouduct uses and application, standards and quality)
3. Market position and trends(installed capacity, production and anticipated demand, export prospectus and information on import and export, price structure and trends).
4. Raw materials (requirements of raw materials, prices, sources and properties of raw materials)
5. Manufacture (processes of manufacture, selection of process, production schedule and production techniques)
6. Plant and Machinery (equipments and machinery, instruments, laboratory equipments, elastic load and water supply and the essential infrastructure)
7. Land and building (requirement of land area building, construction schedule)
8. Financial implications (fixed and working capital investment, project cost and profitability)
9. Marketing channels (trading practices and marketing strategy)
10. Personnel (requirements of staff, labour and expenses on wage payment).

Implementation and monitoring

A project that is considered to be worthwhile at the appraisal stage qualifies for implementation. In practice, implementation tends to be complicated by many unforeseen problems. Therefore flexibility is required at this stage to enable the successful execution of the project. The process of implementation can be long and drawn out (depending on the

nature of the project and the time period over which it spans). It is normal to consider it over three phases:
• investment
• development
• operation.
There is considerable variation in the length of each of these stages between different projects (infrastructure projects tend to have long investment periods, for example). It is probably true to claim that a project is as good as its execution. Thus, implementation of a project is another critical stage in the project's life cycle.
While the project is being carried out, continuous monitoring is required to satisfy those people implementing the project that things are proceeding according to plan. Monitoring typically requires effective information gathering and management system that can check the progress of the project according to the plans that have been drawn up and the project objectives.

Evaluation
Once the project is completed (and possibly also several times during its implementation), it needs to be evaluated so as to enable analysts (borrowers or lenders) to assess its performance and outcome. Thus, evaluation is an *ex post assessment* of whether the project was worthwhile. It seeks to answer such questions as:
• has the project been successful in attaining its objectives?
• if not, in what respect has it failed?
• how might its design and/or implementation have been improved?
All World Bank-assisted projects are now subjected to an *ex post* audit. It allows a reworking of the estimates of the economic rate of return on the basis of actual implementation costs and updated information on operating costs and expected benefits. Evaluation thus helps to identify elements of strength and weakness, success or failure. The results are valuable in planning future projects and in attempts to avoid repeating or committing 'mistakes'. Thus the results of the evaluation process need to be disseminated.
This is why Baum (1982) described the evaluation system as 'a gold mine of information, supplementing and complementing that provided by the broader stream of project supervision reports'.

To design and analyze effective projects, those responsible must consider many aspects that together determine how remunerative a proposed investment will be. All these aspects are related. Each touches on the others, and a judgment about one aspect affects judgments about all the others. All must be considered and reconsidered at every stage in the project planning and implementation cycle. A major responsibility of the project analyst is to keep questioning all the technical specialists who are contributing to a project plan to ensure that all relevant aspects have been explicitly considered and allowed for.

Lecture No 4: Time value of money: Compounding and Discounting Techniques – Project Appraisal: Undiscounted and Discounted measures.

TIME COMPARISON PRINCIPLE

i) Decision - Making over Time

A farm manager has to take decisions over varying horizons of time. Two aspects of such decisions are important, i.e., i) differences in profitability growing out of time alone and ii) differences in the desirability of investments due to risk and uncertainty factors. Time has a very significant influence on costs and returns. There are many decisions where this time comparison principle finds application, such as: soil conservation programmes which bear fruits over a long time; putting land under an orchard which may not give returns for 5-10 years; and so on. Two aspects of the problem are considered under such situations: a) growth of a cash outlay over time and b) discounting of future income.

ii) Growth of a Cash Outlay or Compounding Present Costs

The cash outlay grows over time due to the compounding of interest charges or opportunity costs involved in using the capital; if Rs.100 are put in a saving account with an annual interest at 12 per cent compounded, it will increase to Rs.125.44 by the end of second year. In symbolic terms, you now have the amount earned at the end of the first year. P + Pi, plus the interest that amount earned during the second year (P + Pi) i which could be expressed as: (P + Pi) + (P + Pi) i (or) P (1 + i) + Pi (1 + i) which after factorising (1 + i), results in

Table 3. Compounding the Present Value

(Amount in Rs.)

Year	Beginning Amount	Interest Earned by the End of Year	Beginning Amount + Interest
1	100.00	100.00(0.12)=12.00	112.00
2	112.00	112.00(0.12)=13.44	125.44
3	125.44	125.44(0.12)=15.05	140.49
4	140.49	140.49(0.12)=16.86	157.35
5	157.35	157.35(0.12)=18.88	176.23

(P + Pi) (1 + i). Factorising P from the left term gives: $P (1 + i) (1 + i) = P (1 + i)^2$. In general, the compounded value, F (future value), of a present sum (P) invested at an annual interest rate (i) for ‘n’ years is given by $F = P (1 + i)^n$ .This procedure is called compounding.

iii) Discounting Future Revenues

Costs incurred at one point of time cannot be compared with validity to revenues forthcoming at a later date. The future value of the present sum is estimated through: $F = P(1 + i)^n$ .Dividing both sides of this equation by $(1 + i)^n$, the following equation is obtained:

$$P = \frac{F}{(1 + i)^n}$$

Thus, if a pay-off, F, is due in ‘n’ years in future, its present value, P, can be determined using the above expression where ‘i’ is the interest rate. This procedure is known as discounting future returns. The present value of Rs.176.23 that could be at the end of 5 years if the appropriate discount rate is 12 per cent, is:

$$P = \frac{176.23}{(1.12)^5} = \text{Rs.}100.00.$$

Discounting can be used to determine the present value of the future income stream earned by a durable input (asset).

Table 4.Discounting the Future Values

(Amount in Rs.)

Year	Value at the End of the Year (Rs)	Present Value, if Discount Rate is 12 Per Cent per Annum (Rs)
1	100	89.29
2	100	79.72
3	100	71.18
4	100	63.55
5	100	56.74
Total	500	360.48

The interest rate used to discount or compound sums of money should be at least as large as the current or market rate of interest. How much higher it might be depends upon the manager's opportunity costs. The important variables determining present and future values of a single payment or series of payments are: i) the number of years and ii) size of interest rate. Both factors interact to determine the total effects of discounting or compounding on present or future values.

Here, the cash flows of the investment are not discounted to estimate the present worth of future stream of cash flow. There are four major methods in undiscounted measures as discussed below

Ranking by Inspection: We can tell that by simply looking at the investment cost and stream of net value of incremental production that one project should be accepted over another.

Payback period: Payback period is the length of time from the beginning of the project until the net value of the incremental production stream reaches the total amount of the capital investment. The weakness of the payback period as a measure of investment worth is that it fails to consider earnings after the payback period and it does not take into consideration the timing of proceeds.

Proceeds per Unit of Outlay: The total net value of incremental production is divided by the total amount of the investment. Again, the criterion of proceeds per unit of outlay fails to consider timing; money to be received in the future weights as heavily as money in hand today.

Average Annual Proceeds per Unit of Outlay: The total of the net value of incremental production is first divided by the number of years it will be realized and then this average of the annual proceeds is divided by the original outlay for capital items. By failing to take into consideration the length of time of the benefits stream, it automatically introduces a serious bias toward short-lived investments with high cash proceeds.

All these four measures fail to take into account adequately the timing of the benefit stream. Therefore, undiscounted techniques have lesser applications in project evaluation.

Discounted measures

In undiscounted measures of investment analysis, the time value of money is ignored but which is very important in ranking and choosing the alternate investments. In discounted measures of investment analysis the time value of money is taken care of.

1) Net Present Worth or Value (NPV or NPW)
2) Benefit Cost Ratio (BCR)
3) Internal Rate of Return (IRR)

Discounting Factor

In calculation of net present worth or benefit cost ratio, discounting factor must be chosen prior to investment analysis. Usually the discounting factor used is the opportunity cost of capital. The bank rate given on long term deposit (12%) is chosen as the discount factor. The farmer instead of investing in the proposed investment can deposit in a bank and earn 12% of interest i.e. the proposed investment should earn more than bank interest rate.

Net Present Worth (NPW)

This is simply the present worth of incremental net benefit or incremental cash flow stream. It is interpreted as the present worth of the income stream generated by an investment.

$$NPV = \sum_{t=1}^{n} B_t / (1+r)^t - \sum_{t=1}^{n} C_t / (1+r)^t$$

Where,
Bt = Benefit in year 't' and Ct = Cost in year 't'

Selection criterion: Accept all independent projects with a zero or greater net present worth when discounted at opportunity cost of capital. Ranking of acceptable alternate independent project is not possible with net present worth criterion because it is an absolute and not a relative measure. It is also the preferred selection criterion to choose among mutually exclusive projects.

Benefit Cost Ratio (BCR)

This is the ratio of present worth of benefit stream to present worth of cost stream.

$$BCR = \frac{\sum_{t=1}^{n} B_t / (1+r)^t}{\sum_{t=1}^{n} C_t / (1+r)^t}$$

Selection criterion: Accept all independent projects with a benefit cost ratio of 1 or greater when the cost and benefit streams are discounted at opportunity cost of capital.

Internal Rate of Return

In NPW and BC ratio, market rate of interest is chosen. It differs from place to place.

Internal rate of return is that discount rate that makes the net present worth of incremental net benefit equal to zero. In other words it is the maximum interest that an investment could pay for the resources used.

Selection criterion: Accept all independent projects having an internal rate of return equal to or greater than the opportunity cost of capital.

$$\sum_{t=1}^{n} B_t / (1+r)^t - \sum_{t=1}^{n} C_t / (1+r)^t = o$$

IRR = LDR + Difference between the two discount rates X $\dfrac{\text{Present worth of incremental net benefit stream (cash flow) at lower discount rate}}{\text{Absolute difference between the present of cash flow at two discount rates(Signs ignored)}}$

IRR = Internal rate of return
LDR = Lower discount rate

Lecture No 5: Repayment plans - Farm Financial Statements: Balance Sheet, Income Statement and Cash Flow Statement – Financial Ratio Analysis.

The repayment of term loans (i.e. medium term loans and long term loans) differs from that of short term loans because they are characterized by their partially liquidating nature. These loans are recovered by a given number of instalments depending up on the nature of the asset and the amount advanced for the asset under consideration.
There are six types of repayment plans for term loans and they are
1. Straight-end repayment plan or single repayment plan or lumpsum repayment plan
2. Partial repayment plan or Balloon repayment plan
3. Amortized repayment plan
a) Amortized decreasing repayment plan
b) Amortized even repayment plan or Equated annual installment method
4. Variable repayment plan (or) Quasi-variable repayment plan
5. Optional repayment plan
6. Reserve repayment plan (or) Future repayment plan

1. Straight-end Repayment Plan or Single Repayment Plan (or) Lumpsum Repayment Plan
The entire loan amount is to be cleared off after the expiry of stipulated time period. The principal component is repaid by the borrower at a time in lumpsum when the loan matures, while interest is paid each year.

2. Partial repayment plan or Balloon repayment plan
Here the repayment of the loan will be done partially over the years. Under this repayment plan, the installment amount will be decreasing as the years pass by except in the maturity year (final year), during which the investment generates sufficient revenue. This is also called as balloon repayment plan, as the large final payment made at the end of the loan period (i.e. in the final year) after a series of smaller partial payments.

3. Amortized repayment plan:
Amortization means repayment of the entire loan amount in a series of installments. This method is an extension of partial repayment plan. Amortized repayment plans are of two types
a) Amortized decreasing repayment plan
Here the principal component remains constant over the entire repayment period and the interest part decreases continuously. As the principal amount remains fixed and the interest amount decreases, the annual installment amount decreases over the years. Loans advanced for machinery and equipment will fall under this category. As the assets do not require much repairs during the initial years of loan repayment, a farmer can able to repay larger installments.
b) Amortized even repayment plan
Here the annual installment over the entire loan period remains the same. The principal portion of the installment increases continuously and the interest component declines gradually. This method is adopted for loans granted for farm development, digging of wells, deepening of old wells, construction of godowns, dairy, poultry units, orchards etc.
The annual installment is given by the formula

I = B* i/1-(1+i)-n

Where I= annual installment in Rs.
B= principal amount borrowed in Rs.
n= loan period in years
i= annual interest rate

4. Variable repayment plan or Quasi-variable repayment plan

As the name indicates that, various levels of installments are paid by the borrower over the loan period. At times of good harvest a larger installment is paid and at times of poor harvest smaller installment is paid by the borrower. Hence, according to the convenience of the borrower the amount of the installment varies here in this method. This method is not found in lendings of institutional financial agencies.

5. Optional repayment plan:

Here in this method an option is given for the borrower to make payment towards the principal amount in addition to the regular interest.

6. Reserve repayment plan or Future repayment plan

This type of repayment is seen with borrowers in areas where there is variability in farm income. In such areas the farmers are haunted by the fear of not paying regular loan installments. To avoid such situations, the farmers make advance payments of loan from the savings of previous year. This type of repayment is advantageous to both the banker and borrower. The bankers need not worry regarding loan recovery even at times of crop failure and on the other hand borrower also gains, as he keeps up his integrity and credibility.

The three basic financial documents needed for any business analysis are (1) net worth statement or balance sheet (2) Income statement and (3) Cash flow summary statement. At a given point of time the net worth statement documents, the assets, liabilities and owners equity of the business. It is used to evaluate the solvency of business. The income statement is used to measure the financial profitability of a business during a period of time. It summarizes both cash and non-cash transactions that occurred during the accounting period.

A. Balance Sheet / Net worth Statement

The net worth statement in principle is a simple document. It consists of three main parts (a) list of assets (b) list of debts (liabilities) and (c) statement of owners equity, (or net worth). To prepare a useful and correct net worth statement it is first necessary to make a complete list of the business assets and debts. Further, it is desirable to categorize assets and debts into separate groups so that more detailed analysis can be made of net worth statement. Finally net worth can be calculated once the total value of the assets and debts has been established. The balance sheet corresponds to a particular date on which the asset and debt inventory is worked out

The assets and liabilities have been divided into three sub groups, *viz*., current, intermediate, and long term assets and liabilities. The breakdown of the assets and liabilities into these groups allows for more thorough and meaningful business analysis.

Assets: Any owned physical object having a money value.

Current Assets: It includes items that can be liquidated or consumed in a business operation during the accounting year. The liquidation of these items will have the least effect on the business ability of the individual or firm to continue operating. Items included in this classification include the crops raised for sale, livestock in inventory, advance supplies purchased, and cash on hand and accounts receivable.

Intermediate assets: These are items that can be liquidated but generally would require more time to achieve a fair price and also would have a significant influence on ability to continue in its basic format of operation. Items of this nature include draught animal, milch animal livestock in growing stage to be sold in later years, machinery, equipments and movable farm assets. In a sense these items are basically intended to support production and are not intended for sale. Because of this, intermediate assets are somewhat more difficult to liquidate than current assets and if liquidated, nature of farming operation would be modified to a greater extent. For e.g. liquidating the draught animal would certainly have a major impact on farming activity.

Long term Assets: The long-term assets of the business are the major assets. eg. Land, permanent buildings and improvements. If a major portion of these assets were liquidated, the business would have to be terminated. These assets are the least likely to be liquidated.

Once these assets have been listed and grouped, values must be established for each of them. For current assets the problem of valuation should be fairly straight forward, since most part of the items listed under current assets are frequently sold. Therefore, it is only necessary to determine the current market price for the item, for establishing a value, based on the inventory.

Establishing the value of intermediate assets is a more involved process. For example, values of machinery and equipments are taken at book value (cost minus accumulated depreciation). This non - cash expense, called depreciation is calculated by means of a series of equations.

Using book values (Cost less accumulated depreciation) to establish value of machinery and equipment is a common practice in the preparation of net worth statement. A business with high proportion of assets being of recent purchase and using a slow depreciation (e.g. straight line method) will tend to have an overvalued set of assets. This is because market value of the assets has declined more rapidly than what the depreciation method actually indicates.

The opposite problem often occurs with older machinery. The market value of tractor may be higher than book value. The use of market values might be appropriate method for establishing values for such cases on the net worth statement. This would give a true indication of business's solvency. For valuation of breeding stock or working livestock, market value technique is preferred, as it appreciates and depreciates over its life period. Long-term assets include land, improvements to irrigation structures, drainage structures and buildings. The value of the buildings and improvements is established using the book value. The sum of current intermediate and long term of asset is the total assets of the business. The liabilities are also grouped in to three sub groups, which allows for a more thorough analysis of the balance sheet.

Current liabilities include the accounts payable and the debt that is likely to be repaid within the current accounting year. This type of debt includes operating loans which are used to buy items of production such as, seed, fertilizer and feed. These loans are usually repaid when the commodities produced from the farm are sold. The principle amount that is due to be paid in that particular year for intermediate / long-term liabilities should be included under this.

Intermediate liabilities include debts in which the repayment schedule is within 2 to 10 years. This type of debt is used to purchase assets that are used in production process and would include items like machinery, draught animals and some types of improvement.

Long-term liabilities are debts that have repayment schedules generally in excess of 10 years. Mortgage of land are generally considered as long-term liabilities. The total liabilities are calculated by summing the current, intermediate and long-term liabilities.

The difference between the assets and liabilities is termed as net worth. Net worth is an indication of the amount of equity the owner or owners have in the business and is considered to be the balancing entry of net worth statement. In some cases liabilities exceed the assets of the business. In this situation the business have a negative net worth and the balancing entry is defined as net deficit.

The net worth statement is one of the primary documents used by lending agencies in evaluating requests for new loans or extension of existing loans. A good net worth statement is also important for correct preparation of the income statement. It can be used for tax calculation purposes. It is also used for further detailed analysis like current ratio and debt / equity ratio etc.,

B. Income Statement

The income statement or profit and loss statement is an important financial record that measures financial progress and profitability of business over time. The income statement is a summary of both the cash and non-cash financial transactions of the farm business, which occurred during the selected accounting period. This document is important because it is extensively used in analyzing the profitability, efficiency and financial stability of the business. Information from this document is also used in the preparation of cash flow summary.

The income statement is divided into two major sections namely income and expenses.

Income

(i) Cash Receipts

The accounts indicate only the sales of those items for which the manager has actually received payment.

(ii) Capital sales of the business

The sale of milch animal and equipments are major items. These types of receipts are separated from normal cash receipts. The amount reported should reflect only the actual net gain from capital sale. Net gain from milch animals that was raised on the farm would be defined as the sale value. However for the purchased milch animal the net gain would be defined as the difference between the sale price and current book value.

(iii)Change in inventory value of items produced on the farm.

The adjustments that are made in this part of the income statement are necessary for a true indication of the farm's income. All the income items included influence the amount of cash flowing into the business. One of the management functions of the farms is choosing the best time to market and the quantity of items in the inventory vary with the marketing strategies chosen. The adjustments made in this part of the income statement will give a more accurate picture of the farm's income.

B. Expenses

The other major section of the income statement relates to the expenses of the business. The expenses section is divided into two subsections.

(i) Operating expenses are cash expenses which generally vary with size of the business operation.

(ii) Fixed expenses do not vary significantly with a change in the volume of business done under the period of reporting.

The sum of operating and fixed expenses is the total expenses of the business. This figure when subtracted from gross farm income gives the net farm profit. This gives an indication of business profitability during the accounting period.

Cash Flow Statement

The cash flow statement is the other important financial document needed to analyze the financial position of the farm business. As discussed earlier the net worth statement indicates the financial solvency of the business at a given point of time. In addition, the income statement gives an indication of the net farm profit during an accounting period.

Neither of these financial documents addresses the issue whether the business can meet its various financial obligations. The cash flow statement deals with this issue. In particular it examines the amount of cash available to the farm and his family (both farm and non-farm) and how that cash is utilized in both farm and non farm activities. It identifies the problem areas that would not be apparent in examining the balance sheet and income statement. The cash flow statement can be prepared either on annual basis, or more a frequent basis such as quarterly or monthly. The cash flow summary is used to address the issue of whether the business can meet its various financial obligations. It examines the pattern of cash flowing into and out of business, during a particular period of time.

The cash flow statement consists of the following sections (1) Net cash farm income (2) Net capital expenditures (3) Net other income less expenditures and (4) Cash flow summary.

1. **Net cash farm income**: This relates to the net cash position of the farm business. The actual cash income and expenses are recorded under the time period in which they were actually incurred. The actual cash receipts and expenses are used and no inventory adjustments are made. Note that the net cash farm income varies significantly from one quarter to another.

2. **Net capital expenditure**: It indicates the sales and expenditures related to the capital items. Again these figures are the actual cash account.

3. **Net other income less expenditure**: It contains details on other sources of income and expenditures. Included in the other income group are hired out machineries and bullock, wages from off-farm employment and income from non farm business. The other expenses include non-farm cash business expenses, withdrawals for family living expenses, savings and principal payments on intermediate and fixed debts.

Cash flow summary: If the figure is negative additional debt will be needed to offset this deficit. In case where the cash surplus is positive the money can be used to make principal payments on post debt. The surplus can also remain in bank balance and used in later periods to set off cash flow problems that might exist in later periods.

Cash flow is an important and useful document in the analysis of cash liquidity of the business. When it is used in conjunction with the income statement and the balance sheet, the manager has a great deal of information for analyzing his business and in making management decisions. The summary of the cash flow is to find out the cash surplus. This is arrived at by adding the bank balance at the beginning of the year and the net cash income from the farm less the capital expenditure and other miscellaneous expenditures.

Financial Ratio Analysis

The balance sheet, income statement, cash flow statement supply a great deal of information on the financial structure and progress of the farm business. These records are helpful in assisting the farmer in decision making. The records must be analysed to ascertain the strengths and weaknesses of the business.

There are three types of financial tests and they are a) tests of liquidity, b) tests of solvency and c) tests of profitability.

A. TESTS OF LIQUIDITY

Tests of liquidity are usually conducted to determine the firm's ability to meet its current financial obligations. The current ratio is the most commonly recognized indicator of a firm's liquidity.

1) Current Ratio

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}} = \frac{39{,}100}{18{,}000} = 2.17$$

Nature of current assets determines the value whether the firm is able to meet promptly the current liabilities. The reasonableness of any current ratio can be tested by comparing current ratios of similar firm in the industry.

2) Acid Test Ratio (ATR) or Quick Current Ratio

$$\text{ATR} = \frac{\text{Current monetary assets}}{\text{Current liabilities}} = \frac{31{,}100}{18{,}000} = 1.73$$

The difference between current ratio and acid test ratio is the elimination of inventories in current assets used in acid test ratio. If a firm's cash marketable securities and accounts receivable are more than sufficient to meet its current liabilities, then inventories may be viewed as a buffer to absorb any subsequent deficiency in the receivables, such as unexpected bad debt.

3) The Inventory to Receivable Ratio

$$\frac{\text{Inventory}}{\text{Total receivables}} = \frac{8{,}000}{800} = 10.00$$

It also associated with the acid test ratio. Inventory represents cost items while receivables presumably include profit. Hence, a favourable change in this ratio may be due to the execution of profitability convert its inventory into liquid cash. It also has relevance in identifying a firm's current position in a business cycle since inventory generally is more subject to the value changes than the receivables are.

4) Intermediate Ratio

$$\text{Intermediate ratio (IR)} = \frac{\text{Total current assets} + \text{Total intermediate assets}}{\text{Total current liabilities} + \text{Total intermediate liabilities}}$$

A farm with CR and IR less than 1 may be facing serious financial problems.

B)TESTS OF SOLVENCY

Tests of solvency are designed to measure a firm's ability to meet both interest change and repayment of loans associated with its long-term financial commitments. Tests of solvency tell the manager how well his firm will survive a crisis but will provide little information as to the firm's normal operational viability.

1) Net Worth to Total Debt Ratio

$$\frac{\text{Net worth}}{\text{Total liability}} = \frac{1{,}89{,}100}{2{,}39{,}100} = 0.79$$

In general, the larger the net worth to total debt ratio, the less a firm's creditors concern themselves with thoughts of fore closure. It should be noted that some business may attempt to improve their current ratio, though not necessarily their financial health, though a simple funding operation. They decrease their current obligations by increasing long term debt and leave total debt used by the manager as a valuable supplement to the current ratio. Where a very large proportion of a firm's total debt is funded, a manager may choose to use an auxiliary ratio of net worth to current liabilities, there by emphasizing the relative size of funded debt and its effect on solvency.

2) Net Worth to Fixed Asset Ratio

$$\frac{\text{Net worth}}{\text{Fixed assets}} = \frac{1{,}89{,}100}{1{,}80{,}000} = 1.05$$

This ratio indicates the proportion to the owner's equity invested in fixed assets. The ratio of above one, if it exists, represents the proportion of owner's equity involved in the firm's working capital. A raising net worth to fixed asset ratio indicates that management may be less concerned with insolvency. A declining ratio serves to warn management that the firm possibly may be expanding its physical plant beyond its current ability to support it financially. This would be particularly important to management during a general period of declining business.

3. Net capital ratio(NCR) $= \dfrac{\text{Total assets}}{\text{Total liabilities}}$

4. Debt - equity ratio $= \dfrac{\text{Total liabilities}}{\text{Net worth}}$

5. Equity - value ratio $= \dfrac{\text{Net worth}}{\text{Total assets}}$

The net capital ratio, debt-equity ratio and equity-value ratio are indicators of long term solvency of the business. These ratios indicate a manager's willingness to use borrowed capital in the operation of his business.

If the net capital ratio works out to less than one, the farm is using more of borrowed funds. e.g. for the farm that has relatively stable expense and income situations, such as dairy farm, lending institutions may be willing to advance credit even with NCR as low as 1.0. In other business such as orchards where income and expense fluctuate greatly from year to year financial institutions might consider a NCR of 2 or 3 as a more appropriate value, for advancing loans.

Again direction of movement of these ratios through time is more important.

i. NCR should be increasing over time.

ii. Debt equity ratio should be decreasing over time.

Equity ratio approaching 1, would be making progress towards higher solvency levels.

Lower the debt, the higher degree of protection enjoyed by the creditors. The lower this ratio, the more desirable it is. It is also known as Debt to Net Worth ratio. The net worth indicates the solvency of the business. But this is the ultimate solvency rather than intermediate solvency. Ultimate solvency is meant that total resources are equal to or greater than total liability, in case the entire business is closed out and all the liabilities are met with. Net worth is greater than zero, when business is solvent. When total liabilities are not covered by total resources, the business is insolvent or bankrupt. The intermediate solvency is meant the relationship between current liabilities and liquid assets, which can be used to clear them off, if demanded.

C) TESTS OF PROFITABILITY

Two subgroups of financial ratios are generally used by management to test the profitability of a business. The first sub-group involves those ratios that measure profitability of a business. The first sub-group involves those ratios that measure profitability as related to investment. The second is more concerned with measuring profitability as related to sales. Both sub-groups of ratios are helpful to managers in identifying performance trends over time and/ or comparing profit performance among similar business firms.

1. The Earnings to Investment Ratio

$$\frac{\text{Net income}}{\text{Net worth}} = \frac{\text{Rs.8,00,000}}{\text{Rs. 80,00,000}} = 0.1 \text{ (Hypothetical figure)}$$

This ratio is investor oriented and is of particular interest to the stock holders in so far as it has a direct impact on dividends.

2. The Earnings to Sales Ratio

$$\frac{\text{Net income}}{\text{Sales}} = \frac{\text{Rs.8,00,000}}{\text{Rs.90,00,00}} = 0.89 \text{ (Hypothetical figure)}$$

This ratio measures profit margin to sales. Higher the ratio, the more profitable the firm is. However, in comparing two or more enterprises, extreme care should be taken that net income excludes depreciation, taxes and outside earnings.

Income statement

Ratios calculated from the income statement give an indication of the relative profitability of a business and the degree of flexibility the farm has in meeting the expenses.

The operating ratio indicates the proportion of the gross income to operating expenses.

3. Operating ratio $= \dfrac{\text{Total operating expenses}}{\text{Gross farm income}}$

Fixed ratio indicates the proportion of gross income allocated to meeting the fixed expenses.

4. Fixed ratio $= \dfrac{\text{Total fixed expenses}}{\text{Gross farm income}}$

The relationship between the fixed ratio and operating ratio is important. Farms with relatively large fixed ratio and small operating ratio generally are more vulnerable to cash flow (also called liquidity) problems.

5. Gross ratio (GR) $= \dfrac{\text{Total expenses}}{}$

Gross farm income

Gross ratio (GR) indicates the proportion of gross income needed to meet the total expenses and is the sum of fixed and operating ratios. In examining the three ratios the gross ratio is the important among the three

If GR > 1 the business is not covering the total expenses of operation.

GR < 1 the farm is generating a positive net farm income.

Balance sheet and Income statement analysis

The primary ratio calculated using both the balance sheet/net worth statement and the income statement is the Capital Turn Over Ratio. This ratio compares the use of invested capital in business in relationship to the income generated. Higher the ratio, the more efficient is the business. For a business with low capital turnover ratio to remain competitive, it needs a high level of profit per rupee of income generated.

$$\text{Capital Turn Over Ratio} = \frac{\text{Gross farm income + major purchase}}{\text{Average Capital investment}}$$

The other ratios are

Total Assets Turn-Over Ratio = Net Sales/ Total Assets

Net Income to Total Assets Ratio = Net Income / Total Assets

Lecture No.6: Institutional Lending Agencies – Commercial banks: Nationalization, Agricultural Development Branches – Area Approach – Priority Sector Lending - Regional Rural Banks.

COMMERCIAL BANK

The industrial sector is relatively more organized and less dependent on natural factors than agricultural sector. Hence, the commercial banks tended to concentrate more on industrial sector than agricultural sector.

The Indian Central Banking Committee (1931), the Agricultural Finance Sub-committee (1945), the Rural Banking Enquiry Committee (1950), the All India Rural Credit survey committee (1951), the All India Rural Debt and Investment Survey (1961-62) and the Informal Group on Institutional Arrangements for Agricultural Credit (1964)-all these expert committees were of the opinion that co-operatives and not the commercial banks were the suitable credit agencies for agriculture.

Financing agriculture by commercial banks was not significant till 1950. However, the Rural Banking Enquiry Committee (1950) recommended that banking facilities should be extended to rural areas. The commercial banks were reluctant to enter the field of agricultural finance as they It that it would be risky and costly.

The Imperial Bank of India was established in 1921 by the amalgamation of these residency Banks, (Bank of Bengal, Bank of Bombay and Bank of Madras). Until the establishment of the Reserve Bank of India (RBI) in 1935, the Imperial Bank of India was the sole banker to the government. There was no branch for RBI; the Imperial Bank of India acted as an agent of the RBI for the purpose of transacting businesses of government.

In 1955, the state Bank of India Act was passed and Imperial Bank India was named as the State Bank of India. In 1959, State Bank of India (subsidiary Banks) Act was passed and seven Associate Banks or subsidiary banks of SBI were started functioning. They are:

1. State Bank of Mysore
2. State Bank of Travancore
3. State Bank of Sowrashtra
4. State Bank of Hyderabad.
5. State Bank of Bikanir and Jaipur.
6. State Bank of Patiala.
7. State Bank of Indore.

The role of commercial banks in rural credit was negligible till the sixties as is evident from the All India Debt and Investment survey Report, 1961-62 and 1971-72. They had shown little interest in direct financing of agriculture and had confined their financing activities to the movement of agricultural produces only.

To serve better the credit needs of rural society, fourteen commercial banks with deposits worth Rs.50 crores or more were nationalized on July 19, 1969. In her broadcast address of July 19, 1969 on bank nationalization, Prime Minister Mrs. Indira Gandhi stated that nationalization was meant for an early realization of the objectives of social control which were spelt out as:

(i) Removal of control of money market by a few,
ii) Provision of adequate credit for agriculture, small industry and export,
iii) Encouragement of a new class of entrepreneurs and

iv) Strengthening the professional banking management system.

The nationalized banks were:

1. Central Bank of India
2. Bank of India.
3. Punjab National Bank
4. Bank of Baroda.
5. United Commercial bank.
6. Canara Bank.
7. United Bank of India
8. Dena Bank
9. Syndicate Bank.
10. Union Bank of India
11. Allahabad Bank
12. Indian Bank
13. Bank of Maharashtra
14. Indian Overseas Bank

This was followed by nationalization of six more commercial banks in April 1980. They were:

1. New Bank of India.
2. Vijaya Bank.
3. Corporation Bank.
4. Andhra Bank.
5. Punjab and Sind Bank.
6. Oriental Bank of Commerce.

This institutional change was effected to pursue the goals of growth and social justice.

Functions of Commercial Bank

The objectives of the changes in the banking structure and the king policy since the nationalization of commercial banks are:

i) wider territorial and regional spread of branch net work;

ii) faster mobilization of savings through bank deposits; and

iii) deployment of bank credit in favour of neglected sectors the economy.

In order to achieve these objectives, the commercial banks involved in the following activities:

i) Commercial banks provide both direct and indirect finance to farmers. Banks provide direct finance to farmers for the purchase pump-sets, tractors and other agricultural machineries, for sinking and (deepening wells, for land development, for raising crops, and for setting up of dairy, sheep/goat, poultry, fishery, piggery and sericulture units. Commercial. banks also provide indirect finance which includes loan for distribution of fertilizers and other inputs, loan to electricity boards, loan to primary Agricultural credit societies and subscribing to debentures of land development banks.

ii) They extend financial assistance to small/marginal farmers identified by District Rural Development Agency (DRDA).

iii) They established specialized branches exclusively for rural lending.

iv) They finance Primary Agricultural credit societies ceded to them and organize Farmer's service societies since 1973-74.

v) They have set-up Regional Rural Banks, F.S.S and LAMPS in selected areas to cater to the credit needs of the weaker sections.

Policies and Performance of Commercial Banks

1) Branch Expansion

The branch expansion policy for 1982-83 aimed at achieving a coverage of one bank office, on an average, for a population of 17000 in the rural and semi-urban areas (as per 1981 census) in each block and also to eliminate spatial gaps in the availability of banking facilities so that a rural branch was available within a distance of 10km and would serve an area of about 200 square kilometres. The population norm has been relaxed from March 31st, 1990 to 10,000 with regard to tribal / hilly areas and sparsely populated regions.

Table 5. Branch Expansion of Commercial Banks

Sl.No.	Area	Number of bank offices			
		1969	1989	2009	2013
1.	Rural	1832 (22.1)	33640 (57.6)	82897 (55.7)	109811 (54.9)
2.	Semi-urban	3322 (40.2)	11201 (19.2)	31598 (21.3)	39439 (19.7)
3.	Urban	3108 (37.7)	13576 (23.2)	21022 (14.1)	28691 (14.4)
4.	Metropolitan	-	-	11839 (7.9)	19961 (10.0)
	Total	8262 (100.0)	58417 100.0)	149365 (100)	199915 (100.0)

Source: Statistical Tables relating to Banks in India 2012-2013, Reserve Bank of India bulletin, March 2013 (Figures in Parentheses indicate percentages to total)

The number of rural branches rapidly increased from 22 percent of the total number of branch offices in 1969 to 58 percent in 1989 and at the end of March 2013 share of bank branches in rural area was 55 per cent. The Population per branch office came down from 65,000 in 1969 to 12,000 in 2013.

2) Sectoral allocation – Priority Sector Allocation

The priority sector includes agriculture and allied activities and small scale and cottage industries. A target of 33% lending to the priority sector was set in 1975 (to be achieved by March 1979). In 1979, the target was raised to 40% (to be achieved by 1985). In 1980, sub-targets were set: 16% of lending was to go to agriculture and 10% had to be targeted to "weaker sections". The priority sector advances should be atleast 40 percent of the net bank credit. In 1969, the share of priority sector was only 15 percent of the net bank credit and it increased to 42 per cent in 1990. In 2013, the share was 29 per cent. The priority sector advances by private sector banks at the end of March 1989- constituted 36.7 per cent of their net bank credit. Foreign banks operating in India were advised in August 1988 that their advances to priority sector should reach a level of 10 per cent of their total outstanding advances by the end of March 1989, and 12 per cent and 15 per cent by the end of March 1990 and March 1992 respectively.

3) Credit-Deposit Ratio.

With the objective of reducing the rural urban disparities in the deployment of resources mobilised in the region and for achieving a balanced economic development especially of backward rural and semi urban areas, the Government of India had advised the public sector banks that they should achieve, by the end of March 1984, a credit-deposit ratio of atleast 60 percent in both rural and semi-urban areas. As on March 2013 the credit deposit ratio of commercial banks was 79 per cent. Credit-Deposit Ratio (C-D Ratio) gives an idea as to how much of credit is being sanctioned per unit of deposit mobilised in a particular state or region.

Table 6.Commercial Banks at a Glance

Sl.No	Indicators	2005	2006	2007	2008	2009	2010	2011	2012	2013
1.	Number of Commercial Banks	288	222	182	173	170	167	167	173	155
1.a	a. Scheduled Commercial Banks	284	218	178	169	166	163	163	169	151
1.b	b.Of which RRBs	196	133	96	90	86	82	82	82	64
1.c	c.Non Scheduled Commercial Banks	4	4	4	4	4	4	4	4	4
2.	Population per Office (in Thousands)	16	16	15	15	15	14	13	13	12
3.	Deposits of Scheduled Commercial Banks (Rs.Billion)	17001.98	21090.49	26119.34	31969.40	38341.10	44928.26	52079.69	59090.82	67504.54
4.	Bank Credit of Scheduled Commercial Banks (Rs.Billion)	11004.28	15070.77	19311.90	23619.13	27755.49	32447.88	39420.83	46118.52	52604.59
5.	Deposits as percentage to Gross National Product at factor cost (at current prices)	62.3	64.3	68.8	72.8	77.1	78.2	78.2	78.0	79.4
6.	Advances of Scheduled Commercial Banks to Priority Sectors (Rs.Billion)	3706.03	5127.90	6553.17	7814.76	9089.29	10915.10	13158.59	14710.50	16411.00
7.	Share of Priority Sector Advances to Total Advances of Scheduled Commercial Banks (per cent)	32.2	33.8	33.1	31.6	30.3	31.2	30.6	29.5	28.8
8.	Credit – Deposit Ratio (per cent)	62.6	70.1	73.5	74.6	73.8	73.7	76.5	78.6	79.1
9.	Investment Deposit Ratio (per cent)	47.3	40.0	35.3	35.5	35.7	36.4	34.3	34.6	35.2
10.	Cash – Deposit Ratio (per cent)	6.4	6.7	7.2	9.7	7.3	7.7	8.2	5.8	5.1

Source: Statistical Tables Relating to Banks in India 2012-2013, RBI Report.

Notes:

1. Number of bank offices includes Administrative Offices
2. Classification of bank offices according to population for years are based on 2001 census.
3. Scheduled Commercial Banks' advances to priority sectors and the related ratios are exclusive of Regional Rural Banks
4. For working out cash deposit ratio, cash is taken as the total of cash in hand and balances with the Reserve Bank of India.

4) Specialized Branches for Agricultural Lending

The nationalized banks have set up specialized branched to deal with rural credit. These branches were established to overcome the practical difficulties relating to man power, high cost of operation and follow up of loans given to the farmers.

A few examples of specialised branches are:

a) Agricultural Development Branches (ADB-State Bank of India).
b) Gram Vikas Kendra (GVK)- Bank of Baroda.
c) Gramodaya Kendra (GK)- Indian Bank.
d) Rural Service Centres (RSC)- Dena Bank.
e) Farm Clinic Centre- Syndicate Bank.
f) Rural Credit and Development Division-Indian overseas Bank.

5) Schematic Lending

Under schematic Lending credit is extended directly under Government schemes such as Integrated Rural Development Programme (IRW), Special Rice production Programme (SRPP), Biogas Scheme, Massive Agricultural Production Programme (MAPP). The subsidy portions under these loans were reimbursed to the banks by the government. Loans under schematic lending may either be a short or a term loan.

6) Multi-Agency Approach

The Multi-Agency Approach was adopted as an overall national policy since 1970 as no single agency had the necessary organizational structure or financial strength to meet the total credit requirements of farmers.

Multi-agency approach to finance agriculture was accepted based on the recommendation of All India Rural Credit Review Committee (1969). The committee observed that the co-operatives alone, though they had increased their coverage since 1950 both in terms of membership and finance provided, would not be in a position to meet the increasing requirements of credit. The committee also pointed out that a large number of PACS are not viable and therefore these could be regarded as inadequate and unsatisfactory agencies for the distribution of production credit. It was of the view that both commercial banks and co-operative credit societies can play a complementary role without getting, into conflict with each other.

At present, many agencies, viz., commercial banks, co-operative credit societies and Regional Rural Banks, are significantly operating in the field of agricultural finance.

Problems

RBI constituted a working group in 1976 under the chairmanship of C.E,Kamath to go into the problems of inefficiency in disbursal of credit under multiagency approach in agricultural financing. The main findings were:

a. The existence of a number of financing agencies in a common area of operation and disbursement of credit in an uncoordinated manner have led to multiple financing, over- financing, tinder financing and diversion of loan amount to unproductive purposes.
b. Credit agencies could not formulate a meaningful agricultural development plan on an area basis
c. Recovery of loans becomes difficult as more than one credit agency claim, on the same income/security.

d. Problems arise due to different systems, procedures and policies in lending *by* different agencies. Differences exist in the spheres of timeliness in sanctioning credit, sanctioning powers, security norms, service and supervisory charges, recovery performance and procedures *etc.*

7) Area Approach

Lead bank scheme was launched based on the recommendations of the Gadgil study Groin of National credit council constituted in 1968 for suggesting an organizational frame work for the implementation of social objectives aimed at identifying territorial and functional credit gap and of making recommendation for the extension of institutional credit.

The scheme was introduced in 1969. Under this scheme, each district has been allotted, to a prominent commercial bank in the district and it will play a lead role in promoting the development schemes in co-ordination with other banks and the central and state Government agencies, the twin objectives of the Lead Bank Scheme are:

i) to launch a programme of rapid branch expansion particularly in unbanked and under banked areas; and

ii) to ensure adequate flow of institutional credit to the neglected and weaker sections of the community to fill up spatial and sectoral credit gaps.

After the introduction of this scheme, the population per bank office has come down from 65,000 in 1969 to 12,000 in 2013.

Regional Rural Banks

The need for evolving a hybrid type of credit agency which combines the resource orientation of the commercial banks and the rural orientation of the co-operatives has been expressed in the reports of a few of the committees which have looked into rural credit problems.

To review the flow of institutional credit especially to the weaker sections of the rural community, the Government of India appointed a working Group in 1975 under the **chairmanship of Narasimhan**. The Group identified Certain deficiencies in the functioning of Co-operatives and commercial banks and recommended the setting up of state-sponsored, regionally based and rural oriented banks called Regional Rural Banks (RRBs) which would encompass local feel and familiarity with several problems which the co-operatives possess and the degree of business organisation, ability to mobilise the deposits, access to central money markets and a modernised outlook which the commercial banks have. The Government of India accepted this recommendation and RRBs were established in 1976.

The main objective of RRB is to provide finance to small and marginal farmers, agricultural labourers, artisans and small entrepreneurs whose annual income is less than Rs.10,000.

Features

The idea behind the establishment of RRBS is to develop a comparatively backward area where the commercial bank and co-operative is relatively poor. The main difference from the commercial bank is that the area of operation of RRB is confined to a region comprising one or two contiguous districts. One of the tasks envisaged for the RRBs is to maintain their cost of operations at a lower level than that of the commercial banks. So the salary structures of the staff were comparable to that of the state Government employees.

RRBs are sponsored by schedule commercial banks. A few non-public sector commercial banks and state co-operative Banks are also allowed to sponsor RRBs. The sponsoring bank provides managerial assistance to RRBs for the first five years. The management of RRB is through a nine member Board of Directors headed by a chairman who is an officer of the sponsor bank. The Board consists of three nominees of Government of India, two nominees of the concerned State government, four including the chairman by the sponsor commercial bank.

The authorized share capital of a RRB has been fixed at Rs.5 crore and issued capital is Rs. One Crore. Of this, 50 per cent is subscribed by the central government, 15 per cent by the concerned state government and 35 per cent by the sponsor bank.

Performance

As scheduled banks, they mobilize deposits and they have been allowed to offer slightly higher rate of interest, i.e., 0.5 per cent per annum, on their deposits up to five years.

RRBs have been advised to render other banking services like collection of cheques and bills, issue of drafts, collection of insurance premia, safe custody etc.

Table 7.Progress of RRBs in India

Sl.No.	Particulars	1976	1980	1988	1990	2013
1.	Number of RRBs	40	85	196		64
2.	Number of branches	489	3279	13350	14315	105813
3.	Deposits (Rs.in crores)	7.72	199.83	2305.82	3988.04	196422
4.	Advances (Rs.in crores)	7.02	243.38	2232.26	3525.08	129936
5.	Number of loss making banks	23	60	149	NA.	NA

Source: Statistical Tables relating to Banks in India 2012-2013, Reserve Bank of India bulletin, March 2013

Table 8.Purpose-wise Break up of RRB advances (Percent)

Sl.No.	Purpose	1987	2013
1.	Agriculture	57.7	52.8
2.	Rural artisans, village and cottage industries	6.2	2.4
3.	Retail trade and self employment	27.2	24.0
4.	Consumption loans/other purposes	8.9	20.8
	Total	100.0	100.0

Source: Statistical Tables relating to Banks in India 2012-2013, Reserve Bank of India bulletin, March 2013

Table 9. Indicators of Performance of RRBs (@As on 31 March of given year)

Sl.No.	Particulars	2013	2014@
1.	No. of RRBs	64	57*
2.	Branch Network(No)	17,861	19,082
3.	Share Capital	197	197
4.	Share Capital Deposit	6,001	6,170
5.	Reserves	13,247	15,736
6.	Deposits	2,11,488	2,39,504
7.	Borrowings	38,073	51,736
8.	Investments	1,08,548	1,10,514
9.	Loans & Advances Outstanding	1,37,078	1,59,660

10.	RRBs earning Profit (No)	63	57
11.	Amount of Profit (A)	2,275	2,833
12.	RRBs incurring Losses (No)	1	0
13.	Amount of Losses (B)	2.07	0
14.	Net Profit of RRBs(A-B)	2,273	2,833
15.	Accumulated Losses	1,091	903
16.	RRBs with accumulated Losses (No)	11	8
17.	Recovery (%) (As on 30 June)	81.2	81.9
18.	NPA to loans outstanding (%)	6.1	4.4
19.	Net worth	18,355	21,199

Source: NABARD Annual Report 2013-2014

* Some of the RRBs were amalgamated

Problems:

i) There is a lack of managerial efficiency due to larger area of operation. Some RRB cover 10-15 lakh population
ii) Lack of uniform guidelines for recruitment and promotion.
iii) The number of loss making banks in 1976 was 23 and it rose to 149 in 1988. The accumulated loss of RRB was Rs.550 crores (1991) which was more than their entire paid up capital and reserves.
iv) Lack of both the expertise of commercial banks and local feel of the co-operatives.
v) RRBs could not meet the credit needs of non-farm sector effectively.

The Committee set up by the RBI in 1977 under the chairman ship of M.L.Dantwala to review the working of the RRBs recommended that RRBs should be extended to such areas where DCCBs are not able to adequately serve the PACS under their jurisdiction. The CRAFICARD (1981) recommended that the RBI may transfer the business of commercial banks rural branches to RRBS when such proposals are presented.

The Kalyanasundaram committee (1986) was appointed to study the wage structure and service conditions of the RRB staff.

The Agricultural credit Review committee (ACRC) headed by Prof. Khusro in 1989 recommended that the RRBs and their branches can be merged with their sponsor banks due to the following reasons:

a) The performance of commercial banks in rural lending in terms of branch expansion and recruiting technically qualified staff for rural branches is better than RRBs.

b) The accumulated loss and over dues of RRB were very heavy.

However, the Government of India has decided not to merge the RRBs with sponsor banks. Instead the government has decided to implement the recommendations of the Kelkar committee (1986) in a bid to revive these banks.

Subsequent to review of the financial status of RRBs by the Union Finance Minister in August, 2009, it was felt that a large number of RRBs had a low Capital to Risk weighted Assets Ratio (CRAR). A committee was therefore constituted in September, 2009 under the Chairmanship of K C Chakrabarty, Deputy Governor, RBI to analyse the financials of the RRBs and to suggest measures including re-capitalisation to bring the CRAR of RRBs to at least 9% in a sustainable manner by 2012. The Committee submitted its report in May, 2010. The following points were recommended by the committee:

- RRBs to have CRAR of at least 7% as on 31 March 2011 and at least 9% from 31 March 2012 onwards. recapitalisation requirement of Rs. 2,200.00 crore for 40 of the 82 RRBs. This amount is to be released in' two installments in 2010-11 and 2011-12.
- The remaining 42 RRBs will not require any capital and will be able to maintain CRAR of at least 9% ifs on 31st March 2012 and thereafter on their own.
- A fund of Rs. 100 crore to be set up for training and capacity building of the RRB staff.

The Government of India recently approved the recapitalization of Regional Rural Banks (RRBs) to improve their Capital to Risk Weighted Assets Ratio CRAR) in the following manner:

- Share of Central Government i.e. Rs.1, 100 crore will be released as per provisions made by the Department of Expenditure in 2010-11 and 2011-12. However, release of Government of India share will be contingent on proportionate release of State Government and Sponsor Bank share.
- A capacity building fund with a corpus of Rs.100 crore to be set up by Central Government with NABARD for training and capacity building of the RRB staff in the institution of NABARD and other reputed institutions. The functioning of the Fund will be periodically reviewed by the Central Government. An Action Plan will be prepared by NABARD in this regard and sent to Government for approval.
- Additional amount of Rs. 700 crore as contingency fund to meet the requirement of the weak RRBs, particularly those in the North Eastern. and Eastern Region, the necessary provision will be made in the Budget as and when the need arises.

Currently, RRB's are going through a process of amalgamation and consolidation. 25 RRBs have been amalgamated in January 2013 into 10 RRBs. As on March 2013, 64 RRBs are functioning in India (RBI Bulletin, 2013)

Lecture No 7: Lead bank: Role and Functions, Preparation of District Annual Credit Plan and Scale of finance, Kisan Credit Card (KCC) Scheme and Know Your Customer (KYC) - Rural credit policies followed by State and Central Government – Subsidized farm credit, Differential Interest Rate (DIR) Scheme – Relief Measures and Loan Waiver Scheme.

Under area approach lead bank scheme was launched based on the recommendations of the Gadgil study Groin of National credit council constituted in 1968 for suggesting an organizational frame work for the implementation of social objectives aimed at identifying territorial and functional credit gap and of making recommendation for the extension of institutional credit.

The scheme was introduced in 1969. Under this scheme, each district has been allotted, to a prominent commercial bank in the district and it will play a lead role in promoting the development schemes in co-ordination with other banks and the central and state Government agencies, the twin objectives of the Lead Bank Scheme are:

i) to launch a programme of rapid branch expansion particularly in unbanked and under banked areas; and
ii) to ensure adequate flow of institutional credit to the neglected and weaker sections of the community to fill up spatial and sectoral credit gaps.

After the introduction of this scheme, the population per bank office has come down from 65,000 in 1969 to 12,000 in 2013.

Function of the Lead Bank

a. it acts as a consortium leader among the bank branches functioning in the district
b. It undertakes surveying, of credit needs, development of branch banking and expansion of credit to weaker and neglected sections of the society. For this purpose, the District credit plan (DCP) is prepared by the lead bank. DCP is prepared in line with the development strategy worked out for the district by the government and national plan objectives. After the preparation of credit plan, credit plan targets are allotted among different financial institutions in the districts.

A credit plan is development plan consisting of technically feasible and economically viable schemes which can be taken up for financing by financial institutions. These schemes are **drawn based** on the natural resources, principal economic activities, aspirations and skill of the people etc. in the district.

c. The scheme can correct the regional imbalances in the credit deployment.
d. This scheme can estimate the credit gaps in the various sectors of the economy of each district.
e. It maintains liaison with other banks, government and quasi-government agencies to implement various development programmes in the district.

District Consultative Committee (DCC)

It is an important forum at the grass root level for the co-ordination of the activities of the financial institutions. Meetings will be convened once in three months. The members of DCC Are representatives from Lead Bank, commercial banks (including co-operatives / LDB) operating in that area, officials of the development Departments and NABARD. The district collector is the chairman.

The functions of DCC are:
i) Allocation of credit plan targets among various financial institutions.
ii) Monitoring the implementation of the credit plan,
iii) Serving as a forum for discussing the development needs of the district.

State Level Bankers Committee

It functions as a clearing house for the issues emerging from the discussions of the DCCs. RBI is closely associated with **the** state Level Bankers Committee.

Constraints in the Lead Bank Scheme

i) The district credit plan is formulated on the basis of existing infra-structural facilities and on the assumption of future development plans as envisaged in the five year plans (FYP). But there is delay in the development of such infrastructural facilities.

ii) Non-availability of raw materials and escalation of their costs affect the technical and economic feasibilities.

iii) The execution of this programme is not the exclusive responsibility of the Lead bank. Other banks are equally responsible for the implementation of the programme. Under such circumstances, lack of co-ordination among lending and other development agencies affect the implementation of various programmes.

b) Village Adoption Schème (VAS)

Village Adoption Scheme was first conceived by State Bank of India with an intension to finance small farmers under the area approach strategy. The scheme aims at deriving, in full, the advantages accruing from concentrated and coordinated efforts in areas with significant agricultural development potential and having a large number of small and marginal farms. It is for the bank to take special interest in the development of the village it has adopted, in co-ordination with other agencies functioning in that area. The banks have to undertake detailed survey of the village and prepare development plans. These plans have to be implemented with constant follow-up action. And the banks have to evaluate the performance of productive activities for which loan are given.

C) Service Area Approach

With a view to improve the linkage between the bank credit and its objectives viz., increasing the production, enhancing the productivity of resources and raising the income of rural population, the RBI advised the chief Executives of public sector banks to personally carry out field visits in rural areas of different districts all over the country. A seminar by the top executives of banks and GOI was held in January 1988 wherein it was decided to launch the service Area Approach (SAA) and hence SAA was commenced from April 1, 1989.
Stages of SAA
i Identification of the service area for each bank branch:
ii.) Survey of the villages in the Service Area.
iii) Preparation of credit plan on an annual basis for the service area by each branch

8) Capital Rationing

Capital Rationing refers to allocation of scarce capital resources among competing ends. The conceit of credit rationing is applicable to borrower and lender. The tendency of the lender to limit the amount of credit provided to the farm business is known as external capital rationing. Likewise, the borrower also adopts capital rationing with his limited capital to derive maximum returns from the alternative investment choices. This is called internal capital rationing.

9) Instant Credit Scheme

This scheme was introduced during 1991 with the aim of providing credit without any delay to the persons who repay the loans regularly. Under this scheme, green card is issued to those members who had repaid the loan promptly in the last three years. By showing the green card, the member can avail the credit immediately without waiting for the sanction of loan by the concerned officials. It is expected that this system will induce the farmers to repay the loan promptly and avail fresh to loans without any delay. The possession of the green card will also give a social status.

10) Crop Production Loan

Crop Production loans are granted by the financing institutions for growing crops. This loan amount depends on the input requirements of the crop and hence it varies with the crop. The loan was first introduced in 1950 in the erstwhile Bombay State. Later it was introduced throughout the country based on the recommendations of All India-Rural Credit Survey Committee (1954) and the Committee on co-operative credit (1960). At present, all financing institutions provide crop loan.

Scale of Finance

A scale of finance per acre for different crops is determined on the basis of cost of cultivation. Scale of finance is the credit limit fixed for each crop based on its cost of cultivation. If includes both cash and kind. It is revised once in a year. Since the cost of cultivation varies with the region and time uniform scale of finance could not be adopted.

The disbursement of loan is made in cash and kind. A major part of the loan is disbursed in the form of inputs such as improved seeds, fertilizers and pesticides which ensures its proper utilization. The repayment of loan is so fixed as to enable the farmer to repay the loan after marketing the produce. Wherever facilities are available the credit is linked with marketing to enable the farmer to get better price for his produce. The banker could also easily recover the loan. The crop loan is issued either by hypothecating the crop to the lending institution or based on the personal security of the farmer.

Kisan Credit Card (KCC)

Provision of timely and adequate credit has been one of the major challenges for banks in India in dispensation of agricultural and rural credit to the farmers. Constant innovation is required in order to achieve the aim. Agricultural credit cards are not a new concept in the field of agricultural banking in India. The scheme had already been introduced in a number of public sector banks in a few states much earlier. These schemes were niche-marketed and were exclusively preserved for the privileged class of farmers and the small and marginal farmers did not have much access to them.

Similarly cash credit facilities were being extended by several public sector banks and cooperative banks to farmers with the view to improving their access to credit. Again this scheme was used only selectively. The KCC scheme was started by the Government of India (GOI) in consultation with the RBI (Reserve Bank of India) and NABARD (National Bank for Agricultural and Rural Development) 1998-99 to join the features of both these schemes and to overcome their shortcomings.

The features of the scheme at a glance are:

- Type of revolving cash credit facility with unlimited withdrawals and repayments.
- Meet the production credit need, cultivation expenses, and contingency expenses of the farmers.

- Limits based on the basis of operational land holding, cropping pattern and scale of finance. This limit is inclusive of 20% of production credit.
- Each withdrawal to be paid within 12 months.
- Card valid for 3 years subject to annual renewals.
- Credit limits can be enhanced depending on performance and needs.
- Rescheduling is also possible depending upon the situation. If for example the crops fail due to a natural calamity and the farmer is not able to repay his loan, then he could get an extension of upto four years.
- Cash withdrawals through slips accompanied by card and passbook.
- A credit cum passbook would be issued.
- All branches engaged in agricultural lending could issue Kisan Credit Cards.

Eligibility

Borrowers with good track record over the past 2 years would be the prime customers. New borrowers could also be included if they could get proof of operational land holding from the *Patwari* (Village Administrative Officer).

Target group

Short-term crop loans required by existing/new borrowers

Selection methodology

The farmer would be evaluated by the bank, on financial grounds by looking at his past record with the bank, and on personal grounds by looking at his reputation in the village.

Fixation of credit limit

The credit limit under the card may be fixed on the basis of the operational land holding, cropping pattern and the scale of finance by the District Level Technical Committee (DLTC) and SLTC. If the limit has not been fixed by the DLTC / SLTC or the limit in the opinion of the bank is low, appropriate scale of finance for the crop may be fixed by the bank.

Validity and repayment schedule

A card once issued would be valid for a period of 3 years. The facility may be extended, the amount enhanced or cancelled, depending on the performance of the farmer. Repayments are to be made within 12 months of taking the credit.

Margin

- For loan amount upto Rs. 10,000: NIL
- For amount over Rs. 25,000: 15% to 25%

Collateral

- Loan Amount security to be furnished
- Upto Rs. 10,000 DPN (demand promissory note) / loan agreement is needed only
- Rs. 10000 and upto Rs. 25,000 Hypothecation of crops is required.
- Above Rs. 25,000 Hypothecation of crops and mortgage of land (or) third party guarantee is needed

Interest

This is subject to change. Amount of Interest for Repayment period:

Upto one year Exceeding one year

- Upto Rs. 25,000 11 % 11 %
- Above Rs. 25,000-Rs. 2,00,000 12 % 12 %
- Above Rs. 2,00,000-Rs. 25,00,000 13.5% 13.5%
- Rs. 25,00,000 and above - (Depending on Credit Risk Rating) 13.25% to 15.5%

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Table 10. Number of Kisan Credit Cards issued Agency Wise (Number in Lakhs)

Year	Co-operative Banks		Regional Banks		Commercial Banks		Total	
	Number	Percentage	Number	Percentage	Number	Percentage	Number	Percentage
1998-99	1.55	19.80	0.06	0.77	6.22	79.44	7.83	100.00
1999-00	35.95	70.02	1.73	3.37	13.66	26.61	51.34	100.00
2000-01	56.14	64.89	6.48	7.49	23.90	27.62	86.52	100.00
2001-02	54.36	58.20	8.34	8.93	30.71	32.88	93.41	100.00
2002-03	45.79	55.55	9.64	11.69	27.00	32.76	82.43	100.00
2003-04	48.78	52.76	12.74	13.78	30.94	33.46	92.46	100.00
2004-05	35.56	36.73	17.29	17.86	43.96	45.41	96.81	100.00
2005-06	25.98	32.43	12.49	15.59	41.65	51.98	80.12	100.00
2006-07	22.98	27.00	14.06	16.52	48.08	56.48	85.12	100.00
2007-08	20.91	24.69	17.72	20.92	46.06	54.39	84.69	100.00
2008-09	13.44	15.64	14.14	16.46	58.34	67.90	85.92	100.00
2009-10	17.43	19.36	19.49	21.64	53.13	59.00	90.05	100.00
2010-11	28.12	27.66	17.74	17.45	55.82	54.90	101.68	100.00
2011-12	26.61	23.22	19.95	17.41	68.04	59.37	114.60	100.00
2012-13	26.91	20.73	20.48	15.78	82.43	63.50	129.82	100.00
Total	460.51	35.90	192.35	14.99	629.94	49.11	1282.80	100.00
EGR	1.57%		26.37%		14.27%		9.39%	

Source: Report on Trend and Progress of Banking in India, RBI, Mumbai, various issues

Table 11. Amount Sanctioned through Kisan Credit Cards Agency Wise (Rs. In Crores)

Year	Co-operative Banks		Regional Banks		Commercial Banks		Total	
	Number	Percentage	Number	Percentage	Number	Percentage	Number	Percentage
1998-99	826	35.76	11	0.48	1473	63.77	2310	100.00
1999-00	3606	47.77	405	5.37	3537	46.86	7548	100.00
2000-01	9412	57.30	1400	8.52	5615	34.18	16427	100.00
2001-02	15952	61.93	2382	9.25	7424	28.82	25758	100.00
2002-03	15841	60.28	2955	11.25	7481	28.47	26277	100.00
2003-04	9855	45.24	2599	11.93	9331	42.83	21785	100.00
2004-05	15597	45.62	3833	11.21	14756	43.16	34186	100.00
2005-06	20339	42.73	8483	17.82	18779	39.45	47601	100.00
2006-07	13141	28.12	7373	15.78	26215	56.10	46729	100.00
2007-08	19991	22.65	8743	9.91	59530	67.45	88264	100.00
2008-09	8428	15.88	5648	10.64	39009	73.48	53085	100.00
2009-10	7606	13.19	10132	17.57	39940	69.25	57678	100.00
2010-11	10719	14.76	11468	15.79	50438	69.45	72625	100.00
2011-12	10640	11.61	11520	12.57	69510	75.83	91670	100.00
2012-13	11922	9.44	13263	10.50	101095	80.06	126280	100.00
Total	173875	24.21	90215	12.56	454133	63.23	718223	100.00
Mean	11592		6014		30276		47882	
EGR	8.26%		38.44%		30.44%		23.39%	

Source: Report on Trend and Progress of Banking in India, RBI, Mumbai, various issues

The scheme was revised in 2012 to make room for ATM enabled debit card, operation thorugh wider delivery channels including mobile handsets, in-built cost escalation for assessing limits, wider coverage under crop loans, etc., During 2013-14 upto August 2013, 10.78 lakh cards were issued by Cooperative banks and the amount outstanding was 3,124.51 crore. During the same period RRBs had issued 7.83 lakh cards with outstanding amount of 6,184.50 crore (NABARD, Annual Report 2013-14).

Differential Rate of Interest

The Different Rate of Interest Scheme was introduced in 1972 based on the recommendations of a RBI committee headed by R.K. Hazari to overcome the limitation of the interest rate policy on account of its general and in indiscriminate nature. The Government of India has formulated a scheme for extending financial assistance at concessional rates to selected low income groups for productive endeavours.

The salient features of the scheme as on 31.03.2009 are as under:

1. Eligibility Criteria

i) Family income of the borrower from all sources does not exceed Rs.18000/- in Rural area and Rs. 24000/- in Urban and Semi urban area per annum.
ii) Land holding not to exceed 1 acre of irrigated land or 2.5 acres of nonirrigated land.
iii) SC/ST borrowers are eligible for finance irrespective of their land holdings
iv) The applicant should not be assisted under any of the subsidy linked schemes of Central/State Government and State owned corporation.
v) Physically handicapped persons pursuing a gainful occupation
vi) Indigent students of merit going in for higher education who do not get scholarships /maintenance grants from Governmental or educational authority

2. Institutions

Following institutions are eligible for credit under the Scheme:
i) Orphanages and women's homes where saleable goods are made and for which no adequate and dependable source of finance e.g., endowments or regular charities, exist.
ii) Institutions of physically handicapped persons pursuing a gainful occupation where some durable equipment and/or continuous supply of raw material is useful.

3. State Corporations for Scheduled Castes and Scheduled Tribes

Banks may route credit under the scheme through State Corporations for the welfare of Scheduled Caste and Scheduled Tribes subject to the beneficiaries of the corporation meeting the eligibility criteria indicated in para 1 and other terms and conditions indicated in the scheme.

4. Quantum of Loan

i) For House Loan Purpose : Rs 20000.00
ii) For Others Purpose : Rs 15000.00

5. Target

Minimum of 40% of DIR advances to SC/ST beneficiaries. 2/3rd of the advances should be routed through Rural/Semi urban branch. Overall target for the Bank: 1% of the total advances of the bank as on previous year.

6. Lending to Artisans under DRI

i) Rural Branches : 10 loans per quarter per branch
ii) Semi-Urban/Urban Branches : 5 loans per quarter per branch

7. Subsidy : NIL

8. Margin : NIL

9. Rate of Interest : 4% p.a. at Simple rate

10. Security: Hypothecation of assets created by bank loan. No collateral security is required

11. Repayment : 5 years including moratorium period

12. Moratorium period : Suitable moratorium period may be considered.

13 Selection of beneficiary: By Field Staff

14. Insurance : No insurance except for live stock. If considered necessary, the premium amount should be borne by the Bank.

15. Extend lending under DRI scheme to non-SGSY SHGs provided all the members of SHG meets individually the eligibility and other criteria under DRI lending. The lending to SHGs will be at 4% p.a.

Agricultural Debt Relief Scheme / Loan Waiver Scheme:

Under the Government of India's Agricultural and Rural Debt Relief (ARDR) scheme, 1990, rural borrowers were provided relief by way of waiver / write- off their dues in default as on laid October, 1989. The extent of relief varies from state to state. In Tamilnadu, it was upto Rs10,000. The responsibility of providing relief to defaulters of co-operatives was entrusted to the state governments with the central assistance in accordance with the guidelines issued by the NABARD.

To avail this facility, the farmers have to produce the anawari certificate issued by Tahsildar. The extent of debt relief provided is given below: The agricultural debt waiver scheme announced in 2008 completely waived small and marginal farmers agricultural credit distributed after march 2007.

The general impact of this scheme is as follows:

- Though the scheme has helped the farmers who have been affected by natural calamities, it has increased the number of willful defaulters i.e., it has accentuated the problem of recovery of loan.
- It has resulted in inadequacy of capital for normal business.
- It has put a heavy financial burden to the government.

So the government has to take a policy decision that the relief measures would benefit only by those who are really affected by natural calamities.

Rural Credit Policies

Advantages of institutional Lending

i) The mobilization of deposits and their allocation to sector and projects can be controlled / monitored by the government.

ii) The terms and conditions of credit can be made favourable to farmers especially to weaker sections of the rural area so as to prevent the exploitation of farmers by private lending agencies.

iii) The farmers can avail the professional expertise available at the institutional agencies.

Problems

1. Marginal farmers and agricultural labourers received very less benefits from institutional agencies.

2. One of the major lacunas of IRDP was the wrong identification of beneficiaries in order to achieve the targets quickly and this had made the whole programme unproductive, creating further problems for both the bankers and borrowers.

3. Subsidy has to be passed on to the borrower only after the successful completion of the project, however, in practice, subsidy is given along with loan and this results in the misuse by unscrupulous borrowers, sources of credit.

4. Poor recovery of loans affects the functioning of institutional lending agencies.

Vaidyanathan: Comments on rural credit policies

- Increased credit supply [indebtedness] may not lead to increase in agricultural productivity
- Private capital formation without concurrent effect on economics of agriculture is worrying
- If credit is not appropriately directed, it might lead to deep indebtedness and distress
- Focus on public capital formation and infrastructure to address the problem of productivity

Lecture No 8: Higher financial institutions: RBI, NABARD, AFC, ADB, World Bank and Deposit Insurance and Credit Guarantee Corporation of India: Role and their functions in rural credit.

Reserve Bank of India

The Reserve Bank of India (RBI) was established in April 1, 1935 in accordance with the provisions of the RBI Act, 1934. The Agricultural credit Department (ACD) was organized in 1935 to co-ordinate the Bank's operations with State Co-operative Banks and other banks and organization dealing with agricultural credit. Financing agriculture by commercial banks is looked after by the Department of Banking Operations and Development (DBOD) while ACD continued to take care of co-operative credit may be viewed from three aspects:

a) Provision of finance
b) Promotional Activities
c) Regulatory functions

a) Provision of Finance:

RBI extends short, medium and long-term credits to agriculture through co-operative channels. The bulk of the credit granted by the RBI is related to short-term to meet seasonal agricultural operations. The RBI Act was amended in 1955 to provide for the establishment of two funds, viz., the National Agricultural credit (Long Term Operation) fund and National Agricultural Credit (Stabilization) fund. The three components of medium-term credit are: a) loans for purchasing shares in co-operative processing societies, b) loans for agricultural and other allied purposes, including animal husbandry and pisiculture and c) conversion of short-term agricultural loans into medium term loans when repayment becomes difficult due to natural calamities. While the first two a) and b) are financed out of the NAC (LTO) fund and the c) (Last one) is out of NAC (stabilization) fund. The RBI provides long-term credit as loans to the state governments for contribution to the share capital of the co-operative credit institutions and to NABARD. The RRBs get refinance facility from the RBI up to 5o per cent of their outstanding advances.

b) Promotional Activities:

Under rehabilitation programme, most of the cooperative banks have attained viable status. The study Teams appointed by the RBI have given constructive suggestions to reorganise the co-operative structure on sound lines. The RBI evolved a scheme to finance the weak PACS by commercial banks. It initiated the lead Bank Scheme in 1969 and its impact is seen branch expansion and other activities of the commercial banks. It advised the banks to participate effectively in the Integrated Rural Development Programme and extend loans to the weaker sections.

C. Regulatory Functions:

As a lender, the RBI not only concerns itself with the quantity of credit but also attempts to improve the quality of credit extended and also the efficiency of the channels through which it is provided to the rural sector. The RBI frames the overall credit policy on the basis of the credit needs of agriculture. Limits to credit institutions are fixed by taking into account the demand for credit and not just arbitrarily. The cash / liquidity ratios applicable to co-operatives are lower than those fixed for commercial banks. The co-operatives are enabled to borrow from the RBI at an interest rate which is three per cent below the bank rate in respect of crop loans. They are also permitted to pay slightly higher rates of interest on their deposits. The refinancing functions of RBI relation to rural credit were taken over by NABARD after its formation in 1982.

Agricultural Refinance and Development Corporation (ARDC)

The inadequacy of institution finance with regard to long-term credit was brought to light by the committee on co-operatives credit (1960). So it was recognized that the country needed a refinance body with adequate resources of money and to co-ordinate, guide and assist the long term credit lending institutions. Thus, the Agricultural Refinance Corporation (ARC) was established on 1 July, 1963 under the Agricultural refinance Corporation Act of 1963 for granting medium and long-term credit by way of refinance. In order to emphasize the development and promotional role of the corporation, it was renamed as Agricultural Refinance and Development Corporation (ARDC) in 1975. It was largely meant to refinance, assist and guide State Land Development Banks. In due course, it extended assistance to commercial banks and the state co-operative banks. This corporation was taken over by NABARD in 1982.

National bank for Agriculture and Rural Development (NABARD)

On the basis of the views expressed by the All India Rural credit Review Committee (1969), the Administrative Reforms Commission (1970) , the banking Commission (1972), and the National Commission on agriculture (1976), the Committee to Review the Arrangements for Institutional credit for Agriculture and Rural Development (CRAFICARD) appointed by the RBI under the chairmanship of B. Sivaraman in 1979 considered the desirability and the feasibility of establishing a national bank for rural development in the context of integrated rural development. While examining the activities of the ARDC and the RBI in the delivery of rural credit against massive credit needs for rural development over the coming years, the CRAFICARD felt that the present national level institutions had certain deficiencies affecting their capacity to meet the stupendous task of integrates' rural development aimed at the uplift of the weaker sections in the rural areas within a given time horizon. The committee recommended for the establishment of NABARD and hence it was started, functioning since 12th July 1982.

As such it has replaced by merging in itself, the ARDC and the two credits related constituents of the RBI, namely Agricultural Credit Department and the Rural Planning, dealt with by DBOD, was placed under the charge of the RPCC in 1979). Thus, NABARD is conceived as an exercise of decentralization of the RBI's functions relating rural credit and that it would take over the ARDC and the refinancing functions of RBI in relation to state co-operative banks and RRBs.

Resources

The share capital of NABARD is Rs. 100 crores and is held by the RBI and GOI in equal proportion. The NABARD draws funds from the RBI for its short-term operations and for long-term operations, it draws from the Government of India, floats bonds in the open market and also draws from its National Agricultural credit (Long Term operations) Fund and National Agricultural Credit (stabilization) Fund . The NABARD is also authorized to accept deposits with maturity period of not less than twelve months from the central and state Governments, local authorities, scheduled banks etc. and also to borrow foreign currency with the approval of central government.

Management: The management of NABARD is vested with a 15 member Board of management which consists of a chairman, a managing Director and 13 Executive Directors. The chairman is the ex-officio Deputy Governor of RBI. The managing Director is the Chief Executive of the Bank with operational responsibility for the performance of various tasks. The Executive Director will be in charge of each of the major functional divisions i.e., two Directors from central Government, three sitting Directors from co-operative and commercial

Banks and two experts on rural economy and rural development. The Board of Directors can constitute an Advisory Council.

The two Directors from state Governments will be appointed by rotation to give representation to five Zones, Viz., Northern, Southern, Eastern, Western and North-Eastern. NABARD will be, thus, broadly divided into five zones with its head quarters at Bombay and 16 regional offices located in i) Jammu ii) Chandigarh iii) Lucknow, iv) Patna, v) Gauhati, vi) Kolkata, vii) Bhubaneshwar viii) Hyderabad, ix) Bangalore, x) Chennai Xi. Trivandram, xii) Bombay xiii) Indore, xiv) Ahmadabad xv) New Delhi and xvi) Jaipur.

Functions of NABARD

1. Provision of Finance

NABARD provides different types of refinance to the eligible institutions.

a. Short term credit: The eligible institutions are State co-operative Banks, Regional Rural Banks and other financial institutions approved by RBI. The purposes are seasonal agricultural operations and marketing of crops, marketing and distribution of inputs like fertilizers, pesticides, etc., production and marketing activities of artisans small scale industries, village and cottage industries, any other activity connected with agricultural / rural sector. The period is up to 18 months

b. Medium term credit: The eligible institutions are state cooperative banks, State Land Development Banks, Regional Rural Banks and other financial institutions approved by RBI. The purposes are any investment connected with agriculture and rural sector requiring MT credit assistance. The period is between 18 months and 7 years.

C. Long term credit: The eligible Institutions are State Cooperative Banks (SCB), State Land Development Banks, Regional Rural Banks, Commercial Banks and other financial institutions approved by RBI. The period available is upto to a maximum of 25 years.

The purposes of long term credit are:

i. Refinance for investment in agriculture and allied activities such as minor irrigation, land development, soil conservation, dairy, sheep, poultry, piggery, farm mechanization, plantation/horticulture, forestry, fishery, storage and market yards etc.
ii. Refinances loans meant for artisans, small-scale industries, village and cottage industries and others (non-farm sector)
iii. Loans to state government for contributing share capital to co-operative institutions.

2. Development Functions

- Co-ordinates operations of rural credit institutions.
- Assists governments, RBI and other institutions in rural development efforts.
- Contributes to the share capital and securities of eligible institutions concerned with agriculture and rural development.
- Assists state government to enable them to contribute to the share capital of eligible institutions.
- Frames overall rural credit policies
- Provides facilities for training, research and dissemination of information in the fields of rural banking, agriculture and rural development.
- Undertakes the inspection of RRBs and co-operative credit institutions.

3. Supervisory Functions

- To protect the interest of the present and future depositors
- To ensure that the business conducted by these banks is in conformity with the provisions of the relevant Acts/Rules, regulations/Bye-Laws
- To ensure observance of rules, guidelines, etc., formulated and issued by NABARD / RBI/ Government
- To examine the financial soundness of the banks and

- To suggest ways and means for strengthening the institutions so as to enable them to play more efficient role in purveying rural credit

Deposit Insurance and Credit Guarantee Corporation (DICGC)

The concept of insuring deposits kept with banks received attention for the first time in the year 1948 after the banking crisis in Bengal. Subsequently, in the year 1950, the Rural Banking Enquiry Committee also supported the concept. Serious thought to the concept was, however, given by the Reserve Bank of India and the Central Government after the crash of the Palai Central Bank Ltd., and the Laxmi Bank Ltd. in 1960. The Deposit Insurance Act, 1961 came into force on January 1, 1962.

The Deposit Insurance Scheme was initially extended to functioning commercial banks only. This included the State Bank of India and its subsidiaries, other commercial banks and the branches of the foreign banks operating in India. Since 1968, with the enactment of the Deposit Insurance Corporation (Amendment) Act, 1968, the Corporation was required to register the 'eligible co-operative banks' as insured banks. Further, the Government of India, in consultation with the Reserve Bank of India, introduced a Credit Guarantee Scheme in July 1960. The Reserve Bank of India was entrusted with the administration of the Scheme and was designated as the Credit Guarantee Organization (CGO) for guaranteeing the advances granted by banks and other Credit Institutions to small scale industries. The Reserve Bank of India operated the scheme up to March 31, 1981. The Reserve Bank of India also promoted it as public limited company on January 14, 1971, named the Credit Guarantee Corporation of India Ltd. (CGCI).

The main thrust of the Credit Guarantee Schemes, introduced by the Credit Guarantee Corporation of India Ltd., was aimed at encouraging the commercial banks to cater to the credit needs of the hitherto neglected sectors, particularly the weaker sections of the society engaged in non-industrial activities, by providing guarantee cover to the loans and advances granted by the credit institutions to small and needy borrowers covered under the priority sector. With a view to integrating the functions of deposit insurance and credit guarantee, the above two organizations (DIC & CGCI) were merged and the present Deposit Insurance and Credit Guarantee Corporation (DICGC) came into existence on July 15, 1978. Consequently, the title of Deposit Insurance Act, 1961 was changed to 'The Deposit Insurance and Credit Guarantee Corporation Act, 1981'.

Effective from April 1, 1981, the Corporation extended its guarantee support to credit granted to small scale industries also, after the cancellation of the Government of India's credit guarantee scheme. With effect from April 1, 1989, guarantee cover was extended to the entire priority sector advances, as per the definition of the Reserve Bank of India. However, effective from April 1, 1995, all housing loans have been excluded from the purview of guarantee cover by the Corporation.

Management

The authorized capital of the Corporation is Rs.50 crore, which is fully issued and subscribed by the Reserve Bank of India (RBI). The management of the Corporation vests with its Board of Directors, of which a Deputy Governor of the RBI is the Chairman. As per the DICGC Act, the Board shall consist of, besides the Chairman, (i) one Officer (normally in the rank of Executive Director) of the RBI, (ii) one Officer from the Central Government, (iii) five Directors nominated by the Central Government in consultation with the RBI, three of whom are persons having special knowledge of commercial banking, insurance, commerce, industry or finance and two of whom shall be persons having special knowledge of, or experience in co-operative banking or co-operative movement and none of the directors should be an employee of the Central Government, or the RBI or the Corporation or a director or an employee of a banking company or a co-operative bank, or otherwise actively connected with a banking company or a co-operative bank, and (iv) four Directors, nominated by the Central Government in consultation with the RBI, having special knowledge or practical experience in respect of accountancy, agriculture and rural economy, banking, co-operation, economics, finance, law or small scale industry or any other matter which may be considered to be useful to the Corporation.

The Head Office of the Corporation is at Mumbai. An Executive Director/Chief General Manager is in overall charge of its day-to-day operations. It has four Departments, viz. Accounts, Deposit Insurance, Credit Guarantee and Administration, under the supervision of other Senior Officers.

Deposit Insurance

Banks covered by Deposit Insurance Scheme are (i) All commercial banks including the branches of foreign banks functioning in India, Local Area Banks and Regional Rural Banks. (ii) Co-operative Banks - All eligible co-operative banks as defined in the DICGC Act are covered by the Deposit Insurance Scheme.

Insurance coverage

The Act also empowers the Corporation to raise this limit with the prior approval of the Central Government. Accordingly, the insurance limit was enhanced from time to time and it has been raised to Rs. 1,00,000/- with effect from 1st May 1993 onwards.

Types of Deposits Covered

DICGC insures all bank deposits, such as saving, fixed, current, recurring, etc. except the following types of deposits.

- Deposits of foreign Governments;
- Deposits of Central / State Governments;
- Inter-bank deposits;
- Deposits of the State Land Development Banks with the State co-operative banks;
- Any amount due on account of and deposit received outside India;
- Any amount which has been specifically exempted by the corporation with the previous approval of the RBI.

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Insurance Premium

The rate of insurance premium was fixed at .0.05 or 1/20th of 1 per cent per annum with effect from 1st July 1993. Since 2001, the Corporation has had to settle claims for large amounts due to the failure of banks, particularly in the Co-operative Sector causing a drain on the Deposit Insurance Fund (DIF). While there is sufficient corpus in Deposit Insurance Fund for the present, it is necessary to build up a sound DIF in the long term to protect the interests of the banking system. With this objective the Corporation decided to enhance the deposit insurance premium from 5 paise per Rs.100 of assessable deposits per annum to 10 paise per Rs.100 of assessable deposits per annum in a phased manner over a period of 2 years.

Accounts

The Corporation maintains the following Funds: Deposit Insurance Fund, Credit Guarantee Fund and General Fund. The first two are funded respectively by the insurance premia and guarantee fees received and are utilized for settlement of the respective claims. The General Fund is utilized for meeting the establishment and administrative expenses of the Corporation.

The Mission of DICGC is to contribute to stability and public confidence in the banking system through provision of deposit insurance and credit guarantee to small depositors and borrowers. The Vision is to make it as one of the most efficient and effective deposit insurance and credit guarantee providers, responsive to the needs of its stakeholder.

Agricultural Finance Corporation

Agricultural Finance Corporation India Limited (**AFC India Limited)** was incorporated on April 10, 1968 as a Public Limited Company with an Authorized Capital of Rs. 100 crore and Paid-up Capital of Rs. 5 crore by the then private sector commercial banks to "finance agriculture by all possible means". (Currently the Paid-up Capital is Rs. 15 crore). Subsequent to the nationalization of fourteen major Indian Scheduled Commercial Banks on July 19, 1969, AFC repositioned itself as a Technical Support Institution for facilitating accelerated growth of Indian agriculture. AFC has now blossomed into a diversified reputed consultancy organization.

AFC India Limited (AFC) is governed by eminent Board of Directors comprising Chairmen and Managing Directors of eight Public Sector commercial Banks; Chairman of Development Finance Institutions i.e. National Bank for Agriculture and Rural Development, (NABARD) and Export & Import Bank of India (EXIM Bank) nominees of Government of India from the Ministries of Agriculture, Finance and Planning Commission; and three Experts in the fields of Agriculture, Finance and rural development. One of the three experts is currently the Chairman of the Board of Directors of the company. The Managing Director is the chief executive of the Company.

Promoted and owned by Banks and Development Finance Institutions, AFC is a Board driven Deemed Government Company u/s 619-B of the Companies Act, 1956. AFC's Headquarter is situated at Mumbai. The Company has three Regional Offices at Kolkata, New Delhi and Bangalore besides three Branch Offices at Lucknow, Hyderabad and Pune and Field Offices at Kalahandi, Bargarh (Orissa) and Godda (Jharkhand).

AFC India (AFC) is a multi-disciplinary consultancy and technical support organization specializing in agriculture and rural development segments of the economy. The company has been providing broad-based consultancy services since 1968. Of late, the company has diversified into large scale grassroots level project implementation under watershed development, livelihood promotions, organic farming, agriculture extension services, environmental impact assessments, retail microfinance operations, training and capacity building, education, skill development and financial literacy. In its four decades of its existence, AFC has been involved in more than 5000 consulting assignments in India and also in other countries. AFC's services has been utilised by various Ministries and Institutions of the Central and State Governments and Multi-lateral funding institutions like World Bank, Asian Development Bank, International Fund for Agricultural Development, UNDP/UNOPS, DFID, Islamic Bank.

Asian Development Bank

The Asian Development Bank, a multilateral development finance institution, was founded in 1966 by 31 member governments to promote the social and economic progress of the Asian and Pacific region. Over the past 31 years, the Bank's membership has grown to 57, of which 41 are from within the region and 16 from outside the region. It is a non-governmental organization providing funding and technical assistance throughout the Asian region.

Sources of Finance

ADB raises fund through bond issues on the worlds' capital markets, also rely on members' contributions, retained earnings from its lending operations and the repayment of loans.

Principal Functions

(i) to extend loans and equity investments for the economic and social development of its developing member countries (DMCs);

(ii) to provide technical assistance for the preparation and execution of development projects and programs, and for advisory services;
(iii) to promote and facilitate investment of public and private capital for development purposes; and
(iv) to respond to requests for assistance in coordinating development policies and plans of its DMCs.

Functions
(i) Promote investment in the region of public and private capital for development purposes.
(ii) Provide loans for the economic and social development of the member countries of the region.
(iii) Help member countries in coordinating their development policies and plans.
(iv) Provide technical assistance for the preparation, financing and execution of development projects and programmes.
(v) Undertake such other activities and provide such other services as may advance its objectives.
(vi) Provide financial and technical assistance to member countries for environmental protection.
(vii) Act as financial intermediary by transferring resources from global capital markets to developing countries.
(viii) Support public resource mobilization and management to member countries

World Bank

The World Bank group originated as a result of the Bretton woods conference of 1944, is one of the world's largest sources of development assistance and it has extended assistance to more than 100 developing economies, bringing a mix of finance and ideas to improve living standards and eliminate the worst form of poverty.

Mission
- To fight poverty with passion and professionalism for lasting result.
- To help people themselves and their environment by providing resources, sharing knowledge, building capacity and forging partnership in the public and private sectors
- To be an excellent institution able to attract, excite and nurture diverse and committed staff with exceptional skills who know how to listen and learn.

Purposes of World Bank

The purposes of World Bank as laid down in the articles of agreement are
- To assist in the reconstruction and development of the territories of the members, by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war.

- To promote private foreign investment by means of guarantees or participation in loans and other investments made by private investors, and when private capital is not available on reasonable terms, to supplement private investment by providing on suitable conditions.

- To promote the long range balanced growth of international trade and main tenancy of equilibrium in the balance of payment, by encouraging international investment of the productive resources of members, there by assisting in the raising productivity, the standards of living and conditions of labor in their territories.

Lecture No 9 Mid Semester Examination

Lecture No 10: Microfinance – definition, role in poverty alleviation – Self-Help Groups – characteristics, role, functions, growth and development in India. Role of Non-Governmental Organizations in promoting SHGs.

Micro Finance and Self-Help Groups (SHGs) in Rural Development

Finance is a vital input for economic activity, growth and development of rural areas as poverty is more pronounced in rural India. Financial institutions play a major role in capital formation, and in generation of income and employment of targeted groups of rural community. However, there is no spontaneity from these institutions by way of providing financial assistance to the resource – poor rural households owing reasons such as: i) the difficulties in loan recovery due to both willful and non-willful default in repayment by borrowers and ii) high financial risks associated with production and marketing of agricultural activities. As these rural backward areas lack infrastructure, entrepreneurship, business opportunities, and people are victims of exploitation and ignorance, the transaction cost of investment by the financial institutions and credit risks are high, and return on capital by the borrowing investors are also not attractive.

The nationalization of major commercial banks of India in 1969, paved way for the adoption of several strategies such as project centered approaches, target – group oriented approaches, area specific approaches such as Village Adoption Scheme, Service Area Approach, etc. to alleviate rural poverty. The ambitious credit scheme – Integrated Rural Development Programme (IRDP) with an element of subsidy could not yield the expected results because it was a supply-led, not demand-led credit programme such that the clients did not have their choice over 'purpose' and 'amount'. The Agricultural and Rural Debt Relief (ARDR) scheme further hardened the attitude of the bankers towards rural credit and the rural borrowers towards repayment. All these only weakened the strength of the financial institutions and further reduced their interest to transact such business.

The co-operative credit societies also have deteriorated due to lack of efforts in resource mobilization, mismanagement and inefficiency of the bureaucracy, everlasting problem of overdue and callous attitude of the members about the functioning of their societies. The failure of formal institutions to serve the rural poor effectively led to a review and a look at the informal financial systems and lending groups. One such informal financial system in India, namely 'Chit funds' are old institutions in which members made periodic contributions that are pooled into a fund from which money is given to the members.

In order to bridge the gap between formal and informal credit systems, Mohamed Yunus started a research project in Bangladesh in 1979 and established Grameen Bank (GB) in 1983. The lending programme of GB basically depended on external fund although the members' savings has increased substantially overtime.

The resolutions of the third international symposium on the mobilization of personal savings in developing countries organized by the United Nations in 1984 were that i) internal savings must provide a basis for credit programmes, ii) state control of interest rates must be relaxed in favour of market or near-market rates, iii) for effective service, financial services need to be decentralized, iv) both formal and informal financial institutions are necessary for the financing of development and v) linkages between formal and informal financial institutions seem to be more promising than separate development.

In 1984, the Federal Ministry of Economic Co-operation and the Agency for Technical Co-operation of the Federal Republic of Germany undertook a series of studies and workshops on rural finance in developing countries resulted in a new policy for promoting Self-Help Groups (SHGs), different from Grameen Bank Model, and Self-Help Promotional Institution (SHPI) as a financial intermediation between the rural and micro-enterprises in the informal sector on the one hand and formal institutions on the other.

The project "Linking Banks and SHGs" started in 1988 as a pilot project of the Central Bank of Indonesia through the involvement of SHPI which would provide either training and consultancy services to the SHGs and in some cases additionally act as financial intermediaries.

Micro financing by 'non-formal' organizations has already been started. SEWA (Self Employed Women's Association) owned by women of petty trade groups was established on co-operative principle in 1974 in Gujarat. Working Women's Forum started promoting working women's co-operative societies in Tamil Nadu since 1980. Shreyas in Kerala actively got involved in micro finance operations since 1988 with the objective of promoting people's co-operatives, habits and thrift and self managing people's bank.

Micro Finance

Micro-credit (World Bank, 1997) is defined as "programmes that provide credit for self employment and other financial and business services (including savings and technical assistance to very poor persons". Micro finance or micro credit institutions are dedicated to making it easy for very poor would be-entrepreneurs to borrow start-up capital. Micro finance institutions provide thrift, credit and other financial services and products of very small amounts, mainly to the poor in rural, semi-urban and urban areas for enabling them to raise their income level and improve living standards. Their operations emphasize lending very small, short term loans to very poor micro-entrepreneurs.

In India, during 1986-87, NABARD funded a research project on "Savings and Credit Management of Self-Help Groups of Mysore Resettlement and Development Agency (MYRADA)". In 1988-89, NABARD undertook a survey of 43 Non-Governmental Organizations (NGOs) spread over 11 states in India to study the functioning of SHGs and possibility of collaboration between banks and SHGs in the mobilization of rural savings and improving the delivery of credit to the poor.

Encouraged by the survey results, NABARD impressed upon Reserve Bank of India (RBI) to come out with a circular on July 24, 1991 advising commercial banks (and later RRBs and co-operatives also) to extend credit to SHGs under the pilot project of NABARD (500 SHGs to be covered). During the project period, The Association of Sarva Seva Farms (ASSEFA), Madras promoted 214 groups, mobilized Rs.1.4 million of thrift and disbursed credit of Rs.2.3 million; People's Rural Education Movement (PREM), Behrampur promoted 829 groups, mobilized Rs. 1.9 million of thrift and disbursed credit of Rs.1.9 million; Professional Assistance for Development Action (PRADAN), Madurai, promoted 313 groups, mobilized Rs.1.3 million of thrift and disbursed credit of Rs.3.9 million; Community Development Society (CDS), Alappuza promoted 350 groups, mobilized Rs.2 million of thrift and disbursed credit of Rs.4.7 million. Thus, the results were quite encouraging.

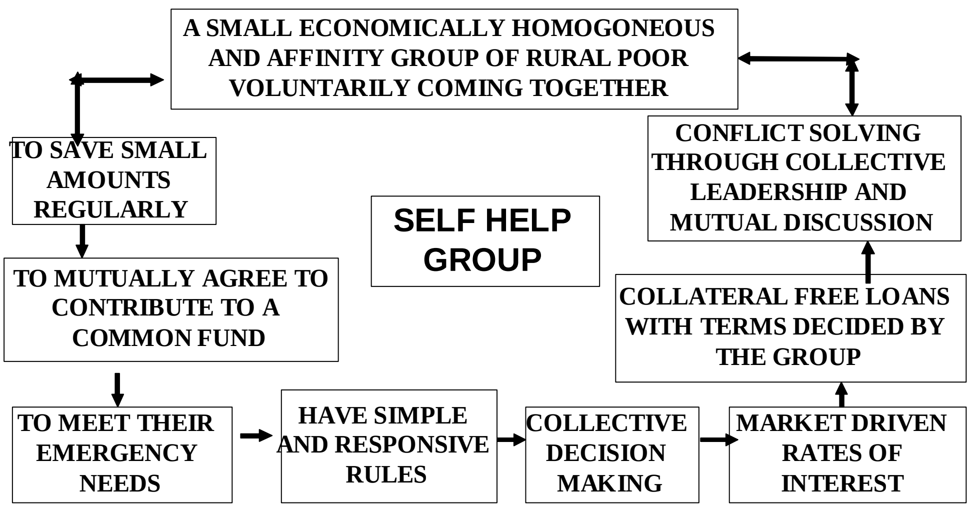
To formalize the mechanism further, RBI constituted a working group in November 1994 to review the functioning of NGOs and SHGs under the Chairmanship of Mr. S.K. Kalla and make recommendations for expanding their activities in rural sector. Accepting the recommendation, in April 1996, RBI advised the banks that lending to the SHGs should be considered as an additional segment under priority sector advances with the mainstream credit operation.

Organization and Functions of Self-Help Groups

The SHGs are small, informal and homogeneous group of not more than 20 members each. The groups have been recommended to keep them away from bureaucracy and corruption, unnecessary administrative expenditure and profit constraints. The size of 20 has been made mandatory because any group larger than this would need to be registered under the Indian legal system. These groups are expected to foster true (direct) democratic culture where all the members actively participate in the debate and decision – making process which is possible only in small groups. When the groups become larger, direct democracy tends towards indirect democracy which would result in the formation of vested interests within the group. Groups are to be homogeneous so that members do not have conflicting interests and all members can participate freely without any fear and adverse consequence. The repayment rate tends to be lower in large groups and the propensity to default is high among heterogeneous groups. These are the features which distinguish small, homogeneous and informal SHGs from large, heterogeneous and formal co-operatives although both are found on the same principle of co-operation.

Loan repayment is guaranteed by group members collectively and access to future credit depends on successful repayment. These institutions are successful in terms of i) outreach and performance in delivering credit services to the poorest of poor women and rural artisans in rural and urban areas, ii) reduction in adverse selection of borrowers and iii) empowerment of women. Micro finance institutions (MFI) in India fall under two categories: i) Financial: Commercial banks, Regional Rural Banks and Co-operative banks and ii) Non-financial: a) Not for Profit MFIs: NGOs, Trusts, etc., b) Mutual Benefit MFIs: State / national credit co-operatives, and c) Profit Centered MFIs: Non-banking financial companies.

Concept of Self Help Group



(Source : NABARD, 2004)

The SHGs after being formed (generally by an external agency) start collecting fixed amount (rarely variable amount) of thrift from each member regularly (mostly monthly). For about six months it only collects thrift; no loan is given to any member for the following reasons. Firstly, the working fund generated out of small thrift is negligible in the initial period; and secondly, it tests the patience and tries to instill mutual trust among the members. During this period the groups are expected to open a savings account with a financial institution which would like to extend credit. After accumulating a reasonable amount of resource, the group starts lending to its members for petty consumption needs. Claimants may be large, but resource is small. This forces them to take appropriate decision to identify the neediest person with regard to endowment level and the purpose of loan. A free and fair discussion removes the element of subjectivity from the decision-making process, makes the borrower understand the value of credit and the importance of repayment and accountability to the group.

The repayment of the loan along with interest and regular thrift enlarge the working fund and increase the scope of lending. Notwithstanding this, the working fund generated by the group may not be adequate to meet all types of credit needs of all the members. The group then approaches the financial institution where it had opened the savings account. If the bank is satisfied with the group in terms of: i) genuineness of demand for credit, ii) credit handling capacity of the members, iii) repayment behaviour within the group and iv) the accounting system and maintenance of the records, it extends a term loan of smaller amount to the group. The group in turn continues to take decision as in the past, the only difference being it has now a higher amount of resource. In addition, the group is jointly liable to the bank for repayment. The group's responsibility in monitoring the members therefore increases. This joint liability, however, provides incentives or compels the group to undertake the burden of selection, monitoring and enforcement that would otherwise fall on the lender. This joint liability, decision – making process and pressure at the group level are the most important aspects for the banks to do business with the poor, illiterate and informal groups.

There is a huge demand for credit in small amounts for consumption, health, education, marriage, petty production, petty trade, etc., for very short to long durations which do not match the priority supply of banks. Banks have large loan amount meant for production purpose but not for other purposes that too for very short periods. It is not the rigidity of the banking procedures, but their constraints due to high transaction costs and risk because of asymmetric information that they cannot extend such credit to individual borrowers. Individual borrowers, on the other hand, face the problems of absorbing large amounts of credit for some unwanted purpose. Instead when the financial institution (FI) extends credit to SHG, i) the transaction cost for FI is minimized because the group takes the decision to borrow on behalf of the members and also the responsibility to repay; ii) the transaction cost of the individual member is reduced because the member transacts at the group level only; iii) the mismatch between demand and supply is reduced because the bank extends credit in lump-sum amount and the group uses the amount according to its own needs; also repayment pattern of the members to the group and of the group to the bank need not be the same.

When both the lender (FI) and the borrower (SHG) grow in mutual trust and the borrower honours the previous contracts, the lender expresses its willingness to extend higher amount of credit and even provide cash credit facility implying more flexibility and lesser interest burden for the borrower; the SHG in turn increases its capacity to manage higher volume of finance, develop entrepreneurial skills, co-operative sense and finally income and employment generating capacity.

This is not confined to a single group of about 20 people. Either because of efforts of the SHGI or demonstration effect, more groups start forming and functioning. A linkage among groups also evolves. In some cases, a number of nearby groups are federated. This federation is nothing but a coordinating mechanism and is not expected to assume any hierarchical role. Crucial decision-making process for sanctioning loan to individual members remains with the SHG. The federation is basically supposed to: i) channelise funds from surplus to deficit SHGs, ii) promote more SHGs and act as facilitator for weak SHGs, and iii) perform entrepreneurial jobs like helping the grass root SHGs for backward and forward linkages and liaisoning with external agencies for the benefit of the groups. Banks may sometimes find it more convenient and economical to deal with the federation rather than individual SHGs. However, the peer pressure which is inversely proportional to the distance is much less at the federation level than at the village or group level.

Interest Rate

The SHPI along with others who promote the SHGs get refinance from different national financial institutions like NABARD, SIDBI (Small Industrial Development Bank of India), FWWB (Friends of Women World Banking), HUDCO (Housing and Urban Development Corporation), RMK (Rashtriya Mahila Kosh), HDFC (Housing Development and Finance Corporation) and a host of other international institutions. Most of the above institutions except RMK and commercial banks do not fix a ceiling on interest rates on the loan amount for lending to the members of the group. The groups are the best judges to determine the rate of interest. It should be as close to the market rate as possible. The following are the rates of interest charged:

<u>Institutions / SHGs</u> <u>Annual Rates of Interest</u>

- Banks to SHGs : 12.0%
- Banks to NGOs : 10.5%
- NGOs to SHGs : 12.0%
- SHG to members interest : As decided by SHG. Most of the SHGs charge 2 -3 % of per month.
- NABARD to bank (Refinance): 6.5% (For SHG lending, 100% refinance is available)

Financing SHGs in India

The number of SHGs availing credit has increased from Rs.287.89 crores in 2000-01 to Rs.14548 crores in 2010-11 (Table 12). The total number of SHGs during 2000-01 alone was 1, 49,050. Ninety per cent of them are women groups. The number of SHGs increased to 12,00,000 in 2010-11.

Table 12. Growth of SHG-Bank Linkage Program (MF) In India

(In Rs. Crores)

Year	No.of SHGs	Annual GR	Bank loan	Annual GR	Refinance	Annual GR
2000-01	1,49,050		287.89		244.85	
2001-02	1,97,653	32.60	545.47	89.47	395.26	61.42
2002-03	2,55,882	29.46	1022.33	87.42	622.47	57.48
2003-04	3,61,731	41.36	1855.53	81.50	705.44	13.32
2004-05	5,39,365	49.10	2994.26	61.36	967.76	37.18
2005-06	6,20,109	14.97	4499.09	50.25	1067.72	10.32
2006-07	11,05,749	78.31	6570.00	46.02	1292.86	21.08
2007-08	12,27,770	11.03	8849.26	34.69	1615.50	24.95
2008-09	16,09,586	31.09	12253.50	38.46	2620.30	62.19
2009-10	15,87,000	-1.403	14453.30	17.95	3173.56	21.11
2010-11	12,00,000	-24.38	14548.00	0.65	2545.36	-19.79
AVG	**804899.5**	**26.21**	**6170.78**	**50.78**	**1386.46**	**28.93**
C.V	**69.01**	**25.18**	**89.84**	**42.86**	**71.14**	**22.50**

Source: NABARD Annual Reports, 2000-2001 to 2010 – 2011

Note: GR – Growth Rate, AVG – Average, CV – Coefficient of Variation

Table 13. Progress under Microfinance – Bank Loans disbursed Region wise / Agency wise during 2013-14

(Amount in Lakh Rupees)

Sl.No.	Region/State	Commercial Banks		Regional Rural Banks		Cooperative Banks		Total	
		Number of SHGs	Disbursed Loan Amount	Number of SHGs	Disbursed Loan Amount	Number of SHGs	Disbursed Loan Amount	Number of SHGs	Disbursed Loan Amount
1.	**Northern Region**	11444	15361.85	4843	5639.67	7631	7046.84	23918	28048.36
2.	**North Eastern Region**	5323	4270.40	10524	8258.07	354	290.57	16201	12819.04
3.	**Eastern Region**	87865	60009.47	73247	62523.38	136366	28534.34	297478	151067.19
4.	**Central Region**	28074	35371.19	36007	25999.73	2312	435.98	66393	61806.90
5.	**Western Region**	43683	59672.94	12330	14820.21	31833	11950.50	87846	86443.65
6.	**Southern Region**	590864	1429063.50	196469	511572.29	87252	120914.91	874585	2061550.70
6.a	Andhra Pradesh	342322	909310.05	153917	411622.39	8112	11549.48	504351	1332481.92
6.b	Karnataka	114874	187899.61	23924	51545.36	36980	56957.00	175778	296401.97
6.c	Kerala	36516	92967.50	4711	10134.00	14054	4153.26	55281	107254.76
6.d	Lakshadweep	1	0.30	0	0.00	0	0.00	1	0.30
6.e	Puducherry	3196	4359.43	543	1247.27	166	524.06	3905	6130.76
6.f	Tamil Nadu	93955	234526.61	13374	37023.27	27940	47731.11	135269	319280.99
7.	**Total**	767253	1603749.35	333420	628813.35	265748	169173.14	1366421	2401735.85

Source: Statistical Tables Relating to Banks in India 2012-2013, RBI Report.

Table 14. Progress under Microfinance – Savings of SHGs with Banks Region wise / Agency wise during 2013-14

(Amount in Lakh Rupees)

Sl.No.	Region/State	Commercial Banks		Regional Rural Banks		Cooperative Banks		Total	
		Number of SHGs	Savings Amount	Number of SHGs	Savings Amount	Number of SHGs	Savings Amount	Number of SHGs	Savings Amount
1.	**Northern Region**	151187	13909.23	98521	7732.99	115500	6652.54	365208	28294.76
2.	**North Eastern Region**	98483	7463.44	189590	5108.84	28226	309.84	316299	12882.12
3.	**Eastern Region**	597399	70039.42	614451	52475.76	256936	30140.38	1468786	152655.56
4.	**Central Region**	245202	30106.79	399748	47647.75	40979	1301.27	685929	79055.81
5.	**Western Region**	366427	34734.63	167280	15626.26	363247	42630.01	896954	92990.90
6.	**Southern Region**	2564112	506892.12	642170	67394.13	490042	49576.14	3696324	623862.39
6.a	Andhra Pradesh	987881	299537.69	405420	46368.19	25375	4056.30	1418676	349962.18
6.b	Karnataka	375573	74864.89	116572	11101.40	217026	22791.00	709171	108757.29
6.c	Kerala	475851	49705.46	50416	4881.00	75058	2356.03	601325	56942.49
6.d	Lakshadweep	229	648.81					229	648.81
6.e	Puducherry	17690	1797.38	3553	363.17	3211	245.86	24454	2406.41
6.f	Tamil Nadu	706888	80337.89	66209	4680.37	169372	20126.95	942469	105145.21
7.	**Total**	4022810	663145.63	2111760	195985.73	1294930	130610.18	7429500	989741.54

Source: Statistical Tables Relating to Banks in India 2012-2013, RBI Report.

Table 15. Progress under Microfinance – Bank Loans outstanding against SHGs Region wise / Agency wise during 2013-14

(Amount in Lakh Rupees)

Sl.No.	Region/State	Commercial Banks		Regional Rural Banks		Cooperative Banks		Total	
		Number of SHGs	Loan Outstanding Amount	Number of SHGs	Loan Outstanding Amount	Number of SHGs	Loan Outstanding Amount	Number of SHGs	Loan Outstanding Amount
1.	**Northern Region**	106809	69874.76	38928	23242.23	38192	16946.56	183929	110063.55
2.	**North Eastern Region**	63030	41614.92	55369	30440.62	6170	3324.37	124569	75379.91
3.	**Eastern Region**	462187	262796.90	365520	186068.56	151253	45597.64	978960	494463.10
4.	**Central Region**	161988	159110.30	249362	108642.53	8484	1913.65	419834	269666.48
5.	**Western Region**	154585	115639.78	53789	31217.21	60634	17189.07	269008	164046.06
6.	**Southern Region**	1552665	2289804.65	464595	725283.84	203778	164044.81	2221038	3179133.30
6.a	Andhra Pradesh	921398	1489020.64	364684	604850.45	19994	20233.04	1306076	2114104.13
6.b	Karnataka	200457	250060.05	61885	81416.88	74854	60107.00	337196	391583.93
6.c	Kerala	87753	148607.72	8336	11123.00	21214	10794.79	117303	170525.51
6.d	Lakshadweep	15	3.65	0	0.00	0	0.00	15	3.65
6.e	Puducherry	11496	8176.66	1410	1420.67	871	866.76	13777	10464.09
6.f	Tamil Nadu	331546	393935.93	28280	26472.84	86845	72043.22	446671	492451.99
7.	**Total**	**2501264**	**2938841.31**	**1227563**	**1104894.99**	**468511**	**249016.10**	**4197338**	**4292752.40**

Source: Statistical Tables Relating to Banks in India 2012-2013, RBI Report.

Participation of Banks in Assisting SHGs

The commercial banks provided maximum assistance by linking 50 per cent of the SHGs and its share of assistance to total financial assistance to all SHGs was to the extent of 67 per cent and they were followed by RRBs and Co-operatives. Southern Region provided for maximum assistance to SHGs (74 per cent) followed by Eastern Region (11.5 per cent), Central Region (6.3 per cent) and so on (Table 15). The various partner agencies, the loan amount sanctioned and the number of SHGs formed by each partner is furnished in Table 16.

Table 16. Grant Support to Partner Agencies (₹ in lakh)

Agency	Cumulative sanction up to 31.03.2013		Cumulative Achievement (31.03.2013)	
	Amount	**SHG Nos.**	**Amount**	**SHG Nos.**
NGOs	19932.18	526699	6647.68	362803
RRBs	744.99	49250	185.43	45852
Coop. Banks	1046.23	73634	353.50	51266
IRVs(Individual Rural Volunteers	460.12	26883	77.04	11228
Farmers Clubs	40.63	2544	20.40	9832
SHG Federation	28.61	250	1.85	46
PACS	397.45	8533	4.28	85
Total	**22650.21**	**687793**	**7290.18**	**481112**

Types of SHGs

Three broad models of bank-SHG linkage which have emerged are: Model - I in which the bank itself acts as SHPI and forms and nurtures the SHG, Model - II in which the NGOs act as SHPIs and banks lend to the SHGs directly, and Model - III in which the NGOs act as both SHPI and micro finance intermediaries.

The sources of income

The sources of income to the SHGs are

i) Penalty fee collected from the members on account of default of repayment in time.
ii) Fine on account of non-attendance of members in the meetings convened by SHGs
iii) Interest earned on the surplus funds lent to other SHGs and
iv) Grants received from the external sources such as government and non-governmental organizations.

Lecture No 11: Co-operation – philosophy and principles – history of Indian Co-operative credit movement – pre and post independence period. Cooperatives in different plan periods.

Co-operation and Co-operative Credit

Co-operation is a specialized form of economic organization in which people voluntarily associate together on a basis of equality for the promotion of their economic interests (Calvert).

A Co-operative Society is an enterprise formed and directed by an association of users, applying within itself, the rules of democracy and directly intended to serve both its own members and the community as a whole (Lambert).

Principles of Co-operation

a) Universality: The membership of a co-operative society is open to those who are convinced of its benefits and those who are prepared to share the benefits and responsibilities involved in such a membership.

b) Democratic Control: The affairs of the society must be ministered by the members themselves and all the members must equally be treated (one member has one vote in the election of Board of Management). All for each and each for all.

c) Self Help Through Mutual Help: The benefit arising out of the collective effort is available to all members.

d) Unity or Political and Religious Neutrality: Unity is the fundamental force behind all co-operative organizations. It is above all beliefs, faiths and convictions.

e) Limited Interest on capital: The main aim of the society is not to earn abnormal profit but to enable the members to improve their economic conditions. If there is any excess income, it will be used to meet unforeseen loss or strengthening the funds of the society so that cheaper services may be made available to the members.

f) Principles of Publicity: The co-operative organizations do not believe in maintaining secrecy about their working and progress.

g) Of the people, for the people and by the people: Members should have the spirit of dedication and service with absolute honesty and unquestionable integrity. Hence, co-operation is the movement of the people, for the people and by the people.

History of Co-operative Movement in India

The Famine commission of 1901 recommended the establishment of Agricultural Banks on the lines of Mutual Credit Association of Europe to provide credit to farmers in order to prevent further famine and also to improve agriculture. A Committee under the presidentship of Sir Edw'ard el bill to establish co - operatives. The bill was passed as Co-operative Credit Societies Act on 25th March, l904.

Provisions were made in this Act to establish credit societies both in rural and urban areas for providing credit facilities at cheap rates to needy people of the locality. Rural societies were organized on ‘Raiffeisen Model’ while the urban societies were established on ‘Schulze Delitzch Pattern’. In Raiffeisen Model unlimited liability was an important feature while in Schulze Delitzch model, limited liability principle was followed.

In the event of liquidation of limited liability societies, the liability of the members is limited to their share capital or it may be one to five times of the share capital as prescribed by the by-law of the society. The advantage is that members have confidence that their property is safe even if the society is liquidated.

In the event of liquidation of unlimited liability societies, the members lose not only their share capital but their other properties upto the extent of the loss of the society. The main advantages of unlimited liability are the mutual trust and watchfulness it creates among the members.

Realizing the defects noticed in the Co-operative Credit Society Act, 1904, that is ,

i) No provision for purposes other than credit, i,e., marketing and

ii) Unlimited liability

The Government passed Co-operative Societies Act., 1912. According to this, a) non – credit societies can also be formed and b) the liability of the central societies (collection of primary societies) shall be limited and the liability of rural (Primary) societies shall be unlimited. After 1912, there was a rapid growth not only in the number of cooperative credit societies but also in non - agricultural credit societies. However, the development was not even. It made rapid progress only in Bombay, madras and Punjab (where agriculturists had mortgage rights) than in the Zamindhari areas like Bengal.

In 1914, the Government of India appointed a committee under Sir. Edward Maclagan to examine the progress of the co-operative movement and to suggest measures for improvement. The defects noticed by the committee were :

a. Misappropriation of funds by the members of the management committee,
b. Nepotism in advancing loans to friends and relatives,
c. Improper auditing and inspection of societies.

The major recommendations were:

1. Formation of three classes of societies namely:
    - Primary meant for individuals and unions or federation of societies meant for supervision;
    - Central bank at district level for banking business; and
    - Provincial bank at the provincial level to serve as apex banks.
2. Restriction of area under primary society to a village, and
3. Encouragement of non –credit societies and central banks may finance them.

Table 17. Progress of Co-operative Societies

Year	Number of Societies	Members (000's)	Amount of Working Capital (Rs. Crores)
1906-07	843	90.844	0.25
1911-12	8177	403.318	3.36
1914-15	17327	824.469	12.23
1921-22	52182	1974.290	31.12
1929-30	104187	4181.904	89.52
1939-40	137000	6080.000	107.10
1945-46	172000	9160.000	164.00
1970-71	161000	31000.000	1153.40
1981-82	94,623	60700.000	4307.10
1990-91	82,905	80100.000	11871.92
2011-12	101297	127646.000	173563.61
2012-13	93488	127468.000	280816.43

Source: Various Annual Reports of NABARD

On passing of the government of India Act in 1919 co-operation became the provincial subject and was administered by provincial governments. The economic prosperity between1920-29 facilitated rapid increase in the number of societies. However, due to the world wide great Depression (1929-34) and the Second World War, the co-operative movement had a serious setback.

Many committees were appointed to study the progress of co-operative movement. In Madres, Madras Co-operative Societies Act, 1932 and the Madras Co-operative Land Mortgage Banks Act, 1934 were passed. While the 1932 Act conferred more power on the Registrar with regard to the recovery of bad debts, audit, supervision and control, the 1934 Act provided for long term credit through co-operative land mortgage banks. The Madras Province appointed a committee on co-operation (1939) under (T.Vijaya Raghavachary) to study the conditions of the co-operative movement in the state. The committee suggested amendments to 1932 Act.

The Reserve Bank of India was established in 1935 with an Agricultural Credit Department. The RBI conducted enquiries and advised the provincial governments to improve the working of credit societies. The agricultural finance subcommittee (Gadgil committee) set up in 1944, recommended that the state aid should be increased so that co-operatives might be enabled to supply better credit facilities. It was also felt that the co-operatives would be strengthened through linking credit with marketing, setting up of processing plants by grant of liberal loans and subsidies, and training of expert staff.

In 1945, the Government of India appointed the cooperative planning committee under the chairmanship of R.G. Saraiya for drawing up a plan for future development of the co-operative movement.

Development of Co-operatives in Post Independence Period

The Rural Banking Enquiry committee (1949-50) recommended for the formation of Rural Co –operative Banks.

The All India Rural Credit Survey (AIRCS) committee was appointed in 1951under the chairmanship of A.D.G Gorwala. The committee brought to light some defects in the organizational, operational and structural aspects of the co operative institutions and stated that ”the co-operation in India has failed but it must succeed as there was no alternative to the co- operative form of association the village for the promotion of agricultural credit development”. The committee recommended an Integrated scheme of rural credit it involving three fundamental principles namely, i) state participation at different levels, ii) co-ordination of credit with other economic activities especially processing and marketing iii) administration through training and efficient personnel responsible to the needs of the rural population. In brief, this means, state i) co-operative credit, ii) co-operative economic activities, iii) storage and warehousing iv) commercial banking.

Under the provisions of the Agricultural Produce (Development and Warehousing) Corporation Act 1956, the National Co-operative Development and Ware Housing Board were established. The RBI had established the National Agricultural Credit (long term operations) fund in 1956 to provide long term loans to the state governments for enabling them to contribute to the share capital of co-operative institutions. It also created National Agricultural Credit (Stabilization) Fund to enable the short term credit granted to the co-operatives to be converted into medium term loans in circumstances in which the co-operatives could not repay short term loans due to natural calamities.

The Committee on Co-operative Credit (1960) headed by V.L.Metha recommended measures to secure a balance between economic availability and the co-operative ideology, liberalization of rules and procedures for disbursal of credit.

The Committee on Taccavi Loans and Co-Operative Credit (1963) recommended measures to channelize government credit through co-operatives.

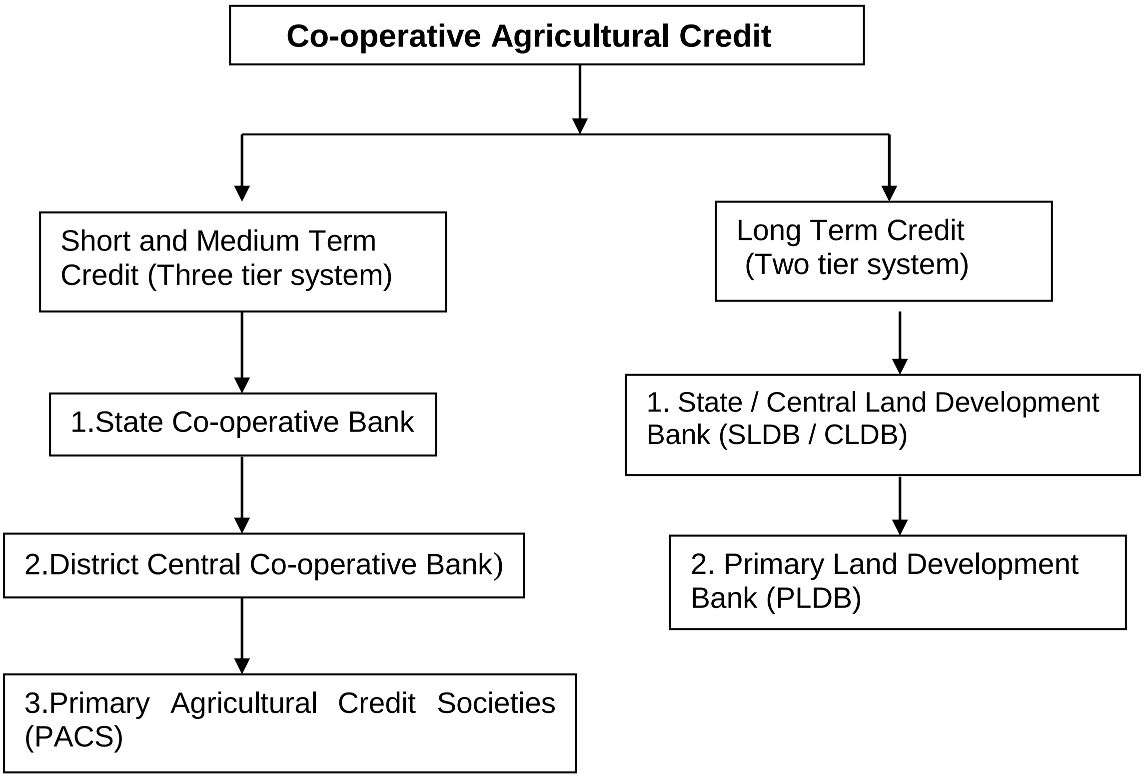
An expert committee under Dr. Dantwala was appointed in 1964. It recommended that the primary marketing societies should take up both marketing and credit activities.

The All India Rural Credit Review Committee (RCRC) was appointed by the RBI under the chairmanship of B.Venkatappaiah in 1969 to review the progress of rural credit in the context of IV plan. As per the recommendation of this committee, 45 Small Farmers Development Agencies (SFDA) were established in the selected districts. Rural Electrification Corporation was also set up in 1969 to promote and finance the rural electricity co-operatives.

Lecture No 12: Co-operative credit institutions: Two tier and three tier structure, Functions: Provision of short term and long term credit and Strength and weakness of co-operative credit system.

Co-operative Credit Institutions

The co-operative credit structure in India is characterized by two types of institutions: one, involved in the dispensation of short and medium term credit and the other in the provision of long term credit.



The Primary Agricultural Credit Societies (PACS) is the foundation stone on which the whole co-operative credit structure is built up. These societies are federated to District Central Co-operative Bank (DCCB), generally at the district level. The DCCBs are federated to State Co-operative Bank (SCB) which is an apex institution having close link with the RBI and NABARD. Long term credit is provided by Land Development Banks (LDBs). The State / Central Land Development Bank is the apex institution which operates through Primary Land Development Banks (PLDBs) at district / taluk / block level in some states or through its own branches where PLDBs do not exist.

a) Primary Agricultural Credit Societies (PACS)

The Formation of these societies dates back to 1904 when the first credit societies Act was passed. The objective was to provide cheap credit to the farmers in order to relieve them from the clutches of money lenders. The main functions of the PACS are:

a. To promote economic interests of the members in accordance with the co-operative principles;
b. To provide short and medium term loans;
c. To promote savings habit among members;
d. To supply agricultural inputs like fertilizers, seeds, insecticides, implements, etc.;
e. To provide marketing facilities for the sale of agricultural produces; and
f. To supply domestic products requirements such as sugar, kerosene, etc.

Management: The general body elects a managing committee which consists of five to nine members and elects a president and a secretary to look after the day – to – day functioning of the society. All the office bearers render honorary service. The RBI has given a directive to appoint a full time paid secretary to maintain the accounts for each society.

Membership: All agriculturists, agricultural labourers, artisans and small traders in the villages can become members of the society.

Share Capital: PACS issue ordinary shares of small value, i.e., Rs.10 and Rs.100 each to their members. The ownership of shares decides the rights and obligations of the holder to the society. Share capital forms an important part of the working capital. Members' borrowing capacity is determined by the number of shares held by them.

Liability: Initially, societies were formed with unlimited liability. The All India Rural Credit Review Committee pointed out that unlimited liability operates as a restraint on the willingness of the society to liberalize its loan policies, to admit new members and to extend its area of operation. Besides, it hinders the society to receive contribution from the state government whose liability inevitably has to be limited. In view of this, the societies were formed with limited liability and the existing societies were converted into limited liability societies.

Sources of Funds: Share capital, entrance fee, deposits, reserve fund, and loans borrowed from higher institutions and government are sources of funds of the co-operative societies.

PACS obtain loans from CCB or SCB to cater to the needs of their members. The maximum borrowing power of the society is based on its liability and it differs from state to state. It is generally fixed at 1/6th or 1/8th of the total value of the net assets of the solvent members. Credit limit is fixed by the Registrar or CCBs on the basis of the factors viz., total assets of the members' income and repaying capacity of members, owned funds of the society, audit classification and repayment performance.

Loaning Policies: PACs supply short term credit on the personal security of the borrowers, while medium term credit is given either by creating charge on their immovable assets or by mortgages. Repayment period is determined on the basis of incremental income derived out of the loan.

Regulation of PACS

As a policy of reorganization of PACS into viable units, the number of societies had been brought from 161,000 in 1970-71 to 82905 in 1990-91. The reorganization programmes envisaged the following aspects:

i. Minimum short term loan of Rs.2 lakhs for a society to become a viable unit.
ii. Coverage of villages with a gross cropped area 2000 ha to achieve this level of business.
iii. Appointment of a suitably trained full – time paid secretary to manage its affairs.

The National bank has formulated a scheme known as instant fresh finance scheme during 1988-89 to issue timely fresh credit to those members of PACS who have repaid their early dues. This policy improvement should go a long way to build confidence of the members in their co-operative society as no member was allowed fresh loan irrespective of whether he has paid or not repaid the loan when the society as such was declared ineligible for fresh financing.

Table 18.Progress of PACS in India

(Amount in Rs.Crores)

Particulars	**1970-71**	**1981-82**	**1990-91**	**2010-11**	**2012-13**
1. Number of societies	161000	94,623	82,905	90279	93488
2. membership (in million)	31.0	60.7	80.1	106.1	127.5
3. Paid-up capital	205.74	598.20	1226.42	7004.97	9868.31
4. Deposits	69. 46	317. 00	1348. 97	3728234	6711310
5. Borrowings	675.19	2609.00	7778.59	48225.91	93359.16
6. Working capital	1153.40	4307.10	11871.92	109384.96	280816.43
7. Loans issued	577.88	1939.90	4678.85	85295.55	161909.16
8. Loans outstanding	322.40	1211.90	6877.23	79503.55	139398.71
9. percentage of Over dues to outstanding	41.1	43. 9	45.65	24.80	24.65

Source: www.nafscob.org

b) Central Co-operative Banks (CCBs)

CCBs form an important link between PACs and SCBs.

Functions

The major functions of CCBs are:

a. to meet the credit requirements of member societies;
b. to perform banking business;
c. to act as balancing centres for the PACs by diverting the surplus funds of some societies to those which face shortage of funds.
d. to guide and supervise the PACs; and
e. to undertake non-credit activities.

The area of operation is generally a district. All types of co-operative societies such as marketing societies, consumers' societies, farming societies and urban co-operative credit societies apart from PACs can become member of CCBs.

Sources of Finance: These banks raise funds by way of share capital, deposits from public, and borrowings from SCBs government, RBI, SBI and commercial banks. The borrowing power of these banks ranges from 12 to 15 times of their paid-up share capital and reserve fund.

Loaning Policy: These banks generally extend short and medium term loans to PACS for financing agricultural activities. Loans are granted against proper security, landed assets, house mortgage, cattle, agricultural produce, jewels etc.

Table 19. Progress of Central Cooperative Banks in India (Amount in Lakhs)

S.No.	Particulars	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
1.	No. of DCCBs	366	365	367	370	373	371	371	372	372	372
2.	No. of Offices incl. H.O	12848	12795	12938	12880	13112	13195	13238	13327	13495	13655
3.	Total Membership	2134456	2124774	2258263	3250131	3383542	3516559	3976725	3145789	3420520	3915657
4.	Paid up Capital	379253	411180	447776	508804	581998	606940	779741	725523	818892	891461
5.	Total Deposits	7677746	8026569	8617732	9195898	10572072	12349115	14636385	16130882	17671091	19572643
6.	Total Borrowings	2105908	2156574	2293102	2786453	3047465	2841328	3052232	3910116	5054498	6173116
7.	Working Capital	11861485	12231699	13036450	14582266	16773886	18351708	20728123	23543070	25730623	28802124
8.	Total loans issued	5749309	6529357	6986666	7655115	8713379	8795431	11107593	13775422	16255743	20937088
	a.Short Term	4195121	4575047	5223524	5814078	6813264	6883718	8877673	10595514	12495576	16564857
	b.Medium Term	691157	940299	807066	868082	918918	995717	1136511	1418158	1641189	1912258
9.	Total loans outstanding	6358706	7208035	7780983	8543544	9581766	9706127	10523993	12279721	14476338	17151279
	a.Short Term	3888022	4074795	4436174	5016705	5908388	6074679	6657099	7672788	9102099	11223693
	b.Medium Term	1588333	2080957	2207348	2326131	2479739	2361805	2522233	2902923	3257929	3659164
10.	Total Demand	5006205	5480226	5662864	6480565	7390670	8077407	8928973	10611864	12437601	15482531
11.	Total Collection	3158502	3679632	3886470	4344294	4645730	5435974	6550430	7706922	9716686	12329501
12.	Balances (Overdue)	1847703	1800594	1776394	2136271	2744940	2641433	2378543	2904942	2720915	3153030
13.	% of overdue to demand	36.91	32.86	31.37	32.96	37.14	32.70	26.64	27.37	21.88	20.37

Source: www.nafscob.org

The number of CCBs has increased due to increase in number of branch offices. Because of various reasons, the percentage of overdue has increased from 8.7 per cent in 1950-51 to 20 per cent in 2012-13.

Management: The management of these banks is vested with board of Directors consisting of 12 to 15 members. A DCCB is considered weak when its estimated bad and doubtful debts, other overdue above three years and accumulated losses exceed 50 percent of its paid-up capital and reserves. Rehabilitation programme is being implemented to revitalize. As on March 2013, as many as 43 DCCBs were at loss and put under rehabilitation programme.

C. State Co-operative Bank (SCB)

It is the apex institution at the state level which links widely scattered PACS with the money market. The main objective of the bank is to link PACS with the money market and the RBI and to coordinate the work of CCBs.

The Functions of SCBs are:

a. to act as bankers' bank to CCBs and also to supervise, control and guide CCBs;
b. To mobilize financial resources needed by the PACS and deploy them properly among the various sectors of the movement;
c. to co-ordinate the various development agencies and help the government in drawing plans for co-operative development and their implementation;
d. to formulate and execute uniform credit policies for co-operative movement; and
e. to perform banking functions such as issuing cheques, drafts, letters of credit (By issuing letter of credit, a banker requests another party (a banker or trader) to grant a specified amount to a third party specified therein and the issuing banker himself binds to pay the money paid under the letter of credit), collecting and discounting bills etc.

Area of Operation and Membership

Area of operation is within the state. Each state has one apex bank. Some States have more than one as in Maharashtra, Madhya Pradesh, Punjab and Andhra Pradesh. Membership is open to all CCBs and such other societies which have direct dealings with SCBs. State Governments have now become shareholders with a view to give them strength, influence and borrowing power.

Management: While the main authority of SCBs is vested with the General Body and powers of day-to-day functioning rests with the Board of Directors. As a share holder, the government nominates some directors and the rests are selected by the General Body. The General Body meets once in a year.

Sources of Finance: The sources of these banks are share capital, reserve funds, deposits from members and non-members, borrowings from NABARD, SBI, State Government and direct state contributions. The ceiling on borrowing varies from 12 to 20 times of the owned funds.

Loaning Policies: SCBs provide short term loans to meet expenses of agricultural operations, marketing of agricultural produces and distribution of controlled commodities. They grant medium term loans for the purchase of cattle, machineries, reclamation of land, renovation of wells, tanks and channels, construction of farm sheds and godowns, etc. Loans are granted to the member societies through their branches.

Table 20. Progress of State Cooperative Banks in India (Amount in Lakhs)

S.No.	Particulars	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
1.	No. of SCBs	30	30	30	31	31	31	31	31	31	31
2.	No. of Offices incl. H.O	929	953	962	979	986	992	1015	1028	1047	1081
3.	Total Membership	150975	156623	153697	148771	150917	200772	330808	234827	254358	339896
4.	Paid up Capital	92455	99228	109424	143668	131617	139047	162958	206677	261707	289424
5.	Total Deposits	4286301	4406765	4767221	4846961	5628692	7131507	8483773	8166424	8665296	8990513
6.	Total Borrowings	1352265	1467097	1687166	2215024	2244428	2194968	2365952	3260686	4271362	4926999
7.	Working Capital	6521629	7068213	7454366	8344690	8985076	10590080	12205733	13067094	14798850	14272895
8.	Total loans issued	3486449	4432506	4880348	4706898	5331376	5186630	5978395	6848063	8152345	8996134
	a.Short Term	3067848	3164529	3553233	3654619	3932476	4280618	4646000	6031657	7462765	8342899
	b.Medium Term & Others	418601	1267977	1327115	1052279	1398900	906012	1332395	816406	689580	653235
9.	Total loans outstanding	3563719	3530652	3896099	4667581	4910142	4620083	4910353	6508182	7563187	8099419
	a.Short Term	2280916	2133628	2337557	3002814	3113836	3154909	3456190	4830839	5863695	6435548
	b.Medium Term & Others	1282803	1397024	1558542	1664767	1796306	1465174	1454163	1677343	1699492	1663871
10.	Total Demand	22034774	2329419	2438956	2770662	3179454	3960732	3454955	3227299	4791169	5930917
11.	Total Collection	1833145	1973608	2103349	2403133	2633473	3617093	3171662	2979191	4606103	5623900
12.	Balances (Overdue)	370629	355811	335607	367529	545981	343639	283293	248108	185066	307017
13.	% of overdue to demand	16.82	15.27	13.76	13.27	17.17	8.68	8.2	7.69	3.86	5.18

Source: www.nafscob.org

Table 21.Performance of Cooperative Banks in Tamil Nadu (2012-13)

Amount in Lakhs

S.No.	Particulars	PACBs	DCCBs	SCBs
1.	No. of Offices incl. H.O	4307	784	47
2.	Total Membership	10420100	16118	24
3.	Paid up Capital	75455	126099	19191
4.	Total Deposits	472540	1790819	778813
5.	Total Borrowings	978866	707195	313954
6.	Working Capital	1484160	2751437	1211067
7.	Total loans issued	1618564	2965535	1132130
	a.Short Term	1413018	2108131	1080626
	b.Medium Term & Others	205546	857404	51504
8.	Total loans outstanding	1182445	2418106	945962
	a.Short Term	1058508	1457069	871862
	b.Medium Term & Others	123937	961037	74100
9.	Total Demand	1091569	2057954	922181
10.	Total Collection	1019082	1951592	912293
11.	Balances (Overdue)	72487	106362	9888
12.	% of overdue to demand	6.64	5.17	1.07
13.	At Profit	2347	478	47
14.	At loss	1650	100	0

Source: www.nafscob.org

Land Development Banks

The advent of new innovations in agricultural technology, increasing demand for food with population explosion, profitability in commercial agriculture, attractive price for exportable agricultural commodities, etc., made the farmers to realize that agriculture could also be taken up as an industry by effecting improvement on land for increasing its production potential through more capital investment, which led to the rising demand for long term credit. Farmers required larger amount to acquire durable farm assets such as machineries and livestock and undertake permanent improvements, construction of wells, buildings, etc. Since the amount is large, it is difficult for them to repay the loan amount in lumpsum. The amount has to be repaid in installments and distributed to a longer period of even 20 years.

Reasons for the Establishment of LDBS

a. A bulk of the credit was extended by non-institutional agencies like money lenders at higher rate of Interest. So indebtedness of farmers was so acute that it did not allow them to receive long-term credit.
b. The organizational structure of the PACS and its lack of expertise in scrutinizing or appraising the securities and long-term credit proposals did not permit them to deploy long-term credit.
c. Commercial banks could not dispense long-term credit because of the short-term nature of their deposits.
d. The government was not considered as all ideal agency for extending long-term credit as stated by the AIRCSC(1951).

Hence, the need for special type of credit institutions to meet the long term credit demand for farmers had arisen. The first co-operative **land Mortgage Bank** was set up at Jhang in Punjab in 1920. In 1924, the land mortgage banking in India was made when central land mortgage bank was set up in Madras in 1929.

During 1920-29, land mortgage banks were established under the co-operative societies Act in Punjab, Mysore, Bombay, Assam and Bengal. The Agricultural finance subcommittee (1945) observed that "Co-operative land mortgage banks in India have so far been advancing loans almost exclusively for the redemption of old debts. If should not, however, be forgotten that the main object of land mortgage banking is to finance land improvement." The AIRCSE (1954) recommended the establishment of a central land mortgage Bank (CLMB) in each state at the apex level and X strengthening of the primary land mortgage Banks (PLMB) at the district level. During the third plan period, the LMBS received massive support from institutional agencies like RBI, 8BI, LIC and Agricultural Refinance Corporation. The LMB reoriented their loan policies towards providing loans for productive purposes and attention was paid to agricultural development and their name was changed to "Land Development Banks (LDBs)'.

Objectives

The main objective of the land Development bank is to promote agricultural the development of agriculture and increase the production.

Organizational Structure

The long-term Co-operative credit structure is not uniform throughout the country. The structural pattern of land development banks falls into one of the following four categories.

1. Federal type with the Central Land development Bank at the top and the primary Land Development Bank at the base. The pattern is adopted in Andhra Pradesh, Assam, Haryana, Kerala, Karnataka, Punjab, Rajasthan, Tamil Nadu and West Bengal.
2. The Central Land Development Bank advances loans directly to farmers through branches. This pattern prevails in Bihar, Gujarat, Jammu and Kashmir and U. P
3. The CLDBs are operating through branches as well as PLDBS
4. The CLDBS operates through separate departments of central Co-operative Banks of the area

Area of Operation

The area of PLDBS shows very wide variation and it ranges from a taluk to a whole district. It was estimated by the working Group for formulation of Fourth Five Year plan proposals on co-operation that a primary Land Development Bank to be an economically viable unit, should handle, a minimum business of Rs.20 lakhs a year with a margin of 1.25 per cent requisite staff for the purpose.

Membership

In PLDBS, all land owners are eligible to become members and borrow funds by mortgaging their land. The principal borrower is enrolled as 'A' class members and others who have interest in the mortgaged property are admitted as B class Members. The members of SLDBs are the PLDBs and a few industrial promoters.

Management

The management of the SLDB is vested in a Board of Directors consisting of 7 to 9 members. The Government nominates 2 to 3 directors in some states. The state/Central LDB nominates the directors in some states. The State/central LDB nominates one directors of PLDB. The members of the Board work for three years. The General Body is the ultimate authority in all matters relating to administration of Bank. In each SLDB, there is an in executive committee consisting of labor a member of whom the President, Vice President, the nominee of the apex Co-operative bank and the Registrar of Cooperatives are the ex officio members. The rest are elected by the Board Directors from among themselves. The administration of the bank vests in the executive committee. It has powers to admit members sanction loans, make investments, borrow funds and approve transfer of shares and debentures. The management of PLDBs is vested in an elected Ward of Directors consisting of 9 to 12 directors.

Sources of Finance

The PLDBs obtain their finance from:

a. Share Capital
b. Loans from SLDBs
c. Admission and Other fees
d. Grants and Subsidies from the Government
e. Borrowing from other agencies.

The SLDBs get their finance from:

a. Share capital,
b. Issue of debentures.
c. Loans from the State Bank of India and other commercial banks on the guarantee of the State Government,
d. Admission and other fees.
e. Grants and subsidies,
f. Deposits.
g. Other funds.

The PLDBs raise their share capital by issuing shares to the members in certain proportion to their borrowings from the bank. The ratio of share capital to the borrowed amount varies from 5 to 10 percent. The PLDBs raise their share capital by issuing shares to the members in certain proportion to their borrowings from the bank. The ratio of share capital to the borrowed amount varies from 5 to 10 percent (Maharastra). The SLDBS raise their finance through issue of ordinary rural and special development debenture. A debenture is a long-term loan issued by SLDBS, carrying fixed interest rate for a fixed period generally upto 20 years. The ordinary rural debentures are issued to the general public institutions and individuals. These are treated as trustee securities and are guaranteed by the state government. They are subscribed by the RBI, SB1, cooperative banks, commercial banks and LIC. Rural debentures are issued to raise funds for sanctioning loans to agriculturists for productive purpose. Special debentures are floated for providing finance to the agriculturists under special agricultural development or land development programmes.

Lending programme of LDBs

The SLDBS grant long-term loans to agriculturists through PLDBs and branches of SLDBS. The SLDBS were advised to ensure that at least to 90 percent of the loans issued by them during 1982-83 were for increasing. Agricultural production, not less than 75 per cent being devoted for easily identifiable productive purposes SLDBs were further required to ensure that at least 20 per cent of the loans granted under normal lending programme were for the benefit of small farmers and weaker sections of society.

Rehabilitation of SLDBs/PLDBs

With a view to improve the organizational and managerial efficiency of some weak SLDBs, several measures were initiated. Based on the suggestions of the committee on Term lending through co-operatives (COTEL COOP), the following pressures were initiated.
ii) In view of the emphasis on the viability of the primary units, the SLDBs were advised to evaluate the performance of primary units every year in September-October
ii) LDBS were asked to advise to undertake a classification overdue/ defaulters.
iii)) LDBS were asked to maintain beneficiary wise profile stating details such as status of borrower, repayment and reasons for default.

PLDBs and SLDBs were renamed as Cooperative Agricultural and Rural Development Banks.

Achievements of Co-operative Credit Societies in India

The Co-operative credit system has been in existence for the past 90 years. The best assessment of co-operative movement was given by the All India Rural Credit Survey Committee, 1954 (i.e., exactly after 50 years of co-operative movements' existence) which stated "Co-operation has failed in India but it must succeed....". But since 1954, the co-operative movement has made great progress. Some of its achievements era listed below:

a. The co-operative credit societies satisfy the basic condition of proximity as they can have intimate knowledge of the character and abilities of their members. Further, the credit provided by co-operative societies is bound to be cheap due to their low administrative costs.
b. In 1951, the money lenders provided 69.7 per cent of the farmers' credit needs and it declined to 17 per cent in 1981. Presently the rural credit system is being dominated by co-operatives as they increased their share from 3.1 percent in 1951 to 30.20 per cent in 2002.
c. Credit societies also provide non-credit services like marketing of farm produces, supply of farm inputs and consumer goods.
d. Co-operatives have created a political awareness among rural people and made them to participate in economic development in a democratic way.

Weaknesses of Co-operative Credit Societies:

There are some important snags and deficiencies in the working of co-operative credit societies and they have failed to acquire the dynamism needed to discharge their responsibilities. The All India Rural Credit Survey committee and other Committees on co-operatives have brought out the following deficiencies in the cooperative credit societies.

(i) Lack.of spontaneity: The movement was not voluntary and the people did not come forward to form societies to satisfy their economic needs. The villagers generally thought that the societies were government lending institutions.

(ii) Lack of funds: The basic feature of co-operative banking system must be a large reliance on resources mobilised locally and a lesser and lesser dependence on higher credit institutions. However, not only PACS but also the higher credit institutions, viz., DCCBs and SCBs could not attract as much deposits from the general public as was anticipated.

(iii) Loans for productive purpose only: Co-operatives give loans only for agricultural operations. But farmers need credit for consumption purpose also. Hence, they either depend on money lenders or they divert the production loans to sorry unproductive purposes which in turn lead to overdue problem.

(iv) Production of credit only: The Co-operatives have failed to appreciate the link between credit and processing and Mannering. What is really needed is a cooperative society which would integrate various aspects of agricultural operations in order to meet all the needs of the farmers.

(v) Non-viable Units: A viable unit is one which renders the more important services adequately to as many numbers of members as possible within a reasonable time. However, it is found that only 54.5 percent of the total number of societies earned profit at the end of 2012-2013 and the remaining societies could not function effectively and efficiently.

(vi) Uneven growth: The development of co-operative movement indicated that the progress in different parts of the country has been uneven.

(vii) Mounting Over dues: The financial soundness of cooperative credit structure depends on the prompt recovery of loans. The problem of overdue affects not only the interests of the defaulters themselves, but also the other regularly repaying members, creditors, and the very co-operative movement itself. The percentage of over dues to demand at the level of PACS was reported to be 24.65 per cent in 2012-2013. At the level of DCCBs, the percentage of over dues to demand was 20.37 per cent in the same year.

(viii) Defective management and leadership: The failure or non-viability of co-operative credit societies is also due to defective management and leadership. The officials do not have proper training and hence they could not compete with money lenders or private lending agencies.

(ix) Interference of the government: The Government attempts to convert co-operatives into a government department with all its rigidities and short-sightedness associated with a government department. Government also did not take adequate interest in improving the financial strength of the societies. It also resorts to ban or postponement of recovery of loans which hampers the functioning of societies.

(x) Delayed credit: A Common complaint is that farmers do not get loans in time. So credit delayed is credit denied. Delayed credit tempts the borrower to divert it to other unproductive purposes.

(xi) Another problem faced by PCARDBs is the high cost of raising ordinary debentures. As noted by ACRC, issue of ordinary debentures for non-schematic lending for production purposes is at present a loss making proposition as the ordinary debentures carry higher rates of interest than the rates at which loans are issued by them.

(xii) Because of their strong socio-economic position, large farmers have cornered greater benefits from co-operatives.

Table 22.Working Results of Co- operative Banks in India

Agency	**StCBs**		**CCBs**		**SCARDBs**		**PCARDBs**	
Year	**2011-12**	**2012-13**	**2011-12**	**2012-13**	**2011-12**	**2012-13**	**2011-12**	**2012-13**
Total (No)	31	32	370	370	20	20	714	714
In Profit (No)	27	29	328	327	10	10	376	373
Profit Amount	759.90	1117.55	1511.00	2322.00	118.63	175.05	225.83	239.60
In Loss (No)	4	3	42	43	9	9	324	327
Loss Amount	139.75	53.66	332.00	493.00	425.92	277.08	443.98	517.59

Source: NABARD Annual Report 2013-2014

Table 23. Accumulated Losses of Co-operative Banks in India (As on 31 March)

Year	**StCBs**	**CCBs**	**SCARDBs**	**PCARDBs**
2012	713.70	4,350.31	1,725.08	4,545.51
2013	602.57	3,202.14	1,922.66	4,765.81

Source: NABARD Annual Report 2013-2014

Suggested Remedies

a. Fresh efforts are warranted to create a cadre of trained, dedicated and honest workers.
b. Co-operative movement should be converted into a people's movement. They should themselves watch against unscrupulous elements taking hold of these societies.
c. Instead of single purpose societies multi-purpose societies need to be organized.
d. Government and political institutions should not interfere in the affairs of co-

operatives

They must have autonomy for granting advances and to recover loans. Cooperatives should take serious actions against willful defaulters (those who do not repay loan- amount want only as per repayment schedule through they are able to generate sufficient funds from the investment for which they got loan).

(v) The working of cooperative credit societies should be improved by arranging for continuous inspection and research into their problems.

The Khusro committee (ACRC) recommended to set up the National co-operative bank of India (NCBI). The NCBI is proposed to be a national body, functioning as a bank owned and operated by the co-operative credit system. It will serve as the national apex institution for all co-operatives and would primarily provide leadership in the area of linking operations to the state apexes and would largely operate as a balancing Centre at the national level. NCBI is proposed to function as a consortium of the co-operative banking system besides mobilizing deposits at the all India level which the state systems are not in a positions to do. It will do all types of banking business including foreign exchange, makes loans and advances, act as an apex co-operative bank at the national level and provide leadership in all matters of cooperative interest, including developmental and promotional activities, evolving and administering an efficient national system of training exclusively for the co-operative banking personnel. It is also designed to function as a national information centre for the co-operative system. The Committee has recommended the same status for NCI as that of any scheduled bank and has advocated that it be granted same concessions and facilities as are available to a scheduled Commercial bank.

The NABARD's interest rate for its refinance facility to SCBs is 3.5 per cent. Interest rate charged by SCB to DCCBs is 4.0 per cent. Interest rate charged by DCCBs to PACS is 6.5 per cent and the interest rate charged by PACS to the borrowers is 10 per cent. The margins available at various levels in the co-operative credit structure at present are inadequate as against the operational costs. The Agricultural Credit Review Committee (ACRC) headed by Prof. A. A.M. Khusro sought to reinforce the role of PACS and the margins recommended are given as follows: PACS-6 per cent; DCCB-3.5 per cent and SCB-1.5 per cent.

Even though there has been some improvement in the margins of land development banks, it still continues to be lower than the following margins recommended by the ACRC:

Federal Structure : PLDB-5 per cent and SLDB - 2 per cent.
Unitary Structure :SLDB - 5.5. per cent.

The average cost of funds raised by was through ordinary debentures is presently about 12 per cent while their lending rates fixed by 8131 range from 11.5 to 15 per cent according to the size of loan. Hence, LDBs should be permitted to advance such loans at economic lending rates or the cost of such debentures has to be reduced by lowering the interest payable to government and other lending institutions.

Lecture No 13: Policies for revitalizing co-operative credit: Salient features of Vaithiyanathan Committee Report on revival of rural co-operative credit institutions, Reorganization of Co-operative credit structure in Andhra Pradesh and single window system and Successful co-operative credit systems in Gujarat, Maharashtra, Punjab, etc.

In the backdrop of these credentials, a look has been taken at the reform process and what it means to the cooperative credit institutions. The financial sector reforms have been components of the overall economic reforms undertaken in a phased manner from 1991-92 by Government of India. These reforms also envisaged improving the efficiency and productivity of the rural credit delivery system which in turn would accelerate the requisite credit flow to the productive sectors of the economy.

The major objectives of these reforms in the cooperative sector were:

• To make the institutions competitive by removing external constraints having a bearing on their operations,
• To improve their financial health,
• To ensure transparency in their business operations,
• To improve their profitability, *and*
• Institutional building and strengthening.

According to the Task Force on Revival of Rural Cooperative Credit Institutions **(Vaidyanathan Committee),** the STCCS never realized the enormous potential opened up by its vast outreach owing mainly to a "deep impairment of governance". While they were originally visualized as member-driven, democratic, self-governing, self-reliant institutions, cooperatives have, over the years, constantly looked up to the State for several basic functions. The Task Force has described in detail how the State Governments have become the dominant shareholders, managers, regulators, supervisors and auditors of the STCCS. The concept of mutuality (with savings and credit functions going together) that provided strength to cooperatives all over the world has been missing in India. This "borrower-driven" system is beset with conflict of interest and has led to regulatory arbitrage, recurrent losses, deposit erosion, poor portfolio quality and a loss of competitive edge for the cooperatives. The Task Force Report also recognised that there is an impasse in the laws governing cooperative banking institutions in the country as cooperation is a State subject while banking activities are regulated by a Central Act. Further, the Task Force also took cognizance of the poor quality of internal control systems, housekeeping and audit in addition to professionally not qualified human resources manning the CCS.

For the revival of the STCCS, the **Vaidyanathan Committee** Report has suggested an implementable Action Plan with substantial financial assistance for recapitalisation subject to introduction of strict legal and institutional reforms together with technical assistance for human resource development (HRD), establishment of a common accounting system and computerisation. The implementation of the Revival Package would result in the emergence of strong and robust cooperatives with conducive legal and institutional environment for it to prosper. At the macro level, the revival Package is expected to promote growth with social justice and greater financial inclusion.

<u>Action Plan</u>

Cooperatives in SHG Linkage – Need for enabling legislations

The Committee is of the view that cooperatives are a good forum for enabling financial inclusion through SHGs. This has been demonstrated in several districts such as Bidar in Karnataka, Chandrapur in Maharashtra and Mandsaur in Madhya Pradesh. The Committee notes that in certain States, legislation has been enacted, admitting SHGs as members of PACS and recommends the enactment of similar legislation in other States to enable the emergence of cooperatives as effective SHPIs. The Committee also recommends that federations of SHGs may be registered in all the States under the Cooperative Societies Act or the parallel Self Reliant Cooperatives Act and availability of funds to these cooperatives for advancing loans may be considered by NABARD, based on objective rating criteria.

Use of PACS and other Primary Cooperatives as Business Correspondents

There are a large number of PACS and primary cooperatives under the parallel Acts located in rural areas where there are no other financial services outlets. Many of these cooperatives are in districts where the DCCBs are defunct or moribund. Such PACS could provide valuable services to their members if they get access to a commercial bank. These PACS could originate credit proposals, disburse loans, collect repayments and even collect savings on behalf of the commercial bank. They could also act as payment channels. RBI has already listed Cooperatives as eligible institutions under the BF/BC Model.

In the circumstances, the Committee recommends that the Cooperatives may make use of this opportunity atleast in States which have accepted the Vaidyanathan Committee recommendations. NABARD may be asked to suggest appropriate guidelines for the purpose, subject to the approval of RBI.

Cooperatives Adopting Group Approach for Financing Excluded Groups

Micro-enterprises, in order to be successful, require larger funding which NGOs cannot provide. It will, therefore, be necessary to develop / test a new form of community based organization other than SHGs which may be more appropriate to support members who engage in micro-enterprises. Those members of SHG who opt to graduate to micro-enterprises could be formed into JLGs or some similar organization.

Banks may be more inclined to lend to individuals in this group based on the performance of each member in the SHG as well as on the assumption that a JLG will provide some degree of mutual guarantee. There is evidence however, that the relations of mutual trust and support which is described as affinity in a SHG tend to be weaker in a JLG. Therefore, new forms of collateral or guarantee may have to be worked out. In this regard, NABARD has already circulated the guidelines which may be adopted by banks.

Further, the use of the BF model could be thought of to organize vulnerable segments of the population into JLGs. The pilot project presently under implementation by NABARD should be sufficiently broad based to cover the role of facilitators in formation and linkage of JLGs.

Risk Mitigation - setting up of Credit Guarantee Fund

The Committee also recommends the setting up of a Credit Guarantee Fund as a risk mitigation mechanism and also for providing comfort to the banks for lending to such JLGs (akin to the Credit Guarantee Fund Scheme for Small Industries - CGFSI - available for small-scale industries - SSI - at present).

Reorganization of Cooperative Credit Structure in Andhra Pradesh and Single Window System

The Andhra Pradesh State Cooperative Bank Limited (APCOB) is a Scheduled State Cooperative Bank for the State of Andhra Pradesh. The Bank is committed to agricultural and rural development through the Cooperatives. The cooperative credit system in Andhra Pradesh with the APCOB at its apex level is a federal system consisting of a family of 22 affiliated District Cooperative Central Banks (DCCBs), which in turn, have 557 Branches and

2748 Primary Agricultural Cooperative Societies (PACS) through which, developmental agricultural credit is provided.

The APCOB and affiliate credit structure in Andhra Pradesh showcase a unique experiment of Single Window Credit Delivery System, as a first of its kind in the country under which, both investment and production credit for agriculture is provided at the grass root level through a single agency. The PACS at village level has been modeled as a one stop shop for the farmer for availing of varied short, medium and long term loans both under production and investment credit, input requirements, produce storage facilities, essential commodities, banking and other rural based services. APCOB has also a network of 26 branches in the twin cities of Hyderabad and Secunderabad and one Head Office Main Branch as also a Branch each at Tirupathi and Vijayawada meeting the exclusive needs of the urban clientele.

Services

The APCOB, through the DCCBs and PACS, provides re-finance support for agricultural production credit for seasonal agricultural operations (crop loans), investment credit for investments in agriculture for Minor Irrigation, Farm Mechanization, Land Development, Horticulture, Dairy, Poultry, Fisheries and other diversified investments and allied activities. In times of natural calamities, the Bank provides credit stabilization arrangements by way of conversion, rephrasement, postponement and reschedulement of agricultural loans. Credit to the weavers sector through Primary Handloom and Silk Weavers Credit Societies, as also financing to the Apex Weavers Society is another important portfolio through which rural development is fostered. Loans to Employees Credit Societies are also extended to provide timely financial support to employees of various organisations mainly through the DCCBs. This apart, the Bank finances Industrial Cooperatives and agro-processing industries in the cooperative fold like Sugar Factories, Spinning Mills, Milk Unions and Dairy Federation.

As a part of its commitment towards rural development, the Bank provides assistance for programmes under **Swarna Jayanthi Gram Swayam rozgar Yojana** (SGSY earlier known as IRDP), Non Farm Sector finance for self employment programmes in the rural and semi-urban areas, micro-credit through Self Help Groups, Youth Associations and Women's Groups. The Bank extends financial support to Apex Cooperative Federations like MARKFED, APCO, FEDCON etc. It has also been providing direct finance to small and medium industries and agro-based units. The Bank offers a host of facilities to its urban clientele. These include, banking facilities under attractive deposit schemes, safe deposit lockers, clean & secured overdrafts, fund transfer and demand drafts, collection of cheques and bills, consumer durable loans, vehicle loans, gold loans, housing loans, real estate mortgage loans and a host of other services. The Bank undertakes all types of standing instructions issued by customers on their accounts with the bank.

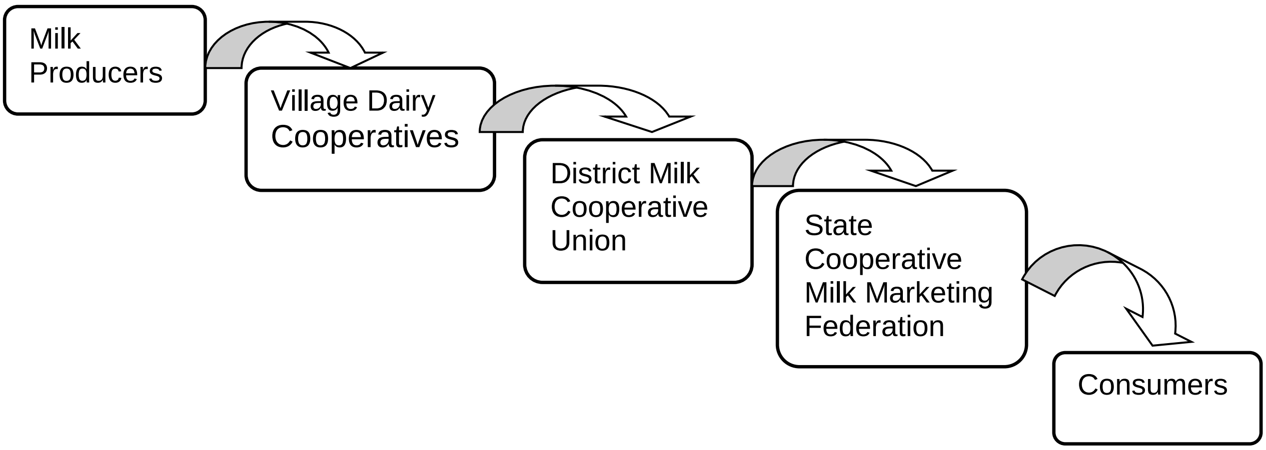
Successful Cooperative System in Gujarat

The seeds of this unusual saga were sown more than 65 years back in Anand, a small town in the state of Gujarat in western India. The exploitative trade practices followed by the local trade cartel triggered off the cooperative movement. Angered by unfair and manipulative practices followed by the trade, the farmers of the district approached the great Indian patriot Sardar Vallabhbhai Patel for a solution. He advised them to get rid of middlemen and form their own co-operative, which would have procurement, processing and marketing under their control.

In 1946, the farmers of this area went on a milk strike refusing to be cowed down by the cartel. Under the inspiration of Sardar Patel, and the guidance of leaders like Morarji Desai and Tribhuvandas Patel, they formed their own cooperative in 1946. This co-operative, the Kaira District Co-operative Milk Producers Union Ltd. began with just two village dairy co-operative societies and 247 litres of milk and is today better known as Amul Dairy. Amul grew from strength to strength thanks to the inspired leadership of Tribhuvandas Patel, the founder Chairman and the committed professionalism of Dr Verghese Kurien,who was entrusted the task of running the dairy from 1950. The then Prime Minister of India, Lal Bahadur Shastri decided that the same approach should become the basis of a National Dairy Development policy. He understood that the success of Amul could be attributed to four important factors. The farmers owned the dairy, their elected representatives managed the village societies and the district union, they employed professionals to operate the dairy and manage its business. Most importantly, the co-operatives were sensitive to the needs of farmers and responsive to their demands. At his instance in 1965 the National Dairy Development Board was set up with the basic objective of replicating the Amul model. Dr. Kurien was chosen to head the institution as its Chairman and asked to replicate this model throughout the country.

The Amul Model

The Amul Model of dairy development is a three-tiered structure with the dairy cooperative societies at the village level federated under a milk union at the district level and a federation of member unions at the state level.



- Establishment of a direct linkage between milk producers and consumers by eliminating middlemen
- Milk Producers (farmers) control procurement, processing and marketing
- Professional management

The Amul model has helped India to emerge as the largest milk producer in the world. More than 15 million milk producers pour their milk in 1,44,500 dairy cooperative societies across the country. Their milk is processed in 184 District Co-operative Unions and marketed by 22 State Marketing Federations, ensuring a better life for millions.

Successful Cooperative System in Maharashtra

Maharashtra has all along been a leader in cooperative movement. Cooperative has become a way of life for people in the State. Almost 50% of the State's population is connected to 1.78 lakh cooperative societies, covering different aspects of people's day to day life. There are about 20,000 primary agriculture credit cooperative societies and 31 district central cooperative banks. As against six villages covered by the society in the country, in Maharashtra one society covers two villages. More than 10 million farmers are members of the primary societies. The cooperative credit system in the State accounts for 65% of the credit disbursements for agriculture as compared to 35% at national level. That is why, the State needs to ensure that the cooperative credit institutions remain vibrant and work in a professional and competitive environment.

The cooperative movement has contributed a great deal in the development of rural economy in the State. While Maharashtra lead the country in terms of financial institutes in the cooperative sector, there are many other success stories like sugar industry, textiles, poultry, milk, agro-processing and marketing etc.

Cooperative Agricultural Credit System in Maharashtra

The co-operative agricultural credit structure in Maharashtra is a three tier structure.

- Short & Medium Term Credit Long Term Credit
- Central Co-op Banks at district level
- Primary Agricultural Credit Societies at Village Level
- Long term credit MASCARD Bank
- Branches at district level
- Sub Branches at Taluk level

Primary Agricultural Credit Societies

The agricultural credit reached the farmers right upto their doorstep through the Primary Agricultural Credit Societies (PACS). The Short Term loan is made available for a period of 12 to 15 months for meeting the cost of expenditure during the agricultural season. Medium Term loan is given for a period of upto five years for the purchase of bullocks, carts, repairs to old wells etc..The Long Term loans are granted for period exceeding five years mainly for sinking of wells, permanent fencing, purchase of land, purchase of heavy agricultural machinery like tractors etc as well as for lift irrigation schemes.

The government has introduced various schemes to provide funds through multipurpose co-operatives to improve the economic conditions at the rural level

- Subsidy to Agricultural Credit Stabilisation fund
- Contribution to Risk Fund
- Share Capital Contribution
- Loans to Co-operative Credit Societies for the conversion of Loans from Short Term to Medium Term.
- Crop Production Incentive to agriculturists.

District Central Co-operative Banks

There are 30 such Banks in Maharashtra whose primary object is to provide for the credit requirements of the PACS. The first such secondary level co-operative was registered in Mumbai in 1911 under the Government of India Act, 1904. Since then these Central Banks have laid the firm financial infrastructure for the co-operative movement in Maharashtra.

The State Co-operative Bank

The State Co-operative Bank, which is at the top of the credit structure, is also called as the Apex bank. Its functions are to co-ordinate and to guide the working of the Central Banks and to arrange re-finance for them. It thus acts like a supervisory body at the top and arranges to spread the co-operative movement.

The Maharashtra State Co-operative Agricultural and Rural Development Bank (MASCARD)

The MASCARD Bank floats debentures for making provision of long term loans to the member Banks. These debentures are purchased mainly by the State Government; however it is necessary for it to create a strong asset base so that it can secure the loans raised by it. During 1999 Maharashtra State Cooperative Agricultural and Rural Development Bank was bifurcated into 29 District Agricultural Cooperative and Multipurpose Rural Development Bank. There will be apex bank of these district banks called as Maharashtra State Cooperative Agricultural and Multipurpose Rural Development bank.

Successful Cooperative System in Punjab

Punjab State Co-operative bank Ltd.,

The Punjab State Cooperative Bank Chandigarh was established on 31st August 1949 at Shimla as a principal financing institution of the cooperative movement in the state. It has 19 branches and 3 extension counters in the city of Chandigarh. 20 Central Cooperative Banks having 788 branches and 29 Extension Counters in the State of Punjab are affiliated with the bank. In the Cooperative banking structure the position of the Punjab State Coop Bank is extremely important as a the whole short term credit system revolves around it. This bank ensures that its member central cooperative banks follow sound banking practices and observe strict financial discipline. The Central Cooperative Banks are financing the farmers through PACS at the village Level. From a farmer, artisan to traders/businessman, everybody has been covered in the fold of this institution. The green, white and sweet revolutions in the state of Punjab are some of the major achievement in which this institution has plays a vital role.

The Punjab State Cooperative Bank has already been awarded "BEST PERFORMANCE AWARD" from NABARD and NAFSCOB for the year 2003-04 which was based on performance of all the SCBs in the country. Similarly Jalandhar DCCB had also been selected for NABARD's "Best Performance Award" out of all the DCCBs in the country for the year 2003-04.

Objectives

- To serve as a Balancing Centre for Cooperative Societies in the State of Punjab registered under the Punjab Cooperative Societies Act, 1961 for the time being in force.

- To promote the economic interest of the member banks and cooperative societies in the state in accordance with cooperative principles and to facilitate the development and funding of any cooperative society registered under the said act.

- To carry on banking and credit business.

The Primary Agricultural Credit/Service Societies

The agricultural co-operative credit structure in the Punjab State is broadly divided into two sectors, one dealing with the short-terms and medium-terms finance and the other with the long-term credit. In the State, the short-term and medium-term credit structure is based on a three-tier system, i.e., the Apex Co-operative Bank at the State level, the Central Co-Coperative Bank at the district/tehsil level and the Primary Agricultural Credit Societies at the village level. The major objectives of the primary agricultural credit service societies are to supply agricultural credit to meet the requirements of funds for agricultural production, the distribution of essential consumer commodities, the provision of storage and marketing facilities and for light agricultural implements and machinery.

The first Agricultural Credit Society in the Firozpur District was registered on 4 October 1911, at the Village of Khalchi Kadim in the Firozpur Tehsil. Originally, the movement was confined to the credit societies only and, thus, credit dominated till the partition (1947). After the partition, the Co-operative Movement began to spread to other field, viz labour, construction and farming.

Owing to an increasing emphasis on the development of land and agriculture, long-term co-operative credit has assumed great importance. There is the Punjab State Land Mortgage Bank at the Apex and the Punjab Mortgage Bank at the district/tehsil level. These Primary Land Mortgage Banks advance loans to the farmers for long term purposes.

At the operational level, there exists a primary co-operative to extend credit to the farmer. This unit epitomizes the vitality and service potential of the Co-operative Movement in India. The organization of these societies dates back to 1904, when the first Co-operative Societies Act was passed. These societies were started with the object of providing cheap credit to the agriculturists in order to free them from the clutches of the rapacious money-lenders. The agricultural primary credit society is the foundation-stone on which the whole co-operative edifice is built. Even now these societies dominate the co-operative picture.

Lecture No: 14: Special Co-operatives: LAMPS and FSS: Objectives, role and functions - National Cooperative Development Corporation (NCDC) and National Federation of State Cooperative Banks Ltd. (NAFSCOB): Objectives and functions.

Large-Sized Adivasi Multi-Purpose Co-operative Societies (LAMPS)

Large-Sized Adivasi Multi-Purpose Co-operative Societies (LAMPS) LAMPS have been set up on the recommendations of the study team (Bawa) appointed by the government of India in 1971. These societies operate mainly in hill and tribal areas.

The objectives of LAMPS are:

i. All types of credit, including those for meeting social obligations and consumer requisites shall be provided under single roof,
ii. Providing technical guidance in the intensification and modernization of agriculture,
iii. Supply of inputs and essential commodities and
iv. Arranging for the marketing of agricultural and minor forest products besides the products of their subsidiary occupations of the tribes.

Members: It is formed in a compact area of having population of 10000 approximately and the majority of whom should be tribes. Membership restriction in there i.e., 70 per cent of the members should be tribes and 30 per cent of the members may be non-tribes.

Sources of Finance: Borrowings from commercial banks, share capital and government contributions

Board of Management: The management is vested with managing committees composed of three government nominated directors, nine tribal and non tribal elected directors.

The CRAFICARD observed constraints which staggered the growth of lamps. They are:

i. Lack of aggressive investment landing
ii. Non availability of trained and experienced personnel for manning executive positions
iii. Unhealthy competition from private traders
iv. Absence of effective marketing organization and market intelligence, lack of infrastructural arrangement for storage and transportation and
v. Inadequate agency commission to the societies for distribution activities.

Performance: There were 2961 LAMPS in the country as on 30th June 1986, nearly 40 per cent of them were in Madhya Pradesh, 17 per cent in Gujarat, Maharashtra, Orissa and Rajasthan and the remaining in other states. There were 2646 LAMPS as on 30 June 1991 with Madhya Pradesh (1073), Bihar (474), Maharashtra (290) and Orissa (223) together accounting for 77.85 per cent of the total. Total members of these societies were 39.31 lakh of which 29.86 lakhs ere scheduled castes and scheduled tribes. The paid up share capital stood at Rs. 30.70 crores and the working capital was Rs. 453.55 crores. Over dues of LAMPS stood at Rs. 163.61 crores which formed 65.20 per cent of their demand. The non-credit business of these societies restricted to marketing of products distribution of farm requisites and consumer goods.

Farmers' Service Society (FSS)

Earlier co-operative societies were mostly under the control of the better-off sections of the society and the small and marginal farmers are not able to get access to the society or its services. They are not able to provide a variety of services like funding infrastructural development such as godowns and agro-service centre as well as providing finances for processing industries in their localities other than credit, and supply of inputs.

Hence, on the recommendation of National Commission on agriculture, the scheme of setting up FSS to cater to the credit and non-credit needs of farmers at a single point was launched in 1973.

The main objective of FSS is to provide all types of credit and full package of services and technical guidance to farmers particularly small farmers, for enhancing production, and for diversification of activities on the farm in an integrated manner and at one contact point.

A Group constituted by the union caninat in July 1974 under the leadership of P.A. Pai recommended the organization of FSS to meet the credit needs of rural area. The study Team head by P.A.Pai recommended the Setting up of 'Farmers Service Co-operatives'. FSS has teen evolved to change the power structure in favour of weaker sections in rural areas and at the same time it will strengthen the co-operative movement through adoption of commercial banking principles in the management of its finances.

Members: Small and marginal farmers and agricultural Labourers can become the members of the society.

Area of Operation: It serves an area covering 10 Kms or extending upto a block or serving 10 villages with a total population of atleast 10,000.

Management: It is managed by board of Directors in which small and marginal farmers have two-third representation. It also has the representatives of the government and its functioning bank. It will have a Managing Director drawn from a Commercial bank as the chief executive officer.

Functions

- It will carry out an agro-economic survey of the area under its jurisdiction to find out the economic situation of the members and accordingly prepare a credit plan for the overall development of the area
- Besides providing loans (cast and kind) for agricultural and allied activities, FSS provide necessary technical assistance to its members for the development of agriculture.

National Cooperative Development Corporation

Genesis

The National Cooperative Development Corporation (NCDC) was established by an Act of Parliament in 1963 as a statutory Corporation under the Ministry of Agriculture & Farmers Welfare.

Functions

Planning, promoting and financing programmes for production, processing, marketing, storage, export and import of agricultural produce, food stuffs, certain other notified commodities e.g. fertilisers, insecticides, agricultural machinery, lac, soap, kerosene oil, textile, rubber etc., supply of consumer goods and collection, processing, marketing, storage and export of minor forest produce through cooperatives, besides income generating stream of activities such as poultry, dairy, fishery, sericulture, handloom etc.

NCDC Act has been further amended which will broad base the area of operation of the Corporation to assist different types of cooperatives and to expand its financial base. NCDC will now be able to finance projects in the rural industrial cooperative sectors and for certain notified services in rural areas like water conservation, irrigation and micro irrigation, agri-insurance, agro-credit, rural sanitation, animal health, etc.

Loans and grants are advanced to State Governments for financing primary and secondary level cooperative societies and direct to the national level and other societies having objects extending beyond one State. Now, the Corporation can also go in for direct funding of projects under its various schemes of assistance on fulfillment of stipulated conditions.

Organisation & Management

The Management vests in 51 member widely represented General Council to give shape to its policies and programmes and Board of Management with 12 members to cater to day-to-day activities. Besides its Head Office, NCDC functions through 18 Regional/State Directorates. The Managing Director is the Chief Executive. Various functional divisions look after the programmes. The field offices play an important role in project identification/formulation and oversee its implementation. NCDC is endowed with in-house technical and managerial capabilities in the areas of Cooperation, Organisation & Methods, Financial Management, Management Information Systems, Sugar, Oilseeds, Textiles, Fruits & Vegetables, Dairy, Poultry and Live stock, Fishery, Handlooms, Civil Engineering, Refrigeration and Preservation to help cooperatives to identify/formulate projects and successfully implement them.

Sources of Funds

Internal accruals, market borrowings and allocations from Government of India including International assistance.

Purposes for which assistance is provided

- Margin money to raise working capital finance (100% loan)
- Strengthening of share capital base of societies (100% loan)
- Working capital to regional/state level marketing federations (100% loan).
- Term loan for creation of infrastructural facilities like godowns, cold storages, equipment financing, purchase of transport vehicles, boats and other tangible assets
- Term and investment loan for establishment of new, modernisation/ expansion/rehabilitation/diversification of agro-processing industries.
- Subsidy for preparation of project reports/feasibility studies etc.

Procedure of Sanction / Disbursal of Assistance

NCDC assistance is not individual beneficiary oriented but is meant for institutional development of Cooperatives. NCDC supplements the efforts of State Government. The State Governments recommend the proposal of individual society / project to NCDC in the prescribed schematic format. The Society may also avail direct funding of projects under various schemes of assistance on fulfillment of stipulated conditions. The proposals are examined in the concerned functional division and if need be on the spot field appraisal is undertaken. Thereafter, formal sanction of funds is conveyed to the State Govt. / Society. The release of funds depends on progress of implementation and is on reimbursement basis. The period of repayment of loan ranges from 3 to 8 years. The rate of interest varies from time to time.

National Federation of State Cooperative Banks

The National Federation of State Cooperative Banks Ltd. (NAFSCOB), Mumbai was established on May 19, 1964 with a view to facilitate the operations of State and Central Cooperative Banks in general and Development of Cooperative Credit in particular.

The specific objectives of NAFSCOB are to:

• Provide a common forum to the member banks to examine the problems of cooperative credit, banking and allied matters and evolve suitable strategies to deal with them.
• Promote and protect the interests of the member banks in all spheres of their activities and to give expression to the views of the member banks.

• Co-ordinate and liaison with Government of India, Reserve Bank of India respective State Governments, NABARD and other higher financing institutions for the development of cooperative credit on behalf of the member banks.

• Provide research and consultancy inputs to the member banks in order to facilitate them to strengthen their own organisations.

• Organize conferences/seminars/workshops/meetings to share the views of common interest with a view to contribute for better policy decisions.

The Federation functions with three of its wings, viz.

(1) Planning, Research and Development (PRD)
(2) All India Mutual Arrangement Scheme (AIMAS) and
(3) Computer Services Division (CSD).

The Funds of the Federation shall be raised as under annual subscriptions, contributions, services charges etc. at the rates fixed by the board from time to time from members only Donations, contributions, grants from members and others and also by way of loans obtained from the financing institutions and others.• Income from publications and journals, etc. Grants and loans from the State Governments, the Central Government, National and International Institutions/Organizations.

Activities

To undertake relevant research studies in Agriculture and Rural Credit from time to time and suggest appropriate strategies.
To implement the All India Mutual Arrangement Scheme evolved in 1967, in order to facilitate the transfer of funds from one corner of the country.
To identify, formulate and evaluate the identified projects for the benefit of the member banks.
To develop a library-cum-documentation center for providing research facilities to cooperatives.
To disseminate the information on latest technology, policies and any other aspects related to cooperative credit through the Federations house journal viz. NAFSCOB BULLETIN.
To undertake any other activity for promoting, protecting and strengthening member banks.

Lecture No 15: Negotiable instruments – meaning, importance, types - Central bank RBI – functions. Credit control – objectives and methods – CRR, SLR, Repo rate. Credit rationing - Dear money and cheap money.

Negotiable Instruments

Exchange of goods and services is the basis of every business activity. Goods are bought and sold for cash as well as on credit. All these transactions require flow of cash either immediately or after a certain time. In modern business, large number of transactions involving huge sums of money takes place every day. It is quite inconvenient as well as risky for either party to make and receive payments in cash. Therefore, it is a common practice for businessmen to make use of certain documents as means of making payment. Some of these documents are called negotiable instruments.

Bill of exchange, cheque, promissory note, or other written contract for payment may serve as a substitute for money. It is simple in form and easy to transfer. Transfer of a negotiable instrument, accomplished by delivery or endorsement and delivery, gives the new holder of the contract the right to enforce fulfillment in his own name. Negotiable instruments made payables to bearer are transferred by delivery; those made payable to order are transferred by endorsement and delivery. Like commercial paper, negotiable instruments were developed to meet the needs of trade.

Definition of Negotiable Instrument

A negotiable instrument is a specialized type of "contract" for the payment of money that is unconditional and capable of transfer by negotiation. Common examples include cheques and banknotes (paper money).

According to section 13 of the Negotiable Instruments Act, 1881, a negotiable instrument means “promissory note, bill of exchange, or cheque **payable either to order or to bearer”.**

Meaning of Negotiable Instruments

To understand the meaning of negotiable instruments let us take a example of day-to-day business transactions. Suppose Kumar, a book publisher, has sold books to Prashant for Rs 10,000/- on three months credit. To be sure that Prashant will pay the money after three months, Kumar may write an order addressed to Prashant that he is to pay after three months, for value of goods received by him, Rs.10,000/- to Kumar or anyone holding the order and presenting it before him (Prashant) for payment. This written document has to be signed by Prashant to show his acceptance of the order. Now, Kumar can hold the document with him for three months and on the due date can collect the money from Prashant. He can also use it for meeting different business transactions. For instance, after a month, if required, he can borrow money from Sunil for a period of two months and pass on this document to Sunil. He has to write on the back of the document an instruction to Prashant to pay money to Sunil, and sign it. Now Sunil becomes the owner of this document and he can claim money from Prashant on the due date. Sunil, if required, can further pass on the document to Amir after instructing and signing on the back of the document. This passing on process may continue further till the final payment is made.

In the above example, Prashant who has bought books worth Rs. 10,000/- can also give an undertaking stating that after three months he will pay the amount to Kumar. Now Kumar can retain that document with himself till the end of three months or pass it on to others for meeting certain business obligation (like with Sunil, as discussed above) before the expiry of that three months time period.

Thus, negotiable instruments are documents meant for making payments, the ownership of which can be transferred from one person to another many times before the final payment is made.

Types of Negotiable Instruments

According to the Negotiable Instruments Act, 1881 there are just three types of negotiable instruments i.e., promissory note, bill of exchange and cheque. However, many other documents are also recognized as negotiable instruments on the basis of custom and usage, like hundis, treasury bills, share warrants, etc., provided they possess the features of negotiability. In the following sections, Promissory Notes (popularly called pronotes), Bills of Exchange (popularly called bills), Cheques and Hundis (a popular indigenous document prevalent in India) are discussed in detail.

i) Promissory Note

Suppose you take a loan of Rupees Five Thousand from your friend Ramesh. You can make a document stating that you will pay the money to Ramesh or the bearer on demand. Or you can mention in the document that you would like to pay the amount after three months. This document, once signed by you, duly stamped and handed over to Ramesh, becomes a negotiable instrument. Now Ramesh can personally present it before you for payment or give this document to some other person to collect money on his behalf. He can endorse it in somebody else's name who in turn can endorse it further till the final payment is made by you to whosoever presents it before you. This type of a document is called a Promissory Note.

Section 4 of the Negotiable Instruments Act, 1881 defines a promissory note as 'an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument'.

A promissory note is a written promise by the *drawer* to pay money to the *payee*. The most common type of promissory note is a bank note, which is defined as a promissory note made by a bank and payable to bearer on demand.

Specimen of a Promissory Note

Rs. 10,000/-	New Delhi
	September 25, 2002
On demand, I promise to pay Ramesh, s/o Ram Lal of Meerut or order a sum of Rs. 10,000/- (Rupees Ten Thousand only), for value received.	
To, Ramesh	Sd/ Sanjeev
Address……..	Stamp

Parties to a Promissory Note

There are primarily two parties involved in a promissory note. They are:
i) The Maker or Drawer – the person who makes the note and promises to pay the amount stated therein. In the above specimen, Sanjeev is the maker or drawer.

ii) The Payee – the person to whom the amount is payable. In the above specimen it is Ramesh.
In course of transfer of a promissory note by payee and others, the parties involved may be -

a) The Endorser – the person who endorses the note in favour of another person. In the above specimen, if Ramesh endorses it in favour of Ranjan and Ranjan also endorses it in favour of Puneet, then Ramesh and Ranjan both are endorsers.

b) The Endorsee – the person in whose favour the note is negotiated by endorsement. In the above, it is Ranjan and then Puneet.

Endorsement means transfer of any document or instrument to another person by signing on its back or face or on a slip of paper attached to it.

Features of a promissory note

- A promissory note must be in writing, duly signed by its maker and properly stamped as per Indian Stamp Act.
- It must contain an undertaking or promise to pay. Mere acknowledgement of indebtedness is not enough. For example, if someone writes 'I owe Rs. 5000/- to Satya Prakash', it is not a promissory note.
- The promise to pay must not be conditional. For example, if it is written 'I promise to pay Suresh Rs 5,000/- after my sister's marriage', is not a promissory note.
- It must contain a promise to pay money only. For example, if someone writes 'I promise to give Suresh a Maruti car' it is not a promissory note.
- The parties to a promissory note, i.e. the maker and the payee must be certain.
- A promissory note may be payable on demand or after a certain date. For example, if it is written 'three months after date I promise to pay Satinder or order a sum of rupees Five Thousand only' it is a promissory note.
- The sum payable mentioned must be certain or capable of being made certain. It means that the sum payable may be in figures or may be such that it can be calculated. (See specimen below).

Rs. 10,000/- New Delhi

November 14, 2002

I, Ramesh , s/o Sadanand of Surat, Gujarat promise to pay Sashikant, s/o Sunil Kumar of Ahmedabad, Gujarat or order, on demand, the sum of Rs 10,000/- (Rupees Ten Thousand only) with interest at the rate of 10 percent per annum, for value received.

Sd/- Ramesh

Stamp

To

Sashikant

Ahmedabad, Gujarat

ii) Bill of Exchange

Suppose Rajiv has given a loan of Rupees Ten Thousand to Sameer, which Sameer has to return. Now, Rajiv also has to give some money to Tarun. In this case, Rajiv can make a document directing Sameer to make payment up to Rupees Ten Thousand to Tarun on demand or after expiry of a specified period. This document is called a bill of exchange, which can be transferred to some other person's name by Tarun.

A bill of exchange or "Draft" is a written order by the *drawer* to the *drawee* to pay money to the *payee*. The most common type of bill of exchange is the cheque, which is defined as a bill of exchange drawn on a banker and payable on demand. Bills of exchange are used primarily in international trade, and are written orders by one person to his bank to pay the bearer a specific sum on a specific date sometime in the future.

Section 5 of the Negotiable Instruments Act, 1881 defines a bill of exchange as 'an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of a certain person, or to the bearer of the instrument'.

Specimen of a Bill of Exchange

Rs. 10,000/-		New Delhi
		May 2, 2001
Five months after date pay Tarun or (to his) order the sum of Rupees Ten Thousand only for value received.		
To	Accepted	Stamp
Sameer	Sameer	S/d
Address		Rajiv

Parties to a Bill of Exchange

There are three parties involved in a bill of exchange. They are
i) The Drawer – The person who makes the order for making payment. In the above specimen, Rajiv is the drawer.

ii) The Drawee – The person to whom the order to pay is made. He is generally a debtor of the drawer. It is Sameer in this case.

iii) The Payee – The person to whom the payment is to be made. In this case it is Tarun.
The drawer can also draw a bill in his own name thereby he himself becomes the payee. Here the words in the bill would be *Pay to us or order*. In a bill where a time period is mentioned, just like the above specimen, is called a ***Time Bill*.** But a bill may be made payable on demand also. This is called a ***Demand Bill*.**

Features of a bill of exchange

- A bill must be in writing, duly signed by its drawer, accepted by its drawee and properly stamped as per Indian Stamp Act.
- It must contain an order to pay. Words like 'please pay Rs 5,000/- on demand and oblige' are not used.
- The order must be unconditional.
- The order must be to pay money and money alone.
- The sum payable mentioned must be certain or capable of being made certain.
- The parties to a bill must be certain.

iii) Cheques

Cheque is a very common form of negotiable instrument. If you have a savings bank account or current account in a bank, you can issue a cheque in your own name or in favour of others, thereby directing the bank to pay the specified amount to the person named in the cheque. Therefore, a cheque may be regarded as a bill of exchange; the only difference is that the bank is always the drawee in case of a cheque.

The Negotiable Instruments Act, 1881 defines a cheque as a bill of exchange drawn on a specified banker and **not expressed to be payable otherwise than on demand**. Actually, a cheque is an order by the account holder of the bank directing his banker to pay on demand, the specified amount, to or to the order of the person named therein or to the bearer.

Specimen of a Cheque

…………......20.....

Pay……..or

Bearer

Rupees…………………………………………………………

Rs.______________

STATE BANK OF INDIA

Jawaharlal Nehru University, New Delhi – 110067

MSBL/97

6 5 3 0 0 3 1 1 0 0 0 2 0 5 6 1 0

Features of a cheque

- A cheque must be in writing and duly signed by the drawer.
- It contains an unconditional order.
- It is issued on a specified banker only.
- The amount specified is always certain and must be clearly mentioned both in figures and words.
- The payee is always certain.
- It is always payable on demand.
- The cheque must bear a date otherwise it is invalid and shall not be honoured by the bank.

Types of Cheque

Broadly speaking, cheques are of four types.
a) Open cheque, and
b) Crossed cheque.
c) Bearer cheque
d) Order cheque

a) Open cheque: A cheque is called ‘Open’ when it is possible to get cash over the counter at the bank. The holder of an open cheque can do the following:
i) Receive its payment over the counter at the bank,
ii) Deposit the cheque in his own account
iii) Pass it to someone else by signing on the back of a cheque.

b) Crossed cheque: Since open cheque is subject to risk of theft, it is dangerous to issue such cheques. This risk can be avoided by issuing other types of cheque called ‘Crossed cheque’. The payment of such cheque is not made over the counter at the bank. It is only credited to the bank account of the payee. A cheque can be crossed by drawing two transverse parallel lines across the cheque, with or without the writing ‘Account payee’ or ‘Not Negotiable’.

c) Bearer cheque: A cheque which is payable to any person who presents it for payment at the bank counter is called ‘Bearer cheque’. A bearer cheque can be transferred by mere delivery and requires no endorsement.

d) Order cheque: An order cheque is one which is payable to a particular person. In such a cheque the word ‘bearer’ may be cut out or cancelled and the word ‘order’ may be written. The payee can transfer an order cheque to someone else by signing his or her name on the back of it.

There is another categorization of cheques which is discussed below:

Ante-dated cheques*:-* Cheque in which the drawer mentions the date earlier to the date of presenting if for payment. For example, a cheque issued on 20th May 2003 may bear a date 5th May 2003.

Stale Cheque*:-* A cheque which is issued today must be presented before at bank for payment within a stipulated period. After expiry of that period, no payment will be made and it is then called ‘stale cheque’. Find out from your nearest bank about the validity period of a cheque.

Mutilated Cheque*:-* In case a cheque is torn into two or more pieces and presented for payment, such a cheque is called a mutilated cheque. The bank will not make payment against such a cheque without getting confirmation of the drawer. But if a cheque is torn at the corners and no material fact is erased or cancelled, the bank may make payment against such a cheque.

Post-dated Cheque*:-* Cheque on which drawer mentions a date which is subsequent to the date on which it is presented, is called post-dated cheque. For example, if a cheque presented on 8th May 2003 bears a date of 25th May 2003, it is a post-dated cheque. The bank will make payment only on or after 25th May 2003.

iv) Hundis

A Hundi is a negotiable instrument by usage. It is often in the form of a bill of exchange drawn in any local language in accordance with the custom of the place. Sometimes it can also be in the form of a promissory note. A hundi is the oldest known instrument used for the purpose of transfer of money without its actual physical movement. The provisions of the Negotiable Instruments Act shall apply to hundis only when there is no customary rule known to the people.

Types of Hundis

There are a variety of hundis used in our country. Let us discuss some of the most common ones.

Shah-jog Hundi: This is drawn by one merchant on another, asking the latter to pay the amount to a Shah. Shah is a respectable and responsible person, a man of worth and known in the bazaar. A shah-jog hundi passes from one hand to another till it reaches a Shah, who, after reasonable enquiries, presents it to the drawee for acceptance of the payment.

Darshani Hundi: This is a hundi payable at sight. It must be presented for payment within a reasonable time after its receipt by the holder. Thus, it is similar to a demand bill.

Muddati Hundi: A muddati or miadi hundi is payable after a specified period of time. This is similar to a time bill.

Features of Negotiable Instruments

- A negotiable instrument is freely transferable. Usually, when we transfer any property to somebody, we are required to make a transfer deed, get it registered, pay stamp duty, etc. But, such formalities are not required while transferring a negotiable instrument. The ownership is changed by mere delivery (when payable to the bearer) or by valid endorsement and delivery (when payable to order). Further, while transferring, it is also not required to give a notice to the previous holder.

- Negotiability confers absolute and good title on the transferee. It means that a person who receives a negotiable instrument has a clear and undisputable title to the instrument.

- However, the title of the receiver will be absolute, only if he has got the instrument in good faith and for a consideration. Also the receiver should have no knowledge of the previous holder having any defect in his title. Such a person is known as holder in due course. For example, suppose Rajiv issued a bearer cheque payable to Sanjay. It was stolen from Sanjay by a person, who passed it on to Girish. If Girish received it in good faith and for value and without knowledge of cheque having been stolen, he will be entitled to receive the amount of the cheque. Here Girish will be regarded as 'holder in due course'.

- A negotiable instrument must be in writing. This includes handwriting, typing, computer printout and engraving, etc.

- In every negotiable instrument there must be an unconditional order or promise for payment.

- The instrument must involve payment of a certain sum of money only and nothing else. For example, one cannot make a promissory note on assets, securities, or goods.

- The time of payment must be certain. It means that the instrument must be payable at a time which is certain to arrive. If the time is mentioned as 'when convenient' it is not a negotiable instrument. However, if the time of payment is linked to the death of a person, it is nevertheless a negotiable instrument as death is certain, though the time thereof is not.

- The payee must be a certain person. It means that the person in whose favour the instrument is made must be named or described with reasonable certainty. The term 'person' includes individual, body corporate, trade unions, even secretary, director or chairman of an institution. The payee can also be more than one person.

- A negotiable instrument must bear the signature of its maker. Without the signature of the drawer or the maker, the instrument shall not be a valid one.

- Delivery of the instrument is essential. Any negotiable instrument like a cheque or a promissory note is not complete till it is delivered to its payee. For example, you may issue a cheque in your brother's name but it is not a negotiable instrument till it is given to your brother.

❖ Stamping of Bills of Exchange and Promissory Notes is mandatory. This is required as per the Indian Stamp Act, 1899. The value of stamp depends upon the value of the pronote or bill and the time of their payment.

Table 24. Distinction between a Promissory Note and a Bill of Exchange

Promissory Note	Bill of Exchange
1. It contains an unconditional promise.	1. It contains an unconditional order.
2.There are two parties – the maker and the payee.	2. There are three parties – the drawer, the drawee and the payee.
3. It is made by the debtor.	3. It is made by the creditor.
4. Acceptance is not required.	4. Acceptance by the drawee is a must.
5. The liability of the maker/drawer is primary and absolute.	5. The liability of the maker/drawer is secondary and conditional upon non-payment by the drawee.

Table 25. Distinction between a Cheque and a Bill of Exchange

Cheque	Bill of Exchange
1. It is drawn only on a banker.	1. It can be drawn on anybody including a banker.
2. The amount is always payable on demand.	2. The amount is payable on demand or after a specified period.
3. It can be crossed to end its negotiability.	3. It cannot be crossed.
4. Acceptance is not required.	4. Acceptance is a must.

Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR)

Both CRR and SLR are instruments in the hands of RBI to regulate money supply in the hands of banks that they can pump in economy. SLR restricts the bank's leverage in pumping more money into the economy. On the other hand, CRR, or cash reserve ratio, is the portion of deposits that the banks have to maintain with the Central Bank to reduce liquidity in banking system. Thus CRR controls liquidity in banking system while SLR regulates credit growth in the country.

The other difference is that to meet SLR, banks can use cash, gold or approved securities whereas with CRR it has to be only cash. CRR is maintained in cash form with central bank, whereas SLR is money deposited in govt. securities. CRR is used to control inflation.

Statutory liquidity ratio (**SLR**) refers amount that the commercial banks require to maintain in the form of gold or govt. approved securities before providing credit to the customers. Here by approved securities we mean, bond and shares of different companies. Statutory Liquidity Ratio is determined and maintained by the Reserve Bank of India in order to control the expansion of bank credit.

Determination of SLR

It is determined as percentage of total demand and time liabilities. Time Liabilities refer to the liabilities, which the commercial banks are liable to pay to the customers after a certain period mutually agreed upon and demand liabilities are such deposits of the customers which are payable on demand. Example of time liability is a fixed deposits for 6 months, which is not payable on demand but after six months. Example of demand liability is deposit maintained in saving account or current account, which are payable on demand through a withdrawal form of a cheque.

Usage of SLR

SLR is used by bankers and indicates the minimum percentage of deposits that the bank has to maintain in form of gold, cash or other approved securities. Thus, we can say that it is ratio of cash and some other approved liabilities (deposits). It regulates the credit growth in India.

The liabilities that the banks are liable to pay within one month's time, due to completion of maturity period, are also considered as time liabilities. The maximum limit of SLR is 40% and minimum limit of SLR is 22% In India, Reserve Bank of India always determines the percentage of SLR. There are some statutory requirements for temporarily placing the money in government bonds. Following this requirement, Reserve Bank of India fixes the level of SLR. At present, the minimum limit of SLO that can be set by the Reserve Bank is 22% AS ON 5 August 2014. A reduction of SLR rate looks eminent to support the credit growth in India.

Objectives of SLR

The main objectives for maintaining the SLR ratio are the following:

- to control the expansion of bank credit. By changing the level of SLR, the Reserve Bank of India can increase or decrease bank credit expansion.
- to ensure the solvency of commercial banks.
- to compel the commercial banks to invest in government securities like government bonds.

If any Indian bank fails to maintain the required level of Statutory Liquidity Ratio, then it becomes liable to pay penalty to Reserve Bank of India. The defaulter bank pays penal interest at the rate of 3% per annum above the Bank Rate, on the shortfall amount for that particular day. But, according to the Circular, released by the Department of Banking Operations and Development, Reserve Bank of India; if the defaulter bank continues to default on the next working day, then the rate of penal interest can be increased to 5% per annum above the Bank Rate. This restriction is imposed by RBI on banks to make funds available to customers on demand as soon as possible. Gold and government securities (or gilts) are included along with cash because they are highly liquid and safe assets.

The RBI can increase the SLR to contain inflation, suck liquidity in the market, to tighten the measure to safeguard the customers money. In a growing economy banks would like to invest in stock market, not in government securities or gold as the latter would yield less returns. One more reason is long term government securities (or any bond) are sensitive to interest rate changes. But in an emerging economy interest rate change is a common activity.

Repo rate is the rate at which the central bank of a country (RBI in case of India) lends money to commercial banks in the event of any shortfall of funds.

Definition: Repo rate is the rate at which the central bank of a country (Reserve Bank of India in case of India) lends money to commercial banks in the event of any shortfall of funds. Repo rate is used by monetary authorities to control inflation.

Description: In the event of inflation, central banks increase repo rate as this acts as a disincentive for banks to borrow from the central bank. This ultimately reduces the money supply in the economy and thus helps in arresting inflation. The central bank takes the contrary position in the event of a fall in inflationary pressures. Repo and reverse repo rates form a part of the liquidity adjustment facility. In India, the bank rate is the rate at which the Reserve Bank of India lends to commercial banks and other financial institutions for meeting shortfalls in their reserve requirements, for long-term purposes.

Credit Rationing

Credit rationing describes the situation when a bank limits the supply of loans, although it has enough funds to loan out, and the supply of loans has not yet equalled the demand of prospective borrowers. Changing the price of the loans (interest rate) does not equilibrate the demand and supply of the loans. The bank finds that raising the interest rate beyond a certain level actually reduces its profitability.

Joseph E. Stiglitz and Andrew Weiss's 1981 paper was one of the early papers to explain why the bank (or any lending institution for that matter) may credit ration its borrower if i) the bank was unable to perfectly distinguish the risky borrowers from the safe ones and ii) the loan contracts were subject to limited liability (if projects returns were less than the debt obligation, the borrower bears no responsibility to pay out her pocket).

Credit rationing denotes a situation where a large section of loan applicants do not get the loans they seek. This has serious implications for a developing economy like India. The proposed no-frills account is a win-win opportunity for banks to cater to such a segment. In a recent move, the RBI has urged the banking community to introduce the no-frills account to bring a large section of under-privileged people into the banking net. The idea has been propelled by the realization that even with 70,000 bank branches in the country, a large section of the population continues to remain credit-starved. The no-frills bank accounts will, therefore, be an innovative instrument to introduce the concept of banking to the under-privileged and reduce credit rationing for this section of people. As the individual bank would have the privilege to design these no-frills accounts, the basic characteristic would involve zero or a very low balance with limited transaction facilities.

Credit rationing captures the situation where the interest rate is different from the market clearing rates and at this rate, the demand for loan is greater than the supply of loan, implying that a large section of loan applicants do not get the loan. This has a serious implication for a developing economy like India, as credit is essential in poor rural economies for the subsistence. Credit rationing forces a large section of poor people to approach informal credit market and accept a usury rate.

Causes of Credit Rationing

The credit market is characterized by the "asymmetry of information". In a market, information asymmetry occurs when one party to a transaction has more or better information than the other. Typically, in an unsecured credit market, the borrower will have better information than the lender and, therefore, the latter cannot distinguish between borrowers of different degrees of risk. One of the perverse fallout of asymmetry of information is the "adverse selection".

Raising interest rate may not be an option (in fact, can turn out to be counter-productive), as the high interest rate leads to an adverse selection. At a high level of interest, lenders would end up attracting only the extremely high-risk applicants. Knowing this, lenders may prefer to hold the interest at a level below the market clearing rating, leaving a vast pool of applicants credit starved. Contrary to this, the informal credit market, based on its private information about the borrower, can charge an appropriate interest rate, often an usurious one, to meet this unsatisfied demand.

Therefore, the only way to combat credit rationing by banks is to improve the informational asymmetry by bringing in more accurate information about the borrowers in the market place. And no-frills bank accounts can be a highly effective instrument to generate this information. As the no-frills accounts are expected to introduce the concept of banking to a large section of underprivileged, it will also help the banks create a database of these customers. The banks, therefore, can prudently use this information to target the honest customers in their databases to cross-sell various unsecured products.

Dear money and cheap money policy of the central bank ie Reserve Bank of India is very important for controlling money markets. In case of dear money policy, RBI raises the Bank rate and this means that the commercial Banks can get the money at the Higher rate of interest which is passed on to the Investors and Consumers. When the cost of Credit goes up the Investors tend to reduce the investments in the Economy and the consumers tend to spend less as the cost of borrowing goes up. Regarding the availability of credit, RBI starts raising the Cash reserve ratio and sells the securities to the commercial Banks which reduces the available credit with them. This tends to reduce the circulation of the Money in the Economy. Generally this policy is followed when there is Inflation in the Economy hoping to reduce the Aggregate Demand in the Economy.

Cheap money is a monetary policy in which a central bank sets low interest rates so that credit is easily attainable. This makes borrowing easy for business, which stimulates investment and expansion of operations. The immediate result of cheap money is a boost in stock prices; in the medium term, cheap money promotes economic growth. However, if cheap money remains in the economy for too long, it can lead to a situation in which there is a glut of currency or too many dollars chasing too few goods and services leading to inflation. For this reason, most central banks alternate between policies of cheap money and tight money in varying degrees to encourage growth while keeping inflation under control.

Lecture No 16: Financial Inclusion- credit widening and credit deepening monetary policies. Credit gap: Factors influencing credit gap -.Non- Banking Financial Institutions (NBFI).

Financial Inclusion – Credit Widening and Credit Deepening

A World Bank report (2008) states, “Financial inclusion, or broad access to financial services, is defined as an absence of price or non price barriers in the use of financial services.” It recognizes the fact that financial inclusion does not imply that all households and firms should be able to borrow unlimited amounts or transmit funds across the world for some fee. It makes the point that creditworthiness of the customer is critical in providing financial services. The report also stresses the distinction between ‘access to’ and ‘use of’ financial services as it has implications for policy makers. ‘*Access’ essentially refers to the supply of services, whereas use is determined by demand as well as supply.* Among the non-users of formal financial services a clear distinction needs to be made between voluntary and involuntary exclusion. The problem of financial inclusion addresses the ‘involuntarily excluded’ as they are the ones who, despite demanding financial services, do not have access to them.

Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost.

Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost (The Committee on Financial Inclusion, Chairman: Dr. C. Rangarajan).

Financial Inclusion, broadly defined, refers to universal access to a wide range of financial services at a reasonable cost. These include not only banking products but also other financial services such as insurance and equity products (The Committee on Financial Sector Reforms, Chairman:Dr.Raghuram G. Rajan). While increasing the number of credit accounts in favour of low income and other disadvantaged sections is defined as ‘credit widening’, increasing the volume of credit per account is defined as ‘credit deepening’.

Financial deepening is a term used often by economic development experts. It refers to the increased provision of financial services with a wider choice of services geared to all levels of society. It also refers to the macro effects of financial deepening on the larger economy. Financial deepening generally means an increased ratio of money supply to GDP or some price index. It refers to liquid money. The more liquid money is available in an economy, the more opportunities exist for continued growth.

It can also play an important role in reducing risk and vulnerability for disadvantaged groups, and increasing the ability of individuals and households to access basic services like health and education, thus having a more direct impact on poverty reduction.

Non-Banking Financial Institutions

According to the Reserve Bank of India Amendment Act 1997 the Non Banking Finance company was defined as under:-

⇒ A financial institution which is a company,

⇒ A non banking institution which is a company and whose principal business is to receiving of deposits under any scheme/arrangement/in any other manner or lending in any manner and

⇒ Other non banking institutions/class of institutions as the RBI may specify.

Non-banking Financial Institutions (NBFIs) carry out financing activities but their resources are not directly obtained from the savers as debt. Instead, these institutions mobilize the public savings for rendering other financial services including investment. All such institutions are financial intermediaries and when they lend, they are known as Non-Banking Financial Intermediaries (NBFIs) or Investment Institutions.

- Unit Trust of India (UTI)
- Life Insurance Corporation (LIC)
- General Insurance Corporation (GIC)

Apart from these NBFIs, another part of Indian financial system consists of a large number of privately owned, decentralized, and relatively small-sized financial intermediaries. While some of them restrict themselves to fund-based business, many others provide financial services of various types. The entities of the former type are termed as "non-bank financial companies (NBFCs)". The latter type are called "non-bank financial services companies (NBFCs)".

***Non-Banking includes*:**

Provident and Pension Funds, Small Savings Organizations, Life Insurance Corporation (LIC), General Insurance Corporation (GIC), Unit Trust of India(UTI), Mutual Funds, Investment Trusts, Investment Companies, Finance Corporations, Nidhis, Chit Funds, Hire-Purchase Finance Companies, Lease Finance Companies, National Housing Bank (NHB), Housing and Urban Development Corporation (HUDCO), Housing Development Finance Corporation (HDFC), and other housing finance companies, Manufacturing companies accepting public deposits, Venture Capital Funds and National Cooperative Bank of India(NCBI).

During 2006 the NBFCs were reclassified as three types they are 1) Asset Finance companies (in this both Equipment Leasing and Hire Purchase companies were merged), 2) Investment Companies and 3) Loan Companies Apart from those classifications, in order to operate these NBFCs smoothly certain regulations/directions were issued they are a) Regulations for deposits for NBFCs accepting deposits, b) Regulations for NBFCs not accepting deposits and c) Regulations for core investment companies to smooth functioning of their businesses as well as to give confidence to the participants as well as operators.

Post 1996, Reserve Bank of India has set in place additional regulatory and supervisory measure that demand more financial discipline and transparency of decision making on the part of NBFCs. Further, one can expect that some areas of co-operation between the Banks and NBFCs may emerge in the coming era of E-commerce and Internet banking.

Table 26. Number of Non-Banking Financial Companies

End-June	All NBFCs	NBFCs Accepting Public Deposits
1999	7855	624
2000	8451	679
2001	13815	776
2002	14077	784
2003	13849	710
2004	13764	604
2005*	13261	507
2014		226

***: net of cancellation.**

Non-banking financial companies represent a heterogeneous group of institutions separated by their type of activity, organizational structure and portfolio mix. Four types of institutions, categorized in terms of their primary business activity and under the regulatory purview of the Reserve Bank, are i) equipment leasing companies, ii) hire purchase companies, iii) loan companies and iv) investment companies. The residuary non-banking companies (RNBCs) have been classified as a separate category as their business does not conform to any of the other defined classes of NBFC businesses. Besides, there are other NBFCs, *viz*., miscellaneous non-banking companies (Chit Fund), mutual benefit finance companies (*Nidhis* and Potential *Nidhis*) and housing finance companies, which are either partially regulated by the Reserve Bank or are outside the purview of the Reserve Bank.

NBFCs were allowed to enter into credit card business on their own or in association with another NBFC or a scheduled commercial bank. NBFCs are not allowed to issue any debit card as it would be similar to opening and operating a demand deposit account, which is the exclusive privilege of banks. Emergency cash withdrawal facility through ATMs of associate bank may only be allowed to credit card holders as a short-term advance with a reasonable limit and necessary built-in safeguards.

Table 27. Non Performing Asset Ratios of NBFCs (in Percentage)

End March	Gross NPAs to Gross Advances	Net NPAs to Net Advances
2001	11.5	5.6
2002	10.6	3.9
2003	8.8	2.7
2004	8.2	2.4
2005	5.7	2.5
2006	3.6	0.5
2007	2.2	0.2
2008	2.1	#
2009	2.0	#
2010	1.3	#
2011	0.7	#
2012	2.1	0.5

: Provisional. # Provision exceeds NPA

Source: Report on Trend and Progress of Banking in India, RBI, Mumbai, various issues

The NBFC would have to satisfy the requirement of a minimum net owned fund of Rs.100 crore and such other terms and conditions as the Reserve Bank may specify to this effect from time to time. NBFCs which were granted Certificate of Registration (CoR) in the non-public deposit taking category should meet the minimum capital requirement of Rs.2 crore for being eligible to apply to the Reserve Bank for accepting deposits.

Table 28. Number of Non Banking Financial Companies Registered with RBI

End-June	Number of Registered NBFCs	Annual Growth Rate	NBFCs Accepting Public Deposits	Annual Growth Rate
1999	7855	-	623 (8.0)	-
2000	8451	7.59	679 (8.0)	8.99
2001	13815	63.47	776 (5.6)	14.29
2002	14077	1.9	784 (5.5)	1.03
2003	13849	-1.62	710 (5.1)	-9.44

2004	13764	-0.61	604 (4.3)	-14.93
2005	13261	-3.65	507 (3.8)	-16.06
2006	13014	-1.86	428 (3.2)	-15.58
2007	12968	-0.35	401 (3.1)	-6.31
2008	12809	-1.23	364 (2.8)	-9.23
2009	12740	-0.54	336 (2.6)	-7.69
2010	12630	-0.86	308 (2.4)	-8.33
2011	12409	-0.02	297 (2.2)	-0.04
2012	12385	-0.001	271 (2.1)	-0.09

Note: Figures in brackets indicate percentage to the total number of NBFCs.
Source: Report on Trend and Progress of Banking in India, RBI, Mumbai, various issues

Table 29. Financial Performance of NBFCs (Amount in Crore)

As at end March	1999	2000	2003	2004	2005	2006	2007	2008	2009	2010	2011
A.Income (i+ii)	6809	6770	5084	4332	4582	4578	5721	11879	13656	13615	15200
i.Fund based	6551 (96.2)	6299 (93.0)	4709 (92.6)	4005 (92.5)	4208 (91.8)	4433 (96.8)	5590 (97.7)	11572 (97.4)	13489 (98.8)	13388 (98.3)	15100 (99.2)
ii.Fee based	258 (3.8)	471 (7.0)	375 (7.4)	327 (7.5)	374 (8.2)	145 (3.2)	131 (2.3)	307 (2.6)	167 (1.2)	227 (1.7)	100 (0.8)
B.Expenditure (i+ii+iii)	6416	6363	4491	3621	3657	4134	4831	8789	11166	11038	10900
i. Financial	4355 (67.9)	3687 (57.9)	2757 (61.4)	2099 (58.0)	2168 (59.3)	2174 (52.6)	2765 (57.3)	5663 (64.4)	6742 (60.4)	6546 (59.3)	6800 (62.3)
Of which interest payment	-	-	-	-	783 (21.4)	- -	508 (10.5)	211 (2.4)	289 (2.6)	730 (6.6)	900 (8.2)
ii.Operating	1077 (16.8)	1614 (25.4)	1734 (38.6)	1522 (42.0)	1489 (40.7)	1960 (47.4)	1261 (26.1)	2392 (27.2)	2587 (23.2)	2666 (24.2)	3000 (27.2)
iii.Others	984 (15.3)	1062 (16.7)	-	-	-	-	804 (16.6)	734 (8.4)	1837 (16.4)	1825 (16.5)	1100 (10.5)
C.Tax Provisions	273	270	254	180	353	291	385	1017	1085	1096	1400
D.Operating Profit	-	-	593	711	924	443	890	3090	2490	2577	4300
E.Net Profit	120	137	339	531	572	152	504	2073	1405	1482	2900
F.Total Assets	35968	40007	37709	32754	36003	35561	48554	77128	93709	94212	105400

Source: Report on Trend and Progress of Banking in India, RBI, Mumbai, various issues

Many activities and functions of NBFC's are similar to those of banks. The distinction between them has become considerably blurred. It is true that NBFCs, unlike banks, are still not a part of payments mechanism. They cannot create money but in many other respects, they are substitution and complementary with banks.

NBFCs are doing functions akin to that of banks; however there are a few differences:
(i) An NBFC cannot accept demand deposits;
(ii) An NBFC is not a part of the payment and settlement system and as such an NBFC cannot issue cheque drawn on itself; and
(iii) Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available for NBFC depositors unlike in case of banks.

Role of NBFIs

The Reserve Bank of India expert committees identified the need of non banking financial companies in the following areas:

- Development of sectors like transport and infrastructure
- Substantial employment generation
- Help and increase wealth creation
- Broad base economic development
- Irreplaceable supplement to bank credit in rural segments
- Major thrust on semi-urban, rural Areas and first time buyers/users
- To finance economically weaker sections.
- Huge contribution to the state exchequer.

Lecture No 17: Assessment of crop losses, Determination of compensation - Crop Insurance: Schemes, Coverage, Advantages and Limitations in Implementation - Estimation of Crop Yields - Livestock Insurance Schemes - Agricultural Insurance Company of India Ltd (AIC): Objectives and functions.

Experimental crop insurance schemes

In reality, crop insurance had already emerged, though on a small-scale, experimental basis. During 1973—76, fertilizer companies, such as Gujarat State Fertiliser Company in Gujarat and Rashtriya Chemicals and Fertilisers Company in Maharashtra, started pilot crop insurance schemes as components of agricultural extension projects. Similar experimental schemes were started in Andhra Pradesh, Karnataka, Tamil Corporation of India (GIC) from its inception in 1973 until 1976-covered cotton, wheat, groundnut and potato crops, and 2,154 farmers. Another experimental scheme for cotton, covering 909 farmers, was operated during 1978–79 in Gujarat, Madhya Pradesh and Maharashtra. These loss-making schemes led to the realization that schemes based on individuals were not practical on a national scale.

The Pilot Crop Insurance Scheme

Following Prof. Dandekar's suggestion, GIC prepared a crop insurance scheme based on the area approach and put it into operation from 1979–80. Initially, it was introduced as a pilot scheme in three States and was extended to twelve States by 1984–85. Participation was voluntary. The insurance premium ranged from 5–10 per cent of the sum insured. The number of farmers covered in a year ranged from 16,000 to 60,000, except for 1984–85, when 4, 47,000 were covered. The loss ratio was 1.10 over the five-year period from 1979–80 to 1980–84. The scheme was discontinued in 1985, when CCIS was introduced.

The Comprehensive Crop Insurance Scheme (CCIS)

The Government of India introduced CCIS in the financial year 1985–86. Operated by GIC in collaboration with the respective State governments, the scheme covered cereals, pulses and oilseeds. Crop insurance was linked to institutional credit; farmers who availed themselves of loans for specified crops were eligible for insurance coverage. State governments were left to decide whether to operate the scheme in the State or not. Once it was operational, participation of farmers taking out short-term crop loans from credit institutions was compulsory. The indemnity and premium were shared by the Central and the State governments in the ratio of 2:1. Originally, the farmer was insured for 150 per cent of the loan disbursed to him for growing the insured crops; this was reduced to 100 percent in 1988. The rate of premium was uniform for the whole country: 2 per cent of the sum insured for rice, wheat and millet crops, and 1 per cent for pulses and oilseeds. Even the low rate of premium was subsidized by 50 per cent in the case of small and marginal farmers. This is in contrast of the rate of 5–10 per cent in the pilot crop insurance scheme. The latter was voluntary, whereas CCIS was compulsory.

The scheme was based on the area approach. Area units called "defined areas" were identified for the purpose of assessing the indemnity. A defined area could be a district, a taluka, a block or any other contiguous area. The actual average yield per hectare of the defined area was determined on the basis of crop-cutting experiments. If the actual yield of an insured crop would fall short of the specified TY, for the area, all insured farmers growing that crop in that area would be deemed to have suffered the shortfall in the respective yield and entitled to receive the indemnity.

The Experimental Crop Insurance Scheme (ECIS)

In 1992, even while CCIS was being implemented, GoI considered introducing a new pilot scheme called the Experimental Crop Insurance Scheme (ECIS) in one district of each State. The idea was to provide insurance coverage to all farmers, unlike only loanee farmers under CCIS. A draft scheme was circulated among State governments and national agencies in 1992. Finally, ECIS was introduced during the *Rabi* season of 1997–98. The scheme was similar to CCIS; however, it was meant only for small/marginal farmers (both loanee and non-loanee) and the premium was fully subsidized. The scheme was operated during 1997–98 rainy season in Andhra Pradesh, Assam, Karnataka, Orissa and Tamil Nadu. The indemnity was Rs 37 80 crore against the premium receipt of Rs 2.80 crore. The scheme was discontinued after one season due to financial problems.

The Pilot Scheme on Seed Crop Insurance (PSSCI)

The Government of India's PSSCI came into effect from *Rabi* 1999–2000. The objective was to provide a sense of financial security to seed breeders and seed growers against failure of seed crops. The scheme covered breeder, foundation and certified seeds of the following crops: Cereals (paddy, wheat, maize, jowar [sorghum], ragi and bajra [pearl millet]), Lentils (soya bean, gram, green gram, black gram, red gram and pea), Oil seeds (sunflower, castor, mustard, and groundnut), Cotton, jute and Potato

The National Agricultural Insurance Scheme (NAIS)

After NAIS was introduced in *Rabi* 1999–2000, leading to the discontinuation of CCIS. Like CCIS, NAIS is primarily based on the area approach. It covers all farmers: loanees and non-loanees. It envisages coverage of cereals, millets, pulses, oilseeds and annual horticultural/commercial crops for which adequate yield data are available.

Salient features of NAIS:

States and areas covered**:** All States and Union Territories had the option of implementing the scheme.

Farmers covered: All farmers including sharecroppers and tenant farmers growing the notified crops in the notified areas were eligible for coverage. The scheme was compulsory for farmers availing crop loans and voluntary for others.

Crops covered: Food crops (cereals, millets and pulses) Oilseeds Annual commercial / horticultural crops (sugarcane, cotton, potato, onion, chilli, turmeric, ginger, jute, tapioca, annual banana and annual pineapple)

Sum insured: The minimum sum insured (SI) in case of loanee farmers is the amount of loan availed, which can be further extended up to value of 150 per cent of average yield. For non-loanee farmer, it can be up to value of 150 per cent of average yield.

Premium rates: The premium rates are 3.5 per cent for oilseeds and bajra and 2.5 per cent for cereals, millets and pulses during *Kharif*; 1.5 per cent for wheat and 2 per cent for other food crops and oilseeds during *Rabi*. The rates for annual commercial/horticultural crops are based on actuals.

Premium subsidy: Premiums for small/marginal farmers are subsidized to the extent of 50 per cent, to be shared equally between the Centre and States. The premium subsidy was to be phased out over a five-year period on sunset basis, starting with 50 per cent subsidy in the first year, which would be reduced by 10 per cent each year and was to be completely phased out in five years. However, 10 per cent subsidy continued to be given till the end.

Scheme approach: The scheme covered losses from sowing to harvesting, and operated on area approach for widespread calamities. For this purpose, a unit of insurance is defined which may be a Village Panchayat, Mandal, Hobli, Circle, Phirka, Block, Taluka, etc., to be decided by the State Government /UT. However, each participating State government/UT was required to reach the level of village panchayat as the unit within three years. The Scheme operated on an individual basis for specific localized calamities on an experimental basis.

Loss assessment, levels of indemnity and threshold yield: The threshold yield or guaranteed yield for a crop in an insurance unit was the moving average yield, based on the past three years, in case of rice and wheat, and five years' yield in case of other crops, multiplied by the level of indemnity. Three levels of indemnity—90 per cent, 80 per cent and 60 per cent, corresponding to low-risk, medium-risk and high-risk areas—were available for all crops. The insured farmers of each unit area could also opt for higher level of indemnity on payment of additional premium. If the actual yield (AY) per hectare of the insured crop for the defined area fell short of the specified TY, all the insured farmers growing that crop in the defined area were deemed to have suffered the same amount of shortfall in their yield.

Sharing of risk: Government of India and States shared claims beyond 100 per cent of premium for food crops and oilseeds on a 50:50 basis. In case of annual commercial / horticultural crops, claims beyond 150 per cent of premium in the first three or five years and beyond 200 per cent thereafter was borne by Centre and State on 50:50 basis.

The Pilot Project on Farm Income Insurance Scheme (FIIS)

FIIS was introduced on a pilot basis in fifteen districts of eight States during FIIS was introduced on a pilot basis in fifteen districts of eight States during *Rabi* 2003–04. Given that NAIS was designed to protect farmers against yield fluctuations, it does not address the problem of price fluctuation or price risk. The income of a farmer depends both on yield and market price. The new scheme envisaged addressing both yield risk and price risk so as to stabilize farmers' incomes. It, however, focused on income in respect to individual crops, and not the farm income. In other words, insurance was for income from specific crops instead of the entire income of a farm growing several crops. The scheme was discontinued on the recommendation of the Joint Group.

Modified National Agricultural Insurance Scheme (MNAIS)

MNAIS was initiated during the 11th Plan from *Rabi* 2010–11 on pilot basis on the recommendation of the Government of India Joint Group, in 50 districts. The salient features of MNAIS are as under: Actual premium, with subsidy in premium ranging up to 75 per cent to all farmers Only upfront premium subsidy is shared by the Central and State government on 50:50 basis; all claims liability is on the insurance company Unit area of insurance is reduced to village/village panchayat level for major crops. More realistic basis for TY calculation; and minimum indemnity level increased to 70 per cent, from 60 per cent in NAIS. Like NAIS, MNAIS is compulsory for loanee farmers and voluntary for non-loanee farmers Private-sector participation to create a competitive crop insurance environment Setting up a catastrophe-relief fund at the national level, with 50:50 contributions from the Central and State governments, to provide protection to the insurance companies in the event of premium to claim ratio exceeding 1:5 at the national level and failure to procure appropriate reinsurance cover at competitive rates. NAIS was withdrawn from those area(s)/crop(s) where MNAIS was implemented.

Weather Based Crop Insurance Scheme (WBCIS)

The basic approach of “weather index” insurance is to estimate the percentage deviation in crop output due to adverse deviations in weather conditions. There are crop models and statistical techniques available to work out the correlation between crop output and weather parameters. These techniques attempt to indicate the linkage between the financial losses suffered due to adverse weather variations and also estimate payouts. WBCIS envisages such weather index-based insurance products designed to offer insurance protection against losses to crop resulting from adverse weather Piloted in the *Kharif* 2007 season, WBCIS also operates on the concept of area approach. For loss estimation, a Reference Unit Area (RUA) is deemed to be a homogenous area unit of insurance. Each RUA is linked to a Reference Weather Station (RWS); claims are determined on the basis of weather data recorded by the RWS. Adverse weather events during the season entitle the insured to a pay-out, subject to the weather triggers defined in the "Payout Structure" and the terms and conditions of the scheme. The claim settlement is an automatic process, based on the weather readings at the RWS. In a given RUA, the payout given per unit area is the same for all cultivators under the same RWS. Claims are normally settled within 45 days from the end of the insurance period. Insurance companies declare a per-unit Sum Insured at the beginning of each crop season in consultation with experts. This may vary from crop to crop in each RUA. The sum insured for the loanee farmer is calculated by multiplying per unit area value of inputs with crop specific acreage declared by the farmer in the loan application form submitted to the lending bank. For a non-loanee farmer, the acreage figure is expected area sown/planted under the particular crop as declared in the insurance proposal form.

National Crop Insurance Programme (NCIP)

As mentioned earlier, the Government of India has discontinued NAIS from *Rabi* 2013–14, with the exception of a few States for one season only, and launched NCIP from November 2013. In the new programme, WBCIS, MNAIS and Coconut Palm Insurance Scheme (CPIS) are included as full-fledged schemes with certain modifications over their pilots. Farmers are entitled to maximum premium subsidy up to 50 per cent under WBCIS and 75 per cent under MNAIS on a graded scale. Premium rates have been capped according to the type of crop and season, and in cases where the actuarial premium rates are higher than the capped limit, the sum insured for such crops will be reduced in proportion to the cap level. The Ministry of Agriculture, GoI, has also issued operational guidelines for the schemes.

Agriculture Insurance Company of India Limited

Agriculture Insurance Company of India Limited (AIC) was incorporated under the Indian Companies Act 1956 on 20th December, 2002 with an authorised share capital of INR 15 billion and paid up capital of INR 2 billion. AIC commenced business from 1st April, 2003.
Agriculture Insurance Company of India Limited is a public sector undertaking with headquarters at New Delhi. It currently offers area based and weather based crop insurance programs in almost 500 districts of India. It covers almost 20 million farmers, making it one of the biggest crop insurers in the world.

Agriculture Insurance Company of India Ltd (AIC) is promoted by General Insurance Corporation of India (GIC), NABARD and the 4 public sector general Insurance companies. AIC has taken over the implementation of National Agricultural Insurance Scheme (NAIS) in 2003 which until the financial year 2002 – 03 was implemented by GIC. . In addition, AIC also transacts other insurance businesses directly or indirectly concerning agriculture and its allied activities.

AIC is under the administrative control of Ministry of Finance, Government of India, and under the operational supervision of Ministry of Agriculture. Insurance Regulatory and Development Authority, Hyderabad, is the regulatory body governing
Main objective of AIC: To provide financial security to persons engaged in agriculture and allied activities through insurance products and other support services.

Share Capital:

- Authorized Share Capital - Rs. 1500 Crores

- Paid-up Share Capital - Rs. 200 Crores

Promoters (Share Holding)

- General Insurance Corporation of India - 35 %
- National Bank for Agriculture And Rural Development (NABARD) - 30 %
- National Insurance Company Limited - 8.75 %
- The New India Assurance Company Limited - 8.75 %
- The Oriental Insurance Company Limited - 8.75 %
- United India Insurance Company Limited - 8.75 %