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An evaluation of effective cost of credit in relation to preferences of rural borrowers: A case study of Nagaur district of Rajasthan

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ABSTRACT

The importance of farm credit as a critical input to agriculture is reinforced by the unique role of Indian agriculture in the macroeconomic framework and its role on the poverty alleviation. Recognizing the importance of agricultural sector in India's development, the Government of India and Reserve Bank of India (RBI) have played a vital role in creating a broad-based institutional framework for catering to the increasing credit requirement of the sector. The crucial aspects of rural financing are (a) providing loanable funds for rural customers, (b) creating access of rural people to financial services which is technically known as Financial Inclusion, and (c) assisting the poor in establishing their own financial institutions thus, rendering them financial independence. The financial requirements can be fulfilled either by the internal sources of the needy (which is limited in availability) or to a large extent, by credit (whose availability can be adjusted according to the requirements). Thus, credit is a more lucrative and flexible source of fulfilling financial requirements. Looking at the importance of farm credit also known as rural credit the ensuing study titled "An Evaluation of Effective Cost of Credit in Relation to Preferences of Rural Borrowers. A Case Study of Nagaur District of Rajasthan "was carried out to address the issues the dynamics of rural credit in rural area of Nagaur district of Rajasthan, understand the various dimensions of rural borrower's preferences at the time of applying for loan, and evaluate the impact of borrower's preferences on effective cost of credit. Both primary and secondary data were used to achieve the objectives of the study. The primary data was collected using a judgmental sampling and in total 120 villagers were selected from the study area. The data collected using a structured questionnaire were analyzed using method of cross tabulation and applying appropriate statistical tools and test. The main findings of the study were as mentioned below: The findings of the study revealed that both formal credit sources commercial banks, private finance companies, co-operative banks, and SHG (self-help group) as well as informal credit sources like money lenders 'mahajans'/'sahukars' were operating in the reference district. Regarding the preference factor of securing credit the research work helped in concluding that accessibility ranked first preference factor of the borrowers and promptness in getting the loan was the least preference factor. More time granted for repayment ranked second followed by flexibility in obtaining loan. The study revealed that cost of credit from different sources comprised of transaction cost and opportunity cost. The effective cost of credit for the borrowers covered in the study during the study period from commercial bank was 13.40 percent, whereas it was 13.94 percent for a loan taken from cooperative societies, and loan from private finance company was about 18.25 percent, and the effective cost of borrowing from informal sources 'Mahajans' was as high as 24.50%. The research work also helped in concluding that the borrowers of the reference group were having highest effective cost of credit (24.50%) to obtain credit for meeting health expenses, followed by social expenses (22.80%), alcohol consumption (18.50%), agriculture purpose (16.55%), household consumption (13.20%) and others was 12.40%. ANOVA test helped in accepting the null hypothesis that ranking difference for different loan preference factor was not significant and all the factors command similar preference by the borrowers.

Keywords: Rural credit, Effective cost of credit, Formal source of credit, Informal source of credit

INTRODUCTION

The rural economy in India is largely agricultural based and is of tremendous importance because it has vital supply and demand links with the Indian industries. India has been predominantly an agriculture-based country and it was the only source of livelihood in ancient time. The importance of farm/rural credit as a critical input to agriculture is reinforced by the unique role of Indian agriculture in the macroeconomic framework and its role on poverty alleviation. Recognizing the importance of agricultural sector in India's development, the Government of Inia and Reserve Bank of India (RBI) have played a vital role in creating a broad-based institutional framework to cater to the increasing credit requirement of rural sector. Agricultural policies in India have been reviewed from time to time to maintain pace with the changing nature of agricultural products that controls the fate of the Rural Economy in India. Accordingly, crucial aspects of rural financing are (a) providing loanable funds for rural customers, (b) creating access of rural people to financial services which is technically known as Financial Inclusion, and (c) assisting the poor in establishing their own financial institutions thus, rendering them financial independence. The financial requirements can be fulfilled either by the internal sources of the needy (which is limited in availability) or to a large extent, by credit (whose availability can be adjusted according to the requirements). Thus, credit is a more lucrative and flexible source of fulfilling financial requirements in rural sector.

THE RURAL CREDIT

Credit is a formal agreement in which two parties the lender and the borrower participate actively. The lender is the credit provider and the borrower is the credit seeker. Borrowers may require credit for various purposes like consumption needs, health and medication, emergencies, social obligations, to buy agricultural/business inputs and so on. The credit lender can be grouped into two groups. First, formal financial institution comprising of bank, financial institution, private finance company, self-help group (SHG). Second, informal lending bodies comprising of money lender a.k.a. 'mahajan'/'sahukar', friend and so on. Apart from commercial banks and financial institutions in the organized sector for agricultural credit there are multiple institutions like network of commercial banks (CBs), regional rural banks (RRBs) and cooperative societies. Other level of entities are village level primary agricultural credit societies (PACS), district central cooperative banks (DCCBs), state cooperative banks (SCBs) providing primarily short and medium term agricultural credit in India. The formal agricultural credit sector has further strengthened its roots by introducing kisan credit card (KCC) and other innovative loan packages, disbursement of loan through SHG and micro finance institutions.

Recently micro finance institutions and SHG-self-help groups have also emerged in different parts of the country providing financial assistance in the form of credit particularly rural credit. Whether the credit is offered by formal financial sector institutions or by the informal Sector the borrowers has the obligation to pay the interest at regular interval and repay the principal amount upon the expiry of the loan term. The loan provided by the lender may be secured or unsecured. Usually unsecured loan carries high rate of interest. The evaluation of borrower by lender is generally based on the standard lending principles character, capacity, and collateral offered by the borrower.

GENESIS OF RESEARCH WORK

For the borrower obtaining rural credit a.k.a. farm credit or agricultural credit, cost of credit/finance has always been a major concern. Apparently, cost of finance for many of us seems to be equal to the rate of interest on loan, but in practice this refers to effective cost of credit. The effective cost of credit (ECC) comprises of interest on loan, transaction cost and opportunity cost. Therefore while evaluating cost of rural credit one need to consider other two elements along with interest (finance cost) on loan. Transaction cost and opportunity cost get affected by several factors convenience in obtaining loan, the collateral value, flexibility, provision of roll-over and so on. These factors are also known as borrowers' preference factors for rural credit or farm credit. Keeping these rural credit preference factors into consideration and how these factors affect the effective cost of rural cost the ensuing research work titled "An Evaluation of Effective Cost of Credit in Relation to Preferences of Rural Borrowers: A Case Study of Nagaur District of Rajasthan" has been undertaken.

REVIEW OF LITERATURE

To gain an insight about different dimensions of the research topic and design the research plan for the study the following studies were reviewed:

One of the challenges of rural credit is that a small group of large farmers monopolizes the lion's share of the total volume of credit disbursed by the formal credit agencies. Braverman, Guasch, and Egger (1986)1 concluded in their study that the social and political clout of large farmers ensures their access to these institutions. On the contrary, small and marginal farmers, including tenant farmers have less access to formal credit institutions because of the asset-based lending policies of these agencies demanding high collateral value.

Shortage of short and long term rural credit is the vital factor that affects cost of credit. Yaron Jacob's (1992)2 research findings support this fact. In his research work it was concluded that shortage of short and long term rural credit affects agricultural growth and development in this sector. Further it was concluded that the lack of formal credit delays and prevents the adoption of new and innovative agricultural technologies. The study also supported that one of the cause of high effective cost of rural credit was absence of formal lending system in many parts of the developing countries.

The cost of rural credit also gets affected by the level of corruption and delay in disbursement of loan. Chaudhuri and Gupta (1996)3 concluded in their analysis that when there is corruption in the distribution of formal credit, and there is an element of subsidy in the credit the effective cost of lending is likely to increase. This also affects the fair disbursement of credit to actual beneficiaries.

- Braverman, Guasch and Egger (1986) “Rural Credit Markets and Institutions in Developing Countries: Lessons for Policy Analysis from Practice and Modern Theory.
- Yaron Jacob (1992) “Rural Finance in Developing Countries: A Case Study Approach”.
- Chaudhuri and Gupta (1996) and Gupta and Chaudhuri (1997) “Delayed Formal Credit, Bribing and the Informal Credit Market in Agriculture”

Well-grounded network of agricultural credit assists in proper delivery of credit and also influences the cost of credit. Chopra (1998)4 discussed in his research work the contribution of co-operative societies in India. These societies have supported in credit disbursement and cost reduction for farm credit.

The research work by Srinivasan and P. Satish (2001)5 discussed the prevalence of high transaction cost in formal lending sector for rural credit has prompted the creation of SHGs self help groups and micro finance companies. Further it was concluded in the study that flaw in the recovery system of formal lending institutions is one of the factors resulting into high percentage of bad loans in the total amount of rural credit. They insisted that setting up of SHGs and micro finance institutions is likely to reduce the proportion of bad loans because of peer group pressure for the repayment of loan.

RESEARCH PROFILE

Review of the studies cited above and of certain other research papers helped in designing the research profile the ensuing research work in the proper direction. The research profile of the work was as follows:

The study titled “An Evaluation of Effective Cost of Credit in Relation to Preferences of Rural Borrowers: A Case Study of Nagaur District of Rajasthan” was descriptive in nature and addressed the following research objectives:

To study the dynamics of rural credit in rural area of Nagaur district.

- o understand the various dimensions of rural borrower’s preferences at the time of applying for loan. Identified as loan preference factors for the purpose of the study.
- To evaluate the impact of borrower’s preferences on effective cost of credit.
- Chopra (1998) “The Structure and Organisation of the Agricultural Credit in India: Relationship between Primary Societies, Apex Bodies and CDFAs
- Srinivasan and P. Satish (2001) “Networking for Micro Credit

Both primary and secondary data were used to achieve the objectives of the study. The primary data was collected using a judgmental sampling and in total 120 villagers were selected from the study area.

The sampling frame for the study comprised of all the villages of Nagaur district. The criteria for including a particular village in the sampling unit were like the selected village must have at least fifty households and there must be minimum one SHG working in the village. The village to be included in the study should be far from the main road. Out of the villages identified in the first stage using the specified judgment criteria discussed above, in total one hundred and twenty borrowers who had availed the loan facility were included in the sample. The primary data was collected using structured schedule. The data were collected for the period from April 2018 to March 2019.

The findings of the study are subject to the limitations of descriptive research method and judgmental sampling method. Further these findings are applicable in the circumstances which prevailed during the study period i.e. from April 2018 to March 2019. In view of these limitations research findings cannot be taken for generalized interpretation.

ANALYSIS OF THE FACTS

Primary data collected from the respondents were analyzed using appropriate research tools. The result of analysis is presented below.

ANALYSIS OF SPREAD OF RURAL CREDIT ACROSS FORMAL AND INFORMAL SOURCES OF CREDIT

Responses of the respondents the borrowers included in the sample revealed that both formal as well as informal lenders were functional in Nagaur district of Rajasthan (Tables 1 and 2).

The table given above shows spread of different lending institutions in the formal sector. Value wise representation of private finance companies accounted for major proportion (50.22 percentages) of the total credit availed by 84 borrowers out of total 120 bor rowers included in the sample. This was followed by commercial banks-KCC (24.22 percentage) and cash-n-credit facility of commercial banks (22.30 percentage). Value wise borrowing from SHG accounted for the least proportion out of the total credit availed by the sample respondents i.e. (0.50 percentage) from formal sector.

This shows that market share of private finance companies in rural credit in Nagaur district of Rajasthan is the largest followed by commercial banks, co-operative banks and SHG in the order.

Table 2 shows the spread of informal sources of rural credit in Nagaur district of Rajasthan. Out of a total 120 borrowers 36 borrowers (30%) had availed loan from informal sources, rest 70% obtained the loan from formal sources shown in Table 1. In the informal source's money lenders 'mahajans' accounted for value wise 75.50 percent proportion in the total amount of credit availed from informal sources.

Table 1: Given below shows the depth and breadth of credit facility availed by the borrowers from formal sources

Sources	**No. of Borrowers**	**Total Credit Amount**
SHG	2	34,000
Commercial Banks (cash-n-credit)	28	15,10,000
Commercial Banks (KCC)	29	16,40,000
Co-Operatives Society/Bank	12	1,86,500
Private finance companies	13	34,00,000
Total	84	67,70,500

Table 2: Given below shows the rural credit availed by the respondents from informal sources

Sources	**No. of borrowers**	**Credit Amount**
Money lender - Mahajans	31	1,80,500
Relatives	5	58,500
Total	36	2,39,000

The Analysis of Loan Preference Factors of Borrowers

Various preferences of the respondents were enumerated to work out the broad preferences of the borrowers, which influence their borrowing decisions. Table 3 shows details of the preferences of the borrowers covered in the study. The respondents were asked to provide maximum three important preferences, the responses were as follows.

Table 3: Loan preferences Factor of Borrowers

Particulars	**Cost of credit**	**Accessi-bility**	**Flexibility**	**Adequacy**	**More Re-payme nt Period**	**Prompt-ness**	**Total re-sponses**
1^{st} prefer-ence(f1)	26	49	18	4	18	5	120
2^{nd} prefer-ence(f2)	27	38	22	14	10	9	120
3^{rd} prefer-ence(f3)	36	15	22	18	11	18	120
Total	89	102	62	36	39	32	360

HYPOTHESIS TESTING ABOUT LOAN PREFERENCE FACTORS

Null Hypothesis (H0)=There is no difference between the preference for different loan preference factors with respect to the ranking of these factors as first, second or third.

Alternate Hypothesis (Ha)=There is a significant difference between the preference for different loan preference factors with respect to the ranking of these factors as first, second or third (Table 4).

The null hypothesis was tested using multi-factor ANOVA at 5% significance level and the result of ANOVA test were as given in Table 5.

The F (0 and 3.252212)<F critical (4.102821 and 3.325845) therefore we accept the null hypothesis, this supports the conclusion that ranking difference for different loan preference factors is not significant and all these six factors (cost of credit, accessibility, flexibility, adequacy, more repayment period, and promptness) are likely to have the similar preference from the viewpoint of borrowers. On the basis of P-value we also fail to reject null hypothesis as P-value (1 and 0.053096) is > significance level (0.05).

After enumerating all the preferences, weighted arithmetic mean was worked out. The mean of all the preferences are presented in Table 6.

Table 6 shows that accessibility ranked first preference factor of the borrowers and promptness in getting the loan was the least preference factor. More time granted for repayment ranked second followed by flexibility in obtaining loan.

SUMMARY	Count	Sum	Average	Variance
Row 1	6	120	20	273.2
Row 2	6	120	20	126.8
Row 3	6	120	20	74.8
Column 1	3	89	29.66667	30.33333
Column 2	3	102	34	301
Column 3	3	62	20.66667	5.333333
Column 4	3	36	12	52
Column 5	3	39	13	19
Column 6	3	32	10.66667	44.33333

Table 5: ANOVA test

ANOVA Source of Variation	SS	df	MS	F	P-value	F crit
Rows	0	2	0	0	1	4.102821
Columns	1470	5	294	3.252212	0.053096	3.325835
Error	904	10	90.4			
Total	2374	17				

Table 6: Weighted Arithmetic Mean of Loan preferences Factor of the Borrowers

Loan Preference	Weighted Mean	Rank
Cost of credit	1.89	4
Accessibility	2.33	1
Flexibility	1.94	3
Adequacy	1.61	5
More Repayment Period	2.18	2
Promptness	1.59	6

ANALYSIS OF EFFECTIVE COST OF CREDIT

Effective cost of credit included finance cost interest cost, transaction cost and opportunity cost. The transaction cost included the cost of documentation and other costs directly involved in securing the credit. Opportunity cost includes the wages or profit foregone for devoting number of days in getting the credit from a particular source of finance. Table 7 shows average effective cost of credit from different sources.

The Table 7 shows that the highest cost of credit (24.50 percent) was for securing credit from money lenders, then the second highest was 18.25 percent for credit procured from private companies, then followed by SHG 17.50 percent, co-operative societies 13.94 percent, commercial banks in the range of 12.49 to 13.40 percent. Thus, was observed that loan from banks was more economical as compared to rest of the sources.

ANALYSIS OF ASSOCIATION BETWEEN EFFECTIVE COST OF CREDIT AND PURPOSE OF CREDIT

Table 7: *Breakup of Effective Cost of Credit*

	Finance Cost	Transaction Cost	Opportunity Cost	Effective cost of credit
Commercial Bank (KCC)	7	5.2	1.2	13.4
Commercial Bank (Cash Credit)	11.25	0.45	0.79	12.49
Cooperative Society	10.8	1.34	1.8	13.94
SHG	17.5	0	0	17.5
Private company	17	1.11	0.14	18.25
Money lender	24	0.07	0.43	24.5

The research findings helped in finding out the association between effective cost of credit and purpose of credit. This association revealed that those seeking loan for health expenses and for social expenses were willing to pay the highest percentage of effective cost of credit. Table 8 reveals this association.

Table 8 shows that the borrowers of the reference group were having highest effective cost of credit (24.50%) to obtain credit for meeting health expenses, followed by social expenses (22.80%), alcohol consumption (18.50%), agriculture purpose (16.55%), household consumption (13.20%) and others was 12.40%.

Table 8: Weighted Arithmetic Mean of Loan preferences Factor of the Borrowers

Purpose of credit	Effective Cost of Credit
Household Consumption	13.20
Health Expenses	24.50
Social Expenses	22.80
Alcohol Consumption	18.50
Agriculture Purpose	16.55
Others	12.49

CONCLUSION

Research findings helped finding in out the association between effective cost of credit and loan preference factors of rural credit in the Nagaur district of Rajasthan. The findings were as summarized below.

The borrowers in the reference district were obtaining rural credit from both formal sources as well as informal sources. 70 percent of the borrowers surveyed obtained credit from formal sources and rest 30 percent obtained it from informal sources. Within the formal sources value wise highest proportion of loan (50.22 percent) was procured by the borrowers from private finance companies. This was followed by borrowing from commercial banks: KCC (24.22 percent) and cash-n-credit facility of commercial banks (22.30 percent). Least contribution was of SHG it was only one-half percent of the total value of loan obtained from formal sources. Within informal sources of credit money lenders: 'mahajans' accounted for the largest proportion of rural credit.

Regarding the preference factor of securing credit, the research work helped in concluding that accessibility ranked first preference factor of the borrowers and promptness in getting the loan was the least preference factor. More time granted for repayment.

Ranked second followed by flexibility in obtaining loan. Though these loan preference factors commanded different ranking on the basis of mean ranked score however the result of hypothesis testing using ANOVA test failed to reject the null hypothesis "There is no difference between the preference for different loan preference factors with respect to the ranking of these factors as first,, second or third" as the P-value was greater than the significance level. Thus, result of ANOVA test support that all these loan preference factors have almost equal importance (weightage) for different borrowers.

The highest effective cost of credit (24.50 percent) was for securing credit from money lenders, and then the second highest was 18.25 percent for credit provided by private companies, then followed by SHG 17.50 percent, co-operative societies 13.94 percent, commercial banks in the range of 12.49 to 13.40 percent. Thus, it is observed that loan from banks was more economical as compared to rest of the sources.

The borrowers of the reference group were having highest effective cost of credit (24.50%) to obtain credit for meeting health expenses, followed by social expenses (22.80%), alcohol consumption (18.50%), agriculture purpose (16.55%), household consumption (13.20%) and others was 12.40%.

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