CHAPTER 6
CROP LOANING SYSTEM- PROCEDURAL ASPECTS

6.0. Introduction

This chapter covers different types of loan products, including the cash credit to agriculturists. The reason for introduction of KCC could be traced to some of the deficiencies in the demand loan system of the past. It is intended to discuss the merits and demerits of a loan account and cash credit so as to evaluate the processes as this would help the research to focus on processes and arrive at hassle free processes. An attempt will be made to discuss the procedures adopted, prior to KCC in the crop loaning activities and identify issues that were causing difficulties for the farmers to avail agricultural credit.

6.1 Loan products

In order to expedite the flow of credit to agriculture, National Commission for Agriculture, the Government of India, had suggested provision of credit through a single agency or source. For a long time the cooperatives were the only agency involved in the agricultural credit delivery. This is because; the credit demand of the farmers in the country of such a vast size and regional climatic diversity cannot be met by a single source. But, today the credit delivery system in India is one of multi product and multi agency approach. Under the multi agency approach, each farmer has the flexibility to approach any Rural Financial Institution (RFI) - branch of a commercial bank, or a branch of a RRB branch or Primary Agriculture Cooperative Society (PACS) in his area of operation\(^1\) for his credit needs in respect of crop cultivation (production) or investment to be undertaken in the farm.

The credit needs of the farmers are varied and the cash flow of rural population is uneven and therefore it would not be appropriate to suggest ‘one size fits all’ kind of product for agricultural lending. Yet, the banks have adopted,

\(^1\) Service Area as defined by the District level bankers committee as per RBI guidelines under lead bank scheme. In the case of big farmers and where ever mortgage of agricultural land or property is available banks are seen to sanction a higher amount as crop loan.
somewhat similar type of credit products such as crop loan, which is a variant of a demand loan to meet the cultivation expenses and term loan to cater to the production or investment needs. Commercial banks have a number of loan products such as demand loan, term loan, cash credit, overdraft, bill finance etc. Generally, Demand loans are used for financing purchase of items such as farm asset; vehicle etc, while cash credit is used for financing working capital needs of industry or business. Overdrafts are typically limits/advances based on some actionable claim or security such as shares/bonds/LIC policy etc., meant for funding the working capital needs of trading houses, which may not have raw material or similar things to pledge or hypothecate. Both cash credit and overdrafts are operated by cheque and used for day to day transactions. Given this the Demand loan is not suitable for crop loan. At the same time, given the limited occasions of cash flow, the farmer cannot operate the account on a day to day basis as if it is a full-fledged cash credit account. Possibly this is why the demand loan type of account came to be used for crop loans and it is only recently that the crop loans are also issued in the form of cash credit accounts. However the crop loan and the term loan ( for purchase of assets, digging of well, land leveling, plantations etc) are the only two types of agriculture loans which are currently in vogue and are classified as priority sector lending as per the RBI guidelines. The difference between the demand loan and the cash credit is indicated below.

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<th>Table 6.1: Characteristics of demand loan and cash credit</th>
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The loan products are drawn in such a way that the appraisal, sanction and operations are considered mutually exclusive. If a person were to have only one of the above loan accounts the above approach is tenable. But if one were to borrow for working capital and investments is it appropriate to appraise and treat the accounts as distinct from each other? Let us consider the issue from the angle of the farmer.

6.2 Are the credit needs distinct or composite?

A farmer will require loan or credit for meeting the crop cultivation expenses and for investment in digging a well or buying assets such as pump set, tractor
etc. It is observed that, when a farmer takes a crop loan for meeting working capital expenses and a term loan buying an asset these are treated as two independent accounts and not as one account\(^2\). The repayments stipulated in the accounts are also independent of each other. The issue of a separate crop loan, be it demand loan or cash credit, and a separate investment loan presume that the economic function of crop cultivation or using a tractor for cultivation purposes or a pump set for irrigation of the crop in a farm is independent of each other or independent of other economic activities of the farmstead. But the cultivation activities, use of tractor and irrigation etc are undertaken for the one and only purpose of producing grain. Thus, though the credit is used for different purposes it is used in the same form and the repayment, in most cases, has to come from one single source of income namely, farm income from sale of produce. In this background treating of the two accounts as distinct beats financial logic\(^2\). It should also be noted that, till recently the production credit extended by the banks confined itself only to crop cultivation and did not cover the working capital need of other farm activities such as poultry, dairy etc carried on a scale not so commercial scale and possibly for farmers own consumption purposes. The KCC also covers non-farm activity carried on by the farmer, if any. The approach is one of considering the household as a business unit and covers all economic activities. These activities are in the nature of sustaining the farm income and ignoring these items for the purpose of estimating the cash flows and loan support may not be appropriate.

### 6.3 The approach to the loan

In the case of the crop loan, the bank, normally lends a third of the ultimate (expected) produce value or up to fifty to sixty percent of the cost of cultivation of intended crops. Banks have indicated that this could be up to 80% of the

\(^2\) With the adoption of core banking solutions it is possible, for the banks to club these accounts in a single ID. For example in the past savings deposit accounts and term deposit accounts were separate. Now the deposit accounts have been brought under a single customer ID. Though the accounts are in one ID the parameters such as rate of interest, repayment etc can be distinct.

\(^3\) RBI, in the circular issued in the year 2004 on introduction of term loans in KCC has advised the banks to keep the crop loan account and term loan account distinct. This could be for delineating information on crop loan etc and not for the repayment stipulation. This issue of separate crop loan and separate term loan account comes in the way of development of composite limit.
cost of cultivation. The expenses on labour for cultivation, land preparation etc are not considered for financing as the farmer is expected to meet the labour cost as margin or down payment. (The insistence of margin or stake of the borrower is a traditional issue. As discussed in the previous chapter, the programmes such as IRDP were developed to meet the margin requirements through capital subsidy.) This approach is somewhat similar to what the banks stipulate as margin while financing business firms against raw materials or pledged goods. In the case of term loan for investment, the down payment or margin which could be up to 25% of the cost of investment has to be met by the borrower from out of farm income or savings. The repayments for the crop loan are stipulated payable from out of the sale proceeds of the grains and the repayments for term loans are stipulated on the premise that (a) term loans result in increased efficiency of the farm operations which result in more than normal surplus known as the incremental income and (b) the repayments for the loan should be made out of the surplus within the economic life of the investment. Thus, if a farmer were to take a crop loan and a term loan for purchase of capital assets say, a tractor he has to repay (i) the entire crop loan within 9 months with interest, (ii) in respect of the term loan; repay the stipulated installment, which as per NABARD norms is half yearly installment for 7 to 9 years and (iii) pay interest on the term loan as and when charged. However, in the case of agricultural loans the normal practice is to charge interest on a half yearly basis but collect the interest along with the installments or when the farmer receives the sale proceeds. This approach underscores the following points:

- The credit needs of the farm are clearly divisible into production and investment needs.
- These needs are mutually exclusive.
- It is possible to estimate, with reasonable accuracy, the income generated on accounted of these two activities and apportion them for the purpose of repayment and
- The overall surplus earned in the farming operations is sufficient not only to repay the entire crop loan with interest along with installment
and interest due on the term loan but will also leave sufficient money in the hands of the farmer for household expenses

- The farmer will approach the bank again for the next seasons short term crop loan credit
- It is necessary to collect and reissue the crop loan, within a very short period, rather than allow the money to be used by the farmer so as to prove recovery and financial discipline at the level of the farmer.

6.3.1 Limitations of farm credit models

The extant product design of crop loan and term loans has been derived from the crop loan system which was developed in the sixties. Crop loan system was primarily intended for cooperative societies in a three tier (Short term) structure. Possibly the distinction between crop loan and term loan came about because the crop loan requirements were met by the ST structure and investment needs were met by the long term coop structure (LTCS) namely Agriculture and Rural Development Banks (ARDBs). It was therefore appropriate to view the two accounts distinct and stipulate repayments independent of each other. However, when a single agency, say a commercial bank finances a farmer for all his requirements, treating the accounts as independent of each other and stipulating multiple repayments may not be warranted/appropriate. The debt service by the farmer becomes more difficult on account of weather related volatility of farm income, emergency expenses on the farm investments or in the household. Add to this, the issue of price and yield risk that the farmers have been facing having over years it would be clear that the loan products, as designed today are clearly unsustainable. As such, it is a matter of further research if surplus income generated from the farm could be viewed as exclusively available for repayment of crop loan and if a portion of the income could be viewed as incremental income for paying the stipulated installment for investment loan, more particularly in the case of small farmers. Researchers must also consider studying if the issue of distress is also related to the product design and the debt service issues. This is because, it is seen that despite (a) a number of waivers, write offs and subventions announced
by both the central government and various state governments over the last two decades, (b) a series of OTS that the RBI and NABARD have announced, (c) crop insurance and (d) roll over and rescheduling of over-dues; the defaults in the system continue. It should be added here that these measures have been of more use to the banks in making their books of account in order than of any real use to the farmer. It is thus evident that having two separate loans one for crop loan and another for investments which is a viable concept for industry and other loans which have multiple cash flow points may not be, per se suitable for agricultural loans. There are other limitations also which are discussed below.

6.3.2 Present Credit Delivery Systems - Limitations

As indicated previously, till the introduction of Kisan Credit Card, the farmer had two options for credit. If the finance is needed for raising crops the farmer can avail of crop loan. If he needed money to buy Capital assets such as tractors, pump-sets, animals etc., investment loan or term loan repayable in installments over a period would be more appropriate. Both these types of credit have certain limitations, giving a rise to Kisan Credit Card (KCC). To understand the background for introduction of KCC, it would be appropriate to identify the limitations of crop loan and Investment loans.

6.3.3. Crop Loan

The crop loan- subject to the eligibility conditions adopted by a bank branch or cooperative society was available in the form of short term demand loan. Normally, the lending bank enquires with the farmer the details of crops grown, proof of land ownership, cropping pattern and estimated the fund requirements for the crops grown in a season based on a scale of finance approved by the District Level technical Committee (DLTC) and lent him monies in proportion to the acreage under the crop/s which were to be repaid on sale of grains/produce or 9 months from the date of availing the loan whichever is earlier. Having less than 9 months in terms of repayment, the loans came to be known as short term loans. However in theory the short term loans could be repaid
within 18 months from the date of issue. In fact for sugar cane and other long term crops banks did adopt a longer repayment period. Generally it was seen that the scale of finance and the resultant bank loan was approximately 35-45% of the likely receipts on marketing of grains/produces or 50-65% of the cost of cultivation. The loans were sanctioned at the beginning of each season. If the farmer were to grow crops in two seasons, he would get two loans sanctioned; one for each season. Thus the loans came to be known, based on the cropping season - Kharif and Rabi loans. Kharif loans were sanctioned in the months of June and July but could go up to September and were repayable by March. Rabi loans were sanctioned in the month of September/October and repayable by June next year.

If this was the general pattern, cooperative banks had a provision, as they owned warehouses to store the fertilizers and produce, to finance the produce under a pledge loan. In the event a farmer availed of produce pledge loans, the pledge loan amount will be used to close the crop loan account and, the balance will be used by the farmer. The produce pledge loan amounts were about 75% of the market value of the grains/produce a (which was equivalent to twice the crop loan) and the loan amount was sufficient to repay the crop loan with interest. It must be added that these warehouses have not gone through the process of approval or certification for the purpose of commodity markets. In fact warehouse receipt based financing is yet to take a firm root in India. The produce pledge loans are not popular or in vogue due to difficult procedures, poor hygiene with the warehouses and lack of market price information with the societies. That the warehouses cannot dispose the grains if the farmer did not redeem the pledge is a major constraint in developing pledge finance. The process of auction and sale is cumbersome. Farmers however find it convenient to deal with adatis (grain merchants) or regulated markets and take such price as was available than store the grains in the wait for the right price.

The scale of finance for each crop is arrived on the basis of the recommendations of the District Level Technical Committee (DLTC), organized by the District
Central Cooperative bank and its members drawn from the officials of the agricultural department and commercial banks. The committee considers various input costs and arrives at the scale of finance for various crops grown in the area. While circulating the details of scale of finance the committee also indicates details such as the installments in which to release the loans, dates prescribed for lending and recovery etc.

Appraising and sanctioning of agricultural and plantation crop loans calls for some level of technical knowledge. Banks have the system of recruiting staff with specific qualification for handling this portfolio. However as the staff of the branch get transferred out once they have put in two years of stint in the branch and as not all the commercial bank branches are endowed with qualified (agricultural graduates) staff, the details of scale of finance and recovery guidelines circulated by the DLTC help in expediting sanctioning of the credit limits. In a way, this has made the loan appraisal a mere routine of multiplying the scale of finance with the acreage of crops and carrying out the documentation. The scale of finance is, at best, a broad indicator of the amount of loan that could be sanctioned per acre of a crop. It does not take into account the specific cash flows of the farmer household which will differ from farmer to farmer, or the fact that the credit requirement of a small farmer could be different than that of a big farmer. In this background it is difficult to ensure that that the farmer is not forced to seek funds from informal sources at exorbitant rates which will hinder the viability of the loan and the farmer unless the banker knows how to avoid under financing. However as the banker does not go beyond using the SOF the under financing becomes inevitable. As the scale of finance is used rather rigidly and as farmers complain about inadequate loans, NABARD has repeatedly advised the banks to be reasonable in arriving at the loan amounts and reiterate that SOF is a guideline and not a strict limit. Yet the fact remains that the quantum of crop loan is often inadequate. This has been the age-old experience, yet in the absence of any other method it must be said the SOF is a reasonable tool of assessment of the credit needs.
As regards sanction and operations (withdrawing money from the loan account) in the crop loan account, the farmer has to produce many documents such as proof of land holding, cropping pattern, NOC from other lenders in the area, land ownership particulars of the surety, invoice for purchase of inputs etc., In the case of PACS the Annual Credit Limit (ACL) procedures are equally elaborate though the society does all the running around for collecting details by itself. In the case of societies there was no need for invoice as, the society insisted on disbursing the kind component (fertilizer and seed) by itself whereas the commercial banks issued cheques, on the basis of invoice favoring the shops to ensure that the borrower will not misuse the funds. It should be borne in mind that misuse of credit cannot be avoided by making payment to vendors as they can collude with such borrowers who want to misuse. A better method would be to educate the farmer on these issues and ensure sharper field supervision. The issue of pay order to the dealer was also fraught with the risk of poor quality material being passed on by the dealer to the borrower. It is indeed strange that the dealer who is not party to the loan contract is trusted by the bank more than it trusts the borrower. This mindset is pervasive in all priority sector and other loans where the borrower is treated as a beneficiary.

As regards security, the standing crop is hypothecated to the bank. If the loan amounts are bigger, banks demand surety (guarantor) and/or mortgage. The execution of mortgage is preceded by title search and a non-encumbrance certificate from an advocate. Since the agricultural lands are ancestral property, in most cases there are no title deeds and the division and ownership is recorded in the land registry. In the absence of title deeds the only proof of ownership is the abstract of land ownership record issued by the land registrar. Banks accept certified land records as the final proof of ownership. However, the abstract of land records are no sufficient proof of ownership for creating the equitable mortgage. Hence most bankers desire a registered mortgage which unlike equitable mortgage attracts more stamp duty and the cost has to be borne by the borrower. In addition the farmers have to spend money, both for official fee for obtaining the abstracts and off record payments. These records need to be produced at the time of every sanction which adds
to the cost of the loan. To overcome these problems, land records must be computerized and the banks must be able to take electronic copies of record. This will reduce the cost of search etc.

One of the risks of financing for crops is that crop yields could vary and the projected income may not happen. It is for this reason that an area based crop insurance was introduced in the country in the year 1989. As of now, most of the crops are insured by the National Agriculture Insurance Company. The borrower has to meet a larger portion of the crop insurance premium; remaining being met by the bank. Over the last two decades the crop insurance scheme has a very mixed performance and it is unfortunate that there are a number of issues which questions the efficiency of crop insurance. GOI is considering new forms of insurance to help the farmer.

In addition to the availability (theoretically at least) of crop insurance, the lenders would agree not to collect the loan if there were natural calamities. In those cases, the farmer would convert his crop loan into a term loan or the amount of installments in the case of a term loan would be rescheduled. This would make him eligible to take another crop loan for the current crop. Wherever the crops suffered on account of other reasons or the farmer had to meet some emergency expenses, or the price of the crop was lower than anticipated (due to higher crop production), the farmer had to make use of own savings, if any or borrow from other sources to ensure that he repaid the money to the banks. If the own income or savings was insufficient, he may access the money lender to keep the farm operations going. The gap in fund available on account of the scale of finance based credit also necessitated informal funding. Another issue with the crop loaning system was that it covered only one season and, therefore, a farmer has to take more than one loan a year particularly if he were raising crops in two seasons. This doubles the interest burden on the same amount of inflows. The installment on the converted loan added to the debt service burden.

The rate of interest is a function of the amount of loan. Till 90’s, banks were advised by RBI on the rate of interest to be charged for given levels of sanctions.
Nowadays, banks have the freedom to decide the rate but then the GOI and the State Governments offer subventions and intervene in the process. Whatever the rate of interest may be, the loan will have to be repaid at the end of every crop period. The interest is normally charged to the account every half year and it is stipulated that the interest should be paid along with the loan amount and that the interest should not be compounded.

In crop loans the banks earned interest on the loan but have to meet a portion of the crop insurance premium. Personal Accident Insurance Scheme has been added recently for which 1/3rd premium has to be met by the bank. Though banks undertook inspection and other follow up work, they are not allowed to collect charges for these from the small farmer or for loans up to Rs 25000. Previously, the rate of interest on crop loans was high. However of late the government has indicated the maximum rates chargeable to the borrower and offers a subvention of 2-3% to the banks. The default in the accounts is continuous and, the NPA continues to be around 15% in the sector. Considering the cost of funds, delivery cost and risk cost, it can be said that crop loans are not viable for the system. Also the average amount in the loan accounts is comparatively small.

The crop loan borrower has to visit the bank a number of times for sanction of the loan, for drawing the loan amount, for paying the interest etc. These visits, though the farmer may combine the visits with other business in the place where the bank is situated, do cost money. In addition, the farmer has to meet the stamp fee, cost of producing the documents necessary for sanction, the mortgage cost wherever applicable, a portion of the insurance premium etc. There is also the possibility that he may incur loss on the bargain of prices that he would have gained had not the bank issued the cheque direct to the vendors. Thus the cost of credit was high. (the interest subventions are of recent origin and started with Kharif 2003 when the GOI had announced a 2% concession on account of unprecedented delay in July rains) The expenses on the visit to the bank, documents fee, insurance premium ( per crop basis), and money spent for obtaining land record documents etc are fixed for each
sanction while the interest amount is variable with the amount of loan. It is possible that these costs were heavier on small and marginal farmers.

As banks gained experience in lending for crops and as track record of borrowers set in, some of the banks introduced cash-credit system. This was a substantial improvement over the demand loan. In these cases the farmer indicated to the banks, his land holdings, crops to be grown, source of irrigation etc. The bank, using the scale of finance or other parameters estimated his peak loan requirements, sanctioned him a cash credit for a period of three to five years wherein the borrower could – subject to seasonality of crops grown and income- operate the account frequently for drawing money and depositing funds. This form of credit reduced the need for frequent documentation and also offered greater flexibility to the farmers. But this was not a universal product and was generally confined to those who were big farmers and those who had financial discipline. Though this method offered larger amount of loans the other constraints of crop loans were seen here also. The cash credit loans simplified the annual appraisal and sanction process but possibly, given that the cash credit amounts were larger and the rate of interest was fixed on the basis of quantum of sanction, resulted in a larger outflow of interest.

6.3.4. Investment or Term Loans

For purchase of assets such as tractors, pump-sets etc, banks issue loans against hypothecation of the asset purchased. As the loan amounts become larger banks may seek additional collateral of land and/or surety. These loans are repayable in half yearly or yearly installments. The amount of loan is arrived on the basis of the estimated cost of investment or asset and normal expenses for installing the same in the farm. NABARD or the agricultural department of the bank issues guidelines on unit cost in the case of area based schemes. In the alternative the costs are arrived at by perusing the invoice etc.

The banks appraise these loans by ascertaining the income on account of the investments on an incremental basis by estimating the likely additional income on account of improved cultivation, reduced cost etc. For example, if
minor irrigation loan were to be sanctioned, it is reasonable to project that an irrigated farm will be more productive than an un-irrigated farm. As such the farm will generate more income with the farmer as he can choose to raise a better crop. The incremental income is arrived at by reducing the pre project (in this case pre investment) income from the post project income to test the viability of the investment and if the Internal rate of return will be sufficient. The amount to be repaid is arrived at after providing for repayment of crop loan for improved agricultural processes. It should be added that post investment the farmer will have to take a larger amount of crop loan which is repayable as and when the produce is marketed. The banks would fix the installments by estimating net cash flow after repayment of crop loan. The investment loans are issued with monthly (dairy loans) half yearly (tractor loans in the case of multiple season crops being grown) or annual repayment. The period of repayment can vary from three to fifteen years. NABARD issues periodical guidelines on appropriate periodicity and repayment period which can be adopted by banks.

In fixing the repayment, NABARD recommends that as a rule up to 50% of the incremental cash flow or net surplus could be stipulated as debt service. However in practice the repayments are arrived not on the basis of farm models and repayment tends to be common for most farmers. This happens because the banks follow the repayment period stipulated by NABARD or their Head offices and arrive at the installments by dividing the loan amount by the period of loan. It was reported that, at the branch or the society level the scale of finance, unit costs, repayment period, grace period etc were adopted somewhat like a thumb rule from the circulars issued by the district authorities and or higher offices of the banks. In view of such rigid approach it is possible that if a farmer takes both crop loan and investment loans the money left with him, after repayment of loans, meeting other expenses such as insurance, interest and expenses for getting documents from authorities on ownership of land etc may not be adequate to carry on normal farm operations. The R.V. Gupta committee had therefore perceived a need to redesign the lending processes in have a re-look of the terms of loans more particularly the method of fixing the repayments.
6.3.5 Need of a composite loan

The process of sanctioning a crop loan and term loan for investments separately has certain structural rigidities. In addition, over the years a set of procedures have been put in place which are more focused on end use verification than on the end result of credit. There was a dominant feeling that loan should be used for the given purpose only and that consumption expenses cannot be funded by bank loans. Diverting of funds for other uses, let alone emergencies was looked down upon. These aspects made the credit less user friendly. Production credit, for example, was issued on crop season basis. This meant that the borrower has to avail credit at a given point of time and repay it within three months (total 9 months from the date of availment) after the harvest of the crop/s. The cooperative banks, being compliant to RBI and NABARD guidelines in respect of kind component were inflexible in their approach on crop loaning system such that it resulted in farmer being forced to use the take the kind component and stockpiling inventory at a time when the farming has not even started. This is because the societies issued the kind component first on the plea that the land will be made ready by use of own labour. This is unreasonable as the farm sizes differ and entire farm cannot be made ready by own labour. Also the farmer did not have proper storage facilities, resulting in deterioration in the quality of fertilizer and other inputs etc, requiring additional debt service by the farmer in the process.

It was observed that, in the case of cooperatives, the system was high on procedural formalities, lacked timeliness in loan sanction and disbursement and the loan amount was inadequate. Possibly the lenders, more particularly the cooperative banks which were completely dependent on higher tiers for funds and were constrained by want of resources. As a rule, the amount of investment credit or production credit excluded the maintenance cost on the analogy that maintenance is a recurring cost which the farm enterprise can meet out of its operational surplus. That the operational surplus accrues at the time of marketing and the previous season’s surplus might have been consumed was not factored. It was also a fact that credit was rationed as the funds were coming from RBI under the General Line of Credit (GLC)
where the bank was feeling that it is created money and it will fan inflation. As indicated earlier, it was also presumed that the credit needs of the farm (crop/investment) and that of the farmer (consumption) are independent and mixing up of the same will adversely affect the economics of the farm. In sum, the banker approached the credit dispensation with certain rigidities and a suspicion that the farmer will, given a chance, misuse the loan. It should be, however, said that the lender cannot plead ignorance of the consumption and other needs of the borrower because, while lending to industries these factors were indeed considered. Invariably, one finds that it is only the case of small loans that the norms are tight, though the small loan borrowers are more vulnerable for cash flow infirmities and need greater flexibility and support. Possibly, this is why there are frequent political announcement of waivers and concessions. In fact, it is in the case of small loans that one needs more flexibility because the borrowers belong to vulnerable section of the economy. The Vyas committee aptly observed, ‘Credit disbursed would be considerably enhanced if investment and production credit were integrated and scales of finance used at the district level were reviewed and readjusted in line with requirements of modern, market-oriented capital-intensive agriculture using newer technologies and superior inputs’.

The banks had adopted rigorous procedures for the credit delivery. The process necessitated farmer visiting the bank a number of times for obtaining credit. He had to comply with the pre-sanction and post-sanction requirements, produce, year after year proof of residence, ownership etc. Even after this, a portion of the loan was disbursed through the suppliers of input to ensure the end use. All this would have been alright if the loan amount was sufficient and was timely. As this did not happen, the farmer had to approach informal agencies, with different credit products, at higher interest rates, to meet in full his credit needs. The economic cost of his time spent to comply with these procedures was high but neglected.

The complicated credit delivery system created by the multiple credit agencies in rural areas resulted in duplication of workload increasing the cost of
accessing the credit. Absence of flexibility (cash flows of agriculture economy is known volatile whereas the repayment and terms of credit were inflexible) and absence of maintenance package in the individual credit product often made the farm investment infructuous for the remaining economic life for want of small repairs, creating conditions for perpetual indebtedness for them.

Despite the presence of multiple credit institutions who in turn received support from the RBI, NABARD and Government, the large presence of money lenders in the rural economy continues. That the farmers depend on them despite all out efforts by banks to augment finance seem to suggest that their product is superior despite the so called usurious lending rate.

This was the situation when the High level committee on Agricultural Credit through commercial Banks (R.V.Gupta Committee) - RBI- 1998 made its recommendations which resulted in the launch of KCC. The level of crop loan disbursements was less than Rs 19000 Crore of which the share of commercial banks and RRB together was at Rs 7600 Crore. The committee identified many obstacles and procedural issues many of which have been discussed above. It will be useful to relate the issues to the recommendations of the committee as under:

1. The comments of the committees on appraisal, sanction amount, scale of finance etc point out the rigidities of the system. The following recommendations have been made to remove rigidities and make the credit user friendly.

   • The focus of credit appraisal should be on evaluation of the income stream of the borrower, and on making comprehensive assessment of credit needs taking into account track record, credibility, capability, as well as technical viability of the proposal.

   • The adoption of scales of finance for short term loans and unit cost of investment credit has led to distortions at the base level and introduced an element of rigidity in assessment of credit requirements. As enough expertise has been developed by banks in
financing agricultural operations it would be in order to give them flexibility to take care of variations in the requirements of borrowers, the fixing of the scale of finance / unit cost may be decided by the concerned banks.

- Short term credit to the farmer should include all requirements directly and indirectly related to production, post harvest and household expenses. Repayment capacity should be assessed on the basis of aggregate household income from all sources including crop production and ancillary activities. The credit facility should be extended through a composite cash credit limit. The limit may initially be provided for one year but over time extended for a longer period and brought to credit at least once a year.

- While some of the minor investments of a medium term nature can be taken into account in the composite cash credit limit, investments of a major nature would still need a separate loan.

- In relation to the systems followed for term lending, the emphasis should be on whether in a given area an activity can be supported profitably, rather than obtaining abstract cash flows and other data based on projected technical parameters.

- On credit balances banks should pay interest.

- In case of production credit, especially for farmers cultivating high value cash crops, a savings component could be built into the loan product to provide cushion during times of distress. The saving-loan linkage should be encouraged by offering a finer rate on the loan.

- The rescheduling of a loan installment during times of natural calamities specifically in regard to a term loan should be based on the bank’s assessment and should not inhibit the bank from extending short-term production credit to the farmer.

2. Another issue that has been identified is the lengthy procedures, processes etc. In this connection, the following recommendations have been made:
• The system of disbursing crop loans, partly in cash and partly in kind has restricted borrower's choice and given rise to undesirable practices including submission of false bills and receipts. In order to foster an environment of trust, banks may disburse loans for all agricultural activities directly to the borrower on cash basis only and discontinue the practice of obtaining bills / receipts of inputs / assets purchased.

• Insistence on No Dues Certificate (NDC) for sanctioning a loan which is unnecessary and time-consuming. Where banks are conversant with the track record of the borrowers, obtaining a NDC is redundant.

• The agreements and other covenants/documents to be completed for obtaining the loan are complicated and must be simplified.

• Unlike in urban areas, most land in rural areas is inherited and there are no title deeds. The original land records in the tehsil office are similar to a share depository and if a farmer has a pass book with an authenticated record of his land holding, the bank should accept the same as valid title for purposes of an equitable mortgage. In States where the Agricultural Credit Operations and Miscellaneous Provisions (Banks) Acts have been passed, bank loans should be secured through the mechanism of the declarations prescribed there under.

• The value of security taken should be commensurate with the size of the loan and the tendency to ask for additional collateral by way of guarantors where the land has already been mortgaged should be discouraged.

3. Application form, Delegation etc

• To ensure quick disposal, at least 90 per cent of loan applications should be decided at the branch level. Banks may, therefore, review the position and suitably modify the powers of sanction delegated to the branch manager.
In line with the change in approach towards appraisal of loan proposals for lending recommended by the Committee, the forms accompanying the main application, especially, for investment credit should be simplified and made more relevant for focusing on the income stream of the farmer.

4. Financial Education

- During cash rich periods, farmers have a propensity to invest in gold, land, implements, and livestock or incur expenditure of a consumption nature. As a result they are vulnerable during times of adverse price fluctuations and natural calamities. To address the issue farmers should be offered a liquid savings product with an appropriate return which should be inbuilt in the loan product so as to provide them a cushion during lean periods.

- In order to inform farmers transparently of the amount and periodicity of the various fees and charges levied by banks, they should be given a statement of the facilities availed, separately indicating the fees, charges, etc. levied. The instructions regarding compounding of interest issued by RBI may be reiterated so as to ensure that these are invariably followed.

5. Others

- In order to give operational flexibility to the lending banker, margin, security and collateral requirements should not be prescribed by RBI or any other agency and should be left to the discretion of the lending banker. For small loans up to Rs.10,000, however, the existing guidelines may continue.

- The requirement to insure all assets purchased through bank loans is an imposition causing financial hardship to borrowers. The decision as to the kind of insurance to be taken should be left to the borrowers.

- Taking into account the procedural difficulties and the high cost of stamp duty connected with registering a mortgage in favor of a bank,
the State Governments may initiate steps to abolish stamp duty on mortgage of agricultural land for obtaining loans from banks.

- Timeliness and adequacy of credit are critical to increasing the credit flow to agriculture. Small loans involve higher transaction and administrative costs. As a result, managers tend to look for larger loans where interest rates are deregulated, while banks seek to equalize the price differential by cross subsidization. In effect, regulated rates of interest operate as a barrier to the sanction of small loans.

- About 20 per cent of lands cultivated at present are by oral tenants. If such tenants are brought within the purview of the banking system, there would be overall gains in income for the tenant farmers and agricultural productivity.

If the above can be summarized in one sentence the committee wanted the credit to be hassle free. The recommendations cover procedures, legal aspects, appraisal methodology and attitude. Also there was a need to develop a composite product. These efforts of RBI and NABARD, in this direction resulted in the development and introduction of Kisan Credit Card (KCC) in 1998-99.

Under the KCC, which is a cash credit approach to agricultural loans, each farmer was offered the flexibility to approach a Rural Financial Institution in his area but of his choice for credit support. The agency would sanction him not a one season crop loan but a three year cash credit limit, which would also include amounts towards maintenance expenses and non-farm expenses. The scheme also included a personal insurance coverage to the tune of Rs.50000 with nominal premium contribution of Rs. 5 per annum by the farmers. Coverage of three different credit needs of the farmer’s viz., production, farm asset maintenance and consumption were expected to overcome the rigidities associated with the earlier crop loan system. KCC aims at providing adequate and timely credit support. In the year 2004 the KCC was expanded to include investment purposes (Rs.50000) making it a composite limit. However KCC is not a credit card in association with VISA and MasterCard. The KCC is an improvement over the erstwhile crop loan and offered the following facilities.
<table>
<thead>
<tr>
<th>S.N</th>
<th>Item</th>
<th>Crop Loan</th>
<th>KCC</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Period of Validity</td>
<td>9 months, but longer in the case of perennial crops like sugarcane</td>
<td>Three to five years</td>
</tr>
<tr>
<td>2</td>
<td>Mode of sanction</td>
<td>Amount per season or crop</td>
<td>Limit for all the crops valid for the period on the basis of peak requirements</td>
</tr>
<tr>
<td>3</td>
<td>Pre-sanction Documents</td>
<td>Copies of land record extract showing proof of ownership, details of crop grown, land record extracts of surety, NOC from banks and societies</td>
<td>Copies of land record extract showing proof of ownership, details of crop grown, land record extracts of surety, NOC from banks and societies. Documents are resubmitted for renewal/review</td>
</tr>
<tr>
<td>4</td>
<td>Disbursement</td>
<td>Predetermined as advised by the Scale of Finance (SOF) committee. Borrower has to make an application</td>
<td>As per SOF committee. Borrower has to make an application</td>
</tr>
<tr>
<td>5</td>
<td>Documents</td>
<td>Valid for one season</td>
<td>Valid for 5 years</td>
</tr>
<tr>
<td>6</td>
<td>Amount of loan</td>
<td>Limited to SOF for the crops grown.</td>
<td>SOF for crops + 20-25% (differed from bank to bank) Can include term loan also</td>
</tr>
<tr>
<td>7</td>
<td>Repayment</td>
<td>9 months</td>
<td>One year for each drawal</td>
</tr>
<tr>
<td>8</td>
<td>Frequent operations in the account</td>
<td>Not possible</td>
<td>Possible</td>
</tr>
<tr>
<td>9</td>
<td>Drawing funds from other branches/use in merchant establishments</td>
<td>Not possible</td>
<td>Possible</td>
</tr>
<tr>
<td>10</td>
<td>Cheque books to operate the account</td>
<td>NO</td>
<td>Could be provided</td>
</tr>
<tr>
<td>11</td>
<td>Is this a payment device? A Card</td>
<td>No</td>
<td>No. But possible</td>
</tr>
<tr>
<td>12</td>
<td>Personal Accident cover up to Rs 50000</td>
<td>NO (some banks had a similar product)</td>
<td>For all KCC borrowers</td>
</tr>
<tr>
<td>13</td>
<td>Crop Insurance</td>
<td>Compulsory for notified crops</td>
<td>Compulsory for notified crops</td>
</tr>
</tbody>
</table>

Based on the study of circulars by the researcher.
The KCC, by design tries to provide improvements such that many of the difficulties enumerated earlier can be overcome.

The KCC scheme is under implementation by the commercial banks, cooperative banks and RRBs. By the end of the financial year 2009-10, more than 832 lakh KCC were reportedly issued by the banks in the country. The number of KCC issued (cumulative) suggests that some of the issues that were constraining the crop loan have been overcome.

Being one of the major innovations in the credit to farmers, the topic has been studied in detail by various agencies; Prominent among them was by NABARD, its training establishments and chair units financed by it in various universities. RBI has also conducted a study of KCC through the National Council of Economic Research and Training (NCERT).

<table>
<thead>
<tr>
<th>Box: 6.1 KCC studies by NABARD</th>
</tr>
</thead>
<tbody>
<tr>
<td>NABARD has been studying the KCC both as a part of its evaluation and through its District Development Offices across the country. Notable among the studies on KCC is the one carried out by Bankers Institute of Rural Development for Planning Commission in the year 2000-01. The Department of Economic Analysis and Research of NABARD had carried a detailed impact assessment of KCC in the year 2002-03 in two states. The latest among these studies was in the year 2006-07 wherein as a part of the study on doubling of credit NABARD carried out a study of Kisan credit card in six States. Currently, NABARD is undertaking a nationwide study on the efficiency of Kisan Credit Card and how to improve the same.</td>
</tr>
</tbody>
</table>

The studies have highlighted positive features of the scheme like wide acceptability of the scheme by the bankers and farmers, improvement in timeliness and adequacy of credit limit fixed, simplification of the procedures and documentation, flexibility in credit operation, removal of kind component in the loan portion, etc. However, these studies have also highlighted certain weakness inherent in the system, which adversely affect its operation. Major weaknesses that have been identified through these studies are:

- Reluctance to extend KCC to farmers under mono-crop or un-irrigated conditions. Poor coverage of small farmers.
• Levy of high service charges for issuing KCC. (This was noticed in the initial year. As no electronic cards are issued banks have discontinued service charges).

• Insisting on collaterals in the form of land mortgage and surety. One of the resultant issues is the levy of stamp duty on mortgage. Previously, the crop loans were for a smaller amount and short period and banks did not insist on mortgage of land.

• Routing of loan from KCC through savings bank account.

• Reluctance by some bankers to issue KCC to new borrowers.

• Insisting floor limit, ceiling etc., for KCC loan.

• Non issue of cheque books, non compliance with norms on margin, security, documentation, renewal, etc.

• Insisting on kind component (input).

• Maintenance of mirror account for the KCC loan cases of Cooperative banks.

Some of these observations have been considered by banks and some of the hurdles have been removed.

6.4 Conclusions

Almost all the studies on KCC have concentrated on the operational and implementation aspect of the scheme and silent on assessing economic impact of the scheme. Further, NABARDs internal studies have, as ascertained by the researcher, attempted to measure the impact but the reports are not available in public domain. Considering the fact that (a) the scheme has completed more than 10 years after implementation, (b) some of the procedural constraints/irritants have been removed, (c) the scheme has been modified by including term loans under KCC, (d) that some of the banks have started issuing ATM cards for KCC and (e) lastly as the banks claim that all eligible farmers in the country have been covered, it is found appropriate to undertake a research with the
major objective to evaluate scheme with special reference to assess its overall impact. This would be done in the backdrop of the recommendations of the Gupta committee and the Vyas Committee. The study will focus on the design and implementation of KCC to see if the design has helped in overcoming some of the issues that had constrained the agricultural credit in the past and what are those issues that are still not sorted out.

As a first step a review of the progress in the implementation of KCC, based on secondary data is attempted in the forthcoming chapter.

1 Syndicate bank. Website of the bank.
3 Barring the recent subvention scheme announced by Government of Maharashtra wherein the borrowers who were prompt in repayment despite the drought were reimbursed most interventions have been aimed at reducing the bank default.
4 Training material for PACS secretary. The department of cooperative restructuring. Website of NABARD.
5 The crop loaning system was eloquent on the “end use” as it was suspected that the farmer will not use the money for crops but may divert it for own use. Hence the guidelines on disbursement to vendors. If a farmer was sanctioned a loan for pump-set the cheque was issued to the dealer and the bank had any contract with the dealer that he will supply the invoiced item and not adjust or change the item. There was no belief on the borrower! Gupta committee advocated greater trust on the borrower.
6 Appropriate repayment based on cash flow is important as otherwise the famer will have to access other sources for repaying the loan and paying the interest thereby pushing him into a debt trap. A NABARD study of 1982 had revealed that repayment schedule not based on cash flows could lead to default in accounts.
7 Derived from “Kshetri Kshethatil Vividh Adarsh Yojana” a publication by NABARD R.O Pune on farm models for plantation crops. Pg 218, etc.
10 Report of the Advisory committee on flow of credit to Agriculture and related activities from the banking system. 2004.
11 Report on Trends and Progress of Banking in India- RBI 2008-09.