CHAPTER – II

THEORETICAL FRAMEWORK AND REVIEW OF LITERATURE

In the preceding chapter an attempt is made to present the brief introduction and plan of the present study. This chapter deals with review of previous studies regarding Grameen Banks and various aspects of institutional credit. In order to create a foundation for the study, to understand the various nuances and dimensions of the topic of study as well as to prepare a proper methodology and framework for the study, elaborate efforts have been made to review the available literature on the topic. Some of the significant theoretical and empirical review of literature and their points of view are presented here below;

2.1 Theoretical Framework

Generally there are in a broad sense, both micro and macroeconomic foundations of the theory of institutional economics. The theory of institutional economics is an important part of theoretical welfare economics.

The theoretical arguments regarding the role of finance in poverty alleviation are broadly classified into two main views, the 'Development School' (Lipton 1998). The Development School views that lack of credit is a major constraint in taking up productive activities aslo. This indicates that there is a need to steer rural credit into productive projects and into the hands of the rural poor. Ragner Nurks argues that the underdeveloped countries are plagued with vicious circle of poverty due to low productivity, low income, and low saving capacity. Hence, Arthur Lewis in his "Theory of Economic Growth" (1995) argues that the poor in rural areas need much more capital than they save in order to invest in productive activities also. The excess in demand of capital can be met with the help of loans. Providing credit (loans) to the rural poor to meet the legitimate needs and expand their opportunities in the prime needs.

In fact the Development School came in for a lot of criticisms by the scholars belonging to the ‘Banking School’. Profound scholars belonging to Banking School like Dale Adams, Van Pischke, Douglas Graham and Gordon Donald argue that credit does not play a leading role but a facilitating role in the process of economic development. Some of the problems that the scholars identified with the traditional credit model are, limited out reach of credit failure of the credit institutions to sustain them financially viable.

Hence, rural loan policies in low developed countries are not supportive to increase productivity in addition to reducing poverty in the country. The years of 50’s and 60’s were marked with the supply of credit, which were seen as important constraints for economic development by many developing countries. Hence, it was widely believed that providing accessibility to credit to the rural poor was considered essential to alleviate poverty and promote economic development. Although informal credit markets operated widely in rural areas, high interest rates of money lenders hindered the process of investing in productive income activities by the rural poor (Von Pischke 1983).

The National Government, Donors, Multilateral Financial Agencies funded credit programmes for the rural poor through various financial institutions at subsidized rates (Padmanaban 1988). Particularly the subsidized credit lending discourages the underprivileged from saving as they provided low rate of interest (Von Pischke 1992). The rate of interest in the rural credit market leads to excess demand for creditable funds in the country. The highest demand for credit caused credit rationing also. Hence the subsidized credit to the rural poor in developing countries did not result in the desired goal of poverty reduction. Government subsidized credits were labeled as credits that hardly reached the poor, generated economic rents, in efficiencies and financially poor. In particular, the past performance of the state or donor sponsored rural finance operation in the country.

The Conventional (subsidized) Credit Model was subjected to serious criticism from the mid – 1970s as donor and multilateral agencies switched their attention from 'state intervention' to 'market – oriented' solution. Changes in interest rate, policies and saving mobilization became the cornerstone of new thinking regarding rural financial institutions.

The downfall of the system gave rise to new awareness among the economists, policy makers and donors in order to look beyond the present credit model and take on a board about the need of institutional viability and efficient allocation of resources. Hence, the Banking School Model emerged as an alternative to the traditional system.

Mellor and Desai (1993) analysed the 'structuralism view' by stating that inappropriate organizational structure of financial institutions was a major reason for poor performance. Generally, financial institutions provide that of 'credit alone' services, which have not contributed to economic development in general and poverty alleviation in particular. It shows the prompted the 'credit plus' approach in development banking and led to the promotion of Multifunctional Financial Institutions which were encouraged to provide credit along with non-credit services to the weaker sections.

Hoff and Stiglitz (1990) and their followers were instrumental in presenting what is known as the 'Information Paradigm'. This paradigm primarily emphasized the problem of information asymmetry in the rural credit market. This asymmetry characterized by three interrelated situations, viz., adverse selection, moral hazard and enforcement also. Operation of these mechanisms cause rationed credit and segmented credit institutions.

The credit lending which is practiced in Micro Finance Institutions can overcome fundamental barriers of financial intermediation between lenders and borrowers. Generally the reduction of transaction cost for both the lenders and borrowers has the potential to lower these barriers thereby increasing credit services to the poor in a more sustainable manner (Von Pischke at 1983, Hulme and Hosby 1996). The success of Micro Finance Institutions like the Grameena Bank, Bancosol of Bolivia, the BRAC and Indonesia, the SEWA in India and many others have been attributed these innovations in the provision of financial services. The institutional innovations have lowered the cost and risks of making loans to the poor due to social collateral, savings promotion and ensuring sustainability of the development.

2.2 Review of Empirical Studies

The empirical studies are applied research studies. They help us to test the theories or models and also provide insights to reformulate old theories and models and/or formulate new theories and models.

Arvinder Singh Chawla (1986) [1] observed that banking developments in Patiala district with special reference to branch expansion, deposit mobilization, credit deployment, priority sector lending and poverty alleviation programmes. It is concluded that, although imbalance in banking presence continues to exist, a clear trend in reduction of inter-block disparities is observed. The analysis reveals that only four banks operating in the district, which have regional character, have opened more branches in rural areas than in urban areas in the country.

Bank of India (1975) [2] analysed that the impact of its direct financing activities in Sholapur district by comparing net farm incomes, yields, intensity of cropping and the per acre income of farmer – borrowers during the investment and post – investment periods of short-term and medium – term credit. The results indicated that the area under irrigation in the district increased by 252 acres with the bank finance. This resulted in an increase in cropping intensity employment and net income. Which was much higher on borrowers, farmers than on those of non-borrowers? The farmers who have borrowed composite loans (short – medium – and long-term loans together) obtained higher incremental income than those who had borrowed crop loans also.

Wadhwa[3] studied on the issue like “Rural Banks for Rural Development” (1980). This study covered an analysis of the progress made by all Regional Rural Banks in India and offered valuable suggestions for its restructure. This study was conducted in 1977 when the Grameen Banks were in the initial stages in the economy.

Satya Sai (1986) [4] studied on institutional credit to agriculture in west Godhavari district of Andhra Pradesh found that on average 90% of the institutional credit was utilized for productive purpose. However a positive relationship was found between the proportion of loan amount used for productive purpose and land size similarly. Ramaswamy and Meskal (1988) in their study on commercial banks found that lending to agriculture in Coimbatore district of Tamilnadu, found mis-utilisation of loan to extent of 38 per cent by agricultural labor households and 20 per cent by small farmers in the country.

Shylendra (1992) [5] examined that the economic impact of Regional Rural Banks in Karnataka loans. The utilisation pattern showed that under none of the purposes of the borrowing, the loan has been used to the full extent of sanction for the intended purpose, he found that borrowers has diverted 4 to 24 per cent of the loan amount from intended purpose to other uses. However the borrowers were found to be using major share of their loans (about 89 per cent) to various productive loans also.

Rai et al (1975) [6] observed in the role of institutional credit in Kalyanapur block of Kanpur District, Uttar Pradesh and found that the cropping intensity on the borrowers and non – borrower farms was 170.4 and 145.4 per cent, respectively. The area under high yielding varieties was about 68.91 and 20.93 per cent on borrowers and non-borrowers farms in that order. The per hectare overall input-output ratio net income family labour income and farm business income for the borrowers farms were higher when compared with the non-borrower farmers in the country.

Vijayakumar (1975) [7] studied on the credit requirements and its impact on irrigated and unirrigated farms in Bangalore South Taluk used linear programming models. He observed that the requirements of credit on irrigated farms were marginal, though there is a possibility to increase the net returns by 2.5 per cent with use of improved technology. The use of unirrigated farms provision of Rs.1,005 as short-term credit in Kharif season enabled the farmers to realize 51.5 per cent of additional net returns over what the farmers could get without credit with improved technology crops also.

Rao and Wahan (1974) [8] in the study entitled Agricultural finance by Commercial Banks in South Canara District of Karnataka found that the increased credit facility enabled a good number of farmers to improve their cultural practices. Also many borrower farmers began to grow high yielding paddy varieties in the study area. The average gross income of farmers has increased by 74 per cent from Rs.14,890 in reference year to Rs.25,784 in current year. The percentage increased across size groups was the lowest (66.33 per cent) for the small farmers and highest (80.69 per cent) on the medium farmers in rural areas.

Kavarjital et al (1981) [9] opined that the impact of farm loans on farm income and employment pattern in Panagar block of Jabalpur district found that the net farm income increased on all categories of farmers. Often avoiding loan, incremental income was the highest in case of small farmers and more or less equal in medium and large farmers.

Hanumanthaiah (1979) [10] studied the commercial banks performance in financing agriculture in the Parchuree block of Prakasham district of Andhra Pradesh. He found that the performance of commercial banks was satisfactory to finance agriculture (short-term loans) in terms of quantum of loan advance coverage of small farmer’s recovery of loans and the rate of interest. The results indicated that there is a scope for increasing the net farm returns by about Rs.10,902 through reallocation of resources even at the existing level of loan limitation.

Kutty et al (1974) [11] studied on the impact of long term – credit on agriculture in Uthanagar taluk of Dharmapuri district of Tamilnadu. The average cost of cultivation per gross cropped areas was higher on the beneficiary farmers when compared with the non-beneficiary category (due to higher use of inputs) and the same was true with regard to the gross income and gross profits in the economy.

Jugale (1997) [12] observed that the term loan for agricultural purpose granted by zonal development bank enabled the borrowers to improve the mechanization by purchasing tractor, tillers and IP sets for minor irrigation. The term loan also helped in increasing irrigated area by 22.40 per cent of land holding a well as cropping patterns and cropping intensity from one crop to two crops per year in the country.

Veerashekarappa (1997) [13] observed in the study on institutional finance for rural development concluded that institutional finance was instrumental in acquiring productive form assets and development of irrigation facilities this results in changes in the cropping pattern increase in the cropping intensity and adoption of variety of crops.

Sasi Rekha and Rani Ratna Prabha (2008) [14] observed that “Agricultural Credit in India in Pre and Post-Reform Period” observed that the problem of agricultural credit is unique, in the sense that, the prospective borrowers are to be reckoned in millions, their credit worthiness is practically nil, their needs of great urgency, their knowledge of accounting matter is small, and their economic status is not satisfactory.

Reddy (2004) [15] opined on “Rural Credit: Status and Agenda” observed that the main problem to be solved in connection with Indian agricultural credit is that of providing loans for millions of uncredit worthiness are mutually irreconcilable. If agricultural credit viewed is solely as a financial matter involving only lending and repayment, a solution to the problem is unlikely to merge.

Deshpande and Nagesh Prabhu (2005) [16] observed that the policy maker should aim at securing the economic and political health of the people through agricultural credit. They should regard the principles of finance and accounting, but they should not be overemphasized. Agricultural credit is a matter which affects millions of people and in democracy, it is important that the people should also try to understand the rights and wrongs of borrowing matters which affect them.

Chandrasekhar Rao (1989) [17] opined that on “How are Rural Commercial Banks” observed that inspite of all the efforts made by institutional agencies the small and marginal farmers are still depending on the informal agencies for the credit needs. This situation can find remedy when the small and marginal farmers has been provided credit with putting less margin for the viability and security and by giving less importance to the commercial viability and profitability of formal agencies in the economy.

Nanda Pandey (1989) [18] opined on “Commercial Banks and Rural Development” has concluded that if commercial banks aim at reaching the poor peasants, rural artisans and other rural people with small or no assets or means, the banks will not only have to develop appropriate organizational skills. Also change their attitudes in favor of the hitherto neglected sector of the rural economy. Opening of commercial bank branches in rural areas is often were a ritual, meant mainly to fulfill physical targets but without any firm commitment or even the faintest notion of serving rural areas and customers particularly .

Deshpande (1989) [19] observed that “Reaching the poor” has noted that, to enable the poor to come forward to take advantage of any scheme, we must create a cadre of local village youths who will organize the poor, train them, supervise the economic activity and, in general, guide them for their development in a comprehensive sense of the term. Anti-poverty programme has to take into accent all these aspects if effective and lasting results are to be achieved. It is observed that provision of credit assistance is not enough in fact, it has only second priority. It is essential to identify obstacles in the development process before any scheme is introduced to a region .The conditions differ from region to region and it may not be possible for the government to prepare a development programme for each region in the country.

State Bank of Patiala (1989) [20] observed that on rural lending in Patiala district recorded that the scale of finance for crop loan is inadequate due to increased cost of inputs. The farmers are still in the clutches of money-lenders/commission agents who are charging exorbitant interest rates, ranging from 30 to 35 per cent per annum. The commission agents bind down the farmers by making advance to them and exploit them at the time of purchase of their produce. It has been suggested that the instead of giving capital-subsidy, the respondents should be provided kind subsidy, i.e., waiving off interest, insurance of animal, etc. It has been observed that shortage of staff at the branches leads to poor exploitation of resources in the form of deposits.

Singh Pasricha (1991) [21] has studied the role of bank finance in the rural development in Punjab and has reported that subsidy-linked social banking schemes should be reoriented in order to check the misutilisation of loans taken just to grab subsidy. It is suggested that subsidy should be released only when the principal amount is repaid. Moreover, the sponsoring agencies should adhere to the quarterly targets assigned to them, while sponsoring loan cases to the financing banking institutions also.

Giriyappa (1993) [22] opined that the role of agriculture, forestry and sericulture as traditional sub-sector of rural development process on the one hand and examined the income and employment effects of the impact of IRDP with reference to Dhakshina Kannada district, Bangalore and Kolar districts in Karnataka State on the other hand. The most important findings of their study is that, the small and marginal farmers, fisherman, artisans, labourers, SC and ST households and also female headed households face the problem of low-income generation and low asset formation particularly.

Kaladhar (1997) [23] observed the design, structure and governance of micro-finance in India. It revealed that the outreach of the programme has been increasing over the years through the help and assistance from SEWA, NGOs, IRDP programmes, Co-operative Banks and Commercial Banks. Banking sector reforms have tried to remove some of the imperfections, which were dealt in detail by institutional economics also.

Upodhyay and Kaveri (1982) [24] studied that the “Impact of Bank Finance on the Decentralized Sector” have observed that bank funds are not fully utilized for business purpose and hence have not made any significant impact on the small business units. A majority of the borrowers use a part of the bank finance for consumption purpose. Hence, it is advisable to grant consumption loans separately apart from business. Moreover, the non-borrowers should be educated on the salient features on bank schemes, in which task bank staff has to play a significant role.

Economic and Statistical Organization, Punjab (1983) [25] observed that the study of commercial bank loans advanced to weaker sections of the community in Punjab. It has been observed that there is no proper scrutiny of applications by sponsoring agencies. The purpose for which loan is being asked for remains quite vague. It is also noted that the sponsoring agencies do not keep a record of the cases sponsored to the financing banks. This sometimes leads to duplication in advancing loans. They suggested that on- the spot loaning should not be done, as it does not allow proper scrutiny of the applications also.

Patel and Shete (1984) [26] observed in their study on “weaker section loans” that banks feel nervous about the extent of overdues in weaker section financing. They have also reported the increasing overdues on the one hand, and the policy maker’s expectations of the bankers to cover more and weaker sections in the minds of general public and nervousness at the gross roots level bankers. But the researchers have found that the recovery of bank loans from DRI respondents was better than that of non-DRI respondents also.

The State Bank of Patiala (1987) [27] studied to know the impact of bank lending in rural areas in Patiala district. The study reveals that there is proper coordination between the lead bank and government agencies but coordination between financing bank offices and field agencies was lacking. It has been observed that credit camps have not made the desired impact in boosting agricultural loans although the overall recovery of advances is satisfactory.

Evaluation and Monitoring Cell, in the Economic Research Department of State Bank of India has studied (1987) [28] on the "Impact of Bank Credit on Weaker Sections" financed under the Differential Rate of Interest Scheme. It has been observed that the utilization of bank loans have generally raised the levels of income and employment of the borrowers, who in turn have found it possible to improve their quality of life at least in quantitative terms. The number of borrowers above the poverty line in the post-loan period was almost double the number in the pre-loan period also.

Banerjee and Datta (1989) [29] have noted that identification of the respondents and target group is the most crucial element for fulfilling the stated objectives of the projects meant for the weaker sections. Identification of the families and specific schemes for their requirements and needs must be assessed and matched sincerely before any monetary help is provided. Provision of inputs required at the proper time is much more beneficial than provision of mere money.

Parthasarathy and Kalyani (1995) [30] reported that the economic impact of women's thrift and credit societies in Cudappah district of Andhra Pradesh. The study was focused on the economic impact of the thrift societies to study access to credit, cost of credit, savings, production and quality of life. These credit associations can serve the interest of the people as they are playing an important role in poverty alleviation in rural areas on democratic country.

Biswajit Mondal (2007) [31] observed that the “Kisan Credit Card Scheme – A Key to improve farmers accessibility – to bank credit” observed that besides the existing facilities of providing crop loan, the scope of KCC scheme has been enlarge to include term loans for agriculture and allied activities and a reasonable component to meet the consumption needs. Further, to provide adequate and timely credit support from the banking system to the farmers for their cultivation needs and to improve farmer’s accessibility to bank credit for production purposes, the credit delivery mechanism is being simplified also.

Patel (2002) [32] observed in the study of “Rural Credit System – Need for Revamping” observed, it is strongly felt that while multi-agency approach to rural credit delivery system is a must for a country of our size and diversified socio-economic environment, there is immediate need for re-engineering the system through the implementation of well studied and conceived recommendations of earlier expert committees; improving operational efficiency of the rural credit system to make system vibrant and responding to the changing requirements taking place inside India and in the global economy also.

Rakesh Malhotra (2002) [33] observed that Regional Rural Banks – The Forgotten Case in Financial Sector Reforms analysed that if tangible reforms are not infused in Grameen Banks to make them vibrant, these institutions may fail to achieve the very objective for which they were conceived, and decay to oblivion.

Badruzzama Siddiqui (2001) [34] opined that of Priority Sectors Lending – Some Major Issues observed that the policy on priority sectors lending assumed great significance after the nationalization of the major banks. The policy has come to be regarded as one of the most important ones aiming at attaining the socio-economic goals. The principle objectives of the new schemes were to achieve a wide spread of bank credit, avoiding concentration, and directing a large volume of credit flow to the hitherto neglected sectors. These sectors were given due priority not because of their tremendous potential of employment generation and various other benefits they confer on the weaker sections but also because of their significant contribution to the national income of the country.

2.3 Identification of Research Gaps

The review of the various studies relating to the agricultural credit and Grameen Banks reveals that they have either focused on macro perspective of outstanding credit or on some issues related to the specific category of the priority sector at the micro level. None of the studies have taken an integrated view of the concept agriculture sector as priority sector credit in general and Cauvery Grameena Bank in Mysore district in particular, based on outstanding as well as incremental credit. In order to fill this gap the present study was undertaken.

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