

# HEDGING LOAN DELINQUENCY IN RURAL CREDIT PROJECTS: LESSONS FROM INDIAN EXPERIENCE

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## 1. *The Scenario of Defaults*

Loan delinquency has become a major bane in agricultural lending in India both by cooperative and commercial banks. Term loans, outstandings to them as of June 1979 is approximately Rs. 25 billion, of which about Rs. 4 billion constitute defaults (Table I). Non-repayment of dues as per the pre-determined repayment schedule has often upset the financial planning (and consequently the financial discipline) in development banks and has, in fact affected their very viability itself, particularly in the case of cooperatives whose major port-folio is agricultural lending. This paper examines some of the relevant issues relating to defaults in Rural Credit Projects. It would be in the interest of those who are concerned with appraisal of rural credit projects in developing countries to build these safeguards into projects at the time of preparation or appraisal stage itself.

## 2. *The Paradox of Under-financing and Over-investment*

One of the important parameters decided under ex-ante appraisal is per unit cost of assets to be acquired out of loans, say, e.g. wells, pumpsets, live-stock animals, farm machinery etc. In many of the projects, the unit cost of investment is fixed taking into account the past conditions prevailing in the project area. Often the beneficiaries find difficult to get the quality units within the cost approved under the projects, e.g. if a sheep unit is costing Rs. 4000/— in the market and the project cost assumed is only Rs. 3000/— it will be possible for the farmers to implement this project only, if they bring in the difference from their own resources, or compromise on the quality. If latter does not happen, it in effect adds to their equity commitments, which itself is usually difficult for them to meet from their savings. Similarly, in the case of ground-water programmes, if the actual cost of the wells in the area works out to say Rs. 10,000/— and the project assumption is Rs. 8,000/— the farmers have to find the balance from non-institutional sources. In many cases, this type of under-financing has resulted in incomplete investments or no investment at all, leading to defaults particularly in the case of small and marginal farmers.

Another side of the same issue is the tendency for over-investment by the farmers disregarding the optimum technical specifications. When a minor irrigation unit need have only 4 mt. diameter, often the farmer is under an erraneous impression that he will get better results if he goes for a much larger diameter. This will naturally increase his cost much more than the unit cost envisaged under the project. Such a tendency

**Table 1**  
SCENARIO OF LOAN - DELINQUENCY IN THE INDIAN LONG-TERM CREDIT SYSTEM

(Rs. Billion)

(July-June)	Loans issued (a)	Year end outstanding (b)	Year end overdues (c)	Percentage of c to b (d)
<b>1973-74</b>				
Land Development Banks <sup>2</sup>	1.467	9.141	0.417	6
Commercial Banks	1.138	2.569	0.316	
	2.605	11.710	0.733	
<b>1974-75</b>				
Land Development Banks	1.838	9.925	0.549	7
Commercial Banks	1.282	3.174	0.384	
	3.120	13.099	0.933	
<b>1975-76</b>				
Land Development Banks	2.049	10.687	0.637	7
Commercial Banks	1.924	4.265	0.513	
	3.973	14.952	1.150	
<b>1976-77</b>				
Land Development Banks	2.489	12.107	0.940	9
Commercial Banks	2.539	5.800	0.725	
	5.028	17.907	1.665	
<b>1977-78</b>				
Land Development Banks	2.390	13.048	1.270	11
Commercial Banks	2.813	7.931	0.968	
	5.203	20.979	2.238	
<b>1978-79</b>				
Land Development Banks	2.477	13.738	2.289	15
Commercial Banks	3.450	10.865	1.358	
	5.927	24.603	3.647	

Author's compilation from different sources and hence only indicates magnitudes.

The term overdues indicates the amount of principal and interest which have fallen due for payment up to that period but not paid by borrowers.

Method of calculating overdues is not uniform in different institutions.

(2) Land Development Banks are State level co-operative organisations which provide investment credit to agriculture in India.

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for over-investment without adhering to the accepted specifications lead to incomplete investments, even though the unit cost has been fixed reasonably. Solution to this would be to fix the unit cost taking into account the project conditions and give discretion to the implementing banks to enhance the same if there is subsequent increase in the price level. Projects should include a suitable component for this contingency over investment should be checked by close monitoring as also through supplying detailed information brochures to farmers.

### *3. Imperfect Analysis*

Basically, projects are prepared based on the economics of representative farm models without identifying the actual beneficiaries in advance. Individual case-by-case appraisal is done within the project, based on the general norms stipulated in the project, after the project is cleared in principle. Although appraisal techniques are understood by the higher level functionaries, the man at the field level, the supervisor, agricultural officer, field assistant etc. who is supposed to investigate the loaning and conduct case-by-case appraisal, is not conversant with many of the appraisal norms. Thus when it comes to the individual appraisal, the various technical norms fixed for lending remains unimplemented. There is also a general tendency among the field staff to fill up the applications and appraisal forms in a mechanical way without reflecting the individual difference of loanees.

The cumulative effect of all these is the distorted feed-back regarding the borrowers, their repaying capacity, their income from the project, investment cost etc. to the decision making authority. Any agricultural credit project should give sufficient emphasis to the training at the field level functionaries and also to the drawing up of simple and self-explanatory format of appraisal forms. Detailed instructions as to how forms have to be completed should be attached to the appraisal forms itself. It would also be necessary to evolve standard cost norms which will serve as a benchmark data for case by case appraisal.

### *4. Incidence of Loan Cases per Field Staff*

Another defect observed in the implementation of rural credit projects has been the large number of loan accounts to be handled per field officer. This has resulted in his inability to concentrate on any set of loanees or to function systematically giving suffi-

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cient time for different activities. In some banks, one field supervisor has to manage as much as 1000 loan accounts as against the normal work load reasonably possible, say 300 per head. Further, lack of transportation arrangements, affects his mobility in the field and consequently the quality of follow-up suffers. The project should safeguard against this lacuna at the stage of preparation itself by allocating sufficient funds for these purposes.

#### *5. Unscientific Banking Plan Allocation*

Normally, a project gets implemented through the framework of a banking plan by which the programmes in terms of units are allocated branchwise to the banks in the area of the project. Often this allocation is done, not to the satisfaction of all the participating banks. In the anxiety to complete the target, at as low a cost as possible, there will always be scramble for good areas with adequate infrastructure and other facilities. Some areas which are either problematic or remote from their branches, are tagged to the banks as it would be essential that someone or the other should take them to avoid a possible gap.

Although initially there is agreement to implement the programme as given in the Banking Plan, subsequently the banks turn from their promises and the programmes remain unimplemented as envisaged. Worse than that, some programmes are implemented halfheartedly and without proper follow-up and appraisal, leading to defaults. To avoid such problems, Banking Plans should be a part of the project itself and areas which are really problematic should either be excluded or should be allocated to the banks only after giving adequate incentives.

#### *6. Feeble Technical Advice*

Although the stipulation regarding appointment of suitable technical staff is a precondition of sanction, because of non-availability of expert personnel, the projects are implemented without adequate technical support. The beneficiaries do not get timely technical advice to implement the programme, particularly in the case of projects for live stock, plantation, fisheries, etc. This results in infructuous investments with inevitable loan defaults. Requirements of essential staff with sufficient practical knowledge of the particular investment as also fixed time schedule for their deployment should be worked out in detail at the time of project preparation itself. These personnel should be

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in position as per the time schedule envisaged under the project. Suitable monetary and other incentives may also have to be provided for these personnel to sustain their interest in the programme. If they need training, suitable component for this under the project should be provided.

#### *7. Improper Planning of Infrastructural Support*

Although at the time of preparation of the project, various essential infrastructural supports are assured by the State Government agencies, at the time of implementation, the required assistance do not often become available due to several administrative constraints inherent in budget mechanism. For example, a minor irrigation programme is sanctioned expecting that the village electrification programme of the State Electricity Board would cover that area soon and if it does not materialise as per the plan, the scheme does not take off the ground. The farmers would have already incurred expenses on wells and for lack of energisation, the pumpsets remain unutilised. This creates a sense of uncertainty on the part of the farmers. Similarly, if adequate number of quality milch animals are not made available as envisaged in the project through complementary breeding programme, the project suffers. Same is true with other infrastructure facilities like roads, storage, extension, markets, inputs, processing units etc. The projects should take a realistic estimate of services available and firm commitments regarding such infrastructural support should be obtained at the time of appraisal itself. If it is not forthcoming, the project should be suitably cut down in size to the level of support which will be really available.

#### *8. Ineffective Tie-up Arrangements*

For any project to be successful, it has been found to be necessary to have effective tie-up arrangements for both marketing of products and supply of inputs. In the case of dairy programmes, if the farmers are not linked to a dairy society, recoveries at times become a problem. Similarly, organised arrangements for marketing are necessary in all cases where the surpluses are small in quantity and individual marketing cost prohibitive. It may even be worthwhile to try to integrate credit and marketing agencies in one body who will synchronise farmers' marketable surplus and credit needs. Similar tie-up arrangements for supply of inputs have also sometimes failed. A good project should ensure its continuity at the time of project implementation by providing necessary incentives.



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#### *9. Inadequate Communication between Branch Office and Head Office*

Although the projects are appraised and negotiated by the Head Office of the Bank, the actual implementation rests with the branch/field staff. Involvement of the branch staff in the formulation of schemes is much limited. The various discipline stipulations regarding the projects are not properly understood by the branch staff. Similarly, the branch agents are not delegated sufficient powers to sanction sub-loans under the project. This results in delay and consequent reluctance on the part of the borrowers of escalation in the cost of the programme. Such poor communication and absence of delegation of enough powers affect the implementation. It is absolutely necessary to involve the branch staff from the identification stage itself.

#### *10. Unrealistic Repayment Schedule*

Repayment schedule for any sub-loan is fixed on the basis of the repaying capacity and life of the assets financed. Repayment commitments are normally at an uniform level annually, during the entire period of repayment. The assumption that all the agricultural years during the project period would generate equal surpluses does not hold good. Out of every five years, cycle, we can say, there will be two normal years, two bad years and one good year. Repayment capacity is related to the surplus estimated in the so called good year and the repayment schedule as fixed now does not take into account this fluctuation in the level of benefits. It would be necessary to introduce a flexible repayment schedule on the basis of this agricultural cycle, in the project itself. Consequently, the financial flow at different levels should be synchronised with this revised pattern.

#### *11. Cursory Assessment of Response from the Farmers*

The projects now prepared are ex-ante projections of investments proposed to be made in a given area. Proper assessment of response from the farmers for the investments is an essential condition for successful project completion. Since individual farmers are identified after sanction of the project, in case the response from the farmers is poor, there is a tendency to force the investments on them. In such cases, the investments are thrust on the farmers without their whole-hearted involvement. This has resulted in less than optimum utilisation of the investments, leading to defaults. Arrangements for dissemination of information about the project in simple local language should be thought of as a part of the project itself.

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### 12. *Reduction in the Unit Value of Sub-projects*

Average value of the projects sanctioned has declined over years as is evident from the representative pattern of projects sanctioned by Agricultural Refinance and Development Corporation (1). This increases the operational work at the base level without corresponding increase in the supporting staff. To avoid this, it would be necessary to fix purposewise floor level regarding the financial commitments for sub-projects. Most of the unnecessary paper work could be eliminated by fixing such a floor level.

### 13. *High Propensity to Consume*

With definite orientation of the programmes in favour of small and marginal farmers, more than 60% of the lendings are now going/will shortly go to small farmers whose propensity to consume is extremely high. The tendency on their part is to appropriate additional income generated out of the investment towards their immediate consumption demands rather than repaying the term loan instalments. Worse, they often consider the term credit as income itself. Their expectation of investment benefits are high and the tendency is to think that road to prosperity should now be short having obtained bank finance. Only effective and timely follow-up could mop up surpluses for debt liquidation rather than for increasing the consumption level.

The above mentioned causes are some of the specific reasons for defaults in Rural Credit projects which a development banker can possibly guard against at the time of project preparation or appraisal. There are several other factors contributing to defaults which have no relation to the type of project appraisal and over which the banker can have hardly any control.

## **PEUT-ON REDUIRE LE TAUX DE DÉFAILLANCE DANS LES PROJETS DE CRÉDIT AGRICOLE? L'EXPÉRIENCE INDIENNE.**

### **RESUME**

*En Inde le non-remboursement des prêts est un véritable fléau dans le secteur du crédit agricole, soit-il octroyé par les coopératives ou les banques commerciales. Les*

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(1) The Agricultural Refinance and Development Corporation is the largest development bank at the National level refinancing rural development projects in India.

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*prêts à terme non remboursés en juin 1979 étaient de 25 milliards de Rs environs, dont 4 milliards de Rs de défaillances (table 1). Le non-remboursement d'après les schémas de remboursement pré-déterminés a souvent bouleversé la planification financière (et donc la discipline financière) des banques de développement et même menacé leur viabilité, surtout dans le cas des coopératives dont le porte-feuille principal est le crédit agricole. Cet article traite de quelques problèmes importants relatifs aux défaillances dans les projets de crédit agricole. Il serait dans l'intérêt de ceux qui s'occupent de l'évaluation des dossiers de crédit agricole dans les PVD de se garantir contre la défaillance au moment même de l'étude du dossier. Les causes principales de défaillance identifiées dans cet article sont les suivantes: (1) sous-financement des investissements qui affecte la qualité des biens; (2) la tendance des bénéficiaires à surinvestir, ce qui aboutit à la sur-capitalisation; (3) le manque d'instructions et de critères clairs pour l'étude des dossiers au niveau de la base; (4) la mobilité insuffisante des spécialistes sur le terrain; (5) l'allocation non-scientifique des programmes aux différentes agences bancaires; (6) le manque de conseil pratique aux exploitants pour leur permettre de bénéficier totalement de l'investissement; (7) une disponibilité d'infrastructures qui ne correspond pas à ce qu'on avait envisagé au moment de l'étude du dossier; (8) une organisation de commercialisation des excédents inadéquate; (9) la défaillance des communications entre l'agence qui s'occupe de la mise en œuvre du projet et le siège centrale où on formule les politiques; (10) des schémas de remboursement des prêts établis sans tenir compte des temps de génération des excédents de liquidité de l'investissement; (11) une étude trop superficielle de la réponse des exploitants qui dans le cadre du projet seront finalement les bénéficiaires du crédit, devront investir les fonds et encourir les risques; et enfin, la tendance des exploitants à destiner le revenu additionnel à la satisfaction des besoins de consommation les plus immédiats plutôt qu'au remboursement du prêt, à cause de leur niveau de vie très bas.*

*Voilà quelques causes spécifiques de défaillance dans le cadre des projets de crédit agricole contre lesquelles les banques de développement peuvent essayer de se garantir au moment de l'étude des dossiers. Il y a d'autres facteurs parmi les causes de défaillance qui n'ont aucun rapport avec le type d'étude des dossiers et sur lesquels les banques n'ont presque pas de contrôle.*