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9. ABSTRACT
This article describes how well nationalized commercial banks in India meet the needs of small farmers in Karnataka State by providing financing through cooperatives, and what adjustments are needed. Commercial banks have had mixed success in providing financing through cooperatives for farmers with small landholdings. In Karantaka State, commercial banks financed about 30 percent of the members of their cooperatives. Several reasons account for the failure of lending institutions to provide loans for most small farmers. First, commercial banks are conservative in their loan policies. They have had little previous experience with cooperatives and agricultural financing. Secondly, the lack of resources of most small farmers prevented them from obtaining adequate financing. Finally, to safeguard the rate of loan repayments, lending institutions concentrated their loans in a few cooperatives. Several policy changes could make crop production loans to small farmers through cooperatives more attractive to commercial banks. If commercial banks were provided subsidies for paying the managerial costs of paid secretaries at the cooperative societies, overhead costs of making and collecting small agricultural loans could be reduced. Also, administrative confusion occurs between commercial banks and district cooperative banks over responsibility of financing cooperatives in districts where both banks operate. This leads to delays and higher costs, which discourage farmers from seeking loans. The confusion also adds to repayment problems.

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HOW COMMERCIAL BANKS FINANCE SMALL FARMERS THROUGH AGRICULTURAL CREDIT COOPERATIVES IN INDIA

by
Glenn C. W. Ames[1]

ABSTRACT

Major objectives of the recent nationalization of 14 commercial banks in India included opening of rural banking services and expanding the availability of loans for small farmers. Commercial banks have had mixed results in using agricultural credit cooperatives to help finance agricultural production. The cooperatives have the facilities and experience that are needed. If managerial costs are subsidized and cooperatives are revitalized, improved working relations between the banks and cooperatives could lower administrative costs, encourage farmers to seek loans, and decrease repayment problems. This paper describes the systems approach to financing small farmers.

KEYWORDS: India, rural, credit, bank.

In the past 25 years, governments of many developing countries have started small farmer loan programs. The most common type has been the special loan program in which a single agency is responsible for agricultural lending. Examples of special programs include supervised credit in Latin America, cooperatives and farmers' associations in Africa and Asia, and total input package programs. The results of the special program strategy are widely available in literature [2].

A second common strategy was to persuade such institutions as private, commercial, and state banks to finance the needs of cultivators of small landholdings [6]. Several authorities call this the systems approach.[2] It is a program of government-sponsored programs of indirect financing through private lenders [1]. The systems approach encourages financial institutions to allocate a larger proportion of their loans to small farmers. This approach has been used in India, Pakistan, Bangladesh, and several Latin American countries. Little information, however, is available on the effectiveness of the program or how it works when it is combined with the special program strategy [6].

Major differences between the special loan program and the systems approach often involve the degree of government financing and participation. Special loan programs include direct government financing and closely supervised distribution of agricultural input kits containing seeds, chemical fertilizers, plant protection chemicals, and extension information for selected groups of farmers. On the other hand, objectives of the systems approach are to induce lenders to service the borrowing needs of farmers that have small landholdings and to assist them in using larger production loans. Generally lenders supply production loans and allow borrowers to purchase inputs from available suppliers. In initial stages, systems lenders lack adequate criteria for identifying the progressive farmers and the infrastructure limitations that often lead to production credit repayment problems [5].

The purpose of this article is to examine systems financing. The example shows how nationalized commercial banks in India finance small farmers. Specific objectives are (1) to describe how commercial

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[2] The term "systems approach" has been used to describe production loans provided by such legally recognized entities as commercial banks and farmer cooperatives.

banks finance farmers through cooperatives, (2) to describe how nationalized banks meet the needs of small farmers in Karnataka (formerly Mysore) State in India, and (3) to outline some adjustments that may be needed by commercial banks to serve the requirements of small farmers.

BANK FINANCING OF FARMERS THROUGH COOPERATIVES

Indian cooperatives are a fundamental part of the National Five Year Development Plan. State governments can stimulate agricultural development by using cooperatives. The Reserve Bank of India finances and subsidizes the agricultural cooperatives through a three-tier organization consisting of the state cooperative through a three-tier organization consisting of the state cooperative Apex banks, district cooperative central banks, and primary agricultural credit cooperative societies at the village level. The Reserve Bank of India grants loans to the state cooperative Apex bank. The Apex bank finances the district cooperative central banks. They, in turn, make loans to the village cooperatives. The primary cooperatives then finance the farmers' seasonal agricultural operations through the crop loan system [14]. The organization of the Indian cooperative system is illustrated in figure 1.

Until 1969 commercial banks operated only in cities and towns with large commercial and industrial centers. But in July 1969, 14 major commercial banks in India were nationalized. This opened up new sources of finance for agricultural credit cooperatives. As a result of public policy since nationalization, commercial banks increased the capital available to farmers on a selective basis. Supplying crop production loans to farmers and revitalizing the administration of the cooperative societies have been two important tasks facing the commercial banks.

Even before nationalization, the Reserve Bank of India used its licensing policy to encourage a branch expansion in rural areas. Since nationalization, over 64 percent of the 5,358 new banks opened in rural areas [8]. During 1973-74, commercial banks opened 1,593 new offices in India. Of these, 909 new offices, or 57 percent, were opened by 14 nationalized banks, and 19 percent were opened by the State Bank of India and its subsidiaries. Other commerical banks opened the rest [13].

How Commercial Banks Finance Cooperatives in Karnataka State

In 1970 commercial banks introduced a program of financing primary agricultural credit cooperatives in seven districts of Karnataka State. The district cooperative central banks were administratively and financially weak. They were ill-equipped to meet agricultural borrowing needs of all farmers [18]. The commercial banks encountered many of the same problems that hampered the district cooperative central banks, such as high overdue payments and defaulting borrowers. The district cooperative banks usually assigned to the commercial banks those societies with the poorest financial resources and operational efficiency.[4] Many cooperatives assigned to commercial banks could not borrow from the district cooperative banks, because their large loans were overdue and had not been repaid. Under these circumstances, commercial banks could not advance new loans until the cooperatives recovered the old debts. Several banks deleted numerous cooperatives assigned to them because of these debts. Consequently, many commercial banks have had limited success in expanding agricultural credit to cultivators through the cooperatives.

The program of financing primary agricultural credit cooperatives by nationalized commercial banks started with 12 participating banks during the 1970 Kharif (fall) production season. Banks were assigned 645 cooperatives or about 6 percent of all agricultural credit cooperatives in Karnataka State in 1970-71 [18]. About 76 percent of these groups were actually financed by commercial banks during the first year. At the end of September 1974, the commercial banks had been assigned 991 cooperatives, and they had financed 841. Commercial bank financing of cooperatives in Karnataka State is shown in table 1.

The Government of India and the Reserve Bank now encourage commercial banks to finance cooperatives even in districts where the district cooperative central banks are financially sound. The Reserve Bank of India also revised upward the rate of interest charged cooperatives. Farmers were previously charged about 2 percentage points above the rate charged cooperatives for short-term crop production loans [12].[5]

Cooperatives are an important source of crop production loans for farmers. Loans consist of cash and of kind components, usually fertilizer. If a farmer in Bangalore District, for example, applies for a loan

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[4]In general, district cooperative central banks have not had the financial resources to meet the needs of all cooperative societies. Even so, the number of cooperatives financed by the Bangalore District Cooperative Central Bank has increased from 85 in 1969-70 to 146 in 1972-73. In addition, the number of cooperative members receiving short and medium term credit rose from 1,958 in 1969-70 to 2,869 in 1972-73. The average amount of credit per borrower rose from Rs. 825 to Rs. 1,320 during the same period.

[5]The Reserve Bank revised upward the rate of interest charged cooperatives twice during 1974. The rate moved from 7 to 11 percent on loans of less than Rs. 150,000 and 12 percent above that amount.

Indian Cooperative Credit System

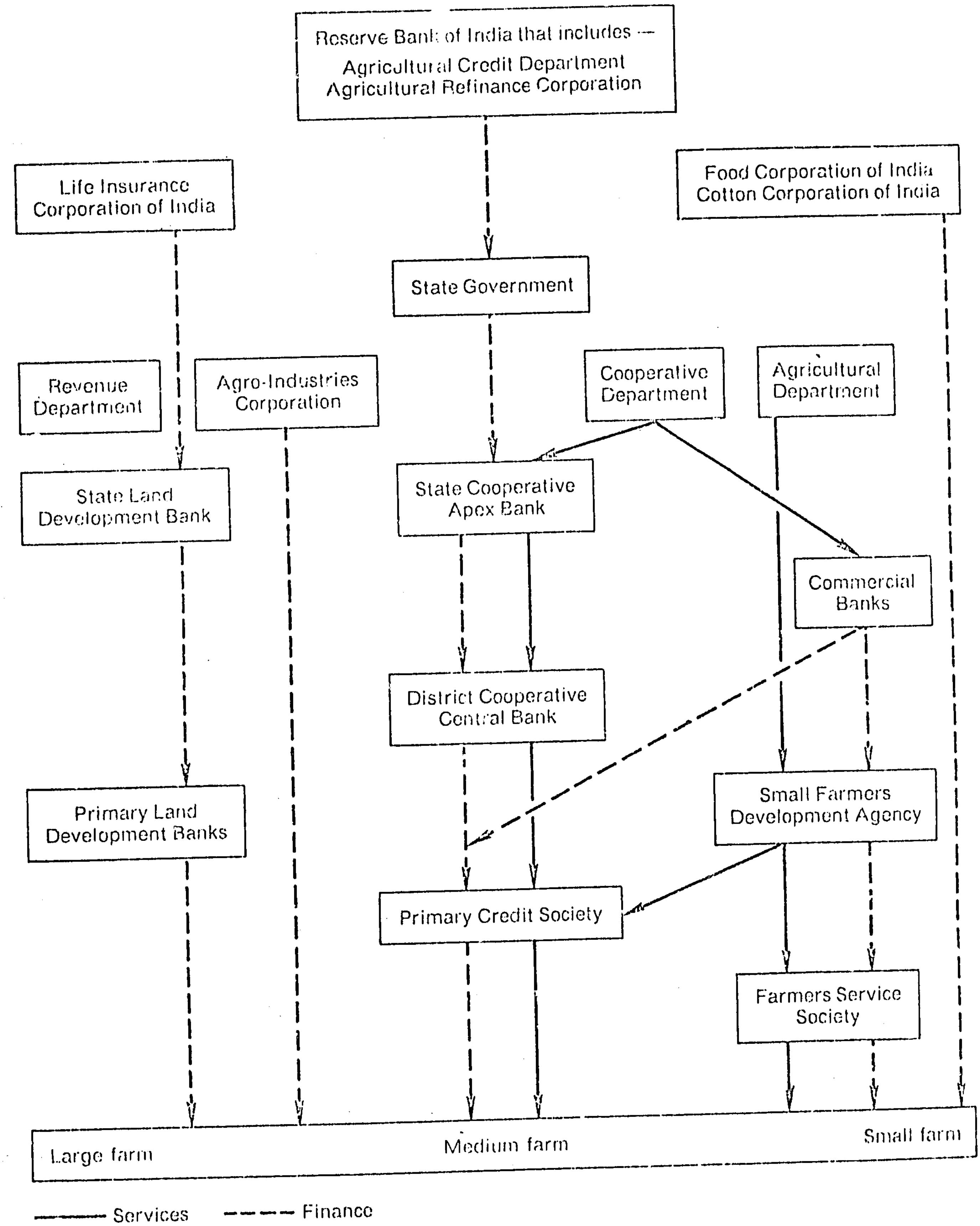

Table 1 Commercial bank loans to cooperatives in Karnataka State, India 1973-74[1]

Commercial bank	Fall[2] 1973		Winter[3] 1973/74		Fall[2] 1974		End of year	
	Cooperatives financed	Amount[4] of loans	Cooperatives financed	Amount[4] of loans	Cooperatives financed	Amount[4] of loans	Cooperatives financed	Amount[5] of loans
	Number	*Million rupees*[6]	*Number*	*Million rupees*[6]	*Number*	*Million rupees*[6]	*Number*	*Million rupees*[6]
Canara Bank	144	8.928	37	1.193	158	9.761	177	13.652
State Bank of Mysore	316	17.251	68	3.641	266	20.132	364	26.792
Syndicate Bank	69	5.936	13	.235	74	7.340	81	8.607
Indian Overseas Bank	9	.472	. . .	. . .	5	.341	12	.592
United Commercial Bank . . .	43	1.573	7	.150	35	1.726	50	3.420
State Bank of Hyderabad . . .	33	2.745	5	.269	9	.260	48	3.035
Union Bank of India	11	.356	1	.051	11	.675	29	.948
Vysya Bank Ltd.	[illegible]	1.028	2	.063	13	.811	29	.974
Dena Bank	4	.100	1	.004	. . .	. . .	10	.173
Central Bank of India	6	.592	2	.089	1	.180	15	1.246
Punjab National Corporation Bank Ltd	4	.361	2	.019	1	.075	8	.770
Total	670	40.851	139	5.752	563	42.144	841	62.493

[1]Source of data is [12]. [2]Loans made during the Kharif (fall) cropping season roughly June through September. [3]Loans made during Rabi (winter) cropping season usually October through January. [4]Calculated on the basis of loans on which an outstanding balance was owed as of September 30, 1974. [5]Calculated on the basis of loans initially made per cropping season. [6]One rupee equals $0.13 U.S. dollar.

to finance an acre of high-yielding variety of rice, the local cooperative would approve a loan consisting of Rs. 170 in cash, Rs. 280 for fertilizer, and Rs. 50 for pesticides [10].[5] Accordingly, loans for other crops are adjusted to estimated cash production expenses. Credit limits per crop per acre are set during the annual field workers conference of bank representatives, extension officials, and prominent farmers.

Many of the commercial banks adopted the scales of finance for short-term crop production loans used by the district cooperative central banks. In some cases different scales of finance were used. Conference committees resolved the differences between the commercial banks' and district cooperative banks' loan limits for specific crops in their respective districts. In addition to crop production loans, the commercial banks provided intermediate term financing to farmers through cooperatives. Intermediate term loans were approved for dairy, poultry, swine, sheep, and sericulture enterprises as well as for deepening old wells, sinking new wells, installing electric pump sets, and purchasing power tillers. Commercial banks issued Rs. 331,000 in intermediate term loans to 11 cooperatives by the end of the Rabi (winter) 1971-72. By the end of September 1974, commercial banks loaned Rs. 6,514,000 in intermediate term loans to 232 societies, an increase of 389 percent in 4 years [12].

Since the beginning of the program, commercial banks increased the average amount of the loan per cooperative society from Rs. 27,000 during the fall of 1970 to Rs. 75,000 in 1974. The average loan per cooperative in 1974 was Rs. 70,000, up 7 percent from 1973. Farmers' cash expenses have increased dramatically, straining resources of commercial banks. In Bangalore District the price of ammonium sulphate rose from Rs. 540 per ton in 1970 to Rs. 925 in June 1974.[6]

Commercial banks also worked with the Small Farmers' Development Agency[7] (SFDA) [5, 5, 11] in Karnataka State to help farmers who owned 5 acres or less obtain credit and agricultural inputs from cooperative societies. In addition, commercial banks sponsored Farmers' Service Societies in cooperation with the State Government and SFDA for small marginal farmers who are receptive to modern innovations. Programs involving commercial banks include the State's crash sericulture program started in 1973. Commercial banks were directed to finance and expand the credit program for sericulturists, silk reelers, and others in the industry in Mysore, Kolar, and Bangalore districts.

[5] One rupee equals $0.13 U.S. dollar.

[6]This unpublished data is from M. B. Nanjappa, Joint Director, Bureau of Economics and Statistics, Bangalore, India, December 13, 1974.

[7]In 1970 the Government of India established the Small Farmers' Development Agencies to help small landholders obtain financial and technical assistance for modern agricultural production. The agencies identify small landholders who have potentially viable operations. The agencies provide the landholders with share capital requirements, risk funds, and other subsidies so they can become active members of cooperatives. The farmers can then qualify for crop production and intermediate term loans. The agencies work closely with district cooperative central banks and commercial banks to coordinate the flow of funds from cooperatives to small farmers.

Financing Difficulties in Bangalore District

The Bangalore District in Karnataka State had many of the typical problems encountered by commercial banks in financing cooperatives. These problems included large amounts of overdue credit from cooperatives, poor administration of the village societies, and the apprehensions of officials who were afraid that commercial banks would weaken the farmer's faith in the cooperative movement. During 1970-71, 5 commercial banks were assigned 72 cooperatives. They actually financed 58 societies with Rs. 2.51 million, an average of Rs. 43,000 per society. During 1972-73, commercial banks were assigned another 111 societies, an increase of 100 percent since the program started. But only 6 banks actually made loans to 81 cooperatives in 1972-73. The other 3 banks were not able to develop a finance program for the cooperatives assigned to them during the year [8]. In addition, many banks were apparently expanding their programs to meet development targets. The targets were the number of societies served rather than meeting the credit needs of a majority of farmers. Commercial bank financing of cooperative societies in Bangalore District is shown in table 2.

Table 2.–Commercial and District Cooperative Central Bank financing of cooperative societies in Bangalore District for 1970-71, 1971-72, and 1972-73

Source and year	Bangalore D.C.C. Bank	Commercial banks					
		Dena Bank	United Commercial Bank	Canara Bank	Corporation Bank	State Bank of Mysore	Union Bank of India
				- - - Number - - -			
Cooperatives assigned							
1970-71	610	7	31	0	10	11	10
1971-72	610	10	38	43	10	11	10
1972-73	584	10	39	35	8	32	10
Cooperatives financed							
1970-71	[illegible]	5	34	0	5	9	5
1971-72	117	8	29	3	6	11	4
1972-73	146	7	29	14	8	20	3
				- - - Million rupees - - -			
Amount of short-term credit [illegible]							
1970-71	2.77	0.12	1.52	0	1.28	0.31	0.08
1971-72	3.83	.11	1.20	.38	.31	.32	.09
1972-73[2]	3.79			3.22			
				- - - Percent - - -			
Short-term credit repaid							
1970-71	19	37	60	. . .	37	69	65
1971-72	12	17	53	96	36	52	44
1972-73	37	. . .	. . .	90		. .	. . .

[1] Source: [17]. [2] In 1972-73, six commercial banks loaned 81 cooperatives Rs. 3.8 million. Information on the amount of credit from individual banks was not available in subsequent years. The Canara Bank claimed it financed one more cooperative society than the Deputy Registrar's report indicated.

FARMERS SERVICE SOCIETIES: COOPERATIVES FOR SMALL AND MARGINAL FARMERS

The National Commision on Agriculture of India recommended that commercial banks sponsor Farmers' Service Societies. These societies would provide, from one source, integrated loans and technical services for small and marginal farmers who are receptive to modern agricultural technology [9, p. ii].* Generally the SFDA or Marginal Farmers and Agricultural Labourers Agency (MFAL) organizes the Farmers' Service Societies at the block development level, serving a population of about 10,000. A Union of Farmers' Service Societies at the district level coordinates the policies.

Farmers' Service Societies are registered in the State as primary cooperative societies. According to the National Commission on Agriculture, Farmers' Service Societies should supply all of the development needs of small and marginal farmers, agricultural laborers, and village artisans either directly or by special arrangements with other agencies. The Lead Bank in each district—nationalized bank, State bank, or cooperative—has the overall responsibility of

*H. Y. Balagopal was interviewed at the State Bank of Mysore, Bangalore, on June 16, 1972.

integrating farm production loans with the supply of inputs and services for small landholders [15]. Initially Farmers' Service Societies were organized in districts that had functioning SFDA's. Bangalore and Mysore Districts are the primary ones in Karnataka State. Although these societies follow the cooperative practices, they are too new to evaluate adequately.

Operational Problems in Bangalore District

The officers of participating commercial banks reported several operational problems at the bank and village levels. First, many commercial banks lacked experience in financing small farmers. Their main problems were the leadership of village cooperatives, collecting past debts, and restoring farmer confidence in cooperatives. Second, crop failures because of climatic conditions and insect damage prevented many farmers from repaying their loans [4, p. 29-31]. Third, the new credit program was delayed because the commercial banks and the district cooperative central (D.C.C.) banks continued to differ in the selection and financing of cooperatives [16].[9] Finally, cooperative officials and some farmers feared that commercial banks would dampen the cultivators' enthusiasm for cooperative credit and weaken their faith in cooperation [7]. Bureaucratic disputes over credit policy between the commercial banks and D.C.C. Banks was certainly a problem in the State.

According to one bank, the problems of cooperatives were poor management, lack of supervision, reluctant attitude of the borrowers toward repayment, and inefficient recovery procedures.[10] These problems accounted for the large amount of overdue credit at the time the cooperatives were taken over by the bank.

The Government of India's National Commission of Agriculture concluded that supervision of cooperative societies was the crucial key to successful institutional credit programs [9]. In the past, supervision of cooperatives has not been a two-way flow of information. Instead, the D.C.C. banks' recovery officers generally have dogmatically dominated the cooperative societies. They were interested only in the recovery percentage from a society rather than in the underlying causes of the cultivator's repayment problems. If the commercial banks' agricultural extension officers are sensitive to farmers' needs, they can make substantial progress in improving crop production repayment through enlightened supervision of cooperative societies.

Commercial banks in Bangalore District had a wide range of rates for short-term loan repayments. The State Bank of Mysore attributed its initial credit repayment success (99 percent) to the superior training of the paid secretary at the village level and to the bank's technical officer who showed the farmers how to use production credit.

Other agricultural loan officers blamed poor leadership at the local cooperative level for their repayment problems. These officers also recognized that the uncertain rains in the dryfarming regions of Bangalore District created repayment difficulties for farmers because of low net returns per acre. In general, the major reasons for crop production credit repayment were the low returns from dryland farming, poor cooperative leadership and administration, and district politics (factionalism).

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[9]Since inception of the program in Bangalore District, commercial banks have charged that cooperatives were not allotted to them from the D.C.C. Bank as promised and hence they could not finance them. However, commercial banks have not financed all of the cooperatives allotted to them and these were retransferred to the D.C.C. Bank. Confusion over sources of finance often means that farmers do not receive credit on time, if at all.

[10]This is based on a letter from K. S. Kamath, Senior Superintendent of the Canara Bank, Bangalore, India, on February 13, 1974.

POLICY CONSIDERATIONS

Nationalized commercial banks developed credit programs for previously unfinanced groups. The banks designed several liberalized credit programs under the Lead Bank scheme for such neglected sectors as agriculture, small-scale industries, small businesses, and self-employed persons in their assigned districts. A few banks developed pilot projects to provide productive credit, at concessional interest rates, to special categories of borrowers who would not normally qualify for loans [3]. In addition, commercial banks are sponsoring Farmers' Service Societies for small and marginal farmers. But these liberalized credit programs could face the same repayment problems as those of the district cooperative central banks.

Agricultural finance officers must not place greater financial burdens upon small farmers just to meet development targets. Profitable returns on agricultural investment are necessary. If excessive development targets are imposted on commercial banks to encourage their financing programs and if a solid base for agricultural production is not built, then the previous pattern of overdue loans and failing cooperative societies will be repeated.

Agricultural loans must be based on a realistic assessment of farmers' requirements. Also, the commercial banks' scales of finance are based on the estimated production costs and production potential of the borrower. These scales need periodic revision to reflect changes in agricultural technology and production costs. The commercial banks' program of providing technical assistance along with loans through Farmers' Service Societies has potential. But some of the farm loan officers, or extension agents, may be young agricultural college graduates with little practical experience and little usable technical advice to offer. They will find that building the farmer's trust is difficult if their recommendations do not improve the farmer's ability to repay loans.

Conclusions

Commercial banks have had mixed success in providing financing through cooperatives for farmers with small landholdings. The changes brought by the special systems approach have not increased loanable funds for small farmers in Karnataka State. Commercial banks did not finance all of their assigned cooperatives nor all of their farmer members. For example, in Karnataka State commercial banks financed about 39 percent of the members of their cooperatives in 1974.

Several reasons account for the failure of the lending institutions to provide loans for most small landholders. First, commercial banks were very conservative in their approach to financing farmers through cooperatives. They had little previous experience with cooperatives and agricultural finance. Commercial banks felt that if their staffs and lending activities were overextended, they might lose direct supervision of cooperatives.[11] Third, a lack of basic resources prevented small farmers from obtaining adequate financing. Finally, lending institutions concentrated their loans in the hands of a few cooperatives and farmers to improve the rate of loan repayments.

[11] Farmers do not borrow from their cooperatives for such reasons as defaults on past loans, failing to provide complete land records, and acquiring funds to provide share capital requirements of about 10 percent of the value of the loan. Consequently, they rely on traditional sources of loans—moneylenders, relatives, and friends.

Several policy alternatives could make crop production loans to small landholders through cooperatives more attractive to commercial banks. If commercial banks were given subsidies for managerial costs of paid secretaries at the cooperative societies, overhead costs of making and collecting small agricultural loans could be reduced. The Small Farmers' Development Agencies now update small farm land records in many districts. Also, administrative confusion occurs between commercial banks and district cooperative banks over responsibility of financing cooperatives in districts where both banks operate. This confusion leads to delays, raises administrative costs, discourages farmers from seeking loans, and contributes to repayment problems. Improved centralized administrative planning at the district level could reduce costs and make agricultural loans more attractive to commercial banks.

Agricultural lending patterns of commercial banks will change slowly. Political and economic problems continue to slow the systems approach in meeting the financial needs of small producers. But if commercial banks succeed in providing loans, inputs, and technical assistance through revitalized cooperatives, the banks can improve loan repayments and make a significant contribution to agricultural development.

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