

CHAPTER TWO

RESOURCE ACQUISITION AND USE OF CREDIT IN AGRICULTURE

Productive resource is any good (commodity) or service used in the production process to create another good (commodity) or service. In the production process, firms use factors (inputs or agents of production) which are often classified into four categories: land, labor, capital and entrepreneurship.

- ✓ **Land:** Land is the basic resource which supports the production of all agricultural commodities. It consists of those gifts of nature which are not the result of human effort and it includes land, water, sunshine, natural forests, minerals, wild animals and local climate.
- ✓ **Labor:** The term labor describes the effort of human beings that include hired labor, family labor and farmers' labor. Labor is needed for every type of production. It can be more productive as a result of time and effort devoted to training.
- ✓ **Management (Entrepreneurship):** Entrepreneurship involves organizing and coordinating the different farm resources (land, labor and capital) so as to get the maximum output and profit.
- ✓ **Capital:** It presents all resources which are the result of past human effort. Which means it consists of all manmade goods which are used in the production of other goods. It includes building, dams, roads, machinery, seed and fertilizer etc.

Obtaining and use of capital in the agricultural business is vital and important. Hence, capital acquisition is our main concern in this chapter.

2.1.CAPITAL ACQUISITION IN AGRICULTURE

2.1.1. Definition of Capital

The term capital refers to the total investment of the company in terms of money, and assets. It is also called as total wealth of the company. Capital is the initial and integral part of new and existing business concern. Capital as a factor of production is commonly defined as those forms of wealth other than the land, from the use of which an income is expected. This means that all

forms of wealth other than land which yields an income is capital. Capital can still be defined as the accumulated product of past labour destined for the production of further wealth. Capital is that wealth which yields an income or aids the production of income. In essence, capital represents resources that are not needed for their own sake but they are needed for the production of other goods. Unlike land, capital is produced as a result of human efforts. Examples of farm capital include: Farm buildings, farm machineries and equipment, fertilizers, farm land, seeds and planting materials, breeding stock, crops, simple farm tools and more importantly, cash. Capital has been produced by man working with nature. Hence capital may also be termed as *man-made instrument of production*. The reward of capital is interest.

2.1.2. Characteristics of Capital

- ❖ Capital is the result of Labour: Some economists consider the capital as the storage of the past labour. The farm implements used for further production of wealth from bumper harvest, were the products of labour.
- ❖ Capital is the result of Savings: Capital is equal to savings, which is equal to income minus consumption.
- ❖ Capital is Productive: Capital in combination with other factors of production like land and labour, produces goods and services. Though Keynes an economist argue that capital is not productive rather efficient.
- ❖ side of capital.
- ❖ Capital is Temporary: Capital is not is not permanent, rather it has to be reproduced and replenished from time to time.
- ❖ A mobile factor: Capital is the most mobile factor of production.
- ❖ Capital is not a free Gift: Capital is earned with hard work and sacrifice. It is not freely available like land to the individual and the society.
- ❖ Capital can be substitute for labour: To some extent labour can be substituted by higher doses of capital. Mechanization of agriculture is one such example. However, all labour cannot be replaced by capital.

2.1.3. Types of Capital

There are many ways of classifying capital. Some of the classes of capital include the following:

Classification of Capital based on source of acquisition

- A. *Equity capital*: It is the capital obtained from own savings, gifts, etc.
- B. *Debt capital*: It is the capital obtained from borrowed funds.

Classification of Capital Based on use: Capital can be divided into two groups:

- A. *Fixed Capital*: These are those durable use producer goods which are used in production again and again till they economically become unfit for use e.g. machinery, tools, railways, tractors, factories, etc.
- B. *Working Capital*: These are those single-use producer goods which are used at once in one production cycle e.g. Seeds, manures, fuel, raw material for process, stored irrigation water, etc.

Classification of Capital Based on use: Capital can be divided into two groups:

- A. Fixed Capital:** Fixed capital refers to such farm assets that are acquired for the farm operation irrespective of the level of production. Such capital include – farm building, tractor and implements and other farm machineries.
- B. Variable Capital:** This form of capital is acquired based on the level of farm operation. The more the size of the farm, the more of such capital will be needed. Examples of variable capital include: cash, seeds and planting materials, fertilizers, e.t.c.

2.1.4. Methods of acquiring capital

Capital acquisition and capital use are important in every phase of agricultural business. But from where the finance is to come to fulfill those productive capitals of farming? There are two sources from which farmers may obtain the capital which they use in their farming business. These are: internal sources and external sources.

I. Internal Sources

Inheritance: In Ethiopia as a result of the land tenure system most land is passed from one generation to another through inheritance. Sons inherit the land cropped by their parents and these are passed down from generation to another. In most communities, as the families enlarge the available land is divided among the many children and therefore land becomes more and more fragmented. Under subsistence farming in the communities, 90 per cent of land ownership is through inheritance.

Gifts: Land is also owned through gifts between two families, friends and mother to son or one type of relation to another. This is common in subsistence farming situations.

Savings: Capital accumulated through savings (defined as net worth, less gifts and inheritance) forms the foundation of the farm financial structure. Except for gifts and inheritance, savings provide the backbone for farm capital. Savings provide not only capital, as such, but risk-bearing ability (reserves) and demonstrate capacity to earn and save the two very essential components of a strong credit rating.

Farming is big business and big business requires a large amount of capital and a sound financial foundation and framework which savings alone can provide. Few people who are unable to save will be successful in commercial farming. The farmer is the one to whom profit derived from farming accrues and, therefore, he must stand the risk of loss. Funds also are needed for sickness, education, and other family uses. Savings must be accumulated by the successful farm family to provide a financial base for all such purposes.

Accumulating any amount of savings takes time for most people. Living standard tends to be upgraded as income increases, which leaves little for saving. However, it is surprising how rapidly wisely invested savings “grow”. Even a small amount saved regularly produces a surprisingly large sum in a fairly short period.

II. External Sources

Incorporation: Forming a corporation provides another method of acquiring capital to farm. A corporation is a legal entity authorized by state law and is capable of doing business, making contracts, borrowing money, and the like, the same as an individual proprietor. Individuals who form a corporation are its owners and are issued certificates representing shares to show the interest each holds in the corporate assets. When a corporation is formed to operate a farm business, it takes the place of the farmer as owner and operator.

Renting: Renting or leasing is a common way of obtaining additional capital for farming. Many lending farmers and ranchers, who own considerable land, rent additional acreage to utilize more efficiently their managerial ability, and the land, machinery, and equipment they own.

Leases are usually classified according to the kind of rent paid. Most of them fall into three general groups: the *crop-share lease*, the *livestock share lease*, and the *cash lease*. With share leases, a share of the crop or livestock production is paid to the landlord as rent. The various types of leases may be combined or otherwise modified in renting a farm.

The crop share lease is the most common type of rental arrangement. With the crop-share lease, the landlord usually provides the land and improvements and pays related taxes and other expenses, while the tenant pays most of the operating expenses and furnishes power, machinery, labour, and livestock. Some expenses such as seed and fertiliser may be shared with the landlord. Crops produced are shared as agreed upon in the lease.

For farms rented under a livestock-share lease the tenant and landlord customarily share crops and livestock production, as well as some of the expenses. The landlord usually furnishes the land, buildings, and other improvements; the tenant furnishes the machinery, power, and his own labour. The tenant and landlord commonly own the livestock jointly and share the annual expenses of crop and livestock production.

Farms rented by cash lease tend to be used most frequently in areas where yields are relatively stable and where production involves a relatively small amount of risk and uncertainty. They also are frequently used for part-time or residential farms. With cash leasing arrangements, the landlord is paid a specified cash payment and usually furnishes the land, buildings, and other improvements. The tenant furnishes all other items required for production, including labour, machinery, livestock and operating expenses. The entire production of crops and livestock belongs to the tenant. The concepts of cash and share rent are sometimes combined in what is called standing rent.

Purchase or Purchase Contracts: If the buyer has sufficient funds, he can pay for the property fully and all documents signed and handed over to him. A purchase contract is a written agreement whereby one party agrees to convey land and sometimes chattel farm property to another party for an agreed price. Possession of the property passes to the buyer while deed to the property remains with the seller, to be delivered at some future date or upon payment of a specified amount. The contract usually provides for the buyer to keep up or make improvements on the farm. Where livestock are involved, provision usually is made for all

livestock raised or purchased and kept on the farm to be considered as replacement equipment, legally belonging to the seller until terms of the contract have been fulfilled. As a general rule, the buyer pays all expenses, including all taxes and property insurance, after a specified date. The kind and amount of insurance usually is specified, with the loss-payable clause being in the name of the seller. It therefore implies that only the rich can make such purchases unless the buyer has access to bank financing. If this is not possible another alternative is purchase contract.

Borrowing: Finance in agriculture is as important as other inputs being used in agricultural production. Borrowing probably ranks next to saving or using one's own capital as a means of obtaining capital to farm. The word "borrow" means to receive something with the understanding that it or its equivalent will be returned as agreed upon. Stated another way; borrowing means the ability to command capital or services currently for a promise to repay at some future time. In terms of money, borrowing involves obtaining a certain amount of funds to be repaid as specified in the note. While credit has a somewhat technical meaning of its own, it is used in financial circles and writings as meaning about the same as borrowing. This synonymous usage probably has come about for convenience sake.

2.2.BASICS OF CREDIT

2.2.1. Definition and Concept of Credit and Agricultural Credit

The word "credit" comes from the Latin word "credo" meaning "I believe". Hence, credit is based upon confidence. When one borrows money, the loan is based upon confidence in the future solvency of the person and in his repaying the loan as per agreement. In this sense, credit means ability to command the capital of another in return for a promise to pay at some specified time in the future. **Credit** also means the ability to command other peoples' capital in return for a promise to repay at some specified time in future. It is therefore the combination of the "ability to borrow" and "willingness to borrow". It can also be regarded as an economic good to be produced, managed and marketed.

Agricultural Credit on the other hand is the capital or money rented by a farmer in the present,(with a specific interest rate charge and future repayment period), from a Lender in a credit institution, for agricultural production and marketing activities. It encompasses all

loans and advances granted to a borrower to finance activities relating to agriculture, fisheries, forestry and for processing and distribution of products resulting from these activities.

2.2.2. Classification of Sources of Credit

The major sources of credit can be classified into institutional or formal and non-institutional sources.

A. Non-Institutional Sources

The non-institutional or informal sources are those which do not have any uniformity in their lending procedure, their interest rate or their collateral requirement. Loan from such sources are usually made directly to the borrower by the lender and are prevalent in areas where individuals are quite familiar with and share confidence in one another. In other words, the lender knows the borrowing farmer and reasonably vouch-safe for his (borrower's) integrity. The relative ease of obtaining the loans devoid of administrative delays, non-insistence by the lender on security or collateral from the borrower and flexibility built into repayment programmes has made the non-institutional sources very popular among the peasant farmers. Non-institutional sources however have such limitations as smallness of loan, high interest rates, etc. Notable examples under this source include:

Ekub: The Ekub is a fund to which a group of individuals sharing common characteristic make a contribution of a fixed amount of money, handed to one person. Each member is able to make use of the money in turn, making allowance for a member in dire need of a loan or advance. These are granted without interest payment.

Money Lenders: Money-lending has been the widely prevalent profession in the rural areas. The moneylenders charge huge rate of interest and mortgage the property of the cultivators and in some cases even the peasants and members of his family are kept as collateral. There are two types of money lenders in rural areas. These are agricultural money lenders and professional money lender. Agricultural money lender's main occupation is farming

and money lending is secondary one. Professional money lender's main profession is money lending.

Advantages

- a. Unrestricted supply of credit for any purpose..
- b. Easy access by farmers as money lenders maintains close relationship with rural families.
- c. Method of business adopted is simple and flexible.
- d. Timely availability of credit without many formalities.
- e. Knowledge on local conditions and experience of money lender facilitate his business.
- f. Money lenders do not insist upon any particular type of security for the grant of loans.

Disadvantages: Money lenders deceive the farmers through many ways such as:

- a. They manipulate bonds and promissory notes obtained from debtors and enter large sum than actually lent.
- b. They give no receipt for repayments and often they deny such repayments.
- c. They charge very high rate of interest
- d. They give loans for both productive and unproductive purposes which results in indebtedness

Friends and Relations: This is part of cultural heritage whereby the prosperous help their less fortunate relatives and friends with loans. In some cases, the loan is not collected back. Farmers borrow from their relatives for temporary exigencies. It is simply a mutual help. Since all farmers are living under similar conditions, they cannot lend large sums as loans. Normally, no interest is paid on such loans. Although, the private agencies satisfied some of the criteria of a good system of credit, their loan were not related to production purposes, they never cared for the end use of the loan extended and the loan is often used for wasteful purposes.

Land Lords: Small farmers and tenants rely on land lords for finance to meet out their productive and unproductive expenses. This source of finance has all the defects associated with money lenders. Interest rates are exorbitant. Often small farmers are forced to sell out their lands to these land lords and they become land less labourers. Landless labourers bonded labourers.

Traders and Commission Agents: They are functioning either to get regular supply of products for their trade or to have a control over the provision of credit by other creditors. Though the rate of interest charged by them is not as high as charged by the money lenders, they charge more in the form of concessions and service charges, they mostly finance for the cultivation of commercial crops like sugarcane, cotton, ground-nut, tobacco, onion, etc.

B. Institutional Sources

The institutional sources are those recognized institutions which follow standardized procedures of lending. They lend at regulated interest but normally require some collateral. The loans from this source are always large compared with those obtained from non-institutional sources. Examples under this source include:

Government: Government gives loans to the cultivators for production of crops, land improvement and distress relief etc. Government loans are characterized as;

- They are granted for long period of time.
- Low interest is charged.
- The repayment plan is convenient, i.e., repayment in equal annual installments.

Rural Cooperative Credit Institutions: Rural Credit cooperatives are the oldest and most extensive form of rural institutional financing. The major thrust of these cooperatives in the area of agricultural credit is the prevention of exploitation of the peasants by moneylenders. Formal cooperatives can be regarded as a transition or an interphase between formal and informal credit sources. Cooperatives especially thrift and credit societies play important role in saving. They mobilize savings for safe keeping and re-investing in the countryside.

Commercial Banks: These are institutions set up by the government or group of private individuals with the aim of accepting savings and deposit from members of the public as well as granting them credit whenever they are in need. Those farmers who keep their money in such banks may be able to get loan from the bank. But due to the inability of most farmers to offer suitable collateral security coupled with the risky and uncertainty nature of agricultural

business, commercial banks often prefer to lend to borrowers engaged in non – agricultural ventures which are less prone to risk and uncertainty.

Micro-finance Banks: Micro-finance Banks are self-sustaining financial institutions owned and managed by local communities to render services to their respective communities. They are meant to promote agriculture, rural as well as economic growth through development at grassroots level. Though their activities are geared towards rural banking, they are also noted for accepting deposits, running other banking services and investing funds in agriculture apart from providing facilities to farmers.

Specialised Banks: These are institutions specially set up to meet the need of a particular sector of the economy. For instance, the Bank of Agriculture (BOA), of Nigerian was specifically established to cater for the agricultural sector of the economy.

2.3.CLASSIFICATION OF AGRICULTURAL CREDIT

Agricultural credit can be classified based on purpose, time (repayment period), and security, generation of surplus funds, creditor and number of activities for which credit is provided.

1. Time Length Classification: This classification is based on the repayment period of the loan. In the Time Classification, credit is classified into three groups – short, intermediate, and long terms – according to the term of the loan. The following general classification is customary, together with the further division into monthly, seasonal and annual loans.

- a. **Short-term loans:** The short- term loans are generally advanced to meeting annual recurring purchases like seeds, feeds, fertilizers, hired labour, expenses on herbicides, pesticides and machinery service charges. It is therefore termed “seasonal loans or production loans or crop loans” and it is usually expected that the loans (principal) and the interest would be repaid through the income received through the enterprise in which it is invested. Time limit to repay such a loan is one year or at most 18 months.
- b. **Medium – term loans:** Medium-term credit, is used to finance items that have a production life that covers several years, such as breeding animals. Here the

repayment period varies from 18 months to 5 years. These loans are required by the farmers for bringing about some improvements on his farm by way of purchasing implements, electric motors, milch cattle, sheep and goat, etc. The relatively longer period of repayment of these loans is due to their partially-liquidating nature.

- c. **Long – term loans:** These loans fall due for repayment over a long time ranging from 5 years to more than 20 years or even more. These loans together with medium terms loans are called investment loans or term loans. These loans are meant for permanent improvements like levelling and reclamation of land, construction of farm buildings, purchase of tractors, raising of orchards ,etc. Since these activities require large capital, a longer period is required to repay these loans due to their non - liquidating nature.

2. Purpose Classification: Based on the purpose for which loan is granted, agricultural credit is categorized into:

- a. **Development or Investment loans:** Credit could be classified based on the purpose of the loan as crop loan, poultry/dairy/piggery loan, machinery and equipment loan, forestry loan, fishery loans etc. This is provided for acquiring durable assets or for improving the existing assets. This type of loan signifies relationship between time of usage and the rate of returns (profitability). Under this, credit is extended for: Purchase of land and land reclamation, Purchase of farm machineries and implements, Development of irrigation facilities, Construction of farm structures, Development of plantation and orchards, Development of dairy, poultry, sheep/goat, fisheries, sericulture, etc.
- b. **Production loans:** These loans refer to the credit given to the farmers for crop production and are intended to increase the production of crops. They are also called as seasonal agricultural operations (SAO) loans or short – term loans or crop loans. These loans are repayable within a period ranging from 6 to 18 months in lump sum.
- c. **Marketing loans:** These loans are meant to help the farmers in overcoming the distress sales and to market the produce in a better way. Regulated markets and commercial banks, based on the warehouse receipt are lending in the form of

marketing loans by advancing 75 per cent of the value of the produce. These loans help the farmers to clear off their debts and dispose the produce at remunerative prices.

- d. **Consumption loans:** Any loan advanced for some purpose other than production is broadly categorized as consumption loan. These loans seem to be unproductive but indirectly assist in more productive use of the crop loans i.e. without diverting them to other purposes. Consumption loans are not very widely advanced and restricted to the areas which are hit by natural calamities. These loans are extended based on group guarantee basis with a maximum of three members. The loan is to be repaid within 5 crop seasons or 2.5 years whichever is less.

3. **Security Classification:** Loans can be classified as secured and unsecured loans. Security are usually advanced against tangible assets like land, livestock or any capital asset, as either medium or long term loans. Note that credit worthiness may sometimes count much more than the security offered, which if doubtful, may result in willful default. Therefore it is essential to classify the loans under this category into two sub-categories viz., secured and unsecured loans

- a. **Secured loans:** Loans advanced against some security by the borrower are termed as secured loans. Various forms of securities are offered in obtaining the loans and they are of following types.

- **Personal security:** Under this, borrower himself stands as the guarantor. Loan is advanced on the farmer's promissory note. Third party guarantee may or may not be insisted upon (i.e. based on the understanding between the lender and the borrower)
- **Collateral Security:** Here the property is pledged to secure a loan. The movable properties of the individuals like LIC bonds, fixed deposit bonds, warehouse receipts, machinery, livestock etc., are offered as security.

- b. **Unsecured loans:** Just based on the confidence between the borrower and lender, the loan transactions take place. No security is kept against the loan amount.

4. Lender Classification: Credit often is classified by the lender because the policies of lenders vary greatly. Lenders are often also classified as either formal or informal or as institutional or non-institutional.

a. Institutional credit: Here are loans are advanced by the institutional agencies like co-operatives, commercial banks. Ex: Co-operative loans and commercial bank loans.

b. Non-institutional credit: Here the individual persons will lend the loans Ex: Loans given by professional and agricultural money lenders, traders, commission agents, relatives, friends, etc.

5. Liquidity Classification: The credit can be classified into two types based on liquidity

a. Self-liquidating loans: They generate income immediately and are to be paid within one year or after the completion of one crop season. Ex: crop loans.

b. Partially -liquidating: They will take some time to generate income and can be repaid in 2-5 years or more, based on the economic activity for which the loan was taken. Ex: Dairy loans, tractor loans, orchard loans etc.,

2.4.THE NEEDS AND ROLES OF AGRICULTURAL CREDIT

Need for Agricultural Credit:: Credit is required in every type of business and agriculture is not exception of it. The need for agriculture credit becomes more important when it moves from traditional agriculture to modern agriculture. The agriculture sector at present is best with number of handicaps. Such as; The land holding is very small, The population is growing at a fast rate, Agricultural labour is often underemployed, Production suffers from weather risks, The capacity of farmers to save and invest is very low and The agricultural productivity is low due to low use of inputs. The farmers therefore, need credit to increase productivity and efficiency in agriculture. This need is increasing over the years with the rise in use of fertilizers, mechanization and rise in prices. Briefly the need for agricultural credit can be summed up as follows;

- 1. Purchase of new inputs:** The farmers need finance for the purchase of new inputs which include seeds, fertilizers, pesticides, irrigation water etc. If the seed of high yielding varieties and other modern inputs are made available to the farmers they can increase productivity not only of land but also of labour.

2. **Purchase of implements:** Credit is required by the farmers for the purchase of tractors, threshers, harvesters, water pumping sets etc. The use of appropriate machinery in land will increase production by growing more than one crop on the same piece of land at the same time.
3. **Better management of risk:** Credit enables the farmers to better manage the risks of uncertainties of price, weather etc. They can borrow money during raining days and pay back the loans during peak years of crops.
4. **Permanent improvement in land:** Credit also helps the farmers to make permanent improvements in land like sinking of wells, land reclamation, horticulture, rotation of crops etc.
5. **Better marketing of crops:** If timely credit is available to the farmers, they will not sell the produce immediately after the harvest is over. At that time the prices of agricultural goods are low in the market. Credit enables the farmers to withhold the agricultural surplus and sell in the market when prices are high.
6. **Facing crises:** The credit is required by the farmers to face crisis. The crisis can be caused by failure of crop, draught of floods.

The Roles of Credit for the Farmer: Credit can help improve the farmers' situation in the following ways:

1. ***Protection against adverse conditions:*** The use of credit can assist the farmer to face adverse weather, disease conditions and price uncertainties in farming. While it is virtually impossible to eliminate all forms of risks in farming credit can play a major role in protecting the business from financial failure or liquidation when adverse conditions occur.
2. ***Meeting seasonal and annual fluctuation in income and expenditures:*** Inputs must be purchased in one period and products are sold later in the year with very little cash inflows and outflows occurring at the same time. Using credit to smooth out these fluctuations and so match cash inflows and outflows is essential to efficient operation.
3. ***For production purpose:*** This may be to buy inputs such as seeds, fertilizer, tractors, chemicals etc.

4. ***Increase Efficiency:*** The use of credit makes it possible to substitute one resource for another. For example, machinery might be substituted for labour as a means of reducing cost, improving timeliness and increasing the efficiency of the farm business.
5. ***Adjust to changing economic conditions:*** New technological development or changing market conditions may require major adjustment. For example, change from one enterprise to another may require major capital investments.
6. ***To meet unproductive purpose:*** Any credit in possession of the farmer can come in handy for meeting expenses such as marriages, children's school fees, funerals, festivals, clothing and feeding the family.

2.5.CREDIT ANALYSIS

When a farmer approaches an institutional agency with a proposal for loan, the banker should be convinced about the economic viability of the proposed investment. In this connection, some guidelines are essential for the banker to ponder over, for, each investment activity is different from the other in terms of productivity. This is done by the so called credit analysis.

2.5.1. The Three R's of Credit

When a proposal for credit reaches the banker's table, three basic financial aspects are assessed by the banker. If the loan is advanced,

- (1) If the loan is advanced, will it generate returns more than the cost?
- (2) Will the returns have surplus, to repay the loan when it falls due? and
- (3) Will the farmer stand up to risk and uncertainty in farming?

These three aspects are popularly known as Three R's of credit, which are as follows:

- (1) Returns from the investment;
- (2) Repayment capacity the investment generates, and
- (3) Risk-bearing ability of the farmer-borrower.

Returns from the Investment:

This is an important measure in credit analysis. The banker needs to have an idea about the extent of likely returns from the proposed investment. The farmer's request for credit can be accepted only if he can be able to generate returns that enable him to meet the costs. Returns obtained by the farmer depend upon the decisions like,

- *What to grow?*
- *How to grow?*
- *How much to grow?*
- *When to sell?*
- *Where to sell?*

The main concern here is that the farmers should be able to generate incremental income when they go for the additional costs to be made good by the borrowed funds.

Repayment Capacity:

Repayment capacity is nothing but the ability of the farmer to repay the loan obtained for the productive purpose within a stipulated time period as fixed by the lending agency. At times the loan may be productive enough to generate additional income but may not be productive enough to repay the loan amount. Hence the necessary condition here is that the loan amount should not only be profitable but also have potential for repayment of the loan amount. Under such conditions only the farmer will get the loan amount. The repayment capacity not only depends on returns, but also on several other quantitative and qualitative factors as;

- ✓ Gross returns from the enterprise for which loan was taken during a season/year
- ✓ Working expenses
- ✓ Family consumption expenditure
- ✓ Other loans due in
- ✓ Literacy
- ✓ Managerial skill
- ✓ Moral characters like honesty, integrity etc

Causes for the poor repayment capacity of farmers

- ✓ Small size of the farm holdings due to fragmentation of the land.
- ✓ Low production and productivity of the crops.
- ✓ High family consumption expenditure.
- ✓ Low prices and rapid fluctuations in prices of agricultural commodities.
- ✓ Using credit for unproductive purposes
- ✓ Low farmer's equity/ net worth.
- ✓ Lack of adoption of improved technology.
- ✓ Poor management of limited farm resources, etc

Measures for strengthening the repayment capacity

- ✓ Increasing the net income by proper organization and operation of the farm business.
- ✓ Adopting technology for increasing production and reducing the expenses of farms.
- ✓ Removing the imbalances in the resource availability.
- ✓ Making the schedule of loan repayment plan as per the flow of income.
- ✓ Improving the net worth of the farm households.
- ✓ Diversification of the farm enterprises.
- ✓ Adoption of risk management strategies like insurance of crops, animals and machinery and hedging to control price variations ,etc.,

Risk Bearing Ability

It is the ability of the farmer to withstand the risk that arises due to financial loss. Risk can be quantified by statistical techniques like coefficient of variation (CV), standard deviation (SD) and programming models. The words risk and uncertainty are synonymously used. Some of the types or sources of risk in farming are: Production/ physical risk, Technological risk, Personal risk, Institutional risk, Weather uncertainty and Price risk.

Measures to strengthen risk bearing ability

- Increasing the owner's equity/net worth
- Reducing the farm and family expenditure.

- Developing the moral character i.e. honesty, integrity , dependability and feeling the responsibility etc. All these qualities put together are also called as credit rating.
- Undertaking the reliable and stable enterprises (enterprises giving the guaranteed and steady income)
- Improving the ability to borrow funds during good and bad times of crop production.
- Improving the ability to earn and save money. A part of the farm earnings should be saved by the farmer so as to meet the uncertainty in future.
- Taking up of crop, livestock and machinery insurance.

2.5.2. The Five Cs' of Credit

Next to the 'Three Rs', the other tests that can be applied to study the economic viability of a scheme or investment activity are the „Five Cs“, viz. *Character* , *Capacity*, *Collateral*, *Capital and Condition*.

➤ Character

The basis for credit transactions is, the trust, the trust that the banker has on his borrowers. No doubt the bank insists upon security for any loan, even then, the element of trust has greater say in the mind of the banker, before he takes a decision in considering the proposal of a prospective borrower. The questions that come to mind are: Is the prospective loan seeker honest, and trustworthy, responsible? Is he a man of integrity? Does he have the ability and willingness to carry out the investment-income project from the beginning to the end? What do his past records suggest in these directions?

The confidence which the institutional agency keeps is influenced by the moral qualities like honesty, integrity, commitment, hard work, promptness, etc., which the borrower exhibits. In essence it means the mental as well as moral characters of the borrower. Generally, people with good mental and moral character will have good credit character.

➤ Capacity

Within this spectrum, the issues of concern are: does the prospective loan seeker have the ability to return the loan along with the interest as at when due? Does he have the requisite

managerial abilities and experience in the particular trade for which he is seeking the loan? This is related to the capacity of an individual to clear loans when they fall due. It is synonymous with repayment capacity. It largely depends upon the income obtained in the farm business, i.e., $C = f(Y)$, where, C = Capacity and Y = Income.

➔ Collateral

Every prospective loan seeker from the commercial banks is expected to provide security (collateral) which will serve as guarantee to the bank in loan recovery in the event of default by the borrower. This is expected to be worth at least the value of the loan facility applied for while in most cases, the net worth of the collateral should be higher than the net worth of the loan in order to guarantee future depreciation of the asset and inflation in the economy.

➔ Capital

Other issues considered by lending bank about the customer include: what is the equity or net worth of the borrower's business? What is the value of the collateral which he has provided as security that could be impounded in the event of failure? Note a banker may refuse to grant if the amount requested is insufficient for successful running of the proposed farm enterprise.

Capital implies availability of money with the farmer-borrower, when character and capacity proved to be inadequate. It represents the net worth of the individual. It is related to repayment capacity and risk bearing ability.

➔ Condition

Last but not the least is the condition upon which the customer stated when applying for bank loan. Would the loan apply be used for productive purposes, consumption purposes, political purposes, or welfare purposes, etc? What is the possibility of the stated conditions to yield income necessary enough to ensure loan repayment at the end of the facility period? To what extent would the stated condition contribute to general wellbeing of the borrower, among others?

There should be perfect understanding between the lender and the borrower in credit

transactions. This is in fact a prima facie requirement for obtaining credit by the borrower.

2.6.PROBLEMS AND SUGGESTIONS TO IMPROVE AGRICULTURE CREDITS

Problems of Agriculture Credit: In the world today, governments have been making efforts to increase the flow of credit in the agricultural sector. However, there are certain problems of agriculture credit that need to be discussed. The problems are therefore highlighted as follows:

- ***Complicated Procedures of Loans:*** It has been observed that number of formalities is to be completed to avail credit facilities. Majority of farmers are illiterate and are unable to furnish requisite informational. Therefore, farmers prefer to borrow from money lenders and pay higher rate of interest. Moreover, there is large time gap between submission of loan application and sanction of loans.
- ***Wastage of Time and Man Power:*** Most of the financial institutions like commercial Banks, State Cooperative Backset. Are situated in cities. Farmers have to visit the bank offices for a number of times to fulfill many formalities leading to the sanction of loans. Thus, results in wastage of time and main power.
- ***Improper utilization of Loans:*** It has been observed that there is a gap between disbursement and requirement in the farm sector. The situation becomes more pitiable when the granted loans are being improperly utilised by the farmers. In other words, the loans are used for unproductive purposes in rural areas of the country.
- ***Inefficient Administration:*** Still another problem faced is that cooperatives and commercial banks are managed by inefficient and incapable persons. These organisations possess inadequacies which are difficult to handle easily. Obviously, they do not work for the betterment of farming community. Rather, they are keen on their personal benefits.
- ***No Provision of Consumption Loans:*** Due to the seasonal nature of farm income, peasants need credit both for production purpose of durable consumption goods but this facility is limited to urban areas. Therefore, farmers are compelled to borrow from money lenders for consumption needs who suck their blood by using malpractices.

- **Lack of Savings:** There is lack of rural savings in the country. Whatever rural savings exist fall short of rural needs and that is why there is a greater need for outside finance in the rural areas of the country. What is needed is not the mobilisation of rural savings but the efforts to make rural savings possible.
- **Complicated Procedure and Strict Conditions:** The farmers have to face very strict conditions and complicated procedures while getting the loans. Again, the official formalities, the behaviours and strict conditions of Bank obstruct the small farmers to get loans. Again, the weak financial position and higher interest rate also hamper loaning on the part of farmers.

Suggestions to Improve Agriculture Credits: Following measures are adopted to remove the problems of agricultural credit;

- **Repayment of Loans:** In this case, government should take strong and meaningful measures to ensure appropriate repayment facilities and provide necessary assistance to institutional credit agencies for loans recovery. It is expected that this will increase loan capacity of credit institutions to supply more loans to the farmers.
- **Provision of Consumption Loans:** To check the exploitation made by money lenders, cooperatives and commercial banks should come forward to extend the facility of consumption loans to rural people. Once they are free from the exploitative tendencies of money lenders, they will think to sell their produce at market price; hence it will help to raise their farm income.
- **Co-ordination of Credit Agencies:** In this case, sincere efforts should be made to coordinate the functioning of various institutions of cooperative societies and commercial banks. These agencies may complement each other to meet the requirements of rural agricultural community. This process will certainly lead farmers to adopt moderate and modern farm technology.
- **Proper Utilization of Loans:** This can lead to enhance crop productivity. To ensure proper utilization of loans by the farmers or cultivators, special cell should be created in all credit institutions. They should keep close watch to ensure that the loans are being utilized for the purpose for which such loans are granted.

