

MONEY AND CREDIT

(Module -2)



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TERMS OF CREDIT

Every loan agreement specifies an interest rate which the borrower must pay to the lender along with the principal amount. In rural areas, the main demand for credit is for crop production. Crop production involves considerable costs on seeds, fertilizers, pesticides, water, electricity, repair of equipment, etc. There is a minimum stretch of three to four months between the time when the farmers buy these inputs and when they sell the crop. Farmers usually take crop loans at the beginning of the season and repay the loan after harvest. Repayment of the loan is crucially dependent on the income from farming.

Collateral: Collateral is an asset that the borrower owns (such as land, building, vehicle, livestock, deposits with banks) and uses this as a guarantee to a lender until the loan is repaid. If the borrower fails to repay the loan, the lender has the right to sell the asset or collateral to obtain payment. Property such as land titles, deposits with banks, livestock are some common examples of collateral used for borrowing.

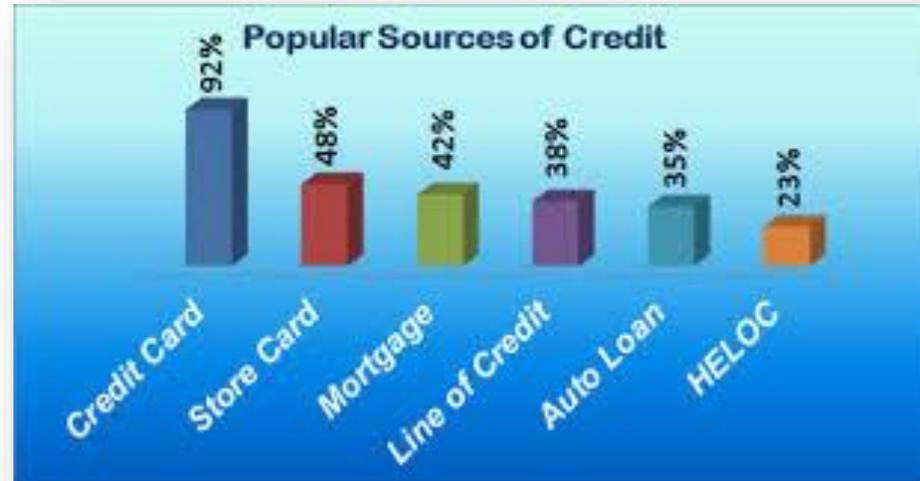
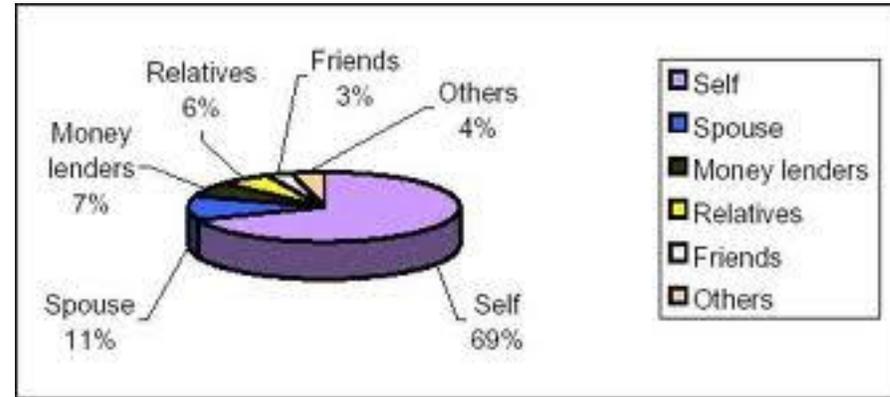
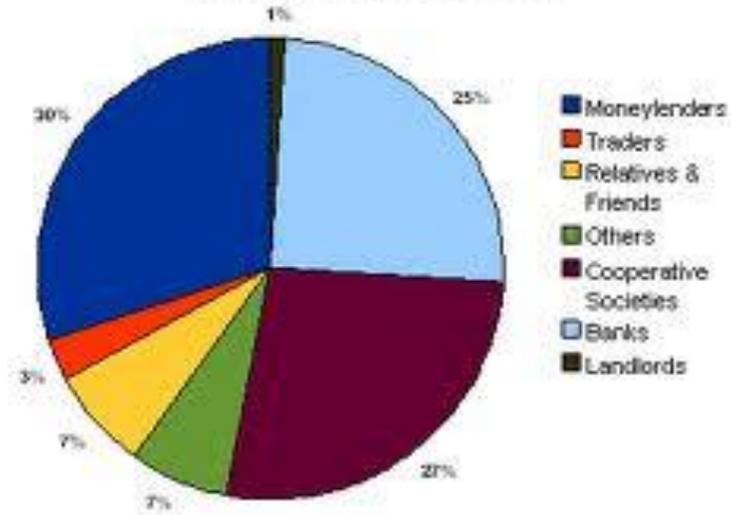
Terms of Credit: Interest rate, collateral and documentation requirement, and the mode of repayment together comprise what is called the terms of credit. The terms of credit vary substantially from one credit arrangement to another. They may vary depending on the nature of the lender and the borrower.

Sources of credit

Formal Sector: The formal Sector comprises of banks and cooperative societies.

Informal Sector: The informal sector consists of money lenders and friends and relatives, merchants and landlords.

Sources of Credit



SOURCES OF CREDIT IN INDIA

The RBI sees that the banks give loans not just to profit-making businesses and traders but also to small cultivators, small scale industries, to small borrowers etc. Periodically, banks have to submit information to the RBI on how much they are lending, to whom, at what interest rate, etc.

There is no organisation which supervises the credit activities of lenders in the informal sector. Compared to the formal lenders, most of the informal lenders charge a much higher interest on loans. Thus, the cost to the borrower of informal loans is much higher.

Higher cost of borrowing means a larger part of the earnings of the borrowers is used to repay the loan. In certain cases, the high interest rate of borrowing can mean that the amount to be repaid is greater than the income of the borrower. This could lead to increasing debt and debt trap. Also, people who might wish to start an enterprise by borrowing may not do so because of the high cost of borrowing.

For these reasons, banks and cooperative societies need to lend more. This would lead to higher incomes and many people could then borrow cheaply for a variety of needs. They could grow crops, do business, set up small-scale industries etc. They could set up new industries or trade in goods.

SELF-HELP GROUPS FOR THE POOR

In recent years, people have tried out some newer ways of providing loans to the poor. The idea is to organise rural poor, in particular women, into small Self Help Groups (SHGs) and pool (collect) their savings. A typical SHG has 15-20 members, usually belonging to one neighbourhood, who meet and save regularly. Saving per member varies from Rs 25 to Rs 100 or more, depending on the ability of the people to save. Members can take small loans from the group itself to meet their needs. The group charges interest on these loans but this is still less than what the moneylender charges. After a year or two, if the group is regular in savings, it becomes eligible for availing loan from the bank. Loan is sanctioned in the name of the group and is meant to create self employment opportunities for the members.

Most of the important decisions regarding the savings and loan activities are taken by the group members. The group decides as regards the loans to be granted — the purpose, amount, interest to be charged, repayment schedule etc. Also, it is the group which is responsible for the repayment of the loan. Any case of non repayment of loan by any one member is followed up seriously by other members in the group. Because of this feature, banks are willing to lend to the poor women when organised in SHGs, even though they have no collateral as such.

Thus, the SHGs help borrowers overcome the problem of lack of collateral. They can get timely loans for a variety of purposes and at a reasonable interest rate. Moreover, SHGs are the building blocks of organisation of the rural poor. Not only does it help women to become financially self-reliant, the regular meetings of the group provide a platform to discuss and act on a variety of social issues such as health, nutrition, domestic violence, etc.



Self help
groups for
poor





THANK YOU...
THANK YOU...

