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Inevitability of Moneylenders in Financial Inclusion in Rural India: A Perspective of Latur District of Maharashtra State, India

SEEMA SHARMA
Swami Ramanand Teerth Marathwada University Nanded (SRTMUN), Sub-Centre, Latur
India

Abstract:

Rural India primarily depends upon informal sources of credit, mostly the moneylenders, for its financial needs. Rural India has witnessed a rise in the predominance of moneylenders over last three decades and especially post 1991 economic reforms. Government of India and the Reserve Bank of India have launched forceful initiatives for 'financial inclusion' in the country. In this scenario, the increasing dependence of rural areas on the informal moneylenders is perceived as the biggest obstacle in achieving the objective of financial inclusion. But, on the same time, it is worth to note that banking services' presence in rural areas has been continuously declining. Thus, rural India's dependence on moneylenders is not by choice, but due to compulsion arising out of lack of alternatives.

The rural moneylenders continue to survive and thrive despite all state-led efforts to find a formal substitute for them. This paper goes on to suggest that, if financial inclusion in rural India has to be achieved in real sense, it would be imperative to formalise the rural moneylenders as the formal loan providers.

Key words: moneylender, financial inclusion, rural credit market, credit-worthiness, repayment capacity, collateral, rural borrower.

Introduction

In the absence of effective reach of Indian banks in rural areas, moneylenders continue to cater to the financial needs of rural credit seekers, as the informal source of credit. Rural moneylenders had a share of 27% in the total non-institutional credit disbursed in rural areas in 2002 (RBI, 2013). The share of rural moneylenders doubled to 20% from 1991 to 2002 in all rural loans, including both the institutional and non-

One of the major aetiology of this is the persistent problem of banks not being able to cover the unbanked rural areas. Because of this inaccessibility of banking services, rural credit seekers obviously approach the informal credit source at cutting edge level- the moneylenders. This happens in spite of the fact that the moneylenders charge almost two to three times the interest on loan vis-à-vis the banks. Due to this, the moneylenders also take on risky borrowers. Thus, the persistence of moneylenders reflects the failure of rural banking system in India.

In the present paper, the endeavour is to show that the moneylender plays an important role in rural economy consisting of distorted and unorganised rural credit market. This informal rural finance system of moneylender will continue to be the dominant player in rural money market. Though the real thrust of financial inclusion will need to come from the formal banking sector through the microfinance route, yet there is little to be gained by labelling the moneylender as the villain of the rural credit market. In fact, to achieve the ambitious target of 100% financial inclusion, it would be a must to formalise the informal moneylender as the major player in the rural money market in the form of 'accredited loan provider' (RBI, 2007). The understandings in the present paper are drawn from interviews with the rural moneylenders, borrowers and staff of rural bank branches, in Latur district of Maharashtra State. The field work involved interaction with twenty-four moneylenders in six villages of Latur, with the period of study spanning between October 2013 and April 2014. All moneylenders in this study were in the money lending business for at least ten years and were well versed with the business nuances. The banks included the District Central Cooperative Bank (DCCB), Regional Rural Bank (RRB) and nationalised banks. (A brief note on the methodology adopted for the study is given as Annex 1).

Formal rural credit delivery mechanism: deficiencies and constraints

Though a multi-agency system exists for formal credit delivery service in rural areas, but in reality, this system suffers from multidimensional design and operation flaws. Therefore this formal system has failed to cater to the genuine needs of rural borrowers. This multi-agency system consists of cooperatives, Regional Rural Banks and commercial banks.

The laggard of this multi-agency system is the ineffective and inefficient cooperatives. The cooperative system has been chronically affected by many ailments affecting its overall health, of which, rampant politicisation, lack of transparency, poor participation, non adaptation to the members' needs, loss of credibility and gross financial indiscipline are the major issues. The result of all this is manifested in the form of heavy losses, which further cripple and incapacitate the cooperatives. The end product of this spectrum is the loss of eligibility of cooperatives for refinance by the NABARD, impairing their ability to lend to the rural borrowers (NABARD, 2005).

Regional Rural Banks (RRBs) were structured to be the hybrids of local low-cost cooperatives and professionally managed commercial banks. But what emerged finally was a product with the high cost of cooperatives and poor work culture of commercial banks. RRBs were further plagued with the restrictions on their client base (NSSO, 2003) and a ceiling on the interest rates, leading to heavy loss-making commercial operations. Later on, the restrictions were relaxed to make the RRBs at par with commercial banks, but still, they have failed to cater to the rural credit needs. Further, the RRBs followed the same methods of operations and procedures as followed by commercial banks, resulting in alienation of rural borrowers (Narasimham, 1991).

Post nationalisation in 1969, the public state commercial banks rapidly increased their presence in rural India. However post financial sector reforms of 1991, profitability and financial viability became the main planks of operations of these banks. This resulted in closing down of loss-making rural branches en masse. On an average, 260 rural branches shut shop every year from 1991 to 2006 (Mohan, 2006). Due to this, the involvement and share of commercial banks in rural credit declined considerably, affecting the bona fide credit needs of rural borrowers adversely. The uneven and weak spread of branch network further accentuated the problem, resulting in the creation of a big vacuum in rural credit market.

The moneylender emerging as the pivot of rural credit market

This vacuum, created due to the failure of formal multi-agency rural credit delivery mechanism, was filled primarily by professional moneylenders operating informally in rural areas. Further, as the commercial banks and RRBs failed to achieve the targets of credit disbursal to weaker sections, the moneylenders rapidly cast a strong hold over these weaker section borrowers of rural areas (Chavan, 2007). By the year 2002, professional moneylenders had captured 39% of rural credit market in terms of size (NSSO, 2005). Thus, the hold of moneylenders has strengthened post 1991 liberalisation.

In rural areas, the formal banking channels are conspicuous by their inadequate presence. Even where they are present, the banks are reluctant to lend to the rural population. This makes moneylenders the substantive player in the rural credit market. Due to this, the number of both registered and unregistered moneylenders has increased considerably since 1991. Between 1995 and 2006, the number of registered moneylenders increased by 56% (Sarangi, 2010). During the same period, the percentage growth in the number of unregistered moneylenders is likely to be much more.

The rural Indian moneylender is a complex heterogeneous entity comprising of pawn brokers, gold merchants, grain trades and petty private moneylenders, some of these being licensed and registered but most often not. For centuries, the moneylenders have monopolised the rural credit market, having clients in almost all sections of rural society, primarily as poor and marginalised women and farmers. They are an integral part of the rural social structure and are almost omnipresent.

Value proposition of the moneylender

A detailed insight into the functioning of moneylenders in Latur district of Maharashtra State has revealed many facets of value proposition of the moneylender.

The moneylender functions in close physical proximity to the borrower, enabling frequent, direct and personal contact. He does not need the traditional collateral to lend money; any kind of collateral available with the borrower is good enough to extend credit worthiness to the borrower. This collateral may range from agricultural land, jewellery, food grains, to other moveable and immoveable assets of the borrower, thus, giving a choice to the borrower (Verghese, 2004). The loan extended is usually short-term, ideal to meet consumption needs of the rural borrower. Screening of borrower before lending by the moneylender is highly subjective and based on personal relations and personal assessment of moneylender.

The loan appraisal and loan approval is almost instantaneous. Since the moneylender keeps money at home, he is able to extend 'any time loan' to the borrower from the comfort of his own home. Further, the moneylender is not at all concerned about the purpose of loan, all he is concerned about the timely repayment of loan. For repayment, the moneylender extends multiple options depending upon the situation of the borrower. The flexible repayment mode could be in cash, or in kind (even farm produce or manual labour).

The moneylender is ever-ready to fund a risky business venture too. For him, repayment capacity is the guiding principle during loan appraisal and credit-worthiness screening. The documentation required by the moneylender is minimal, resulting in a loan sanctioned without cumbersome and complicated paper work. Further, as the moneylender deals with the borrower directly, in person, on one-to-one basis, there are no middlemen in the process.

Also, there is no cap on the loan amount a moneylender can lend to a borrower, it solely depends upon his perception of repayment surety from the borrower.

The exploitative moneylender: The flip side

The moneylender is often labelled as the 'loan shark' due to the extreme nature of terms and conditions on which he extends loan. The first and foremost issue is the highly exaggerated rate of interest which he charges for loan. The rate of interest in some of the cases may go up to 50-60%, that too, calculated on a fixed daily basis (Bhaduri, 2006). Further, this interest rate on loan varies from customer to customer. Since the rural folk approach moneylenders for urgent cash requirement, they are not much bothered about the interest rate. The actual rate of interest is arbitrarily fixed by the moneylender depending upon a variety of factors such as the customer profile, nature of loan sought, repayment period, security provided etc.

As the moneylender is not at all concerned about the purpose of loan, the rural borrowers tend to borrow from him for their consumption needs. Due to high repayment liability and poor repayment ability, the borrowers usually tend to default on loan repayment. The moneylender adopts harsh recovery strategies, resulting in the permanent loss of collateral - land, jewellery etc. for the borrower in favour of moneylender (Dasgupta, 1980). Most of the time, the dealings of moneylender do not get reflected in his account books due to non-transparent style of operation. This results in a situation, where the illiterate rural borrower never comes to know the accurate amount and account of his loan and repayment. Many a times, the moneylender keeps on taking money from the borrower even after the principle amount and interest thereon has been completely repaid.

The moneylender has also been traditionally accused of undervaluing the borrower's collateral while giving loan to him. Usually, with gold jewellery as the collateral, the moneylender lends only 60-70% of the value of gold as the credit money. In case of land or other immoveable assets, the range of loan extended is only 50-60% (Basu, 2005). In case of any default, even in part, the borrower usually has to forego the collateral in its entirety, resulting in a double loss for the borrower. For 60-70% of outstanding loan amount, the borrower repays with 100% value of the collateral. Further, in case of default, the time period intervening before the money lender attaches the security of the borrower, depends entirely on the money lender's discretion. Even when the borrower repays the entire outstanding amount, the moneylender sometimes never returns the collateral to the borrower, he only pays the monetary value of the collateral to the borrower. Thus, the assets of the borrower are lost permanently to the moneylender. The moneylender keeps on accumulating more and more wealth and prosperity, and the borrowers keep on losing their precious assets in this vicious cycle.

Some illustrations from Latur

In one of the villages under study in Latur, where almost two-third working population of the village comprises of migrant workers in sugarcane fields, Mr. Balsidam (name changed), who is a traditional moneylender told that there are around 60 moneylenders in the village. The business is brisk and people are repaying their loans faster. Few of his clients are vegetable vendors who take a loan of 200 rupees in the morning and repay the amount the same evening with 20 rupees interest. In most of the cases, the interest amount is deducted upfront from the loan amount in the morning itself. For instance, if the borrower needs 200 rupees of loan for a day on an interest of 20 rupees a day, he will get 200 - 20 = 180 rupees from the moneylender, and in the evening he has to pay back 200 rupees.

In one of the other villages under study, the moneylender, Mr. Shamrao (name changed) told that he runs an unlicensed and unregistered moneylending business since last 37 years. His forte is to give the borrowers short term loan, for a period of up to thirty days at the maximum, without asking for any collateral. He gives loan 'as quickly as the ATM gives money'. Only condition is that the interest has to be paid on a daily basis and annualised rate of interest comes to 48%. Another interesting observation made by him was that many a times, the self help group members avail this money lending services as a stopgap when they are unable to meet their weekly repayment commitment to the bank.

In another study village, it was found that one of the moneylenders, Sh. Balmani (name changed) issued a kind of 'passbook' to the borrowers and all payment entries were being noted in that passbook. He provided door-to-door repayment collection service on weekly basis too. According to him, his successful money lending business hinges on three pronged strategy of 'small loans, large volumes and regular repayments'. He also told about how in some instances, the SHGs could avoid bank default by availing instant short term loan from him to repay the bank. Another moneylender from the same village justified the high rate of interest he charges from borrowers. According to him, the cost of making money available at all times is very high, reflecting in the interest rate.

Conclusion and suggestions

The modus operandi of moneylenders fringes on the grey area of legality-illegality. Their working definitely poses challenges for financial stability and effectiveness of monetary policy in rural credit market. Suitability, convenience, timeliness, adequacy and informal natural are the plus points of moneylenders which attract rural borrowers. Moneylenders step in to bridge the gap in rural credit supply. The wisdom emanating from this paper is that, however much one may wish to do away with the money lender, he will remain a part of the credit system in rural India.

Therefore, any realistic rural credit delivery system must seek to assimilate the moneylender in the system, rather than alienating him to drive him out of the system. But this is also equally important that the moneylender acts as an additive to the formal rural credit system and not as an alternative to it. Formal credit delivery infrastructure must spread in rural areas, banking upon the existing wide network of money lenders rechristened as accredited loan providers.

It would not be prudent to have a biased assumption that the moneylender lures innocent victims into his evil trap by offering them a bait of consumption loans, misusing their illiteracy with their thumb print (Adams and Fitchett, 1992). Further, it would be incorrect to assume that informal rural credit market is exclusive domain of the moneylender. In fact, he is only one of the several actors in the game, others being family members, friends, neighbours, local shopkeepers, grain traders, landlords, teachers and fellow farmers. Also, the moneylender faces a stiff competition from the self help groups in rural credit market. As far as the issue of excesses is concerned, excesses also occur in formal financial sector. A critical examination of all these issues clearly reveals that the inevitability of money lenders in financial inclusion in rural India is a reality requiring further deep insights.

Annex : 1

Villages' description

The 24 moneylenders were taken up for study in six villages, having diverse demographic and livelihood profiles. Out of these 24 moneylenders studied, 3 belonged to scheduled tribes, 6 to scheduled castes, 7 from other backward castes and 8 from upper castes. Further, of the six villages, 2 villages had no presence of any bank, whereas in other 4 villages, either the RRB or the DCCB or the nationalised banks were present. All the villages under study had a population of less than 3,000 as per census 2011 with a mixed caste structure. Similarly, the borrowers included in the study were taken from all the caste groups so as to have a representative sample. The borrowers had availed the credit in the range of 15,000 rupees to 50,000 rupees. All the loans were extended for a period of upto one year only.

Table 1: Moneylenders' description by caste and village

Village / Caste	A	B	C	D	E	F	Total
ST	1	1	-	-	1	-	3
SC	1	1	2	1	-	1	6
OBC	2	1	1	1	1	1	7
Upper Caste	1	2	1	2	1	1	8
Total	5	5	4	4	3	3	24

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