be ... taking up crop and other insurance, etc. ... of the earnings should

'FIVE Cs' OF CREDIT

Next to the 'Three Rs.' of credit the other tests that can be applied to study the economic viability of a scheme or investment activity are the 'Five Cs' of credit, *viz.*,

1. Character
2. Capacity
3. Capital
4. Condition, and
5. Commonsense

1. 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 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 a good credit character.

2. Capacity

This is related to the capacity of an individual borrower to repay 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.

3. Capital

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

4. Condition

This refers to the conditions needed for obtaining a loan from the financial institutions (presented in detail under the topic, procedural formalities followed in obtaining a loan).

5. Commonsense

This relates to perfect understanding between the lender and the borrower in credit transactions. This is in fact a *prima facie* requirement for obtaining credit for the borrower.

'SEVEN Ps' OF CREDIT

The role of financial institutions in the light of the technological changes that have been brought in, on the agricultural front, lies in evolving principles of farm finance which are expected to bring not only commercial gains to the bankers but also social benefits. The principles thus evolved by the institutional agencies are supposed to have universal validity. These are popularly known as 'Seven Ps' of credit which are listed and explained hereunder:

1. Principle of productive purpose;
2. Principle of personality;
3. Principle of productivity;
4. Principle of phased disbursement;
5. Principle of proper utilization;
6. Principle of payment; and
7. Principle of protection.

1. Principle of Productive Purpose

When owned capital is a limiting factor on the farms, the credit needs of the farmers are many and varied. The requirements of credit commence right from short-term loans to term loans. This capital limitation is visible on all the farms but more pronounced on small and marginal farms. The farmers of these tiny holdings require another type of credit, which the large farmers do not need, *i.e.*, the consumption loan. In the absence of consumption loans for the small and marginal farmers, the crop loans advanced may not be as productive as they are expected to be, because of their diversion for other purposes. But inspite of this known fact, the consumption credit is relegated to the backseat by the institutional agencies. When the loan is diverted for other purposes, the productivity of the loan receives a setback and the desired results will be a far cry. But the principle of productive purpose says that the loan distributed to any borrower should be capable of generating incremental income. If one wants the principle of productive purpose to hold good, the short-term loans of small and marginal farmers can be made productive, if they are provided with other income augmenting assets through term loans. The income generated from these productive assets will add to the income obtained from farming. In this process, the term loans not only turn out to be productive but also help in enhancing the productivity of crop loans taken by these categories of farmers. To cite some of the assets for which term loans required are dairy animals, sheep and goat (grazing or stall-feeding), poultry, installation of pumpsets on group action, *etc.*

2. Principle of Personality

The 'Three Rs.' which were explained earlier are the sound indictors of credit-worthiness of the farmers. Credit-worthiness of the farmer makes him eligible for the loan he desires from the institutional agencies. Over the years of experience in lending, the bankers have identified an important factor in credit transactions, *i.e.*, the trust-worthiness of the borrower. It has relevance to personality of the individual. When the farmer-

borrower fails to repay the loan in the event of natural calamities, his is a case of non-wilful default. He has to be bracketed in the category of defaulters, not by his own fault, but by the natural forces that influence farming, which are beyond the control of human beings. But a large farmer who profitably uses the loan, and still falls in the category of defaulters means, his is a case of sheer wilful default. This character is born out of the dishonesty of the individual. When this habit becomes perpetual with large farmers, who borrow substantial funds, the very functioning of the institutional business gets crippled. Thus, the safety element of the loan is not totally dependent up on the security of the loan alone, but also on the personality (character) of the borrower. The growth and progress of the lending institutions have dependence on this major influencing factor, *i.e.*, personality. The personality of the individual and growth of the financial institutions, thus are inter-linked.

3. Principle of Productivity

This principle emphasizes that the credit, which is advanced, is not just meant for increasing production from that enterprise alone, but should be able to increase the productivity of other factors employed in the enterprise. For example, for taking up any enterprise we need resources (factors of production), but the resource productivity (marginal value productivity) of the factors employed exhibit a varying trend among the enterprises choosen. To cite a few more examples in crop enterprises, preferring HYV to improved variety among the competing crops, choosing the one, which gives relatively higher returns, and in livestock, selecting the breed which is superior among alternatives, *etc.* Here what we understand is that by our above decisions of varietal preference in crops, better competing crops and superior breeds, not only increase the returns by themselves, but also augment the productivity of other complementary factors employed in the respective production activities. The main concern here is that since we are using scarce borrowed capital resources, no stone should be left unturned in realizing as much productivity as possible from each resource employed. Thus, this principle is based on the point of making the resources as productive as possible by choosing the most appropriate enterprises.

4. Principle of Phased Disbursement

Ensuring the end-use of the funds is the most vital aspect of institutional lending. No enterprise or investment activity needs all the required funds at a time and the requirements of funds is spread over a period of time. In paddy crop enterprise, the need for capital is felt over 4 or 5 months for different operations, for sugarcane over an year and investment activities like digging a well or installation of pumpsets require an altogether different time schedule. Relevant to this situation, the principle of phased disbursement underlines that the loan amount needs to be distributed in phases or spells' to make it productive and the banker can also make himself sure about the end use of the borrowed funds. This procedure holds good in perennial crops and investment activities, where the phased disbursal of the loan helps to overcome the misuse or diversion of funds, but the demerit of this system is that it will make the cost of credit higher.

5. Principle of Proper Utilization

Proper utilization implies using the borrowed funds for the purpose for which they are advanced. It sounds pretty good because every banker by heart and soul

wishes this particular aspect for the mutual benefit. This, to certain extent, depends upon the situation prevailing in the rural areas. Explaining, this a bit further, this means whether the farmers are getting the type of resources they need at the right time and in right quantities. Are the resources like seeds, fertilizers, pesticides, etc., free from adulteration to guarantee the farmer to take full advantage of their use? Whether the technical advise is available with regard to production problems that crop up from time to time? Whether infrastructure facilities like storage, transportation, marketing, *etc.*, are available? Is price stability in existence to help the farmer plan the cropping pattern for effective use of funds? Proper utilization of funds is possible, when the suitable conditions for investment of funds exist.

6. Principle of Payment

This principle deals with the fixing of repayment schedules of the loans advanced by the institutional agencies. As far as the investment credit is concerned, say for irrigation structures, tractors, *etc.*, the annual repayments are fixed over a given number of years depending upon the incremental returns that are supposed to be obtained after duly accounting for consumption needs of the farmers. With reference to crop loans (barring perennial crops) the loan is to be repaid in lumpsum because he gets the output only once. Two to three months are allowed after the harvest of the crop to enable the farmer to get a reasonable price for his produce; otherwise, he will resort to distress sales. Whenever the crop fails due to the unfavourable weather conditions, the repayment is not insisted upon immediately, and the repayment period is extended besides assisting the farmer with another fresh loan to enable him carry on the farm business.

7. Principle of Protection

In view of the unforeseen calamities striking farming more often than not, banks cannot abstain themselves from extending loans to the farmers. Instead, what they do is that they demand the security for the advances they make, otherwise, the overdues resulting due to non-payment of loans by the farmers owing to the natural calamities, affect the recycling of bank funds adversely. To tide over the situation of this nature, the institutional agencies resort to safety measures, *viz.*, (i) insurance coverage, (ii) linking credit with marketing or tie-up arrangement, (iii) provision of finance on production of warehouse receipt, (iv) covering credit under small loan guarantee scheme of Deposit Insurance and Credit Guarantee Corporation of India, and (v) taking securities.

1. *Insurance Coverage:* The loans for certain crops and investment activities like poultry, dairy, piggery, irrigation structures, *etc.*, are insured. Suppose any eventuality breaks out and brings colossal loss to the farmers, it is beyond their capacity to repay the loan, more so if the affected happens to belong to small and marginal categories. Under such situations, the insurance agencies estimate the losses and indemnity is paid to the farmer, from which banks recover their dues.
2. *Linking Credit with Marketing or Tie-up Arrangement:* By linking credit with marketing, the banker is quite safe in recovering the loan. Let us take the case of a sugarcane grower-borrower who supplies cane to the factory as per the agreement. The loan particulars of the sugarcane farmer are let known to the sugar factory. As soon as the crop is harvested, it is supplied to the factory. The fac-

tory will not pay the proceeds of the entire cane received, but deducts the loan component and the balance is paid to the grower. The loan amount so deducted will be credited to the bank against the loan amount taken by the farmer.

3. *Provision of Finance Against the Warehouse Receipt:* When the prevailing product prices are not acceptable to the farmers, they need not submit to the situation. They can store the produce in the warehouse and based on the warehouse receipt, the financial institution advances loans to the extent of 75 per cent of the value of the produce. It is a symbiotic process wherein the bank can recover the loans and the farmers can derive the price benefits when they sell after the glut period was over.

4. *Credit Guarantee:* When the banks fail to recover the loans advanced to the weaker sections, Deposit Insurance and Credit Guarantee Corporation of India (DICGC) reimburses the loans to them.

5. *Taking Sureties:* The banks advance loans either by hypothecation or mortgage of assests