

Antecedents of Dependence on Informal Credit by Rural Households: Evidences from Kerala

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Abstract

Informal credits are penetrating into the normal life of rural households in an unprecedented manner. There are several factors which influence rural households to borrow money from informal lenders at a rate unusually higher than the normal rate. This study identifies the antecedents of dependence on informal credit using empirical evidences from rural households in Kerala. Quick access to informal credit, poor access to formal credit and consumerism are found to be the factors influencing rural households for dependence on moneylenders.

Keywords: Rural credit; Informal credit; Moneylenders; Rural households; Kerala.

Introduction

Rural credit system assumes importance in India because in most of the rural families their savings are inadequate to finance their economic activities. It is primarily on account of lack of income and lack of assets with the rural households (Thuruman, 2007). Small credits from exclusive Micro Finance Institutions, self-help groups, commercial banks, cooperative banks and Non-banking Financial Institutions are the major sources of formal credit for the rural households (Wu, Si, & Wu, 2016; Deshpande & Prabhu, 2005; Adikari, 2014; Akoijam, 2013; Bhavani & Bhanumurthy, 2012). However, the increasing dependence of the rural households on informal moneylenders for their credit needs are alarming (Household Finance Committee,

2017; Lainez, 2014; Basu, 2005; Deshpande & Prabhu, 2005; Okurut, Schoombee, & Berg, 2005; Pham & Lensink, 2007; Gupta & Chaudhuri, 1997; Tanaka & Molnar, 2008; Buckley, 1997; Guérin, Roesch, Venkatasubramanian, & D'espallier, 2011; Madestam, 2014; Ayyagari, Demirgüç-Kunt, & Maksimovic, 2010; Aliber, 2002). Though the formal credit sources have proven their potential to serve the poor households, provision of adequate credit on time was always been a challenge for the formal sources of credit (Tanaka & Molnar, 2008; Wu, Si, & Wu, 2016; Schrader, 1997; Pradhan, 2013; Timberg & Aiyar, 1984; Basu, 2005). The informal sources of credit include occasional lending (funds from friends and relatives), regular lending (moneylender transactions), inter-linked credit (continued relationship between the lender and the borrower), collective agreement (ROSCAs, credit unions) and corporate level financiers (finance corporations). It is quite evident that the informal credits are penetrating into the normal life of rural households in an unprecedented manner (Household Finance Committee, 2017; Lainez, 2014; Basu, 2005; Deshpande & Prabhu, 2005; Okurut, Schoombee, & Berg, 2005; Pham & Lensink, 2007; Gupta & Chaudhuri, 1997; Tanaka & Molnar, 2008; Buckley, 1997; Guérin, Roesch, Venkatasubramanian, & D'espallier, 2011; Madestam, 2014; Ayyagari, Demirgüç-Kunt, & Maksimovic, 2010; Aliber,

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2002). There are several factors which influence rural households to borrow money from informal lenders at a rate unusually higher than the normal rate (Berensmann, et al., 2002; Kislak, Menkhoff, & Neuberger, 2017; Dasgupta, 1989; Ayyagari, Demirgüç-Kunt, & Maksimovic, 2010; Sharma & Chamala, 2003; Jeromi, 2007; Pham & Lensink, 2007; Soyibo, 1997; Adikari, 2014; Mohieldin & Wright, 2000; Caskey, 1991; Chan, 2001; Tanaka & Molnar, 2008; Timberg & Aiyar, 1984; Schrader, 1997). The antecedent factors may differ from country to country and from region to region. The current study makes a pragmatic effort to identify the antecedents of dependence on informal credit among the rural households in Kerala.

Review of Literature

There are a lot of studies confirming the fact that most of the people uses a combination of formal credit and informal credit for their financial needs (Adikari, 2014). Informal credit has become a necessity as households are reluctant to tap formal credit as it involves rigid procedures, lengthy sanctioning time, stringent requirements of collateral and heavy documentation (Tanaka & Molnar, 2008; Wu, Si, & Wu, 2016; Schrader, 1997; Pradhan, 2013; Timberg & Aiyar, 1984; Basu, 2005). Guérin, Roesch, Venkatasubramanian, & D'espallier (2011) conducted a study to assess the magnitude of credit borrowed from various sources and its utilisation to various purposes. They found that the households are rational about the utilisation of fund availed from different sources of credit and so both the informal and formal credit will persist and expand in future. Mohieldin & Wright (2000) in their study found that most of the poorer households depend on informal financial sector for their needs. Poor households once rejected by formal financial sector turn towards informal lenders. It is also noted that formal financial sector serves the richer households as their collateral requirements can only be met by them. Times of India (2016) reports that households prefer moneylenders over banks as the requirements for granting a loan is cumbersome in the case of the latter. Time being a constraint, the high interest rate charged by the moneylenders are most of the times ignored by the households. Inability of banks to cater to the needs of poor and lack of easiness in doing business with formal institutions forces poor households to rely on informal lenders. They cater to the needs of households, but on default of payment of credit obligations, the borrowers' life are haunted by them. Even studies have found that the magnitude of the collateral requirement by

informal lenders are forty per cent lower than the formal lenders requirement that really paves the way for informal financiers to operate (Basu, 2005; Mohieldin & Wright, 2000; Adikari, 2014; Pradhan, 2013; Timberg & Aiyar, 1984).

The influencing factors for informal credit reported by studies are to a larger extent location specific factors though the lower income and assets are the primary causes (Household Finance Committee, 2017; Buckley, 1997; Okurut, Schoombee, & Berg, 2005; Mohieldin & Wright, 2000; World Development Report, 2000). Informal sources of finance are preferred even due to personal relations and family ties, and easy access to borrowing. Bhavani & Bhanumurthy (2012) in their study reveals that the Kerala households having loans from formal sources has decreased by 10% and from informal sources has increased by 9%. Factors such as suitability, convenience, timeliness, adequacy and informal nature of moneylenders are found by Jeromi (2007). Above all, unserved households by formal financial sectors find the moneylenders as the only hope (Biswas, 2018).

Research Problem

The unemployment rate is higher in Kerala (12.5%) third among the states in India and youth unemployment marked a high of 29 percent (Ravi, 2019). Financial distress is crucial among rural households and they struggle to meet the daily expenditure. Demand for credit is rising day by day with increasing price in commodities also (Jeromi, 2007). To meet their needs, the rural households borrow either from formal channels like commercial banks, regional rural banks, cooperative societies or through informal channels like moneylenders, friends and family, landlords, traders, and so on. Due to various reasons, the needy households are left unserved or underserved by the formal lenders (Okurut, Schoombee, & Berg, 2005; Mohieldin & Wright, 2000). There are several factors which influence rural households to borrow money from informal sources of credit. There are even evidences for borrowing money from moneylenders to repay formal credit obligations from bank, co-operative banks and other micro finance institutions (Mallick, 2012; Jain & Mansuri, 2003). Though a large number of studies have been done on informal sources of credit and its negative impact on borrowers. A comprehensive study focusing the antecedents of dependence on informal credit by rural households in Kerala is almost missing. Thus the investigation on the antecedents of dependence on informal credit in Kerala is the research problem.

Objective, Materials and Methods

The study intends to identify the factor structure of the antecedents of dependence on informal credit by rural households in Kerala. A sample of 960 rural households were selected from six districts out of the 14 districts across Kerala using a multi-stage sampling method. A structured interview schedule was used for collecting the data. The views of rural households on the abstract variables relating to the antecedents of dependence on informal credit were recorded on a five- point Likert-type scale wherein '5' denotes 'strongly agree', '4' denotes 'agree', '3' denotes 'neutral', '2' denotes 'disagree', '1' denotes 'strongly disagree'. An Exploratory Factor Analysis (EFA) is done on the 21 statements which could reflect the possible antecedents of dependence on informal credit by rural households so as to identify the factor structure. The statistical package for social science (SPSS 23) is used for analysis of the data.

Results and Discussion

The results obtained from the EFA on the 21 statements of dependence on informal credit and discussions on it follow. A brief profile of the rural households precedes the results and discussions.

Profile of the sample

Majority of the main income earners of the rural households (94%) belong to the age between 31 years and 60 years. On the whole 91.35 per cent of the breadwinners of the family are male members and 89.06 per cent of them are married. Among the households, 40.73 per cent are daily workers, 18.44 per cent are self-employed, 18.33 per cent are private employees, five per cent work in the government sector, meager three per cent are farmers and two per cent are professionals, and about ten per cent are jobless. Regarding the ownership of house, 89.06 per cent of households, lives in self-owned houses and 10.63 per cent in rented houses and mere 0.31 per cent in leased houses. Regarding the family size, about 87 percent of the households have up to six members in their family; 12 per cent have seven-nine members and less than two per cent have members above ten in their family. About 48 per cent of households earns annual income up to Rs.2 lakh, 47 per cent belongs to a band of Rs.2- Rs.4 lakh and mere five per cent earns above 4 lakh (Table 1).

Exploratory Factor Analysis (EFA)

The responses on the 21 statements on the antecedents of dependence on informal credit

Table 1: Profile of the Sample Rural Households

S. No.	Profile		Frequency	Percentage
1.	District	Kottayam	160	16.67
		Kollam	160	16.67
		Ernakulam	160	16.67
		Thrissur	160	16.67
		Mallappuram	160	16.67
		Kozhikode	160	16.67
		Total	960	100.00
2.	Gender of main income earner	Male	877	91.35
		Female	83	8.65
		Total	960	100.00
3.	Age of the main income earner	19-30	49	5.10
		31-50	673	70.10
		51-60	233	24.27
		61 & Above	5	0.52
		Total	960	100.00
4.	Marital Status	Single	55	5.73
		Married	855	89.06
		Widow/Widower	42	4.38
		Divorcee	4	0.42
		Seperated	2	0.21
		Total	960	100.00

(Contd.)

S. No.	Profile		Frequency	Percentage
5.	Job Status of Head of the Family	Jobless	70	7.29
		Daily Worker	391	40.73
		Govt. Servant	49	5.10
		Private Sector	174	18.13
		Self-employed	177	18.44
		Farmer	31	3.23
		Profession	15	1.56
		Homemaker	30	3.13
		Other	23	2.40
		Total	960	100.00
6.	Ownership of house	Self-owned	855	89.06
		Rented	102	10.63
		Leased	3	0.31
		Total	960	100.00
8.	Number of Family Members	1-3	142	14.79
		4-6	691	71.98
		7-9	115	11.98
		10 & Above	12	1.25
		Total	960	100.00
9.	Annual income of the household	Below 1,00,000	14	1.46
		1,00,001-2,00,000	445	46.35
		2,00,001-4,00,000	453	47.19
		4,00,001-6,00,000	36	3.75
		6,00,001-8,50,000	12	1.25
Total	960	100.00		

Source: Author's Data

Table 2: Antecedents for dependence on informal sources of credit- 21 statements

Sl. No	Antecedents
1.	There are less cumbersome initial formalities for informal credit
2.	Proximity to informal lenders led to availing credit from them
3.	Informal lenders charge less processing fees
4.	Little or no collateral requirements for informal credit
5.	There is speedy disbursement of loan from informal lenders
6.	Informal lenders allow flexibility in repayment of credit
7.	Informal lenders won't ask the purpose of borrowing
8.	We have difficulty in accessing available formal finance
9.	Unavailability of collateral to avail credit from formal sector
10.	Cumbersome formalities with formal sector led to informal credit
11.	Formal lenders requires long period to sanction a loan
12.	Insufficient sanctions by formal lenders led to informal credit
13.	Low family income forces us to rely on informal lenders
14.	Accidents/Death of family member led to informal credit
15.	Sufferings from long- term illness or disability led to informal credit
16.	Poor money management by the family led to informal credit
17.	Our tendency to imitate others led to informal credit availing
18.	Our excessive attraction to some products led to informal credit
19.	Alcoholism and other addictions of family members leads to credit
20.	Lack of influence with formal sector officials led to informal credit
21.	Bribing requirements with formal sector led to informal credit

Table 3: Antecedents for dependence on informal sources of credit-dimension reduction with EFA model fit

No. of variables	Kaizer- Meyer- Oklin measure of sampling adequacy	Barlett’s test of sphericity chi-square	df	Sig.
21	0.759	9084.512	210	0.000

Table 4: Antecedents for dependence on informal sources of credit-factor classification based on PCA

Name of factor	Antecedent variables	Factor loading
Quick access to informal credit (QAIC)	Proximity to Informal sources of credit	0.600
	Less cumbersome Initial Formalities	0.716
	Little or no collateral requirements	0.698
Poor access to formal credit (PAFC)	Difficulty in accessing available formal finance	0.701
	Unavailability of collateral	0.591
	Cumbersome formalities	0.691
	Lengthy sanctioning time	0.554
	Insufficient sanctions	0.503
Consumerism (CON)	Poor money management	0.660
	Tendency to imitate others	0.656
	Excessive attraction to some products	0.617

is given in Table 2. Using Principal Component Analysis (PCA) by Varimax rotation method, the data are reduced into correlated factors. The communalities matrix in PCA revealed that only 11 antecedent variables out of the 21 variables

have a significant factor loading of 0.5 and above. The Kaizer- Meyer- Oklin Measure of Sampling Adequacy was 0.759, exceeding the recommended value of 0.6 and the Barlett’s Test of Sphericity chi-square 9084.512 reached statistical significance,

Table 5: Reliability test

Construct	No. of items	Cronbach’s alpha	Composite reliability
Quick access to informal credit	3	0.864	0.888
Poor access to formal credit	5	0.839	0.839
Consumerism	3	0.883	0.893

supporting the factorability of the correlation matrix (Table 3). The classification of variables based on the factor loading for the variables of antecedents for dependence on informal sources of credit is listed in Table 4.

Reliability Test

The Cronbach’s coefficient of the three constructs ranges from 0.839 and 0.883, and it is considered acceptable (Hair et al., 2010). The composite reliability which indicates internal consistency of the latent variables ranges from 0.83 to 0.89 which is well above the suggested threshold of 0.70 (Fornell and Larcker, 1981) (Table 5). These numbers are considered adequate for confirming a statistically satisfactory level of reliability. The confirmed factor structures are explained below.

Factor 1: Quick Access to Informal Credit

The increased proximity to informal lenders, less initial formalities to obtain credit and lesser

collateral requirement by informal lenders are providing quick access for rural households to informal credit. In other words, these distinct features of informal sources of credit induces rural households to depend more on them.

Factor 2: Poor Access to Formal Credit

Difficulty in accessing available formal credit, cumbersome formalities, stringent collateral requirements, lengthy sanctioning time and insufficient sanctions restrain rural households from accessing formal credit. Poor access to formal credit lead rural households to depend on informal sources of credit.

Factor 3: Consumerism

The tendency of rural households to imitate others, their excessive attraction to some products and poor money management has increased the consumerism among them. These leads to dependence on informal sources of credit.

Conclusion

The study was focused on the identification of the factor structure of antecedents of dependence on informal credit by rural households in Kerala. Though Kerala is the most literate state in India, is not free from the clutches of the informal moneylenders. They do depend on the informal moneylenders on account of their poor access to formal credit accompanied by easy access to informal credit and the ever increasing consumerism among them. These dependence can cause significant economic erosion among the rural households which may ultimately result in a permanent debt trap.

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