Objectives of the lecture

- To explain the meaning and definitions of credit.
- To elucidate the detailed classification of credit

Meaning: The word "Credit" comes from the Latin word "**Credo**" which means "I Believe". Hence credit is based upon belief, confidence, trust and faith. Credit is otherwise called as loan.

Credit is the trust which allows one party to provide money or resources to another party wherein the second party does not reimburse the first party immediately but promises either to repay or return those resources (or other materials of equal value) at a later date.

The resources provided may be financial (e.g. granting a loan), or they may consist of goods or services (e.g. consumer credit). Credit encompasses any form of deferred payment. Credit is extended by a creditor, also known as a lender, to a debtor, also known as a borrower.

Definition:

Credit (or) loan is certain amount of money provided for certain purpose on certain conditions with some interest, which can be repaid sooner (or) later.

(or)

According to Professor **Galbraith** credit is the "Temporary transfer of asset from one who has to other who has not"

Credit is broadly classified based on various criteria:

1. Based on time: This classification is based on the repayment period of the loan. It is sub-divided in to 3 types

i. **Short–term loans:** These loans are to be repaid within a period 6 to 18 months. All crop loans are said to be short–term loans, but the length of the repayment period varies according to the duration of crop. The farmers requires this type of credit to meet the expenses of the ongoing agricultural operations on the farm like sowing, fertilizer application, plant protection measures, payment of wages to casual laborers etc. The borrower is supposed to repay the loan from the sale proceeds / money obtained from the sale of the crops raised.

ii. **Medium – term loans:** Here the repayment period vary 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.

iii. **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, rising of orchards etc. Since these activities require large capital, a longer period is required to repay the loan (or) due to their non - liquidating nature.

2. Based on Purpose: Based on purpose credit is sub-divided in to 4 types.

i. **Production loans**: These loans refer to the credit given to the farmers for crop production. These loans are intended to increase the production of crops. They are also called as seasonal Agril operations (SAO) loans (or) Short – term loans (or) crop loans. These loans are repayable with in a period ranging from 6 to 18 months in lumpsum.

ii. **Investment loans**: These are loans given for purchase of equipment whose productivity is distributed over more than one year. Ex: Loans given for tractors, pump sets, tube wells etc.

iii. **Marketing loans:** These loans are meant to help the farmers in overcoming the distress/forced sales and to market the produce in a better way. Regulated markets and commercial banks, based on the ware house receipt are lending the financial assistance in the form of marketing loans by advancing 75% of the value of the produce. These loans help the farmers to clear off their debts and dispose the produce at remunerative prices.

iv. **Consumption loans**: Any loan advanced for some purpose other than production is broadly categorized as consumption loan. These loans are seems to be unproductive but indirectly assists in more productive use of the crop loans i.e. with out diverting then to other purposes. These 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 basin with a maximum of three members. The loan in to be repaid within 5 crop seasons (or) 2.5 years whichever is less. The branch manager is vested with the decretory power of sanctioning these loans up to Rs. 5000 in each individual case. The rate of interest is around 11 per cent.

The scheme may be extended to

1) IRDP beneficiaries
2) Small & marginal farmers
3) Landless Agril. Labourers
4) Rural artisans
5) Other people with very small means of lively hood such as carpenters, barbers, washermen etc.

Consumption credit is provided for the following purposes (since 1976):

i) Medical expenses Rs. 500/-
ii) Expenses related to Marriage needs -Rs. 500/-
iii) Educational needs Rs. 200/-
iv) Birth , funerals etc Rs.150/-
v) Religious ceremonies Rs.150/-
vi) General consumption Rs.150/-

4. Based on security: The loans transacted between lender and borrower is governed by confidence and this assumption is confined to private lending to some extent, but the institutional financial agencies do have their own procedural formalities on credit transactions. Therefore it is essential to classify the loans under this category in to two sub-categories viz., secured and unsecured loans .

I. **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.

i. **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 (i.e. based on the understanding between lender & borrower)

ii. **Collateral Security**: Here a property is pledged to secure a loan. The movable properties if the individuals like LIC bonds, fixed deposit bonds, warehouse receipts, machinery, livestock etc, are offered as security.

iii. **Chattel loans:** In these loans credit is obtained from pawn-brokers by pledging movable properties such as jewellary, utensils made of various metals etc.

iv. **Mortgage:** As against to collateral security immovable properties are presented for security purpose Ex: Land, farm buildings etc. The person who is creating the charge of mortgage is called mortgagor (borrower) and the person in whose favour it is created is known as the mortgagee (banker). Mortgages are of two types

a) **Simple mortgage:** When the mortgaged property is ancestrally inherited property of borrower then it is called simple mortgage. Here, the farmer borrower has to register his property in the name of the banking institution as a security for the loan he obtains. The registration charges are to be borne by the borrower.

b) **Equitable mortgage:** When the mortgaged property is self-acquired property of the barrower, it is called equitable mortgage. In this no such registration is required, because the ownership rights are clearly specified in the title deeds in the name of farmer-borrower.

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v. **Hypothecated loans**: Borrower has a national charge on his movable and the banker has legal right to take a possession of property to sale on default (or) a right to sue the owner to bring the property to sale and for realization of the amount due. The person who creates the charge of hypothecation is called as hypothecator (barrower) and the person in whose favor it is created is known as hypothecate (bank) and the property, which is denoted as hypothecated property. This happens in case of tractor loans, machinery loans etc. Under such loans the borrower will not have any right to sell the equipment until the loan is cleared off . The borrower is allowed to use the purchased machinery (or) equipment so as to enable him pay the loan instalment regularly.

Hypothecated loans are of again of two types' viz., key loans and open loans.

a) **Key loans :** The agricultural produce of the farmer / borrower will be kept under the control of lending institutions and the loan is advanced to the farmer . This helps the farmer from not resorting to distress sales.

b) **Open loans:** Here only the physical position of the purchased machinery rests with the borrower , but the legal ownership remains with the lending institution till the loan is repaid .

II. **Unsecured loans:** Just basing on the confidence between the borrower and lender, the loan transactions takes place. No security is kept against the loan amount

5. Lender's classification: Credit is also classified on the basis of lender such as of

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

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

6. Barrowers classification: The credit is also classified on the basis of type of barrower. This classification has equity considerations.

Based on the business activity like crop farmers, dairy farmers, poultry farmers, pisiculture farmers, rural artisans etc.

i. Based on size of the farm: agricultural laborers, marginal farmers, small farmers , medium farmers , large farmers ,
ii. Based on location hill farmers (or) tribal farmers.

7. Based on liquidity: The credit can be classified into two types based liquidity and they are

i. **Self-liquidating loans**: They generate income immediately and are to be with in one year or after the completion of one crop season. Ex: crop loans.
ii. **Partially -liquidating (or) non- liquidating loans**: 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 each loan was taken. Ex: Dairy loans, Tractor loans, orchard loans etc.,

8. Based on approach:

i. **Individual approach**: Loans advanced to individuals for different purposes will fall under this category
ii. **Area Based approach**: Loans given to the persons falling under given area for specific purpose will be categorized under this. Ex: Drought Prone Area Programme (DPAP) Loans

   - **Differential Interest Rate (DIR) approach**: Under this approach loans will be given to the weaker sections @ 4 per cent per annum.

9. Based on contact:

i. **Direct Loans**: Loans extended to the framers directly are called direct loans. Ex: Crop loans.
ii. **Indirect loans**: Loans given to the agro-based firms like fertilizer and pesticide plants, which are indirectly beneficial to the farmers are called indirect loans.