RESEARCH REPORT NO. 16S

The Structure of Informal Credit Market in Pakistan

M. Irfan

Joint Director.

G. M. Arif

Senior Research Demographer,

Syed Mubashir Ali

Senior Research Demographer,

Hina Nazli

Research Economist,

Pakistan Institute of Development Economics, Islamabad

The PIDE Research Report Series offers an up-to-date exposition of various economic, demographic, and anthropological aspects of the development process in developing countries generally and in Pakistan particularly. Its wide dissemination is aimed at providing a firm foundation for useful policy-making in addition to encouraging academic interaction.

The major areas of research addressed by the Series are macroeconomics and sectoral issues, international trade, labour market issues, demographic patterns, anthropological approaches, growth, and distribution. Manuscripts submitted for publication in the Series are reviewed by the PIDE Research Report Committee and published from time to time.

ISBN 969-461-079-6

CONTENTS

		Page
	Preface	(v)
	Introduction	1
Chapter 1	**Data Sources and Their Limitations**	4
	1.1. The Survey of Informal Lenders—Sample Size and Coverage	4
	1.2. The Questionnaire	7
	1.3. Limitations of the Questionnaire Approach	7
Chapter 2	**Structure of Informal Credit Market**	9
	2.1. Types of Informal Lenders	9
	2.2. Geographic Distribution of Informal Lenders	10
	2.3. Sources of Funds for Informal Lending	11
	2.4. Ability to Generate Funds	13
	2.5. Cost of Borrowing by Lenders	15
Chapter 3	**Informal Credit—Procedures, Volume and Costs**	17
	3.1. Screening the Borrowers	17
	3.2. Lending Volume and Composition	17
	3.3. Interest Rate and Mark-up	18
	3.4. Purpose of Borrowing	21
	3.5. Cost of Lending Operations	22
	3.6. Default Rate and Recovery of Loans	23
Chapter 4	**Summary and Conclusion**	26
Appendix A.	**Statistical Tables**	28
Appendix B.	**Demographic and Socio-economic Profile of Informal Lenders**	40
Appendix C.	**Case Studies**	49
	Bibliography	57
	Abstract	60

List of Tables

		Page
Table 1.1	Distribution of Household Responses by Sources of Credit	4
Table 1.2	Distribution of Informal Lenders Covered in the Survey	6
Table 2.1	Locations by Lenders	10
Table 2.2	Average Amount of Funds Generated by Informal Lenders	11
Table 2.3	Percentage Distribution of Funds by Sources and Type of Lenders	12
Table 2.4	Factors Affecting Capability of Lenders to Borrow from Formal Sector (Dependent Variable = Funds Borrowed from Formal Sector as Proportion of Total Borrowed Funds)	14
Table 2.5	Average Annual Interest Rate by Sources of Funds	15
Table 3.1	Average Amount of Loan Borrowed from Informal Sector by Type of Borrower	18
Table 3.2	Average Annual Mark-up (Interest) by Inputs	19
Table 3.3	Transaction of Moneylenders in Rural and Urban Areas of Samundari Tehsil	21
Table 3.4	Average Annual Transaction Cost by Informal Lenders	22
Table 3.5	Default Rate by Borrowers and Funds Controlling for Type of Lenders	23
Table 3.6	Proportion of Informal Lenders Who Extended Additional Loans to Those Borrowers Who Could not Return Loan Last Year by Reasons for Non-payment of Loan	24
Table 3.7	Proportion of Loans Returned After the Due Date and Mean Duration of Delay	24

List of Tables Appendix A

Appendix Table A1	Percentage Distribution of Total Borrowing by Source	28
Appendix Table A2	Percentage Distribution of Informal Lenders by Province/Region and Ecological Zones, 1996	29
Appendix Table A3	Number of Locations Where Survey was Conducted by Number of Lenders and Ecological Zones	29

Page

Appendix Table A4	Average Number of Villages Covered by Informal Lender at the Time of Survey	30
Appendix Table A5	Percentage Distribution of Informal Lenders by Sources of Funds, 1996	31
Appendix Table A6	Percentage Distribution of Total Funds Generated by their Sources and Type of Informal Lenders, 1996	32
Appendix Table A7	Distribution of Funds by Sources of Funds, Lenders' Level of Educational Attainment, Land Ownership and Work Experience	33
Appendix Table A8	Average Annual Interest Rate Paid by Type of Informal Lenders to Informal Source of Credit Controlling for Province and Ecological Zones	33
Appendix Table A9	Percentage Distribution of Informal Lenders by Methods of Assessment of Loan Applicant (Pakistan)	34
Appendix Table A10	Average Time Spent by Lenders on Assessment of Borrowers and Average Assessment Cost of Informal Lenders by Methods of Assessment	35
Appendix Table A11	Distribution of Loans Obtained from Non-institutional Sources by Size of Farm, Pakistan 1973 and 1988	35
Appendix Table A12	Percentage Distribution of Credit by Type of Lenders and Borrowers, Pakistan 1995-96	36
Appendix Table A13	Distribution of Loan by Purpose of Loan	37
Appendix Table A14	Reasons for Non-payment of Loans	38
Appendix Table A15	Percentage Distribution of Lenders by Steps Undertaken to Recover Loans	39

List of Tables Appendix B

Appendix Table B1	Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96 (Pakistan)	41
Appendix Table B2	Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96 (Punjab)	42

Page

Appendix Table B3	Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96 (Sindh)	43
Appendix Table B4	Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96 (NWFP/Balochistan/AJK)	44
Appendix Table B5	Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96 (Irrigated Areas)	45
Appendix Table B6	Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96 (Semi-irrigated Areas)	46
Appendix Table B7	Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96 (Non-irrigated Areas)	47

List of Tables Appendix C

Appendix Table C1	Type and Number of Informal Lenders Identified by Study Areas	50
Appendix Table C2	Cash and Credit Prices of Different Pesticides	52
Appendix Table C3	Transaction of Five Moneylenders in Samundari Tehsil	56

ABSTRACT

This study has examined the structure of informal credit market in Pakistan by combining two approaches; a field survey administering semi-structured questionnaire to more than 1000 informal lenders supplemented by case studies. According to the survey, a good deal of interlinkages exists between formal and informal credit institutions. However, informal credit system draws readily on additional sources including friends and moneylenders. Informal credit market can be characterized as competitive. If a monopolistic situation prevails in the market it is because of peculiar relationship between lender and borrower, such as landlord vs. tenant. It appears from the survey that like the formal financial market, lenders in the informal markets also follow credit worthiness as the major criteria to lend. This reduces considerably the levels of funds allocated to less privileged and assetless.

Mark-up tends to vary from product to product and also by type of borrower as well as lender. On the average, the mark-up is estimated to be 25 percent. In the case of fertilizer it is 29 percent while for the pesticides it comes around 35 percent. High mark-up charged on the pesticides sold on credit is mostly due to rather unholy alliance between the manufacturers and traders/dealers. The case studies suggest that pure money lending is on the rise with quite exploitative interest rates ranging from 48 percent to 120 percent per year. Failure of cotton crop for the last three years, and increasing requirements of farmers for inputs partly explain this rise. The high rate of interest can also be attributed to illegal nature of the business. Legal registration of this business is likely to bring down the interest rate. If this is not politically feasible then there is a real need to introduce some sort of crop insurance scheme as well as innovative credit schemes such as group based lending.

PREFACE

This study is primarily based on a survey of more than one thousand informal lenders operating in different parts of the country. These lenders were selected on the basis of information collected through a household census conducted in 250 villages randomly selected from four provinces of the country and from Azad Jammu and Kashmir. The study was completed with the financial assistance provided by the State Bank of Pakistan and the World Bank.

This study was jointly undertaken by three research organisations of the country: Pakistan Institute of Development Economics (PIDE), Islamabad, Applied Economics Research Centre (AERC), Karachi and Punjab Economic Research Institute (PERI), Lahore. In addition to preparing this study, the PIDE team developed the questionnaire for informal lenders and trained field interviewers. AERC and PERI took the responsibility of data collection and its partial processing. PERI's activities were limited to Punjab province and Azad Jammu and Kashmir, while the rest of the three provinces of the country, Sindh, the NWFP, and Balochistan, were covered by the AERC.

During the process of data collection and data analysis, certain inherent limitations of the questionnaire approach became evident. Four case studies were carried out in four small towns of Punjab province to enrich the analyses in understanding the mechanism of rural credit market,

We are grateful to Dr Sarfraz Khan Qureshi, Director, PIDE, for his valuable guidance and encouragement. We also owe our thanks to Masood Ashfaque, Nabeela Arshad, Jafar Hussain, Anis Haider Hamdani, and Ali Shan Ahmed for their excellent assistance at all stages of data processing and data analysis. We are especially thankful to Dr Faiz Bilquees, Chief of Research, PIDE, for her helpful comments on an earlier draft of this study and for editorial assistance. Finally, our thanks also to Noor Ahmed for providing us excellent typing assistance and preparing several drafts of this study before it could be published.

M. Irfan
G. M. Arif
Syed Mubashir Ali
Hina Nazli

INTRODUCTION

Heterogeneity of practices and complexity of operations obtained in the informal credit system defy efforts to encapsulate and comprehend its functioning. Conventional reductionism identifying moneylender as the typical informal lender in fact scratches the tip of the iceberg. Credit transactions in the informal market are enmeshed with the web of business matrix in wholesale and retail trade of the country. In the chronological order informal credit system being rooted in history and culture pre-existed the modern banking system—the so-called formal sector. Variety of agents having different titles such as arhtis, input dealers, commission agents, landlord and moneylenders are some of the major operator in the field of informal credit.

It is imperative to understand the complex operations taking place in the informal credit market. Not only does the informal network help the poor and needy to tide over difficult times but also constitutes a predominant source of credit in the country in particular for the rural areas. It is because of these important roles performed by the informal credit market which make it highly relevant subject to examine in depth for macro and sectoral policy formulation.

Both as an ingredient of economic development and specific thrust of the governments in the developing countries like Pakistan formal credit system expanded substantially over the years. In Pakistan, considerable resources have been devoted to set-up many institutions with particular focus on the objective of providing credit to farmers at interest rates lower than charged by informal sources.

Notwithstanding the massive expansion in the institutional network—Agricultural Development Bank (ADBP) Commercial Banks and Co-operative Societies, the informal sector still accounts for overwhelming share of credit extended to rural population, in particular to farmers. In a recent survey of rural households, conducted by the Applied Economics Research Centre (AERC) and Punjab Economic Research Institute (PERI) in 1996, informal credit accounted for 78 percent of the borrowings made by the households. An inter-temporal comparison based on various surveys (Appendix Table A1) is suggestive of a decline in the share of informal sector in total borrowings of rural households during the 1973-85 period. Since 1985 the trend appears to have been reversed. This overtime comparison is however marred by varying sample sizes and different definitions used in various surveys.

Dependency of small farm households (5 acres or less) on non-institutional sources seems to be even greater. According to the 1990 Agriculture Census, about

95 percent of outstanding debts obtained by these households were from non-institutional sources. In case of tenant households this proportion further increased to over 95 percent. Not only does this suggest the predominance of the informal credit system but also possibly a rise in its share over the years, particularly in the case of small farmers. In other words, escalation in the credit demand owing to rising input costs and consumption liberalisation over the years outstripped the expanded credit provisions of formal sector institutions.

The dominance of informal credit has been attributed to various factors. Because of geographic proximity of the lending sources, borrowers usually have low transaction costs if they resort to informal sources. No extensive legal procedures are involved and hardly any collateral is required in the non-institutional sector, while the lag between loan agreement and loan disbursement is minimal. Formal sources, on the other hand, are usually located in towns and because of the complex procedures, delayed disbursement, and requirements of collateral, small farmers and poor people cannot avail the opportunity to borrow.

The working of informal financial markets in Pakistan has long been a subject of interest to researchers such as Qureshi *et al.* (1984); Malik (1989, 1990, 1992); Aleem (1990); Qureshi and Shah (1992). However, an examination of the relevant literature reveals that research exercises mostly focussed on the demand side of the lending operation *i.e.,* the credit demand of the households. The supply side, the generation of loanable funds, has largely been ignored. Aleem (1990) though collected information on the lending practices of informal lenders, but his findings had three main limitations. First, these findings cannot be generalised because they were based on only one semi-urban setting in Sindh. Informal credit market in Pakistan like other developing countries exhibits a good deal of heterogeneity and the structure and operations vary from region to region. Second, the study ignored the credit functions of the processing units, such as cotton ginning factories and sugar mills, which play a role in supplying inputs on credit to farmers and also provide funds to other informal lenders. Third, the study did not explore the sources of funds of the informal lenders.

The nature and the issues related to operation of the informal credit market and its linkages with the formal system cannot be fully understood unless the supply side of the lending operations is examined. The present study aims to bridge this gap by extensively examining the operation of informal rural credit market utilising the data collected through informal lender survey and case studies. The specific objectives of the study are:

- To describe the structure of informal credit market.
- To examine the sources and costs of funds generated by informal lenders.
- To determine the transaction costs of lending.
- To understand the mechanism entailing the credit extension and recovery of loans.
- To quantify the interest charged by the informal lenders on the loans.

Data sources of this study and their limitations are discussed in Chapter 1 of this report. The description of the structure of informal credit market by type of lenders, their geographical concentration and the sources of funds are contained in Chapter 2. Procedures adopted in credit extension, volume of credit and its variation and recovery of loans constitute the subject matter of Chapter 3. Summary of the findings is provided in final chapter. Appendix A comprises of statistical tables. Demographic and socio-economic characteristics of informal lenders and the detailed discussion of case studies are presented in Appendices B and C.

Chapter 1

DATA SOURCES AND THEIR LIMITATIONS

1.1. The Survey of Informal Lenders—Sample Size and Coverage

The survey of 1018 informal lenders conducted in May-June 1996 is the main source of data for the present study. The selection of these lenders was based on information gathered through a household census conducted by AERC and PERI in 250 randomly selected villages from four provinces of the country and in Azad Jammu and Kashmir (AJK).[1] During the conduct of census, respondents were asked to report the sources of credit irrespective of the fact whether they borrowed or not. Distribution of the responses of those households, which reported the sources of credit given in Table 1.1, indicates that shopkeepers and landlords were the most important source of credit for rural households. Moneylenders, commission agents, and input dealers were also identified as sources of credit by the households.

Table 1.1

Distribution of Household Responses by Sources of Credit

(Percent)

Sources of Credit	Punjab/AJK	Other Provinces
Moneylenders	2.2	74
Shopkeepers	39.8	19.2
Landlords	8.3	49.8
Commission Agents	18.5	12.1
Village Beoparis/Sub-agents	2.8	1.4
Input Suppliers	8.7	1.8
Processing Unit	0.9	2.4
Others	18.8	6.1
Total 100.0	100.0	
Sample Size (N)	(4812)	(6083)

Source: **Computed from the household census data.**

Note: **It is likely that households reported more than one source of credit.**

[1] **A list of these villages is available with the authors.**

PERI and AERC, which were responsible for sample designing and data collection, used the household census data to draw samples for the survey of informal lenders in Punjab/AJK and "other provinces".[2] However, the procedure adopted by these two organisations to select informal lenders was not uniform. By using the census data, PERI first prepared a list of informal lenders operating in Punjab/AJK. From this list, a sample of 599 lenders was drawn. In the final selection of different types of informal lenders, certain adjustments in their relative proportions, as yielded by the household census, were made. The proportion of shopkeepers among the identified lenders was quite large in Punjab/AJK (Table 1.1). But, in terms of volume of credit transactions, their share was likely to be small because shopkeepers usually did not deal with large amounts of credit. The proportion of shopkeepers in the sample selection was, therefore, adjusted downward. In view of the importance of commission agents and input dealers in the provision of credits to farmers, an upward adjustment was made to increase their representation in the sample.

In the household census questionnaire, farm machinery suppliers and livestock/poultry feed dealers were not distinguished as separate categories of informal lenders. It was assumed that these lenders were recorded under the 'others' category in the census questionnaire. After examining various documents including the 1985 Farm Machinery census, the share of farm machinery suppliers and livestock/poultry feed dealers in the Punjab/AJK sample was assumed to be 13 and 5 percent, respectively. On the basis of these proportions a sample was drawn by PERI. Finally each interviewer was given a list of lenders to be interviewed in the assigned area of Punjab and AJK.

The procedure adopted by the AERC to select 419 lenders in Sindh, NWFP and Balochistan was different from the procedure outlined above. While AERC adjusted the household census data for assigning weights to different types of lenders, it left at the discretion of enumerators to select the respondents. The proportion of landlords among informal lenders yielded by Household Census data was quite large in Sindh. However, their credit transactions were likely to be confined to their tenants only. It was deemed appropriate to make some downward adjustments: in the representation of landlords. Also an upward adjustment was made to increase the proportion of commission agents and input dealers. The share of farm machinery suppliers and livestock/poultry feed dealers in the sample was regarded to be 12 and 8 percent respectively an adjustment partly based on the information available in the 1985 Farm Machinery Census.

Since the AERC did not prepare any list of lenders identified during the household census, the enumerators were sent to those areas, where household census was carried out previously, to conduct the required number of interviews

[2]The category "other Provinces" includes Sindh, NWFP, and Balochistan.

with informal lenders. It was the responsibility of interviewers to find out different types of lenders. The possibility that many lenders who were interviewed in Sindh, NWFP and Balochistan were not identified during the household census cannot be ruled out.

Distribution of the 1018 informal lenders covered in the actual survey by their types by province is given in Table 1.2. Commission agents, input dealers, landlords, shopkeepers and farm machinery suppliers constituted more than 80 percent of the total sample. The proportion of moneylenders in the total sample was less than 4 percent. Low coverage of the moneylenders has been mostly due to difficulties in getting information as discussed in the following pages.

Admittedly the present study is hardly based on a representative sample of informal lenders operating in the country. The sample of informal lenders was partly based on the household census data pertaining to sources of credit. The information provided by the households about informal sources of credit may not be representative of the borrowing households because the information on sources of credit was gathered from all households irrespective of their participation in credit transactions. Furthermore, in Pakistan non-institutional lenders were mainly concentrated in small towns, excepting possibly the landlords, farm machinery suppliers, and shopkeepers who operate in rural areas. The concentration of lenders in urban/semi urban areas could not be reckoned while selecting the sample. In addition, the two organisations, PERI and AERC, which were responsible for sample designing and data collection in different regions, did not adopt uniform procedures to draw the sample of the informal lenders. Despite these shortcomings, however, the survey of informal lenders was a pioneering attempt in the country and it has generated useful data to assess the structure of non-institutional credit market in the country.

Table 1.2

Distribution of Informal Lenders Covered in the Survey

Type of Lenders	Pakistan	Punjab/AJK	Sindh	NWFP/ Balochistan
Commission Agents/Input Dealers	220	162	39	19
Input Dealers	112	60	28	24
Landlords	234	107	96	31
Farm Machinery Holders	130	78	34	18
Moneylenders	35	26	–	9
Processing Unit	24	11	11	2
Shopkeepers	149	79	56	14
Livestock/Poultry Feed Dealers	67	32	29	6
Others	48	44	4	3
Total	1018	599	293	126

Source: 1996 Survey of Informal Lenders.

1.2. The Questionnaire

A questionnaire was designed keeping in view the objectives of the study. The questionnaire had ten major sections: characteristics of informal lenders; procurement of inputs and their sales during 1995-96; quantity of outputs purchased by informal lenders; purpose of loan by types of borrowers; services provided to borrowers by lenders; nature of loans; recovery of loans and its mechanism; sources of funds for lending operation; costs incurred on transaction; and methods used by informal lenders to select the borrowers (the questionnaire is available with the authors). Interviewers and supervisors of field survey were imparted comprehensive training, involving pilot testing of questionnaire that facilitated improvement of questionnaire as well as sharpened the comprehension of enumerators.

However, it would be unrealistic to claim that the questionnaire was flawless. It had certain limitations. For example, the possibility that lending was not the only business activity of several informal lenders could not be reflected in the design of the questionnaire wherein provision for collecting information on activities of lenders was not made. This was because inclusion of questions on other activities would have increased considerably its length thereby affecting the quality of response. Similarly, business activities of informal lenders differed widely but the questionnaire was not designed to reckon with these variations. Had the questionnaire been divided into sub-modules to deal with different types of actors such as moneylender, input dealer, the quality of data collected would have been improved. In fact the generalised approach opted in the questionnaire focussing upon sale/purchase of inputs and outputs almost led to exclusion of the transactions of pure moneylenders. Precisely because of this omission, the case studies of four areas (communities) were undertaken which supplemented the data collected through field survey and improved our understanding of informal credit market.

1.3. Limitations of the Questionnaire Approach

There are certain inherent limitations of the questionnaire approach to understand the rural informal credit system of Pakistan. These limitations made their appearance during the process of data collection and analyses. First, a large majority of the population in Pakistan is Muslim. This fact has particular relevance for a study on rural credit because Islamic laws prohibit the practice of lending on interest. Yet, on the other hand, lending on a fixed interest rate by moneylenders appears to be on the rise in both rural and urban areas of the country. These lenders when interviewed generally did not admit their involvement in lending particularly when the required information was recorded on a questionnaire. Despite the initial plan to interview 35 moneylenders in Sindh, the field enumerators could not succeed in interviewing a single moneylender. Even where enumerators were successful in conducting interviews with moneylenders in other provinces, it was very difficult to extract information on the interest rate charged by them.

Second, it was found difficult to understand the mechanism of rural credit market by using a structured questionnaire. In the questionnaire used for the present study, informal sector traders were asked to report both their cash as well as credit transactions of different inputs, such as fertiliser, pesticides and seeds. This was needed to compute the mark-up rate, the differential between cash and credit price. The answers to these questions could be misleading in the circumstances where market prices exhibit more than one interpretation. Hence the need to supplement the information collected through questionnaire was real one. For example, the maximum retail price (MRP) written on a box (or a bottle) of a pesticide was reported to be almost equivalent to the credit price, while the cash price was determined by the fraction of commission, offered by the relevant pesticide manufacturing company passed on to cash buyers. It was this type of information that appeared to be elusive to structured questionnaires.

Third, the success of an informal lender depended heavily on the recovery of loans. In a questionnaire, the lender could only be asked to report about the methods he used to recover loans. Social pressure was the most commonly used measure for the recovery of loans. But what was a social pressure and how was it used to recover the loans? These questions could only be explored through participant observations and in-depth interviews not only of lenders but also of borrowers.

Because of the above-mentioned limitations of the questionnaire approach, there has been an increased use of community or qualitative studies by the researchers to understand the functioning of the rural credit market [Saimwala *et al.* (1990); Aleem (1990)]. For the present study, it was, therefore, decided to supplement the survey data with four case studies. Observations made during the case studies however have been used extensively to supplement and qualify the results of the 1996 Survey of Informal Lenders, presented in the next two chapters while the case studies are discussed in the Appendix C.

Chapter 2

STRUCTURE OF INFORMAL CREDIT MARKET

The structures and operations of informal credit system are likely to differ from region to region. The analysis in this report is therefore carried out by controlling the sample of informal lenders for province/region and, where possible, for ecological zones—irrigated and non-irrigated area. Also the observations made during the case studies have been used extensively. This chapter contains discussion of the structure in terms of type of lenders, the geographic dispersion, sources of funds and the cost at which these funds have been acquired by lenders.

2.1. Types of Informal Lenders

The term "lender" hardly appears appropriate to cover the range of activities performed by operators in the informal credit market. The money is neither borrowed nor lent but credit transactions through the sale of goods made by different dealers constitute most of what is often characterised as informal credit market particularly in an environment where money lending can not be quantified. The distribution of these functionaries (lenders) as yielded by the survey indicates that thirty six percent of the lenders covered in the 1996 survey are landlords/farm machinery suppliers, while the share of commission agents and inputs dealers is 32 percent. Shopkeepers accounted for 15 percent of the total sample. The share of moneylenders and processing units in the sample are 2 and 3 percent respectively. It may be noted that the shares of different types of lenders are somewhat pre-determined in sample selection because of adjustment in the proportions yielded by census to capture the volume of credit transactions rather than the number of dealers. These adjustments are already discussed.

This distribution, however, changed markedly by ecological zones within the provinces. About one-thirds of the informal lenders in non-irrigated areas were in 'others' category which, contained mainly livestock and poultry feed suppliers (Appendix Table B7). Commission agents were concentrated in irrigated/semi-irrigated areas, where role of landlords as lenders also seemed to be important. Although the share of moneylenders and processing units in the total sample was small, they play a dual role in informal financial market. They could provide funds directly to the farmers and also indirectly through other informal lenders such as commission agents and input dealers. The volume of the business of processing units was therefore likely to be much larger than the one reported by other lenders. Wherever possible, data on processing units have been presented separately in the present report.

2.2. Geographic Distribution of Informal Lenders

In general, lenders were located in towns, where a number of institutional sources of credit, mainly banks, were also located. The survey of informal lenders was conducted at 296 locations (Table 2.1 and Appendix Table A3). At 87 locations, which account for 29 percent of the total locations covered four or more lenders were interviewed. In the case of Punjab, this ratio increased to 60 percent. Roughly half of the total locations covered in Sindh, two or more non-institutional lenders were interviewed at each place. Most of the locations, where four or more lenders were interviewed, were tehsil or district headquarters, such as Mirpur Khas in Sindh, Khuzdar in Balochistan and Patoki and Okara in Punjab.

A similar observation was made during the four case studies. In Samundari, a tehsil headquarter in district Faisalabad, about 200 commission agents and 50 input dealers were operating in the credit market. Eight moneylenders, who lent only to commission agents, were also identified in the same town. Concentration of informal lenders in small towns was explicable in that they could extend their operations to surrounding villages. People from rural areas could contact them easily at these places which were linked with the surrounding villages through roads.

Table 2.1

Locations by Lenders

(Numbers)

Number of Lenders	Location (Province/Region)			
	Punjab	Sindh	Others	Total
1	11	60	40	111
2	19	27	20	66
3	9	17	6	32
4–10	45	16	9	70
10+	13	2	2	17
Total	97	122	77	296

Source: 1996 Survey of Informal Lenders.

On average, business of the informal lenders covered in the survey was spread over 9 villages. However, there were significant differences among different types of the lenders in terms of geographic coverage of their businesses. For instance, business of the commission agents was spread over 19 villages, while the corresponding number for the moneylenders was only 2. Similarly, lending business of landlords was limited on average to only 3 villages. The business of commission agents was more widely spread in Sindh than their counterparts in Punjab and other provinces/regions (See Appendix Table A4).

The above was suggestive of the fact that the widely held notion that informal lenders were invariably enjoying a monopoly *vis-à-vis* the borrowers hardly found support from the data. The findings of the present study were consistent with that of Aleem (1990) who showed that the often-imagined picture of a single village moneylender with monopoly power over clients in the village did not hold true in the Chamber[3] context. There were in fact a large number of lenders serving farmers in rural areas. Thus, rural non-institutional credit market could largely be regarded as being competitive. But some informal lenders, such as, landlords, may be well placed to function as monopolists because they were the sole source of credit for their tenants and it was possible that they may have overpriced their loans.

2.3. Sources of Funds for Informal Lending

Previous studies on rural informal financial market in Pakistan ignored the supply side of the market, particularly lenders' sources of fund. Unlike formal credit institutions, such as the commercial banks and ADBP, which depended entirely either on their deposits or on refinancing from the State Bank of Pakistan and/or foreign financial institutions, informal lenders varied considerably with respect to their sources of funds. One way of generating the funds could be to use credit institutions, banks and co-operative societies. These funds, in turn, could be lent on interest rate higher than what is paid.

Table 2.2 shows that, on average, lenders were able to generate about 347,000 rupees during 1995-96. This amount varied considerably by type of informal lenders. Shopkeepers mobilised, on average, about 115,000 rupees, while in the case of input dealers, this average increased to 729,000 rupees. Moneylenders generated, on average, 275,000 rupees. It appeared that more funds were generated by those lenders engaged in sale of agricultural inputs such as fertiliser, pesticides and seeds.

Table 2.2

Average Amount of Funds Generated by Informal Lenders

Type of Lenders	Average Amount of Funds (Rupees)
Commission Agents	469013
Input Dealers	729216
Commission Agents/Input Dealers	507773
Landlords/Farm Machinery Suppliers	153362
Professional Moneylenders	275402
Shopkeepers	114856
Others	435414
Total	346529

Source: The 1996 Survey of Informal Lenders.

---

[3]The name of the area where Aleem conducted his study.

The case studies revealed that the volume of funds generated by moneylenders depended on the nature of their operations, which diversified over time. For example, the moneylenders who operated in rural areas of Samundari extended generally small loans to local residents mainly for their consumption needs. The funds mobilised by these lenders varied between 35,000 and 150,000 rupees. However, moneylenders of the Samundari town disbursing larger amounts to local commission agents were able to generate relatively larger funds. In other words, moneylenders could mobilise the funds by tapping variety of sources to meet the demands of their own business. To a large extent this applied to other categories of lenders too.

Nearly two-thirds of the informal lenders reportedly relied on their own sources to run their businesses (Appendix Table A5) lending an impression of little dependence on external sources. The distribution of actual funds generated by informal lenders from various sources however indicated that about half of these funds were borrowed, and more than two-thirds of the borrowed funds were obtained from banks or societies (Table 2.3). This suggested that one-thirds of the total funds utilised in informal credit transactions originated from the formal credit system.

About 83 percent of the total funds obtained from banks/societies were utilised by a single category of lenders, i.e. the processing units. Commission agents and landlords were the other main users of formal credit institutions (Appendix Table A6). It appeared that a good deal of interlinkage existed between the funds lent by formal credit institutions and the volume of credit transacted in the informal credit market. The institutions or influential persons in the society, who could also offer collateral, borrowed from the formal sector for onward lending in the informal sector presumably at higher rates of interest.

Table 2.3

Percentage Distribution of Funds by Sources and Type of Lenders

Type of Lenders	All Sources	Own Sources (percent)	Borrowed Formal Sources	Borrowed Informal Sources	Friends and Relatives*
Commission Agents	100	78.3	2.6	19.1	0.9
Input Dealers	100	84.0	5.0	11.0	3.3
Commission Agents/ Input Dealers	100	45.5	21.7	32.8	3.0
Landlords/Farm Machinery Suppliers	100	71.8	15.1	13.1	3.6
Moneylenders	100	62.6	0.0	37.4	5.0
Processing Units	100	26.6	69.6	3.8	0.0
Shopkeepers	100	72.3	3.8	23.9	6.0
Others	100	59.9	7.3	32.8	2.2
Total	100	52.0	33.2	14.8	2.2
Total (Excluding Processing Units)	100	68.4	9.6	22.0	2.9

Source: The 1996 Survey of Informal Lenders.

*Friends and relatives are included in 'informal sources'.

2.4. Ability to Generate Funds

Whilst it was not possible to examine the effect of all possible factors on the ability of informal lenders to generate resources, an attempt was made to investigate the impact of some socio-demographic factors in this context. Both bivariate and multivariate analyses were undertaken. (For detail of these factors, see Appendix B).

In the bivariate analyses, total funds generated by informal lenders were divided according to sources of funds: own, formal and informal. They were controlled for education, landownership and work experience. The multivariate analysis focussed on funds borrowed either from formal or from informal sources. In other words funds generated from own sources were excluded in the multivariate analysis.

The bivariate analysis suggests that level of lenders' educational attainment appeared to be associated with specific types of sources of funds (Appendix Table A7). Informal lenders with no formal education depended heavily on non-institutional sources of credit. For those informal lenders who were graduates (BA) or above, this dependency shifted to some extent to formal sources of credit. Similarly lenders owning less than 7 acres of agricultural land were more likely to borrow from non-institutional sources than the lenders who owned more than 7 acres.

The duration of experience in the business reveals a positive association with the proportion of funds borrowed. The influence of work experience in this business on the funds borrowed from different sources is suggestive of a tendency that the lenders initiated their business mainly with their own savings. With the passage of time and expansion in the volume of business they needed extra funds. Their long experience of financial market enabled them to benefit from the formal sources, probably through developing good contacts with the staff of local bank branches as well as acquiring desired credit worthiness.

The multivariate analysis, where funds borrowed from banks and co-operatives as proportion of total funds borrowed by informal lenders were used as the dependent variable, yielded some interesting results. Processing units and landlords were more likely than other lenders to borrow funds from banks and co-operatives. In contrast, commission agents/input dealers were less likely than others to rely on the formal sector for funds (Table 2.4). It seems that ability to provide collateral, and size of funds required influenced the choice of the sources. Landlords could use their land as a means (collateral) to obtain loans from lormal credit institutions. Similarly processing units enjoyed the same privileges and got the required funds from formal sources.

According to the multivariate analysis, commission agents/input dealers, whose funds requirements were likely to be lower than the processing units, depended primarily on the informal sector. This finding was consistent with the observations made during the case studies. For example, in Samundari several

Table 2.4

Factors Affecting Capability of Lenders to Borrow from Formal Sector (Dependent Variable = Funds Borrowed from Formal Sector as Proportion of Total Borrowed Funds)

Variables	Estimated Coefficients	T-ratios
Constant	0.6999	11.53
Type of Lenders		
Commission Agents/Input Dealers	–0.1371	2.26*
Professional Moneylenders	–0.0861	0.46
Processing Units	0.1623	1.82**
Landlords	0.15008	2.09*
Others	–	–
Previous Occupation		
Agriculture	0.1861	2.66**
Service	–0.1460	2.49*
No Previous Occupation	–	–
Lending Experience		
5–10 years	–0.1397	2.38*
> 10 Years	–0.1317	2.17*
< 5 Years	–	–
Ecological Zones		
Non-irrigated	0.3031	1.17
Irrigated	–	–
R^2	0.32	
F	5.36	P< 0.0000

Sources: The 1996 Survey of Informal Lenders.

* Significant at 0.05 level of confidence.

** Significant at 0.10 level of confidence.

commission agents were reported to have obtained loans from the local moneylenders on a 4 percent monthly rate of interest. The duration of loan was generally of a short duration, ranging between three to six months.

Table 2.4 also reflects that the occupation held by informal lenders before entering into this business had an effect on the sources of funds. Informal lenders who were engaged in the agriculture sector prior to their entry into the lending business more often borrowed funds from banks and co-operatives. Lenders who were employed in the services sector before their involvement in this business relied less on formal sources. Probably they did not own property (land) as well as experience to borrow funds from banks or co-operatives.

2.5. Cost of Borrowing by Lenders

Little has yet been done in the studies of rural financial market in Pakistan to estimate the cost of borrowing, such as interest rate paid by informal lenders on the funds borrowed. This is important since a substantial proportion of funds generated was through borrowings either from formal or informal sources. In the questionnaire respondents were asked to report the total funds generated during 1995-96. Also the information was solicited on annual interest rate and duration of loan by source of funds. Reporting of this information remained somewhat unclear. It was observed during the data analyses that interest rate was recorded annually only for those loans which were obtained from banks and co-operatives. In case of other sources, the reported interest rate presumably pertained to the duration of these loans, which was generally less than six months. The information on annual rate of interest as per requirement of the questionnaire was not provided in case of the funds obtained from informal sources. In an effort to seek clarification enumerators and supervisors of the survey were consulted. They confirmed that the interest rate on loans obtained from non-institutional sources was recorded for the duration of the loan. The reported information was therefore corrected to reflect annual rate of interest.

In addition, many informal lenders covered in the survey have obtained loans from their friends and relatives. Mostly zero interest rate was reported against these borrowings. Of the 86 lenders who borrowed from friends and relatives 68 reported zero interest rate. These cases were excluded while computing the interest rate. Admittedly, the underlay assumptions where in zero interest rate has been excluded could be questionable and would inflate the rate of interest.

Table 2.5 shows that on average informal lenders paid less than 19 percent annual interest on their funds borrowed from the formal credit institutions. In the case of borrowings from informal sources, this rate was about 23 percent. The annual interest on loans from friends and relatives was 28 percent in the cases where it was reported.

Table 2.5

Average Annual Interest Rate by Sources of Funds

Sources of Funds	Interest Rate (Percent)
Formal Sources	18.8
All Informal Sources	22.8
Factories/Mills	27.1
Friends/Relatives*	28.4
Other Informal Sources	19.7

Source: The 1996 Survey of Informal Lenders

* Out of 86 lenders who borrowed from friends/relatives, only 18 reported interest rate.

The interest rate paid by informal lenders on non-institutional credit classified by the type of lender, province/region and ecological zones is reported in Appendix Table A8. Both, commission agents and input dealers, obtained loans on relatively higher interest rate than their counterparts. One likely reason could be their relatively higher level of dependency on moneylenders. In Samundari, for example, it was reported that commission agents generally obtained loans from moneylenders on 4 percent monthly rate of interest. They were required to pay the amount of interest monthly (for details see Appendix C). Regular interest payments to moneylenders persuaded them not to press for the return of principle amount.

It is also evident from Appendix Table A8 that interest rate paid by informal lenders operating in irrigated areas was higher than in non-irrigated areas. Similarly it was higher in Punjab than in Sindh and other provinces/regions. This could be partly due to compositional change in the sources of funds having different costs and partly because of the volume of credit demand that may have been higher in irrigated areas and in Punjab province.

In short, both the survey data and the case studies suggest that informal lenders depended primarily on their own sources to run their lending businesses. However, it also appeared that formal credit institutions provided substantial funds too, particularly in the case of processing units, commission agents and landlords. Although it was not uncommon for informal lenders to obtain interest free loans from friends and relatives, in general they paid interest on all types of loans.

Chapter 3

INFORMAL CREDIT—PROCEDURES, VOLUME AND COSTS

3.1. Screening the Borrowers

In the absence of any collateral in non-institutional credit market, considerable effort has to be made to obtain information about prospective borrowers to reduce the risk of default. Thus a careful screening process has to be undertaken by lender. The survey data show that the previous experience of a lender with borrower was the most commonly used method of screening (Appendix Table A9). In addition, personal relations of informal lenders with potential borrowers and testing them by giving a small initial loan for one season seems to be another important method to determine the credit worthiness of the borrowers. This pattern of assessment prevails for all types of informal lenders. On average, informal lenders spent one day on screening loan applications (Appendix Table A10). It seems that informal lenders select borrowers carefully, but the borrowers may not be fully aware of the terms and conditions of the informal lenders for extension of credit.

3.2. Lending Volume and Composition

In the questionnaire, borrowers were classified into seven groups: small farmers (<12.5 acres), medium farmers (12.5–25 acres), large farmers (>25 acres), landless, livestock holders, shopkeepers/wholesalers and others. Lenders were asked to report their transactions in cash or kind to each type of borrower.

Informal lenders reported to have on average 44 borrowers at the time of the survey. Small farmers constituted 38 percent of the total borrowers, while the shares of medium and large farmers were 22 and 9 percent, respectively (Table 3.1). About 6 percent of the borrowers were shopkeepers/wholesalers. The average amount of loan per borrower was slightly more than 10,000 rupees. If the loans disbursed by processing units were included, the average rose to 31,400 rupees.[4] The results of the 1996 survey of informal lenders are in line with the previous

---

[4]To ensure the supply of cotton, some ginning factories have developed close contacts with local cotton-growers by supplying them fertiliser and pesticides on credit through their agents. Mark-up on these inputs is similar to the mark-up charged by local input dealers. The ginning factories make the booking of required quantity of fertiliser and pesticides in the month of March. According to key informants, the owners of the factories use bank guarantees, which are valid for 6 to 9 months, for this booking. Banks charge a nominal interest rate on these guarantees.

study by Qureshi and Shah (1992), wherein average amounts borrowed by households in 1988 were around eight thousands rupees from non-institutional sources. The average amount of loan (excluding processing units) varied substantially among the borrowers, around 800 rupees for livestock holders to about 25,000 rupees for large farmers. Average amount borrowed by large farmers was more than four times that of the small farmers (Table 3.1).

Table 3.1

Average Amount of Loan Borrowed from Informal Sector by Type of Borrower

(Rupees)

Type of Borrowers	Distribution of Borrowers (Percent)	Average Size of Loan (Rupees) Including Processing Units	Excluding Processing Units
Small Farmers	37.9	6555	5750
Medium Farmers	21.6	15322	13810
Large Farmers	9.1	27144	24761
Landless	14.8	8592	8459
Livestock Holders	6.0	1974	822
Shopkeepers/Wholesalers	6.2	6242	6153
Others	4.4	491016	24970
All	100.0	31404	10185

Source: The 1996 Survey of Informal Lenders.

Note: Small farmers <12.5 acres; medium farmers 12.5–25.0 acres; and large farmers 25+ acres.

The share of small farmers in total volume of credit (excluding the credit provided by processing units) was 21 percent (Appendix Table A12 last column), while, as noted earlier, they constituted 38 percent of the total borrowers. In contrast, large farmers (9 percent of the total borrowers) were able to obtain 22 percent of the total credit. Farmers and shopkeepers/wholesalers borrowed primarily from commission agents and input dealers, while processing units were the main source of funds for livestock holders (Appendix Table A12, row-wise percentages).

3.3. Interest Rate and Mark-up

Credit transactions take place through the sale of inputs used in agricultural production and consumption goods. In the questionnaire therefore there was no question soliciting information directly on interest charged on the loans. Instead the lenders (arhtis, commission agents and input dealers etc.) were asked to report prices and quantity of commodities sold both in cash and on credit. The differentials between cash and credit price facilitate calculation of mark-up. It may also be noted that traders who sell inputs on credit may buy the farm produce of borrower to recover the loan. To the extent the borrowers are paid less than the market price it constitutes an element of interest on borrowings.

The differentials on credit and cash prices in the survey were collected for major agricultural inputs such as fertilisers, seeds and pesticides and not on consumption goods. In other words information obtained from nearly one-half of the lenders/traders is utilised to arrive at mark-up which acts as a surrogate of interest rate. A questionnaire approach to extract such an information confronts many problems and results in serious underestimation of mark-up. This is reflected in the difference between the mark-up estimated on the basis of survey information and that of the case studies in the Table 3.2.

The estimated average annual mark-up on the basis of survey data worked out to be 18 percent. It, however, differs widely across the types of inputs: 19 percent for fertiliser and 35 percent for pesticides. The estimated average price differential for different crops purchased by lenders is about 2 percent. The case studies support these findings, although the credit prices of different inputs reported by informal lenders during the survey seem to be lower than the prices reported in case studies. Implying that the survey results could be under estimating the mark-up.

Table 3.2

Average Annual Mark-up (Interest) by Inputs

(Percentage)

Inputs	Mark-up
Fertiliser	18.6 (29.0)
Pesticides	35.2
Seeds	7.8
Other Inputs	8.0
All Inputs	18.0 (25.0)

Source: The 1996 Survey of Informal Lenders.

Note: Numbers in parentheses indicate mark-up on the basis of the information obtained through the case studies.

The main reason for the high mark-up on pesticides (more than 35 percent) is due to the fact that pesticides are used heavily by cotton-growers during the months of June and October. Invariably all pesticide manufacturers start booking for their product in January. Early booking means high rate of commission for dealers, which varies from about 25 percent in case of multinational companies to over 60 percent for some national companies (for details see case studies). The commission is given on the Maximum Retail Price (MRP) written on every box or bottle of a pesticide. At the end of a season, the pesticide companies also give a 'rebate' to input dealers/commission agents on there total purchases, and its rate varies between 2 to 7 percent. Generally input dealers book in advance. The farmers may also book in advance subject to the availability of funds.

Input dealers sell the early-booked pesticides to farmers in cash or credit. Cash prices of pesticides are usually much lower than the MRPs because the sellers (input dealers/commission agents) give up some portion of their commission in order to get 'rebate' from the respective companies. For sale on credit, input dealers not only charge the full MRP of the pesticide sold but sometimes they charge more than the written price, particularly on the products of multinational companies, such as of Ciba-Gaigy and Bayer, which offer relatively low commissions to input dealers. It is a common practice among input dealers to sell on credit those pesticides, which yield higher rate of commission. Although the mark-up on pesticides varies between 20 to 60 percent, it depends on the nature of product being purchased and on the relations between the borrower and the dealer. The likelihood that price of an input sold on credit varies substantially among borrowers cannot be ruled out (for detail see case studies).

The case of fertiliser appears different from the pesticides. Any dealer can arrange booking for the required quantity of fertiliser by sending full payment through a bank draft to the nearest fertiliser company. The dealers are eligible to receive only 8 rupees per bag of fertiliser as their commission from the company. This commission is usually their only profit if they sell fertiliser in cash. However, if they sell it on credit, they charge an extra 100 rupees per bag of urea fertiliser. The market price of a bag of the urea fertiliser at the time of case studies, was 350 rupees. In other words the mark-up on credit sale comes to around 29 percent. The foregoing discussion is reflective of the difficulties entailed in arriving at a mark-up. Not only does it vary across different commodities but also is influenced by the commission offered by manufacturers.

It was noted earlier that not all the informal lenders in the sample were involved in selling inputs or buying outputs from their customers. As discussed earlier, one of the limitations of the questionnaire administered to informal lenders was that it did not contain questions or sub-modules to reckon with the variation in transactions of different types of lenders. It was thus not possible to determine the rate of interest charged by these lenders in particular the pure moneylender. However, this was investigated during the conduct of case studies. It may be added that this subset of information was provided by borrowers of the area, not the moneylender themselves.

Moneylenders extend credit to farmers, commission agents, input dealers and livestock dealers for different durations and at different rates of interest. Lenders who lend money to farmers charge 40 to 50 percent interest for the duration of 8 to 10 months. The monthly interest of those who lend mainly to landless households is between 10 and 13 percent. Some moneylenders disburse loans to only commission agents on a monthly interest of 4 percent. They also give loans to livestock dealers on similar terms and conditions. Information pertaining to one location where case studies were conducted is provided below in Table 3.3.

Table 3.3

Transaction of Moneylenders in Rural and Urban Areas of Samundari Tehsil

Area	No. of Moneylenders Identified	Type of Borrowers	Purpose of Loan	Loan Per Borrower (Rs)	Monthly Interest Rate (Percent)
Rural	5	Small Farmers/ Live Stock holders	Consumption/ Health/Live stock Purchase	30,000	4–13 (10)
Urban	8	Commission Agents	Business	150,000	4

Source: Case Studies (See for details in Appendix C).
Figures in parenthesis denotes average rate of interest.

Thus the information gathered through the survey and case studies suggest that the mark-up estimated on credit extended through sale of agricultural input ranges between 18 percent (survey) to 25 percent (case studies). The interest rate in case of pure money lending works out to 48 percent per year for commission agents and climbs up to an exorbitant rate of 120 percent per year for landless households.

3.4. Purpose of Borrowing

It is widely held that rural households borrow from informal sources to meet their consumption needs besides production and investment purposes. Malik (1992), for example, showed that a considerable amount of in-kind loan was extended by shopkeepers to facilitate the daily consumption needs of the rural households. It may be added that the lenders reported the purpose for which the credit was extended. This survey did not cover borrowers. According to this survey of informal lenders, approximately 90 percent of the total amount disbursed by the lenders was meant for production and investment purposes (Appendix Table A13). Commission agents and input dealers did not generally advance loans for consumption needs. However, a substantial proportion of loans disbursed by shopkeepers, moneylenders and landlords was used for the daily consumption needs of the borrowers (Appendix Table A13).

There is a considerable variation in the purpose of borrowing by province/region and ecological zones. In Sindh one-fifth of the loan was extended to meet the daily consumption needs of borrowers, while in Punjab it was only 5 percent (Appendix Table A13). In other provinces informal sources lent only for production and investment purposes. In non-irrigated areas, 17 percent of the total loan was given for poultry and dairy production, which reflects the concentration of these activities in these areas. Borrowing for this purpose was not reported from irrigated areas.

3.5. Cost of Lending Operations

This sub-section is mainly concerned with the administrative cost of lending, comprising of overhead cost and other variable costs. A major problem in estimating average administrative costs is that of allocating the costs between lending activities and other activities carried out simultaneously by the informal lenders. According to Aleem (1990), the allocation of administrative cost to the lending operation depends on the assumption regarding the lender's main activity. All administrative costs can be allocated to the lending operation, if it is considered to be the primary activity of the lender. Allocation of administrative cost is difficult, if lending is considered a joint activity. It can be distributed according to the time allocated to various activities by the lender if such an information exists. In the survey of informal lenders, respondents were not asked to provide information about their other business activities and no information was obtained regarding time allocation among different business activities. Therefore, it is difficult to separate the administrative costs due to lending from rest of the activities.

Three types of costs were reported in the survey: overhead costs, labour costs and other costs. Approximately half of the lenders did not report any type of cost. These lenders were excluded while computing the average cost (See Table 3.4).The average annual overhead cost of lenders was more than 7,000 rupees (Column 1). It varied from Rs 516 for moneylenders and about Rs 15,000 in case of commission agents. The average labour cost per lender was about 11,000 rupees (Column 2), while the average of 'other costs' was more than 8,000 rupees. Thus, the total transaction cost of informal lenders on the average constituted only five percent of the total volume of lending.

Table 3.4

Average Annual Transaction Cost by Informal Lenders

Type of Lenders	Overhead Cost (Rs)	Labour Cost (Rs)	Other Costs (Rs)
Commission Agent	14649	23553	6770
Input Dealers	11069	12494	9044
Commission Agent/Input Dealers	14497	19332	8046
Landlord/Farm Machinery	1523	8488	10839
Professional Moneylenders	516	2271	2060
Shopkeepers	4328	2589	1782
Others	12560	9345	9408
All	7155	10831	8040

Sources: The 1996 Survey of Informal Lenders.

3.6. Default Rate and Recovery of Loans

Success of an informal lender in his business depends largely on the recovery of loans. Repayment of loans can be made in cash or kind. One way of ensuring the recovery is to get commitment from the borrowers to sell their outputs to the lenders if it falls in the domain of the business of lenders. About three-quarters of the lenders did not report any commitment from their borrowers. However, commission agents were an exception. Approximately 40 percent of the commission agents reported that their borrowers were committed to sell all outputs to them.

The question is whether informal lenders were successful in recovering loans? In the survey, lenders were asked to report number of borrowers who did not return loan last year. Similarly they were asked to report the amount which could not be recovered at scheduled time of payment. From this information, default rates for both the number of borrowers and funds were estimated. Table 3.5 shows that 15 percent of borrowers, which account for 12 percent of volume of credit, failed to pay at the scheduled time. Commission agents and input dealers who loaned large amounts and who generally got commitment from borrowers of selling their outputs were able to recover more than 90 percent of their loans. Shopkeepers faced relatively greater risk of non-recovery of their loans.

However, the proportion of loan, which could not be returned, may not be strictly called default rate, because some of the more recent overdue loans may eventually be recovered. It was difficult to estimate how much of the overdue loans were likely to be recovered after the stipulated date. In the survey lenders were asked to report the reasons for non-payment of loans and they were also asked whether or not they extended loans to those who could not repay at the scheduled time.

Table 3.5

Default Rate by Borrowers and Funds Controlling for Type of Lenders

Type of Lenders	Borrowers Who Did not Pay Loan (%) at Scheduled Time	Amount of Loan Which Could not be Returned (%)
Commission Agents	8	7
Input Dealer	9	7
Input Dealers/Commission Agents	10	8
Landlords/Farm Machinery Owners	8	10
Processing Units	21	14
Moneylenders	18	13
Shopkeeper	17	17
Others	12	9
Total	15	12

Source: The 1996 Survey of Informal Lenders.

According to the survey, financial difficulty and crop failure were the main reasons for non-payment of loans (Appendix Table A14). But 47 percent of the lenders covered in the survey extended additional loans despite the fact that the borrowers failed to pay back at due time last year (Table 3.6). If the reason for non-payment of loan was crop failure, this percentage increased to 62; probably in order to ensure the recovery of loans during the next crop.

Table 3.6

Proportion of Informal Lenders Who Extended Additional Loans to Those Borrowers Who Could not Return Loan Last Year by Reasons for Non-Payment of Loan

Reasons for Non-Payment of Loan	percent of Informal Lenders Who Extend Additional Loan
Crop Failure/Natural Disaster	61.6
Financial Difficulties	37.2
Others	33.2
All	46.8

Source: The 1996 Survey of Informal Lenders.

Table 3.7 shows that 9 percent of loans recovered last year were paid after the scheduled time, and on average the delay was of 8 months. In the case of commission agents and input dealers the duration of this delayed payment increased to 11 months. Based on this information it is estimated that lenders would be able to recover more than half of the overdue loans during the next crop. The ultimate default rate is thus likely to decline to less than 6 percent. The views of the researchers engaged in survey and case studies tend to support this estimate.

Table 3.7

Proportion of Loans Returned After the Due Date and Mean Duration of Delay

Type of Informal Lenders	Proportion of Loans Returned After the Due Date (Percent)	Mean Duration of Delay (Months)
Commission Agents	9	11
Input Dealers	8	11
Commission Agents/Input Dealers	9	2
Processing Units	8	3
Landlords/Farm Machinery Owners	7	7
Moneylenders	12	2
Shopkeepers	14	9
Others	8	14
All	9	8

Source: The 1996 Survey of Informal Lenders.

Informal lenders in general relied on personal and social pressures to recover loans. It is not common among these lenders to use the legal system of the country for the recovery of loan (Appendix Table A15). It was observed during the case studies that the meaning and use of 'social pressure' is specific to the type of lender. Commission agents and input dealers usually extend credit without any collateral or written agreement. Recovery of their loans is generally smooth. In order to maintain good relationship with the dealers and in view of their future needs for credit, farmers normally return the borrowed money. In the case of crop failure, the recovery of full loan is very difficult, and many commission agents and input dealers wait for the next crop for the recovery of their loans. Some, however, do adjust loans by transferring moveable or immovable property of the borrowers in their name. This is usually done with the help of influential people of the area.

Moneylenders extended loans through mediators, local councillors or landlords, and recover their loans by using the influence of these intermediaries. Some moneylenders were found powerful enough to force borrowers to hand over to them jewellery, livestock and farm machinery to adjust the loans. Even in some instances land was taken from borrowers by moneylenders in lieu of the loan. (see case studies Appendix C).

Chapter 4

SUMMARY AND CONCLUSION

The structure of informal credit market in Pakistan is examined in the present study by combining two approaches; a field survey administering semi-structured-questionnaire to more than 1000 informal lenders supplemented by case studies. The field survey was undertaken in four provinces of the country and AJK while the case studies were conducted in four small towns of the Punjab province. The main findings of the study are as follows:

1. Notwithstanding substantial expansion in the formal credit institutions the predominance of the informal rural credit is manifest from its reportedly high share in total credit extended to rural population in cash and/or kind. However, a good deal of interlinkages exists between formal and informal credit institutions. According to this survey around one-third of the credit extended by informal lenders is provided by formal sector institutions like banks. Processing units, landlords and other influential persons borrow from the banks for onward lending through informal channels.
2. In addition to availability of funds from formal sector, informal credit system draws heavily on additional sources including friends and moneylenders. Informal operators were successful in generating on an average Rs 347 thousands for the business. This however ranged from 114 thousands in case of shopkeeper to Rs 729 thousands for input dealer. Interest rate paid on the borrowed funds was 19 percent in case of formal sector while the same was 23 percent if the source of funds was informal. However moneylenders charged much higher rate of interest ranging from 48 percent to 120 percent.
3. Except landlords and shopkeepers, informal lenders were concentrated in towns, which is a better location to extend their operations to surrounding villages. On average, the business of commission agents was spread over 19 villages, while for both moneylenders and landlords it was only 2 villages each.
4. Informal credit market can be characterised as competitive. The locations covered in the survey had more than one dealer or lender. If a monopolistic situation prevails in the market it is because of peculiar relationship between lender and borrower, such as landlord vs. tenant.
5. On average informal lenders spent one day to make a decision before disbursing the loan to a borrower. The previous experience of a lender was the most commonly stated method used to select the borrowers. The average cost on screening a loanee was reported to be nominal, only 18 rupees.

6. Informal lenders reported to have on average 44 borrowers at the time of survey. The average amount of loan per borrower was more than 10,000 rupees. This average displays wide variations across different type of lenders as well as borrowers. For instance large farmers on the average were extended a credit of Rs. 25000 in contrast to Rs. 6000 for small farmers during the year of 1995-96. These averages alter substantially if the credit extended by processing units is incorporated.
7. Small farmers constituted 38 percent of the total borrowers, but their share in total credit was only 21 percent. It appears that like the formal financial market, lenders in the informal markets also follow credit worthiness as the major criteria to lend. This reduces considerably the level of funds allocated to less privileged and assetless.
8. It is not easy to provide a firm estimate of the mark-up that can be regarded as interest rate charged on credit transactions made by informal lenders. Mark-up tends to vary from product to product and also by type of borrower as well as lender. On the average, however, the mark-up is 25 percent. In the case of fertiliser it is estimated to be 29 percent while for the pesticides it comes around 35 percent.
9. High mark-up charged on the pesticides sold on credit is mostly due to rather unholy alliance between the manufacturers and traders/dealers. Multinationals, like Ciba Gaigy, offer 25 percent commission to dealers for six months advance booking. Some domestic manufacturers even pay 60 percent commission in addition to 5 to 7 percent rebate on total volume of transactions. Farmers who buy pesticides in cash are sold at prices lower than the prices printed on boxes/bottles hence some commission gets passed on to them. However, those who buy on credit have to pay full printed price. One fails to understand this high commission policy of manufacturers. This aggressive salesmanship needs to be investigated further. Not only does the farmer end up paying higher prices but he also gets substandard product particularly from those manufacturers who pay high commissions.
10. The results of the case studies carried out in some areas in Punjab show that pure money lending is on the rise with quite exploitative interest rates ranging from 48 percent to 120 percent per year. Failure of cotton crop for the last three years, and increasing requirements of farmers for inputs partly explain this rise. The high rate of interest can also be attributed to illegal nature of the business. Legal registration of this business is likely to bring down the interest rate. If this is not politically palatable then there is a real need to introduce some sort of crop insurance scheme as well as innovative credit schemes such as group based lending.
11. Approximately 90 percent of the total credit disbursed by the lenders was given for production and investment purposes. Only shopkeepers, landlords and moneylenders extended some loans for daily consumption. Information

on purpose of loan was provided by lenders. It is possible that ultimate use of the credit was different to an unknown extent than the one cited above.

12. Though we cannot be conclusive on cost effectiveness of formal versus informal lenders, but a crude measure such as total cost of lenders (overhead, administrative and labour costs) per volume of credit transaction ranges between 3 percent to 5 percent in case of informal sector. In contrast similar crude estimates for ADBP work out to be 14 percent. Further in depth investigation appears in order.
13. The ultimate default rate for total loans disbursed was estimated to be less than 6 percent. Generally the borrowers pay the loans because they would like to maintain the credit line. Social pressure was the commonly used method to recover loans which are not paid back. For some lenders social pressure means use of power to get back their loans. Some moneylenders were reportedly powerful enough to take land from the borrowers in lieu of unpaid loan.

Appendices

APPENDIX A

STATISTICAL TABLES

Appendix Table A1

Percentage Distribution of Total Borrowing by Source

(Percent)

Sources	1973 (2)	1985a (3)	1985b (4)	1990 (5)	1996 (6)
Institutional Sources	9.8	39.5	58.5	23.6	22.0
Non-institutional Sources	90.2	60.5	41.2	76.4	78.0
Total	100	100	100	100	100

Source: Malik (1989); Malik (1991).

Notes: The first rural credit survey was conducted in 1973. This survey covered 94082 households. The second rural credit survey that covered 54987 household was conducted in 1985. In 1990, 2300 households were selected from the lists of 1985 rural credit survey. Out of them, a sample of 633 household was drawn by IFPRI. Col. 4, 1985(b) and Col. 5 of 1990 presents the distribution credit acquired by these households.

(a) Column 3 reports the results of full sample that are comparable with the results of Rural Credit Survey 1973.

(b) Column 4 reports the results of the selected sample of the Rural Credit Survey 1985 in order to make a comparison between the findings of 1985 and 1990. The sample consists of 633 households.

Appendix Table A2

Percentage Distribution of Informal Lenders by Province/ Region and Ecological Zones, 1996

Type of Informal Lenders	Pakistan	Province/Region			Ecological Zones		
		Punjab	Sindh	Other*	Irrigated	Semi-irrigated	Non-irrigated
Commission Agents	11.6	15.8	7.2	5.7	12.0	21.1	4.6
Input Dealers	11.0	9.3	9.5	19.0	11.2	10.5	10.0
Commission Agents/Inputs Dealers	10.0	13.6	6.1	5.2	11.3	5.3	3.8
Pressing Units	2.4	2.0	3.8	1.1	2.7	1.7	0.8
Landlords/Machinery Suppliers	35.8	33.6	44.4	28.2	36.7	47.4	24.6
Professional Moneylenders	3.4	4.4	-	5.2	3.1	3.5	5.4
Shopkeepers	14.5	13.2	18.8	11.5	14.3	8.8	18.5
Poultry Feed Dealers/Others	11.3	7.8	10.2	24.1	8.7	1.7	32.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
(N)	(1018)	(551)	(293)	(174)	(831)	(57)	(130)

Source: The 1996 Survey of Informal Lenders.

* NWFP, Baluchistan and AJK are included in 'others'.

Appendix Table A3

Number of Locations Where Survey was Conducted by Number of Lenders and Ecological Zones

(Numbers

Number of Lenders	Ecological Zones			Total
	Irrigated	Semi-irrigated	Non-irrigated	
1	84	17	10	111
2	43	13	10	66
3	27	1	4	32
4–10	58	2	10	70
10+	15	0	2	17
Total	227	73	36	296

Source: The 1996 Survey of Informal Lenders.

Appendix Table A4

Average Number of Villages Covered by Informal Lender at the Time of Survey

(Numbers)

Province/Region/ Ecological Zones	Types of Informal Lender: Commission Agents	Input Dealers	Commission Agents/Input Dealers	Processing Units	L.lords/Farm Machinery Suppliers	Professional Moneylenders	Shopkeepers	Others	Total
Province/Region									
Punjab	11	13	10	21	2	2	3	9	7
Sindh	55	17	12	24	3	–	7	7	10
Other Provinces	12	16	21	3	6	3	5	15	11
Ecological Zones									
Irrigated	20	15	10	18	3	2	5	8	8
Semi-irrigated	14	6	7	2	7	4	7	4	8
Non-irrigated	7	20	28	100	3	2	4	15	11
Total	19	15	11	21	3	2	5	10	9

Source: The 1996 Survey of Informal Lenders.

Appendix Table A5

Percentage Distribution of Informal Lenders by Sources of Funds, 1996

(Percentage)

Sources of Funds	Commission Agent	Input Dealer	Commission Agent/Input Dealer	Processing Unit	Land lord/Farm Machinery Suppliers	Professional Moneylender	Shopkeeper	Others	Total	Total (Excluding Processing Unit)
	Types of Informal Lenders									
Own Sources	66.7	59.9	45.2	41.2	72.9	60.3	68.1	58.1	63.1	63.6
Banks/Societies	6.4	11.0	9.1	35.3	10.5	0.0	4.9	6.5	8.8	8.1
Friends and Relatives	5.3	8.7	9.6	0.0	3.8	12.1	4.9	5.8	6.0	6.2
Factories/Mills	13.5	14.5	24.4	17.6	5.0	20.7	7.4	20.6	12.9	12.8
Shopkeepers/Brokers	4.7	2.3	10.2	0.0	4.0	3.4	12.3	4.5	5.9	6.0
Landlords/Farmers	2.9	2.3	0.5	2.9	1.2	1.7	2.5	2.6	1.8	1.8
Moneylenders	0.0	0.0	1.0	0.0	1.7	1.7	0.0	0.6	0.8	0.8
Others	0.6	1.2	0.0	2.9	1.0	0.0	0.0	1.3	0.7	0.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
(N)	(171)	(172)	(197)	(34)	(421)	(58)	(204)	(155)	(1412)	(1378)

Sources: The 1996 Survey of Informal Lenders.

Appendix Table A6

Percentage Distribution of Total Funds Generated by their Sources and Type of Informal Lenders, 1996

(Numbers)

Sources of Funds	Types of Informal Lenders: Commission Agent	Input Dealer	Commission Agent/Input Dealer	Processing Unit	Landlord/Farm Machinery Suppliers	Professional Moneylender	Shopkeeper	Others	Total	Total (Excluding Processing Unit)
Own Sources	78.3	84.0	45.5	26.6	71.8	62.6	72.3	59.9	52.0	68.4
	(15.7)	(25.1)	(11.4)	(20.1)	(11.3)	(2.5)	(4.1)	(9.8)	(100)	
Banks/Societies	2.6	5.0	21.7	69.6	15.1	–	3.8	7.3	33.2	9.6
	(0.8)	(2.3)	(8.5)	(82.5)	(3.7)	(–)	(0.3)	(1.9)	(100)	
Friends and Relatives	0.9	3.3	3.0	–	3.6	5.0	6.0	2.2	1.8	2.9
	(5.4)	(29.4)	(22.1)	(–)	(16.7)	(5.8)	(10.0)	(10.6)	(100)	
Factories/Mills	11.6	5.2	18.2	3.4	2.2	28.3	5.5	10.6	7.5	10.2
	(16.0)	(10.8)	(31.4)	(17.6)	(2.4)	(7.7)	(2.2)	(12.0)	(100)	
Shopkeepers/Brokers	2.9	0.7	9.9	–	2.3	2.8	10.3	3.4	2.5	4.2
	(11.8)	(4.2)	(50.8)	(–)	(7.5)	(2.2)	(11.9)	(11.5)	(100)	
Landlords/Farmers	2.5	0.6	0.3	0.3	0.3	0.6	2.1	4.2	1.0	1.4
	(26.6)	(9.0)	(4.0)	(13.3)	(2.3)	(1.3)	(6.4)	(37.2)	(100)	
Moneylenders	–	–	1.4	–	4.6	0.7	–	0.2	0.6	1.0
	(–)	(–)	(31.1)	(–)	(64.0)	(2.2)	(–)	(2.7)	(100)	
Others	1.2	1.2	–	0.1	0.1	–	–	12.2	1.4	2.3
	(9.3)	(13.0)	(–)	(2.8)	(0.6)	(–)	(–)	(74.3)	(100)	
Total	100	100	100	100	100	100	100	100	100	100

Sources: The 1996 Survey of Informal lenders.

Appendix Table A7

Distribution of Funds by Sources of Funds, Lenders' Level of Educational Attainment, Land Ownership and Work Experience

Lenders' Characteristics	Sources of Funds			
	Own Savings	Formal Sources	Informal Sources	Total
Level of Educational Attainment				
Illiterate	57.8	10.7	31.5	100.0
Primary	75.1	3.1	21.8	100.0
Middle	66.1	6.1	27.7	100.0
Matriculation	67.1	10.6	22.3	100.0
Intermediate	72.4	4.6	23.0	100.0
Graduate and Above	64.4	18.7	16.8	100.0
Land Ownership				
No Land	70.5	14.4	15.1	100.0
1-6 Acres	55.0	3.7	41.3	100.0
7-12 Acres	67.8	8.7	23.5	100.0
13+ Acres	70.0	4.9	25.1	100.0
Work Experience				
< 5 Years	75.1	7.2	17.7	100.0
5–10 Years	67.2	6.4	26.4	100.0
11+ Years	65.0	12.2	22.8	100.0
All	67.9	9.3	22.8	100.0

Sources: The 1996 Survey of Informal Lenders.

Appendix Table A8

Average Annual Interest Rate Paid by Type of Informal Lenders to Informal Source of Credit Controlling for Province and Ecological Zones

(Percentage)

Type of Lenders/Province/Ecological Zones	Interest Rate (%)
Type of Lenders	
Commission Agents	26.8
Input Dealers	26.8
Commission Agents/Input Dealers	28.9
Processing Units	26.5
Landlords/Farm Machinery Suppliers	17.1
Moneylenders	20.0
Shopkeepers	22.3
Others	21.3
Province/Regions	
Punjab	27.3
Sindh	20.7
Others	16.5
Ecological Zones	
Irrigated	23.2
Non-irrigated	15.7
Total	22.8

Sources: 1996 Survey of Informal Lenders.

Appendix Table A9

Percentage Distribution of Informal Lenders by Methods of Assessment of Loan Applicant (Pakistan)

(Percentage)

	Types of Informal Lenders								
Method of Assessment	Commission Agents	Input Dealers	Commission Agents/Input Dealers	Processing Units	Landlords/Farm Machinery Suppliers	Professional Moneylenders	Shop-keepers	Others	All Lenders
On the Basis of Past Dealing	75.4	60.4	62.7	50.0	63.2	51.4	63.8	57.3	64.5
Assess Through other Activities	.8	.9	7.8	4.2	2.2	8.6	2.7	6.0	3.3
Through Personal Guarantee	1.7	5.4	13.7	16.7	1.6	5.7	2.7	3.4	4.2
Enquiry in Applicant's Village	4.2	6.3	5.9	–	5.2	5.7	7.4	5.1	5.6
Visiting the Applicants Place of Work	–	.9	–	4.2	–	–	2.0		0.5
Testing him by giving a Small Initial Loan	2.5	5.4	2.9	–	4.9	8.6	7.4	5.1	5.0
Personal Relations	3.4	14.4	5.9	12.5	9.3	2.9	6.7	18.8	9.6
No Screening/Others	11.8	6.3	1.0	12.5	13.5	17.1	7.4	4.3	7.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
(Numbers)	(118)	(111)	(102)	(24)	(364)	(35)	(35)	(117)	(1020)

Source: 1996 Survey of Informal Lenders.

Appendix Table A10

Average Time Spent by Lenders on Assessment of Borrowers and Average Assessment Cost of Informal Lenders by Methods of Assessment

Methods of Assessment	Average Time Spent on Assessment (Days)	Average Cost (Rs.)
On the Basis of Past Dealing	1	14
Assess Through other Activities	3	27
Through Personal Guarantee	4	28
Inquiring in Applicant Village	5	107
Visiting the Applicants Place of Work	4	6
Testing him by giving a Small Initial Loan	2	10
Personal Relations	0	–
No Screening	0	–
Total	1	18

Source: 1996 Survey of Informal Lenders.

Appendix Table A11

Distribution of Loans Obtained from Non-institutional Sources by Size of Farm, Pakistan 1973 and 1988

Size (Acres)	Average Amount (Rs)	
	1973	1988
0–5	1197	6807
5–15	1252	6822
15–25	1557	9735
25–50	2169	15772
>50	4235	8222
All Sizes	1477	8222
Gini Coefficient	0.589	0.507

Sources: Qureshi and Shah (1992).

Appendix Table A12

Percentage Distribution of Credit by Type of Lenders and Borrowers, Pakistan 1995-96

Sources of Funds	Types of Informal Lenders: Commission Agent	Input Dealer	Commission Agent/Input Dealer	Processing Unit	Land lord/Farm Machinery Suppliers	Professional Moneylender	Shopkeeper	Others	Total	Total (Excluding Processing Unit)
Small Farmers	24.7	25.0	23.2	1.4	17.9	24.3	23.2	12.9	7.9	21.4
	(13.4)	(23.4)	(26.4)	(12.3)	(7.4)	(3.3)	(4.2)	(9.6)		
Medium Farmers	28.8	32.5	40.3	1.5	17.8	34.9	17.1	16.7	10.5	29.2
	(11.8)	(23.0)	(34.6)	(9.9)	(5.5)	(3.5)	(2.3)	(9.4)	(100)	
Large Farmers	22.0	34.1	20.2	1.0	21.8	31.3	6.0	12.8	7.9	22.2
	(12.0)	(32.1)	(23.2)	(8.8)	(9.0)	(4.2)	(1.1)	(9.6)	(100)	
Landless	0.6	4.8	13.1	0.1	39.0	1.4	16.4	15.2	4.0	12.3
	(0.6)	(8.8)	(29.2)	(1.5)	(31.4)	(0.4)	(5.9)	(22.2)	(100)	
Livestock	0.4	0.1	0.0	0.3	0.2	0.4	2.6	1.5	0.4	0.5
	(4.7)	(1.1)	(0.0)	(58.3)	(1.4)	(1.0)	(9.9)	(23.6)	(100)	
Shopkeeper/Wholesaler	0.7	2.9	2.5	0.0	0.1	1.5	15.1	8.6	1.2	3.8
	(2.3)	(17.3)	(18.6)	(1.4)	(0.4)	(1.3)	(17.6)	(41.1)	(100)	
Others	22.8	0.7	0.7	95.6	3.2	6.4	19.5	32.3	68.0	10.7
	(1.4)	(0.1)	(0.1)	(94.9)	(0.2)	(0.1)	(0.4)	(2.8)	(100)	
Total	100	100	100	100	100	100	100	100	100	100
	(4.3)	(7.4)	(9.0)	(67.6)	(3.2)	(1.1)	(1.4)	(5.9)	(100)	

Source: The 1996 Survey of Informal Lenders.

Note: In parenthesis, row-wise percentage distribution is given.

Appendix Table A13

Distribution of Loan by Purpose of Loan

	Purpose of Loan						
	Fertiliser	Pesticides	Seeds	Poultry Feed	Farm Machinery	Consumption	Total
Type of Lenders.							
Commission Agents	22.2	22.2	33.3	–	11.1	11.1	100
Input Dealers	40.0	33.3	26.7	–	–	–	100
Commission Agents/Input Dealers	43.8	31.3	18.8	–	6.3	–	100
Processing Units	–	–	100	–	–	–	100
Moneylenders	22.2	15.0	17.8	–	28.9	15.6	100
Shopkeepers	33.3	–	33.3	–	–	33.3	100
Others	33.3	–	–	33.3	–	33.3	100
Province/Region							
Punjab	26.8	24.4	19.5	2.4	22.0	4.9	100
Sindh	26.3	15.8	21.1	–	15.8	21.1	100
Other Provinces	46.2	23.1	30.8	–	–	–	100
Ecological Zones	22.2	22.2	33.3	–	11.1	11.1	100
Irrigated Areas	40.0	33.3	26.7	–	–	–	100
Non-irrigated Areas	43.8	31.3	18.8	–	6.3	–	100
All	29.3	20.7	21.7	1.1	16.3	10.9	100
All (Lenders Distribution %)	(27.2)	(14.3)	(12.0)	(4.6)	(11.6)	(30.3)	100

Sources: The 1996 Survey of Informal Lenders.

Appendix Table A14

Reasons for Non-payment of Loans

Reason for Non-payment of Loan	Types of Informal Lenders							
	Commission Agents	Input Dealers	Commission Agents/Input Dealers	Landlords/ Farm Machinery Suppliers	Professional Moneylenders	Shopkeepers	Others	All Lenders
Financial Difficulty	51.0	42.6	50.0	47.5	50.0	53.9	58.6	50.4
Crop Failure	32.7	41.0	37.5	42.4	26.6	30.4	20.7	35.4
Natural Disaster	14.3	6.6	7.1	5.6	14.3	7.8	12.1	7.8
Others	2.0	9.8	5.4	4.5	7.1	7.9	8.6	5.3
All Reasons	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.

Sources: The 1996 Survey of Informal Lenders.

Appendix Table A15

Percentage Distribution of Lenders by Steps Undertaken to Recover Loans

Reason for Non-payment of Loan	Types of Informal Lenders							
	Commission Agents	Input Dealers	Commission Agents/Input Dealers	Landlords/ Farm Machinery Suppliers	Professional Moneylenders	Shopkeepers	Others	All Lenders
Personal Pressure	85.9	73.8	77.6	89.2	58.8	73.8	74.1	78.6
Social Pressure	12.5	19.0	19.7	7.8	41.2	22.1	13.8	16.2
Through Court	0.0	2.4	2.6	0.6	0.0	1.6	–	1.8
Other Steps	0.0	2.4	0.0	0.0	0.0	0.0	3.4	0.7
No Steps Taken	1.6	2.4	0.0	2.4	0.0	2.5	8.6	2.8
All	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: The 1996 Survey of Informal Lenders.

APPENDIX B

DEMOGRAPHIC AND SOCIO-ECONOMIC PROFILE OF INFORMAL LENDERS

The background characteristics of informal lenders may reflect their abilities to generate the required resources for lending business. They may also define the context in which recovery of loans is ensured. Some demographic and socio-economic characteristics of informal lenders are discussed below.

Age of Informal Lenders at the Time of Survey

Forty percent of informal lenders were concentrated in relatively older age group, 45+ (Appendix Table B1). About one-third of them were less than 35 years old at the time when the survey was conducted. Another one-quarter of the lenders were in age group of 35–45. Age distribution of the lenders did not change much when controlled by their types, though owners of the processing units and commission agents were older than other types of informal lenders. This pattern of age distribution did not even change when the data were controlled for provinces and ecological zones (Appendix Tables B2–B7).

Education

As compared to national literacy level, informal lenders had a fairly high level of literacy. About 80 percent of Lenders covered in the survey were literate, while according to the 1981 Population Census approximately 36 percent of male population aged 15 years or older in the country was literate. The higher level of literacy among informal lenders could be attributed to their types of business activity where a great amount of record keeping may be needed.

After controlling for types of lenders, educational distribution of informal lenders slightly changed. Commission agents and input dealers appear to be more educated than other types of informal lenders (Appendix Table B1). The reason for this distribution could be that the commission agents and the input dealers usually maintain small offices and they use sub-agents to keep contact with their clients. The other likely reason is that they have to deal with the agents designated manufacturing companies of fertiliser and pesticides and who are well educated. High level of educational attainment may help them in these dealings. Appendix Tables B2 to B7 show that proportion of informal lenders having matriculation or higher level of education was relatively higher in Sindh and non-irrigated areas than in other provinces and ecological zones.

Land Ownership

Land owned by informal lenders covered in the survey is also included in Appendix Tables B1-B7. Land holding may be an important factor in mobilising the resources and in recovering the loans. Its use as collateral to obtain loan from

Appendix Table B1

Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96 (Pakistan)

Socio-demographic Characteristics of Informal Lenders	Types of Informal Lenders								
	Commission Agent	Input Dealer	Commission Agent/Input Dealer	Processing Unit	Landlord/Farm Machinery Suppliers	Professional Money lender	Shopkeeper	Others	All Lenders
Age at the Time of Survey									
< 35 Years	20.3	35.7	28.4	8.3	32.7	17.1	47.7	38.3	32.9
35 – 45 Years	28.0	28.6	25.5	20.8	24.5	37.1	24.2	33.0	26.7
45+ Years	51.7	35.7	46.1	70.8	42.9	45.7	28.2	28.7	40.4
Education									
No Schooling	5.9	7.1	8.8	8.3	20.6	17.1	16.8	10.4	14.1
Primary	8.5	19.6	21.6	16.7	22.3	8.6	27.5	24.3	17.0
Middle	21.2	15.2	16.7	4.2	13.5	37.1	17.4	21.7	17.0
Matric	34.7	23.2	35.3	12.5	19.8	20.0	24.8	19.1	23.9
F.A.	19.5	18.8	8.8	16.7	8.5	14.3	8.7	7.8	11.3
B.A. and Above	10.2	16.1	8.8	41.7	15.4	2.9	4.7	16.5	13.0
Land Ownership									
No Land	32.2	42.9	41.2	50.0	8.5	14.3	67.1	49.6	32.7
1 – 6 Acres	13.6	18.8	19.6	4.2	8.8	34.3	24.2	29.6	16.9
7 – 12 Acres	22.0	10.7	19.6	4.2	12.6	34.3	4.7	7.8	13.1
13 + Acres	32.2	27.7	19.6	41.7	70.1	17.1	4.0	13.0	37.4
Lending Experience									
< 5 Years	17.8	34.8	25.7	17.4	28.1	44.1	32.4	38.1	29.5
5 – 10 Years	32.2	33.0	33.7	30.4	30.5	29.4	34.5	26.5	31.4
10 + Years	50.0	32.1	40.6	52.2	41.4	26.5	33.1	35.4	39.1
Previous Occupation									
No Job before this Job	60.2	55.4	49.0	70.8	66.2	28.6	68.9	49.6	59.9
Government/Private Services	4.2	13.4	14.7	12.5	5.8	17.1	10.1	10.4	9.0
Farming	18.6	13.4	24.5	8.3	20.1	45.7	12.8	12.2	18.3
Others	16.9	17.9	11.8	8.3	8.0	8.6	8.1	27.8	12.8
Total	100.00	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
(N)	(118)	(112)	(102)	(24)	(364)	(35)	(149)	(115)	(1018)

Source: The 1996 Survey of Rural Informal Lenders.

Appendix Table B2

Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96
(Punjab)

Socio-demographic Characteristics of Informal Lenders	Types of Informal Lenders								
	Commission Agent	Input Dealer	Commission Agent/In–put Dealer	Processing Unit	Land lord/Farm Machinery Suppliers	Professional Money lender	Shopkeeper	Others	All Lenders
Age at the Time of Survey									
< 35 Years	18.4	31.4	28.0	–	27.6	10.2	42.5	46.5	29.0
35 – 45 Years	28.7	29.4	21.3	27.3	23.8	38.5	19.2	25.6	25.0
45+ Years	52.9	39.2	50.7	72.7	48.6	42.3	38.4	27.9	45.9
Education									
No Schooling	6.9	7.8	9.3	9.1	28.1	19.2	21.9	18.6	18.0
Primary	6.9	25.5	20.0	18.2	20.0	11.5	32.9	32.6	20.7
Middle	23.0	17.6	16.0	9.1	15.1	30.8	20.5	20.9	18.5
Matric	37.9	19.6	38.7	18.2	24.3	19.2	21.9	14.0	26.5
F.A.	18.4	19.6	8.0	18.2	7.3	15.4	2.7	4.7	10.0
B.A. and Above	6.9	9.8	8.0	27.3	5.4	3.2	–	9.3	6.4
Land Ownership									
No Land	25.3	15.7	24.0	27.3	3.8	11.5	45.2	37.2	20.0
1 – 6 Acres	11.5	25.5	25.3	9.1	15.1	30.8	41.1	30.2	22.1
7 – 12 Acres	29.9	15.7	25.3	9.1	18.9	38.5	9.6	11.6	20.1
13 + Acres	33.3	43.1	25.3	54.5	62.2	19.2	4.1	20.9	37.7
Work Experience as Informal Lenders									
< 5 Years	20.7	37.3	26.7	9.1	31.9	50.0	35.6	37.2	31.2
5 – 10 Years	35.6	29.4	34.7	27.3	31.9	30.8	31.5	30.2	32.3
10 + Years	43.7	33.3	38.7	63.6	36.2	19.2	32.9	32.6	36.5

Source: The 1996 Survey of Rural Informal Lenders.

Appendix Table B3

Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96

(Sindh)

Socio-demographic Characteristics of Informal Lenders	Types of Informal Lenders								
	Commission Agent	Input Dealer	Commission Agent/Input Dealer	Processing Unit	Landlord/Farm Machinery Suppliers	Professional Moneylender	Shopkeeper	Others	All Lenders
Age at the Time of Survey									
< 35 Years	23.8	57.1	33.3	18.2	43.1	–	55.4	36.7	43.2
35 – 45 Years	19.0	25.0	33.3	9.1	24.6	–	28.6	40.0	26.5
45+ Years	57.1	17.9	33.3	72.7	32.3	–	16.1	23.3	30.3
Education									
No Schooling	4.8	3.6	33.3	9.1	8.5	–	10.7	6.7	7.5
Primary	9.5	21.4	22.2	18.2	25.4	–	23.2	33.3	24.5
Middle	14.3	14.3	16.7	–	10.8	–	14.3	16.7	12.9
Matric	23.8	21.4	16.7	9.1	16.2	–	26.8	3.3	17.7
F.A.	28.6	14.3	16.7	18.2	8.5	–	12.5	10.0	12.2
B.A. and Above	19.0	25.0	11.1	45.5	30.8	–	12.5	30.0	25.2
Land Ownership									
No Land	71.4	96.4	94.4	81.8	12.3	–	96.4	90.0	56.1
1 – 6 Acres	4.8	–	–	–	2.3	–	–	–	1.4
7 – 12 Acres	–	–	–	–	6.2	–	–	3.3	3.1
13 + Acres	23.8	3.6	5.6	18.2	79.2	–	3.6	6.7	39.5
Work Experience as Informal Lenders									
< 5 Years	9.5	32.1	22.2	30.0	25.5	–	25.5	31.0	25.5
5 – 10 Years	19.0	42.9	38.9	40.0	29.4	–	45.5	31.0	34.6
10 + years	71.4	25.0	38.9	30.0	45.1	–	29.1	37.9	39.9

Source: The 1996 Survey of Rural Informal Lenders.

Appendix Table B4

Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96 (NWFP/Balochistan/AJK)

Socio-demographic Characteristics of Informal Lenders	Types of Informal Lenders								
	Commission Agent	Input Dealer	Commission Agent/Input Dealer	Processing Unit	Landlord/Farm Machinery Suppliers	Professional Moneylender	Shopkeeper	Others	All Lenders
Age at the Time of Survey									
< 35 Years	30.0	24.2	22.2	–	24.5	11.1	45.0	31.0	27.6
35 – 45 Years	40.0	30.3	44.4	50.0	26.5	33.3	30.0	35.7	32.2
45+ Years	30.0	45.5	33.3	50.0	49.0	55.6	25.0	33.3	40.2
Education									
No Schooling	–	22.2	–	–	24.5	11.1	15.0	4.8	13.2
Primary	20.0	9.1	11.1	–	22.4	–	20.0	9.5	14.4
Middle	20.0	12.1	11.1	–	14.3	55.6	15.0	26.2	19.0
Matric	30.0	30.3	44.4	–	12.2	22.2	30.0	35.7	26.4
F.A.	10.0	21.2	–	–	14.3	11.1	20.0	9.5	13.8
B.A. and Above	20.0	18.2	11.1	100	12.2	–	–	14.3	13.2
Land Ownership									
No Land	10.0	39.4	77.8	–	16.3	22.2	65.0	33.3	33.3
1 – 6 Acres	50.0	24.2	11.1	–	2.0	44.4	30.0	50.0	26.4
7 – 12 Acres	–	12.1	11.1	–	6.1	22.2	–	7.1	7.5
13 + Acres	40.0	24.2	–	100	75.5	11.1	5.0	9.5	32.8
Work Experience as Informal Lenders									
< 5 Years	10.0	33.3	25.0	–	18.2	25.0	40.0	43.9	31.1
5 – 10 Years	30.0	30.3	12.5	–	27.3	25.0	15.0	19.5	23.5
10 + Years	60.0	36.4	62.5	100	54.5	50.0	45.0	36.6	46.4

Source: The 1996 Survey of Rural Informal Lenders.

Appendix Table B5

Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96
(Irrigated Areas)

Socio-demographic Characteristics of Informal Lenders	Types of Informal Lenders								
	Commission Agent	Input Dealer	Commission Agent/Input Dealer	Processing Unit	Landlord/Farm Machinery Suppliers	Professional Moneylender	Shopkeeper	Others	All Lenders
Age at the Time of Survey									
< 35 Years	20.0	35.5	28.7	9.1	33.1	23.1	51.7	43.1	33.9
35 – 45 Years	30.0	31.2	23.4	18.2	23.9	38.5	21.7	31.9	26.1
45+ Years	50.0	33.3	47.9	72.7	43.0	38.5	26.7	25.0	40.0
Education									
No Schooling	6.0	7.5	7.4	9.1	19.3	19.2	18.3	13.9	14.2
Primary	8.0	20.4	22.3	18.2	21.6	11.5	29.2	33.3	21.6
Middle	22.0	14.0	17.0	4.5	12.8	23.1	15.8	16.7	15.4
Matric	34.0	20.4	34.0	13.6	21.3	23.1	24.2	8.3	23.3
F.A.	23.0	19.4	9.6	18.2	8.5	19.2	6.7	8.3	11.9
B.A. and Above	7.0	18.3	9.6	36.4	16.4	3.8	5.8	19.4	13.6
Land Ownership									
No Land	34.0	43.0	38.3	50.0	8.2	15.4	71.7	59.7	33.5
1 – 6 Acres	12.0	18.3	20.2	4.5	10.2	26.9	20.0	18.1	14.9
7 – 12 Acres	23.0	11.8	20.2	4.5	14.8	38.5	4.2	6.9	14.3
13 + Acres	31.0	26.9	21.3	40.9	66.9	19.2	4.2	15.3	37.3
Work Experience as Informal Lenders									
< 5 Years	16.0	34.4	25.5	14.3	29.7	53.8	31.9	31.4	28.9
5 – 10 Years	34.0	35.5	35.1	33.3	30.8	26.9	37.8	32.9	33.4
10 + Years	50.0	30.1	39.4	52.4	39.5	19.2	30.3	35.7	37.7

Source: The 1996 Survey of Rural Informal Lenders.

Appendix Table B6

Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96 (Semi-irrigated Areas)

Socio-demographic Characteristics of Informal Lenders	Types of Informal Lenders								
	Commission Agent	Input Dealer	Commission Agent/Input Dealer	Processing Unit	Landlord/Farm Machinery Suppliers	Professional Moneylender	Shopkeeper	Others	All Lenders
Age at the Time of Survey									
< 35 Years	25.0	16.7	–	100	18.5	–	20.0	–	17.5
35 – 45 Years	25.0	33.3	33.3	–	25.9	50.0	60.0	–	31.6
45+ Years	50.0	50.0	66.7	–	55.6	50.0	20.0	100	50.9
Education									
No Schooling	–	16.7	–	100	33.3	–	20.0	–	19.3
Primary	–	16.7	–	–	22.2	–	20.0	–	14.0
Middle	–	–	33.3	–	11.1	100	20.0	100	19.3
Matric	–	33.3	66.7	–	14.8	–	20.0	–	26.3
F.A.	25.0	16.7	–	–	11.1	–	20.0	–	8.8
B.A. and Above	50.0	16.7	–	100	7.4	–	20.0	–	12.3
Land Ownership									
No Land	16.7	66.7	66.7	–	14.8	–	100	100	31.6
1 – 6 Acres	16.7	–	–	–		100	–	–	7.0
7 – 12 Acres	16.7	–	33.3	–		–	–	–	5.3
13 + Acres	50.0	33.3	–	100	85.2	–	–	–	56.1
Work Experience as Informal Lenders									
< 5 Years	16.7	–	33.3	–	16.0	–	40.0	100	18.2
5 – 10 Years	33.3	33.3	–	–	24.0	–	–	–	21.8
10 + Years	50.0	66.7	66.7	–	60.0	100	60.0	–	60.0

Source: The 1996 Survey of Rural Informal Lenders.

Appendix Table B7

Percentage Distribution of Informal Lenders by their Socio-economic Background Characteristics and Types of Lenders, 1995-96

(Non-irrigated Areas)

Socio-demographic Characteristics of Informal Lenders	Types of Informal Lenders								
	Commission Agent	Input Dealer	Commission Agent/In–put Dealer	Processing Unit	Landlord/Farm Machinery Suppliers	Professional Money lender	Shopkeeper	Others	All Lenders
Age at the Time of Survey									
< 35 Years	16.7	46.2	40.0	–	40.6	–	33.3	31.0	33.1
35 – 45 Years	–	7.7	60.0	–	28.1	28.6	29.2	35.7	28.5
45+ Years	83.3	46.2	–	100	31.1	71.4	37.5	33.3	38.5
Education									
No Schooling	16.7	–	40.0	–	21.9	14.3	8.3	4.8	11.5
Primary	33.3	15.4	20.0	–	28.1	–	20.8	9.5	17.7
Middle	–	30.8	–	–	21.9	71.4	25.0	28.6	26.2
Matric	16.7	38.5	40.0	–	9.4	14.3	29.2	38.1	26.9
F.A.	–	15.4	–	–	6.3	–	16.7	7.1	8.5
B.A. and Above	33.3	–	–	–	12.5	–	–	11.9	9.2
Land Ownership									
No Land	33.3	30.8	80.0	100	6.3	14.3	37.5	31.0	27.7
1 – 6 Acres	33.3	30.8	20.0	–	3.1	42.9	50.0	50.0	33.8
7 – 12 Acres	16.7	7.7	–	–	3.1	28.6	8.3	9.5	8.5
13 + Acres	16.7	30.8	–	–	85.5	14.3	4.2	9.5	30.0
Work Experience as Informal Lenders									
< 5 Years	50.0	53.8	25.0	100	23.3	16.7	33.3	47.6	38.1
5 – 10 Years	–	15.4	25.0	–	33.3	50.0	25.0	16.7	23.0
10 + Years	50.0	30.8	50.0	–	43.3	33.3	41.7	35.7	38.9

Source: The 1996 Survey of Rural Informal Lenders.

formal sources is well established. The data show that informal lenders differ widely in land ownership. One-third of lenders covered in the survey did not own any land. This percentage decreased to 20 in the case of Punjab, while it increased to 56 percent for Sindh province. It is difficult to explain this difference. However, one possible explanation could be that Sindhi landlords might not usually engage themselves for their livelihood in any activity except land cultivation. This ambiguity clears off once land ownership is examined after controlling for types of lenders. Table B3 shows that in Sindh, the majority of commission agents, input dealer and shopkeepers did not have access to land, suggesting that except landlords persons involved in lending business in Sindh generally did not own land. Probably they were based in small towns from where they run their businesses.

Lending Experience

Lending experience could be particularly important in reducing the cost, screening loan applicants and recovery of loans. Informal lenders in all regions have a fair level of work experience of business (Appendix Table B1–B7). More than one-third of the informal lenders had more than 10 years experience of this business. Processing units and commission agents had the longest experience in all provinces and ecological zones.

With some reservations, it can be claimed that emergence of professional moneylenders in Punjab is a new phenomenon (Appendix Table B2). About 50 percent of professional moneylenders in this province had less than five years experience in the lending business. It has been observed during the case studies conducted in different parts of Punjab that many professional moneylenders are migrants who have returned from the Middle East (See Section 4). Probably overseas savings enabled them to lend money to rural needy people against a fixed amount of interest rate. However, it is not possible to confirm this link from the survey of informal lenders.

Occupations before the Job of Informal Lending

Appendix Table B1 shows that about 40 percent of the informal lenders covered in the survey had a job before they entered into lending business. This proportion was substantially higher among professional moneylenders than among other types of lenders. More than one-quarter of informal lenders who had a previous job were employed in the service sector. It is likely that the desire to become self-employed has pulled them in the lending business.

In brief, informal lenders covered in the survey were primarily in the middle age group and their level of education was fairly high compared with that of the nation as a whole. Except informal lenders who were operating in Sindh, vast majority of them owned some land. They had a fairly long experience of lending business. With all these background characteristics, lenders seem to be in a good position not only to generate resources for their business but also to recover timely the extended loans.

APPENDIX C

CASE STUDIES

In view of the several shortcomings of the questionnaire approach as discussed earlier (see Section 2), it was decided to supplement the survey data with four case studies. In April, 1997, four teams of researchers, one from the PIDE and three from the PERI, were sent to four small towns of Punjab to stay there for about three to four days. These researchers, who were familiar with the selected areas, were advised to use informal methods to examine in depth the social relations and borrowing and lending activities of both the lenders and the borrowers. The research teams identified the key lenders and gained their confidence. It is important to note that at no time did the researchers attempt a precise measure of the size and turnover of these lenders' business. Although the observations made in this section are based on very short visits to the study areas, they did help in understanding the mechanisms of informal credit market.

The Geographic Setting

Four case studies were conducted in four small towns of Punjab: Samundari and Tandlianwala (district Faisalabad), Kacha Khoh (district Multan) and Zahir Pir (district Rahim Yar Khan). The selection of these towns was arbitrary, mainly dictated by the availability of researchers. The selected localities represent well the irrigated areas of Punjab. Time was the main constraint to send teams to non-irrigated areas of Punjab or to other provinces, where the structure of credit market could be different from that of the study area.

Samundari and Tandlianwala tehsils are situated in the 'mixed cropping zone' where maize; cotton, sugarcane and rice are the major crops, while Kacha Khoh and Zahir Pir are in the cotton zone. However, sugarcane and wheat are also the common crops of this zone. Both the mixed and cotton zones have well-established canal system. In the former (mixed), irrigation water is supplied through the canals for both seasons - *Rabi* and *Kharif*, while the canal water is available only for the *Rabi* season in the case of cotton zone. A network of tubewells, mainly private, provides irrigation water for *Kharif* season in the cotton zone.

In irrigated areas the financial requirements of farmers to purchase agricultural inputs, such as seeds, pesticides and fertiliser, have increased over time. This has increased the demand for credit. Influential persons such as landlords obtain the loans from formal credit system like Agricultural Development Bank of Pakistan (ADBP), situated mainly in tehsil headquarters. But the long and complex process of the ADBP seems to have forced many needy farmers to borrow from the informal lenders on relatively higher interest rates.

Structure and Composition of Informal Market

The structure of informal credit market differs across different areas, primarily depending on the size of the market, type of commodity transacted, location and proximity to the processing facilities.

Samundari, for instance has a good grain market where about 200 commission agents are presently operating (Appendix Table C1). These agents play a vital role in providing credits to local farmers. More than 50 input dealers are also working in Samundari. The researchers were also able to identify 8 professional moneylender operating in this town (Appendix Table C1). Besides one sugar mill, couple of ginning factories are also engaged in lending business.

Appendix Table C1

Type and Number of Informal Lenders Identified by Study Areas

Type of the Lenders	Name of Areas			
	Samundari	Tandlianwala	Zahir Pir	Kacha Khoh
Commission Agent	200	5	5	20
Input Dealers	50	20	12	15
Moneylenders	8	5	3	–
Ginning Factories	3	10	2	18
Sugar Mills	1	2	–	–
Oil Mills	–	3	2	10
Rice Mills	1	5	–	–
Poultry Feed Production Units	5	–	–	–

Samundari provides a good opportunity to study the mechanism of the non-institutional credit market, since farmers can obtain loan in cash or kind from the lenders situated in the town and they can also sell their outputs. Tandlianwala has a relatively small grain market (Appendix Table C1). Only 5 commission agents and 20 input dealers operate in this town. There is a concentration of processing units in Tandlianwala but according to our research team the role of these units in providing loans to farmers is very limited. To ensure the supply of the required inputs, they do sometimes lend through their agents. In Zahir Pir and Kacha Khoh, informal credit market is mainly controlled by input dealers and commission agents. Kacha Khoh is situated on the National Highway where several ginning cum oil factories are operating. There are only two ginning factories in Zahir Pir. Hye-Sons Sugar Mills is situated at a distance of 30 kilometres from this small town. Another sugar mill is operating in Sadiqabad and has its depots in the area. Functions of the informal lenders by different categories are discussed below.

Input Dealers

Input dealers usually sell pesticides, fertiliser and seeds on cash and credit. To know the role of input dealers as lenders, it is important to understand the whole business of inputs, particularly pesticides and fertiliser. Presently, more than two dozen manufacturing companies are selling their products (pesticides) in the study areas. Some of these companies, such as Ciba-Gaigy and Bayer, are multinationals. The national companies were also allowed in 1992 to bring their products in the market. Most of the manufacturers market pesticides through their well-educated, well-paid and trained sales officers, who keep close contacts with local input dealers and large farmers.

For the cotton crop, pesticides are used between the months of June and September. However, all pesticide manufacturing companies start booking in advance for their products from January. For input dealers (and for farmers), early booking means high commission, which varies by manufacturers. Multinationals offer 25 percent commission on early booking. This percentage rises to 60 percent in the case of some national manufacturers. However, it declines to only 10 percent or even less if booking is made during the months of June and September when the demand for pesticides is at its peak. The commission is given on the Maximum Retail Price (MRP) written on every box or bottle of a pesticide. In addition domestic producers also give rebate on total sales, which varies from 2 to 7 percent.

Input dealers are usually obliged to pay full amount at the time of booking. However, in 1997, some companies made the booking on only 25 percent advance payment. Some local companies were willing to make the bookings without any advance payment. Sales agents of different companies play a vital role in the size of the bookings. They are usually given targets by their respective companies hence they have developed close contacts with local growers, input dealers and commission agents.

The question is at what price the booked pesticides are sold to farmers? Cash price of different pesticides is usually much lower than the MRP, and several additional factors determine it. The pesticides market is not monopolistic in its nature; rather it seems to be highly competitive. For cash transactions, input dealers give up a major part of their commissions (Appendix Table C2) in the hope of getting some 'rebate' from the respective companies. Some time they sell pesticides without any profit, in other words, they pass on all the commission to the cash buyer. Time is also an important factor in determining the cash prices of pesticides. During the months of January and May, when the use of pesticides is limited to vegetables and orchards, input dealers sell them on a very low profit.

Credit prices of pesticides differ widely from the cash prices. For sale on credit, input dealers not only receive the full MRP of a pesticide but sometimes they also charge more than the MRP, particularly on the products of multinational companies, such as Ciba-Gaigy and Bayre, which give relatively low commissions. However, it is common among input dealers to sell on credit those pesticides,

Appendix Table C2

Cash and Credit Prices of Different Pesticides

Name of the Pesticides	Manufacturer	Maximum Retail Price (almost equal to credit price (Rs)	Permissible Commission on Advance Booking %	Permissible Commission on Advance Booking Rs	Cash Price (Rs.)	Commission Passed to Cash Buyer (%)	Estimated Mark-up (%)
Methomidophos (1 Litre)	Agro-Pak	425	50	212	225	47	89
Cypermetharin (1 Litre)	National Intextiside	740	50	370	400	46	85
Polybion C (500 ML)	Ciba-Gaigy	424	25	106	400	6	6

which give them high rate of commission. Therefore input dealers' mark-up on pesticides depends on the nature of product being sold and also on the status of association between the borrower and the dealer. It is highly likely that price of an input sold on credit varies substantially among borrowers.

The question is why does commission vary substantially across the different pesticides? One possibility is that the quality of those pesticides that are being sold on 60 percent or more commission is very low. According to some key informants, pesticides sold on a high commission contain only half of the recommended dose. It means low quality pesticides are currently being sold on credit to farmers on very high prices, which entails exploitative rates of mark-up.

The case of fertiliser is different from the pesticides. Any dealer can arrange booking for the required quantity of fertiliser by sending full payment through a bank draft to the nearest fertiliser manufacturer. The dealers are eligible to receive only eight rupees per bag as their commission. Generally this commission is the only profit, if they sell it on cash. However, if they sell it on credit, they charge an extra one hundred rupees on each bag of fertiliser. The current market (cash) price of a bag of fertiliser (urea) is 350 rupees, thereby yielding a 29 percent mark-up rate for the dealers selling on credit.

Some input dealers also sell seeds and oil cakes, particularly in Samundari and Tandlianwala. These inputs are usually sold in cash. In the case of sale on credit, not only is the duration of loan very short, one to two months only, but also the mark-up is quite high, 10 to 20 percent for this short duration.

Input dealers generally extend credit without any collateral or written agreement. Recovery of loans is usually smooth. Farmers, because of both their close contacts with the dealers and in view of their future needs for credit, tend to return the money borrowed well in time. However, in the case of crop failure, which has been the case in Zahir Pir area over the last three years, recovery of full loan was very difficult. Unlike moneylenders who charge compound interest rate after the due date, input dealers usually wait for the next crop for recovery of their loans without increasing their interest.

It appears that in general input dealers are meeting effectively the needs of local farmers. However, their mark-up on some pesticides such as Methomidophos and Cypermetharin (Appendix Table C2) is very high, mainly because of the high-commission policy of their manufacturers. To the extent this high rate of commission facilitates the sale of sub-standard pesticides it should constitute a source of concern. Some quality control on these types of pesticides can reduce this high mark-up.

Commission Agents

In Pakistan grain markets are generally situated at the tehsil headquarters, although some small towns also have well-established markets. As noted earlier, in the areas covered by the present study, only Samundari has good grain market where about 200 commission agents operate (Appendix Table C1). Observations made below are mainly based on the functions of the commission agents located in this town.

Commission agents generally do not sell inputs directly to farmers. However, they do meet the requirements of their customers indirectly, through the local input dealers. A very close link between the commission agents and input dealers has developed in Samundari. The former asks input dealers to provide the required inputs to their customers, wherein the money is paid within one week. This payment is made on the basis of prevailing cash prices of the inputs sold. However, the commission agents charge their customers the MRP, so, they earn a mark-up on supply of inputs similar to that being earned by input dealers.

Farmers who buy inputs on credit from commission agents are generally bound to sell their outputs through them on a fixed commission, usually one percent. The profit of commission agents can be further increased if they buy outputs from the farmers whom they extend loans. It is also not uncommon among the local commission agents to lend money to farmers without interest on the surety that the borrowers will sell outputs to them.

An indirect link was also found between the members of local co-operative societies and the commission agents. The co-operative societies give loans to their members on 13 percent annual interest. If it is not possible for a member to return his loan and the amount of interest on due date, he contacts a commission agent for payment. The commission agent receives a profit equal to 5 percent of the total payment. Within a day or two, the member reobtains the loan and returns the actual amount in addition to 5 percent to the commission agent, both.

Commission agents, who sometimes provide short-term loans without interest to facilitate farmers to buy fertiliser and pesticides, also control vegetable markets. According to key informants, high rate of commission, 7 to 9 percent, prevailing in the vegetable markets is the main reason for this interest-free lending practice. An interesting network has been developed between the tomato-growers in the surrounding areas of Zahir Pir (district Rahim Yar Khan) and commission agents situated in Karachi fruit and vegetable market. In these areas, production of tomato exceeds the local demand; therefore, the growers sell their produce in Karachi. Some farmers obtain small interest-free loans for short duration from the commission agents, through their local sub-agents.

Moneylenders

Lending money on interest is not a very old phenomenon in Punjab. Moneylenders who have currently been lending money started their businesses during the last 8 to 10 years. It is difficult to know precisely how and why did they enter in the business of lending. But it seems that occasional failure of cotton crops during the last decade was the main reason for their entry. The crop failure not only limits the capacity of farmers to return their loans but it also hinders traditional lenders, such as commission agents, to extend loans to farmers. This gap was filled by individuals who had some savings to be loaned. Some of these individuals had a chance to work in the Middle East. Moneylenders charge high interest rates, which may have enabled them to accumulate these savings in a short period of time.

Moreover, the role of moneylenders has diversified over time. In the study areas, they lend money to farmers, commission agents, input dealers and livestock dealers. Duration of loans and rate of interest vary across the types of borrowers. It is useful to discuss these variations in detail.

Moneylenders and Farmers

The research team in Zahir Pir was able to identify five moneylenders operating in the town and its surrounding rural areas. These lenders usually lend money to farmers through a mediator - the local councillor or landlord. Annual interest rate charged by these lenders varies between 40 and 50 percent. In 1996 only one moneylender distributed a loan of Rs 2.5 million in one village on 50 percent annual interest. One-fourth of this amount was loaned to the mediator's elder brother. To ensure the recovery of loan, a written agreement was also signed between the two parties, and witnesses were selected by the lenders. Rate of interest or the amount of total interest was not shown in the agreement separately. Rather it was considered as part of the capital amount. For example, if a farmer has borrowed 100,000 rupees on 40 percent interest rate, he was required to sign on a legal document showing that he has received 140,000 rupees as simple loan without any interest rate to be paid (Qarz-i-Hasna). This enables the moneylender to use legal apparatus to recover the amount specified in the agreement.

One moneylender has recently introduced a new collateral system through which he gets a written statement from the farmer who borrows money that he has sold a fixed piece of land against the amount borrowed. Because of these terms and conditions, this moneylender was able to get two acres of agricultural land in 1996 from one of his defaulters. For loan adjustment, the same moneylender took in his possession a tractor of a farmer. Two other farmers sold their lands to return the loan. Three consecutive crop (cotton) failures have limited the capacity of local farmers to return their loans; therefore they were forced to sell their property for loan adjustment.

In rural areas surrounding Samundari and Tandlianwala, moneylenders operate in a different way. They lend relatively small amounts of money on 10 to 13 percent monthly interest rate (Appendix Table C3). Small farmers or landless households usually take these high-interest loans for their consumption needs or health care. Duration of loan is very short and jewellery is the common form of collateral. Amount of interest is paid monthly to lenders. Delay in payment gives the lenders opportunity to demand for return of total loan. This recovery is sometimes made by selling the jewellery taken as collateral or by collecting farm animals from the borrowers.

Appendix Table C-3

Transaction of Five Moneylenders in Samundari Tehsil

Moneylender	Total Experience of Lending Business (Years)	Amount Loaned (Rs)	Monthly Interest Rate (percent)	Number of Borrower	Main Purpose of Loan
1	15	150,000	10	10	Livestock purchase
2	5	45,000	10	3	Consumption
3	4	115,000	13	8	Health/livestock
4	12	350,000	4	2	Business
5	2	35,000	10	–	Consumption

Moneylenders and Commission Agents/Input Dealer

It was noted in the beginning of this section that in the four study areas, only Samundari has a good grain market where about 200 commission agents operate (Appendix Table C1). The research team designated in this area was able to identify a link between the local commission agents and moneylenders. Eight moneylenders operating in the town lend money only to local commission agents. The amount of loan is usually more than 100,000 rupees and interest rate is 4 percent per month. Commission agents who obtain loan from moneylenders are required to pay the amount of interest monthly. The regular payment of interest refrains lenders to demand for the principle amount. However, because of the high interest rate, borrowers (commission agents) usually return loan within three months. It is still unclear that what proportion of local commission agents borrow from moneylenders and, more importantly, why do they borrow on such high interest rate?

As noted earlier, under the prevailing system, input dealers need large amounts of money to make early bookings of pesticides, and moneylenders can be one of their sources of funds. In all areas covered by the present study, moneylenders do provide money to some input dealers for 6 to 7 months on 18 to 20 percent interest.

Moneylenders and Livestock Dealers

Moneylenders seem to be the major source of funds for livestock dealers who operate in the local markets (mandis) which are organised regularly in Samundari, Tandlianwala and several other places surrounding these towns. Livestock dealers borrow money from the local moneylenders on 4 percent monthly interest. Like commission agents, they are also required to pay the amount of interest every month. However, research teams did not have enough time to explore the details of this business. There is a need to carry out a study to work out the role of the moneylenders in the livestock business.

Processing Units

Cotton ginning factories, sugar mills, oil mills, rice mills and poultry feed production units are located in the different study areas. It was observed during the case studies that processing units have a very little direct role in informal financial market. There is a possibility that these units are involved in the lending business but the research team could not identify their role because of both their short duration of stay in the study areas and their focus on other informal lenders such as input dealers, commission agents and moneylenders.

Cotton-growers who take loans from factories sell them their outputs. The outputs are sold directly or through agents who receive a fixed commission from both the factories and the growers. Because of the supply of cotton, loan adjustment is easier for factories than for input dealers or moneylenders. However, growers who are bound to sell their outputs to factories are sometimes at a disadvantage, factory rate could be lower than the market rate. It happens when cotton production in some districts is lower than the demand of local cotton factories.

In Samundari poultry feed production units sell their produce on credit for 35 to 40 days. The mark-up for this period is about 4 percent. To ensure the recovery of loans, the production units are sometimes involved in the sale of birds (chicken). According to key informants, sugar mills used to provide loans to sugarcane growers in the mill area. In the wake of increased competition among the sugar mills to buy sugarcane at long distances, recovery of loans became problematic so the sugar mills stopped loaning to growers.

Despite the short time period the researchers were able to collect valuable information that would not have been available otherwise. Moneylenders have dual role in informal financial market: they lend money directly to farmers and livestock dealers and they are also a source of funds for other informal lenders, such as commission agents and input dealers. Their interest rate is well beyond 40 percent per annum. On small amounts, the monthly interest rate is about 10 percent. We are not in a position to claim that the role of moneylenders has been investigated comprehensively. Rather through these observations we have been able to show the importance of moneylenders in the non-institutional financial market. Further investigation will definitely enhance our understanding.

BIBLIOGRAPHY

Aleem, Irfan (1990) Imperfect Information, Screening and the Cost of Informal Lending. *The World Bank Economic Review* 4:3.

Applied Economic Research Centre (1986) *Specific Constraints Facing Small Farmers in Balochistan and Sindh*. AERC, Karachi.

Bahaduri (1973) Agriculture Backwardness Under Semi-Feudalism. *Economic Journal* 83:1 20–37

Bell, Clive (1990) Interaction Between Institutional and Informal Credit Agencies in Rural India. *The World Bank Economic Review* 4:3.

Bottomley, A. (1975) Interest Rate Determination in Underdeveloped Rural Areas. *American Journal of Agriculture Economics.* May.

Fernando, N. (1988) The Interest Rate Structure and Factors Affecting Interest Rate Determination in the Informal Rural Credit in Sri Lanka. *Saving and Development* 12:3.

Ibe, Aforka C. (1990) The Structure of Credit Market in Nigeria: Lessons from Awka Town of Anambra State. *African Review of Money, Finance and Banking.* A Supplementary Issue of Saving and Development.

Iqbal, Farrukh (1983) Demand for Funds by Agricultural Households: Evidence from Rural India. *Journal of Development Studies* 20:1.

Iqbal, Farrukh (1988) The Determinants of Moneylender's Interest Rate: Evidence from Rural India. *Journal of Development studies* 24:3.

Lipton, Michael (1976) Agricultural Finance and Rural Credit in Poor Countries. *World Development* 4:7.

Malik, S. J. (1989a) *The Changing Source Structure and Utilisation Patterns of Rural Credit in Pakistan.* Washington, D. C.: International Food Policy Research Institute, July.

Malik, S. J. *et al.* (1989b) Differential Access and the Rural Credit Market in Pakistan: Some Recent Evidence. *The Pakistan Development Review* 28:4.

Malik, S. J. (1990) Report on the Benchmark Rural Credit Survey. International Food Policy Research Institute. Report submitted to the Government of Pakistan/USAID, Islamabad.

Malik, S. J. (1992) Credit Constraints and Household Borrowing Behaviour: Impact on Household Consumption and Fertilizer Use in Selected Areas of Rural Pakistan. International Food Policy Research Institute, Washington, D.C. September. Mimeo.

Moll, H. A. J (1989) Farmers and Finance: Experience with Institutional Savings and Credit in West Java. Wageningen Agriculture University, The Netherlands.

Nisbet, S (1967) Informal Credit Market of Rural Chile. *Economic Development and Cultural Change* 16:1.

Pakistan, Government of (1974) Pakistan Rural Credit Survey 1973. Lahore: Agricultural Census Organisation.

Pakistan, Government of (1989) Pakistan Rural Credit Survey 1985. Lahore: Agricultural Census Organisation.

Punjab Economic Research Institute (1986) *Constraints Facing Small Farmers in Punjab.* PERI, Lahore.

Qureshi, S. K., K. Abbas, A. N. Siddiqui, and E. Ghani (1984) Rural Credit and Rural Development: Some Issues. *The Pakistan Development Review* 23:2&3.

Qureshi, S. K., and A Shah (1992) A Critical Review of Rural Credit Policy in Pakistan. *The Pakistan Development Review* 31:4.

Saimwala, A. *et al.* (1990) The Thai Rural Credit System: Public Subsidies, Private Information and Segmented Markets. *The World Bank Economic Review* 4:3.

Stiglitz, Joseph E., and Andrew Weiss (1981) Credit Rationing and Markets with Imperfect Information. *American Economic Review* 71: 393–410.

Udry, C. (1990) Credit Markets in Northern Nigeria: Credit as Insurance in a Rural Economy. *The World Bank Economic Review* 4:3.

Von Pischke, Dale W. Adams, and Donald Gordon (eds) (1983) *Rural Financial Markets in Developing Countries.*