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## **STRATEGIC LINKS BETWEEN BORROWING BEHAVIOUR AND PURPOSE OF CREDIT: EVIDENCE FROM INDIA**

### **Abstract:**

Microfinance bridges the credit gaps that formal financial institutions, like banks, are unable to meet for the rural populations. Micro Finance Institutions (MFIs) like Grameen Bank in Bangladesh, Bank Rakyat Indonesia and BancoSol in Bolivia have brought small credit, savings and other financial services within the reach of millions of financially excluded poor and uneducated.

This paper explores the workings of this credit market and the underlying strategies in borrowing and repayment in India through a primary field survey of 829 rural borrowers in four districts of the Indian states of Andhra Pradesh and Telangana. The paper seeks to answer the following four questions, namely, Do rural borrowers plan their borrowings? Does the purpose of credit decide the source of credit? Is there a demand and supply elasticity in credit market? Would mortgage borrowing behave differently?

Results, using regression models, show a link between borrowing behavior and the purpose of credit.

- Source of credit does depend upon the purpose of borrowing. Agriculture and business investment loans are more likely to be sourced from formal sources, and education and health loans, from informal sources. Loans for agriculture might be sourced from banks only in part, or may not be supplied in time for cropping season, forcing borrowers to approach money lenders

- The demand elasticity is minimal. Interest rates do not seem to impact borrowing, except for mortgage borrowing. More so for lifecycle needs like health and consumption, where all classes of borrowers borrow.

- Mortgage borrowers drop their investment plans during time-lag between application and approval of loans, pointing to supply-side constraints

- Small and marginal land-holders borrowing for mortgage, are likely to pay higher interest rate for money-lenders' loans. This shows that lenders follow a price rationing of credit to low collateral borrowers. That farmers and business investors default on money-lenders' loans shows that the latter, may have financed their investment in part. This shows that they do not get as much loan as applied for, from banks, pointing to size-rationing of credit.

The results show a clear debt-trap where borrowers could be borrowing from one source to repay another, or may be resorting to multiple borrowings for the same purpose, as predicted by Jain and Mansuri (2008), who observe that moneylenders finance loan installments.

### **Keywords:**

Credit; Purpose; Borrower; Behavior; India

**JEL Classification:** A14, C10