

# Some insights into the credit transactions of small - scale fishers along the Kerala coast, India

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## Abstract

This study examines the fishery credit delivery system in the state of Kerala that mainly involves informal players such as auctioneer-middlemen, third-party shareholders and private money lenders; and formal sources such as Matsyafed societies, co-operative banks, commercial banks and non-banking financial entities. The main features and credit contract conditions associated with each major type of credit source is discussed and their share in the credit basket of ring seine vessels is assessed empirically based on sample survey data collected from major landing centres. The findings from the study throw several insights into the general state of affairs related to Kerala's fishery credit delivery system and provide some policy prescriptions for improving the service delivery.

*Keywords: Small-scale fisheries, financial institutions, fisheries credit*

## Introduction

Credit plays a central role in propelling fishing and allied activities in developing economies. Fishers' dependence on credit to meet their operational and capital investment requirements have been ever-growing due to the increasing adoption of capital-intensive techniques in fishing. As in several other coastal economies, Kerala's marine fisheries sector accommodates distinct financial market systems with multifarious financial intermediaries, involved in diverse but regular credit-based economic transactions. There has been a steady growth in institutional financing of Kerala's marine fisheries over the past three to four decades, under the umbrella of the co-operative sector. The coverage of formal banking in the coastal belts has also undergone notable improvements during this period. Despite this, recent studies have shown the obstinate presence of informal financial institutions that wield significant economic-power among fishing communities in Kerala. Several reasons have been pointed out, that mainly include (i) the reluctance of the institutional agencies, including that of the co-operative sector, to risk their loanable funds beyond certain limits, given the inability of the fishers to offer entitlements other than a share of their harvest and (ii) the 'Banker on the Beach' advantage enjoyed by the informal sector. Further,

the informal credit system has evolved over the years, mainly by virtue of changes in ownership pattern of factors of production, investment requirements and the wider socio-economic fabric of the fisher folk community. Against this backdrop, this article discusses the broad categories of credit sources in Kerala's fishery sector, their inter-linkages, the main actors involved and their general features. Further, the results obtained from a primary survey is discussed to throw light on the fishers' predominant borrowing practices, types of credit contracts, the conditions of borrowing and repayment as well as the costs associated with certain predominant modes of borrowing. Various constraints in the way of financial inclusion are deliberated upon, and policy perspectives to circumvent them are discussed.

## Fishery credit market in Kerala: An overview

### Formal sector

The formal financial sector in Kerala's coastal arena includes the scheduled commercial banks such as public sector banks, private banks and regional rural banks (RRBs) as well as the cooperative banking institutions and societies.

The banking sector presently comprises of 43 commercial banks, one Regional Rural Bank (Kerala Gramin Bank), Kerala State Co-operative Bank with 14 affiliated District Co-operative Banks (DCBs), 1638 Primary Agriculture Co-operative Societies (PACS) and the Kerala State Agriculture and Rural Development Banks (PCARDBs). Besides these, the Kerala State Co-operative Federation for Fisheries Development Ltd. (Matsyafed) deals with diverse credit delivery services. The South Indian Federation of Fishermen Societies (SIFFS) is another non-governmental entity that provides a variety of services including small-scale credit to the artisanal fishermen. The National Marine Fisheries Census, 2010 reported a total of 289 bank branches and 276 fishery co-operative societies in the marine fishing villages of Kerala that to the financial requirements of fisher folk. Though bank lending has increased, both in terms of actual quantity of money disbursed and as a share of fisheries in priority sector lending, it is worth noting that the latter accounts to be less than one percent.

Matsyafed presently operates with a two-tier co-operative institutional framework with the apex body at the state level and the fishermen co-operative societies at the primary level. It has strategically placed itself in a unique position so as to meet the distinctive credit requirements of the fishing community in the best possible way, by abating the rigidities of the banking sector. Every loan granted by the Matsyafed Societies has a commission component and an interest component. Commission generally includes the charges towards the services, including auctioning, rendered by Matsyafed through its primary societies, as well as the mandated savings for the debtor fisher. Interest is a fixed charge decided at the time of disbursement of the loan. This is operationalised through designated auctioneers, who are empowered to auction fishers' harvests on behalf of Matsyafed Societies. They collect commissions as a percentage of gross value of catch per-trip. On getting good catches, a part of the proceeds (generally 40%) are deducted, which is subsequently apportioned between principal and interest. Such apportioning is made by the societies on a flexible basis considering the outstanding credit amount. The savings part collected is returned to the fishers as lump sum during festivals as bonus payments. The system in a way mimics the strategy of the informal lenders/auctioneers who accept a share of the fishers' harvest towards loan repayment.

Though a minority, certain non-banking financial entities also finance fishermen. These are financial companies

registered under the Companies Act, 1956 and are engaged in providing loans and advances, acquisition of shares, stocks, bonds, hire-purchase, insurance business or chit business adhering to the rules and regulations of the Reserve Bank of India (RBI). Companies lending money against gold as collateral security are a dominant category under this, with interest rates generally higher than the banking institutions.

## Informal credit sources

Among the many informal credit choices, the output/market-tying credit contract is the dominant one in the study area. This is typically characterized by inter-linked deals wherein, the commission agent/auctioneer creditor enters into an output-tying contract with vessel-owner fishers who are in need of credit. Here, the beneficiary fisherman obtains credit on condition that the future catches from his vessels are marketed through the commission agent/auctioneer at an agreed upon rate of commission. It is interesting to note that the commissions are based only on the daily catch volumes, and has no correlation whatsoever to the amount of outstanding debt. As long as a debtor fisherman has an outstanding loan, he is bound by the contract not only to continue selling their catches through the creditor-auctioneer, but also to pay the due commission per catch. The loanee fishermen are supposed to repay part of their outstanding loan in lump sum on getting good catches, so that the creditors can restore their capital on a regular basis. However, the creditors generally discourage complete closure of a loan, as it means loss of a steady stream of commission for them. The contracts are unwritten, legally untenable and are purely based on mutual trust and reciprocal dependence between the parties involved.

Third-party share is another common mode through which the fishers raise funds for capital expenditure or other unforeseen expenditures like repairs and maintenance works. These are shares disbursed generally to people outside the fishing community or to businessmen in the locality interested in investing in fishing business. Unlike the primary shareholders of a fishing vessel, who are active fishermen themselves, the third-party shareholders generally stay detached from routine fishing activities. The interest is paid in the form of share of harvest revenues accrued from routine fishing. The value of a share on a fishing vessel is generally fixed rather arbitrarily by the primary share holders, but is strongly linked to

the economic performance of the vessel in question, experience of the skipper and general reputation of the shareholders as well as the crew. Third-party share is understood to be a relatively new practice that has emerged in the wake of financial prosperity attained by rural and coastal dwellers of Kerala through foreign remittances over the past two decades.

The loans obtained from private money lenders involve predetermined interest charges payable at definite intervals. Though interest payments are collected on regular intervals without fail, such obstinacy is not shown in collecting repayments to the principal. The loans may involve collateral security such as land titles, jewellery or promissory notes. However, money lenders do not always insist on collateral security, but follow their own compulsive means to enforce interest payments and principal repayments. Factors such as urgency in fund requirements and quick access with minimal procedural formalities make them much sought after entities within fishing communities.

Other than the above mentioned informal loans, fishermen also resort to reciprocal loans, which are one-to-one interest-free financial transactions between fellow fishermen based on a triadic relationship. The triadic relationship between the debtor, the creditor and the community at large ensures that the parties involved are insured against extreme financial distress at any point in time through mutually enforced transaction systems.

## **Borrowing pattern and credit contract conditions**

This section presents the borrowing pattern of Kerala fishermen as revealed based on a primary survey conducted by ICAR - CMFRI in 2017 in 8 maritime districts covering 137 inboard ring seine units. Table 1 provides estimates of average borrowing by fishermen from various formal and informal lending sources. Average credit outstanding was found to be generally higher among informal sources compared to the formal. The annual interest rate on loans varied between 11-15 per cent in case of commercial banks, between 11-14 per cent in co-operative banks and 4 -13 per cent in Matsyafed. Non-banking entities were found to charge an interest rate between 18 - 20 per cent as observed from the three cases in the sample. The auctioneers and third-party share-holders did not charge any interest

rates as noted earlier. However, the rates on loans advanced by private money lenders were quite high falling in the range of 24-60 per cent on an annual basis; with lenders actually specifying the rates on a monthly basis. Commissions on harvest proceeds are charged by auctioneers (4-10%) and Matsyafed (3-6%). Quite obviously, the rates of commission charged by auctioneers were higher compared to Matsyafed in most of the cases. Loan term is another important factor that determines the demand for loans across sources. Hundred per cent of loans advanced by commercial banks, co-operative banks and non-banking entities required a repayment within 2-7 years. About 97 per cent of the loans given by Matsyafed also fall in this category. In contrast, none of the loans from informal sources are time-bound. Scrutiny of the repayment schedule prescribed by various types of lending sources suggests that only two types of scheduling is prevalent in the study area - either monthly or flexible. While all commercial banks and 67 per cent of co-operative banks and non-banking financial entities followed monthly schedule of repayment, the rest followed flexible schedule. In case of Matsyafed, 74 per cent of the active loans required monthly repayment. Notably, all loans advanced by the informal sources are scheduled for flexible repayment thereby better suiting the requirement of a clientele like fishermen. However, it is worth noting that interest / commission payments for these loans were done on regular schedule, either monthly or as per availability of catches. Any delays or default in such payments attracted penalties that varied from case to case.

## **Costs of loans from auctioneers and third-party shares**

The actual costs of loan sourced from auctioneers and third-party share-holders are not explicitly known as the interest payments on them are paid on a per-trip basis in the form of auction commission and owners' share of catch revenue respectively. Their annual imputed values was estimated based on full set of trip-wise cost and earnings information collected from 10 sampling units (Table 2). The four units that obtained loans from Matsyafed incurred costs varying from 15.1 per cent to 38.1 per cent of the loan amount per annum in the form of auction commission. In contrast, the imputed value of interests on loans from auctioneers range from 34.4 per cent to as high as 159.8 per cent. It could be seen that, in addition to higher

Table 1. Main characteristics of fishery credit contracts by source in Kerala, India

Particulars	Formal credit sources			Informal credit sources				
	Commercial banks	Cooperative banks	Matsyafed	Non-banking entities	Auctioneer	Private money lenders	Third-party shares	Friends & relatives
Average credit availed (million Rs.)	1.22	1.03	1.20	1.03	0.77	1.01	1.19	0.25
Average credit outstanding as a share of total (%)	57	73	65	90	96	90	90	80
Annual interest rate (%)	11-15	11-14	4-13	18-20	NA	24-60	NA	0
Commission on harvests (% of catch revenue)	NA	NA	3-6	NA	4-10	NA	NA	NA
Loan term (%)								
One year or less	0	0	2	0	0	0	0	100
2-7 years	100	100	97	100	0	0	0	0
Above 7 years	0	0	1	0	0	0	0	0
Unspecified	0	0	0	0	100	100	100	0
Repayment schedule (%)								
Monthly	100	67	74	67	0	0	0	0
Quarterly/ Semi-annual	0	0	0	0	0	0	0	0
Annual	0	0	0	0	0	0	0	0
Flexible	0	33	26	33	100	100	100	100

Source: Parappurathu *et al.*, 2019

auction commission charged by the auctioneers (2 to 3 percentage points higher in relation to Matsyafed), relatively lower amounts of loans disbursed by them push up the interest rates. The imputed value of interest on third party shares ranged between 8.8 per cent and 45.8 per cent across the units studied, based on their relative fishing performance. These are in fact the rates of return on equity realized by the concerned third-party investors. The above results show that, the interest burden incurred by an average fisherman on output-tying loans and third-party shares is generally much higher compared to those offered by banks and other formal financial institutions. Though commission payments on Matsyafed loans also go beyond bank rates many a times, its co-operative mode of operation and quasi-state-ownership nature ensure that a part of the commission payments are returned to the debtors in the form of their savings and the profits are ploughed back to benefit the fishing community through multiple channels from time to time.

## Constraints in the way of financial inclusion

The main factors leading to the continuance of informal financing in Kerala, as revealed by the survey include (i) strict terms and conditions prescribed for disbursement of formal credit; (ii) collateral requirements; (iii) procedural complexities; (iv) delays in sanction; (v) political interference; (vi) non-flexibility in the schedule for repayment; (vii) attachment of collateral property in cases of loan defaults; (viii) general aversion of fishermen to institutional formalities involved; (ix) hesitation on the part of banks to fund fishers due to risks involved and (x) lower credit allocation for the fisheries sector in general. The main advantage of the output-tying credit deals and third-party shares, the dominant sources of informal credit, is the non-essentiality of collateral and the willingness of the creditors to accept interest payments as a share of harvest. Another attraction is the high level of flexibility

Table 2. Estimated imputed interests paid as harvest shares and third-party share payments of selected ring seine units, 2017

Ring seine unit No.	No. of trips	Catch revenue (million Rs.)	Auction commission paid (million Rs.)	Total operating cost (million Rs.)	Crew share (million Rs.)	Owners' share (million Rs.)	Loan from Matsyafed (million Rs.)	Loan from auctioneer (million Rs.)	Third-party loan (million Rs.)	Imputed interest paid as share of harvest (%)	Imputed interest paid on third-party share (%)
Unit 1	196	5.80	0.43	3.66	1.50	0.64	0	1.00	0.50 (3)	34.4	25.7
Unit 2	133	11.77	0.59	4.63	5.15	2.75	0	0.50	1.50 (6)	47.1	45.8
Unit 3	141	26637	1.33	8.98	13.31	4.34	0	0.50	3.00 (5)	159.8	24.1
Unit 4	110	18072	0.45	7.19	7.88	3.00	3.60	0	1.00 (3)	15.1*	15.5
Unit 5	139	25404	1.02	6.39	14.81	4.20	2.00	0	0	38.1*	0
Unit 6	222	30861	1.54	6.87	16.91	6.98	0	1.50	0	82.3	0
Unit 7	172	18171	0.91	5.93	9.87	2.41	0	1.20	0	60.6	0
Unit 8	101	15921	0.79	4.56	8.63	2.75	0	0.80	0	79.6	0
Unit 9	76	4152	0.17	1.96	0.46	1.36	0.70	0	5.00 (20)	17.8*	8.8
Unit 10	182	14852	1.48#	5.11	8.10	1.64	1.20	0.70	0	37.1* 127.3	0

Notes: Auction commission includes service charges (1-2%). This is deducted before working out the imputed interest rate; \*denotes imputed value of interest paid to Matsyafed. This does not include the regular interest due, which varies from 4-13% of the loan outstanding; #Covers auction commission paid to both Matsyafed and auctioneer; Figures in parentheses show the number of shares allotted to the third-party share holder/s.

Source: Parappurathu *et al.*, 2019

allowed for repayments to the principal, depending on the revenue obtained from routine fishing trips. They are also free from other hassles that constrain timely availability of credit. Over and above, the fishermen fear that in case of bankruptcy due to economic loss of fishing units, the formal institutions would proceed to attach their collateral property, which in most cases would be the only asset at their disposal.

On the contrary in the informal system, a loss making vessel operator generally is able to clear his dues by selling off his fishing assets (vessel / gear / equipment) and sharing the resultant proceeds among his many creditors. This is an accepted lenience shown by majority of the informal creditors, which also helps the defaulter fisherman to take an honorable exit from the debts involved. The extensive social networks and information-base maintained by the creditors within the community help to minimize chances of willful defaults, thereby maintaining the sanctity of the system.

Notwithstanding the many perceived merits, the output-tying system cannot be treated as one which is fully

endorsed by the fishing community. There is widespread concern for the implicit exploitation involved. As evident from Table 2, the cost of such loans is often exorbitant, with interest payments in the form of auction commission estimated to be several multiples of the rates charged by the formal financial institutions. The biggest demerit of the output-tying credit system is that it leaves the fisherman an eternal debtor, never actually able to get rid of his outstanding loans, and forcefully tied to the perpetual bond of commission payments. Similarly, the third-party share system also ends up as a debt trap wherein the real owners' share to harvests keeps on narrowing commensurate with their third-party dues. Nevertheless, the fishermen consider private money lenders as the last resort and approach them only when other formal and informal financial sources are either exhausted or inaccessible.

## Policy options for enhancing financial inclusion

A logical solution to the fishermen's problem of dearth of collateral security would be to secure acceptance

of borrowers' fishing vessels as collaterals by the lending institutions. The banks generally reject such arrangements citing high vulnerability of fishing boats to unforeseen risks in the seas. Such risks however, can be mitigated to a great extent if the vessel in question is insured by a recognized insurance company. An insured vessel would be free from the risks of monetary loss in case of accidents and hence should qualify as a collateral security. The government-supported Fisheries Mutual Insurance Scheme (FMIS) in Japan is a well quoted example for such a system, wherein it necessitates financial institutions to extend loans against insurance claims of fishers which are considered as collaterals. However, the coverage of vessel insurance in India is quite limited, exposing majority of the vessel owners to high level of risks. In this context, if the institutional lending agencies can facilitate insurance coverage of vessels they lend and simultaneously accept them as a collateral security, the twin problems mentioned above could be addressed at one go. Due to non-essentiality of any immovable collateral security under such an arrangement, the fishermen should find it as an option worthy of trial. To make things easier, the lending banks can tie up with insurance companies to smoothen the transition. As a result, if the enrollments to vessel insurance schemes go up, the premiums would naturally decline, further catalyzing the process. The government can play a facilitating role by incentivizing the fishermen who opt for such schemes and by enforcing adequate regulatory mechanisms to minimize misuse of any sort. Nonetheless, the outcomes indicated above are certainly not easy to realize and would require concerted and co-ordinated efforts by multiple stakeholders. Moreover, success in this regard would depend on a number of factors such as banks' willingness to try such innovative lending models, technological readiness of the insurance industry for effective fishery insurance

administration and the fishermen's inclination to participate in such experiments.

Bringing about flexibility in credit contracts is another sensible way of improving financial inclusion. Credits cards offer such flexibility whereby the consumers have a reasonable amount of freedom in scheduling withdrawals and repayments within their credit limits. Considering the success of credit cards in agriculture sector (Kisan Credit Card) in India and the high demand for incessant credit in the fishery sector, introducing credit cards for the benefit of fishers seems to be a worthy option. India's union budget 2018-19 has made an allocation in this regard which needs to be capitalized for the benefit of fishermen. Other than banks, institutions such as Matsyafed can also venture in this direction.

Though informal lending agencies serve a role, which cannot be understated, in meeting the credit demand of fishermen, moral hazards associated with such borrowing often result in bankruptcy of fishermen. However, while addressing such concerns, a systematic approach towards enhancing financial inclusion is necessary, fully acknowledging the role played by the informal sector in meeting the much needed liquidity requirement of fishers over decades. Bringing about reforms in the fish auctioning system by introducing electronic/automated auction systems at the landing centres with proper state supervision as well as strict monitoring of informal lending activities may be explored. Considering the alluring role played by fishery cooperatives in advancing financial inclusion by far, and their collective bargaining potential to achieve some of the above mentioned reforms in the days to come, measures to further boost their reach and penetration are also called for.

## References

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