

# A STUDY OF INFORMAL CREDIT SERVICES AVAILABLE TO RICE FARMERS IN SAINT BERNARD, SOUTHERN LEYTE

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## ABSTRACT

The study revealed that cash and credit in-kind were extended by the informal lenders to many rice and non-rice farmers. The informal lenders employed two major credit arrangements, namely: the *butang* and *plete* systems. The *butang* system requires borrowers to pay one cavan of palay for every cash credit which averaged P74 and payable within 4 months. One variant of the *butang* scheme is the practice where borrowers pay 2.4 cavans of palay for an average credit worth P204 of fertilizer and pesticides which is payable within 3 months. In the *plete* credit scheme, the borrowers either pay an average of 2.6 cavans of palay as interest for the P1,000 cash loan payable within 5 months or an average monthly interest of 12.5%.

In the *butang* credit arrangement, all types of lenders generally collected more than the total credit to farmers although none of them collected 100% of the total amount due. Under the *plete* system, the lenders generally could not collect the total interest due during the period covered by the study.

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**KEY WORDS:** Credit arrangements. Informal credit. Rice farmers.

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## INTRODUCTION

Recent empirical evidences show that formal rural credit and financial resources channeled by the government to formal rural financial markets have become less available due to the dis-

qualification or non-participation of formal lending institutions, the problem of high arrearages and the disqualification of farmers in the supervised credit programs. On the other hand, the informal credit sources which disappeared during the periods of massive

financial infusion to the countryside particularly in the M-99 and the *Maisan* credit programs, have recently regained its dominance in the rural financial markets. Nowadays, it represents the bigger segment of the rural credit market particularly among the poor members of the rural society. Its credit operations are basically tied with other business undertakings which in turn depend on the goodwill of the credit clientele. With the interlocking transactions as an operational advantage of the informal credit sources, the formal credit channels would find it very hard to duplicate such credit arrangements.

Despite the services provided by the informal credit sources to the farming population particularly to the small farmers who can not avail of the services of banks, researchers and policy makers still can not clearly grasp their operational practices and performance. In the past, our policy makers have accused them for being the exploitative and insufficient sector of the rural financial markets in the absence of solid empirical evidences. Hence, previous government policies on rural financial intermediaries excluded them from being a component of the rural financial markets. Consequently, policy makers recently expressed their support to the informal credit sector in supplying the credit needs of majority of the small farmers. However, empirical data about their operations are still scanty.

This study was conducted to determine the existing credit arrangements, lending and repayment practices and the performance of the informal

sources of credit patronized by rice farmers in Saint Bernard, Southern Leyte.

## METHODOLOGY

The top five rice-producing barangays of Saint Bernard, Southern Leyte during the 1985 second cropping and 1986 first cropping including the municipality proper were chosen as the study area. Nineteen informal lenders operating in the study area were identified, categorized according to main source of income (10 storeowners/merchants, four professionals, four friends and one rice miller) and interviewed using pre-tested survey instruments. Data were verified and additional information were gathered from local officials and key informants in the selected barangays.

## RESULTS AND DISCUSSION

### *Description of the Place of Study*

Saint Bernard, a third class municipality according to P.D. 465, is situated in the southern coast of the Pacific area in the province of Southern Leyte. The municipality has a total land area of 8,168 hectares with only 1,538 hectares of developed agricultural land. In 1980, its population is approximately 19,153. The major products of the municipality are copra, rice, corn and banana. Among the 30 barangays in Saint Bernard, five (i.e. Mahayahay, Tambis I, Tambis II, Guinsaungan and Catmon) in addition to the municipality proper (Poblacion) were included in the study area.

*Classification of Informal Lenders*

The 19 respondents (informal lenders) earned their income from various sources and had different average

annual income (Table 1). Among the four types of lenders, the rice miller had the highest average annual income (P53,232) while the lowest was from those classified as friends (P20,116).

**Table 1.** Classification of informal lenders and their average annual income in Saint Bernard, Southern Leyte, 1986.

Type of Lender	Number Reported	Average Annual Income (P)
Rice miller	1	53,232
Storeowner/trader	10	20,161
Professional	4	30,182
Friend	4	20,116
Total/Average	19	30,923

*Lending Criteria and Collateral Required*

The capacity to pay was the most important criterion considered by all informal lenders in extending credit to prospective borrowers (Table 2). Lenders considered not only the economic status of the borrowers but also their previous credit record in the community. The next criteria considered were the personal character of the borrowers and the *suki* system, i.e. higher priority to *suki*. These criteria were primarily adopted by lenders apparently to reduce risk of non-payment.

Different forms of collateral were also imposed on borrowers. Most of the lenders (74%) required mere verbal promise as an assurance for payment whereas 56% required promissory notes (Table 2). Land titles and guar-

antors were required by 42 and 32% of the respondents, respectively. Twenty-six percent of the lenders, mostly storeowners and merchants, required their borrowers to sell their produce to them (market tie-up).

*Type and Number of Borrowers*

From the fourth quarter of 1985 to the third quarter of 1986, a total of 411 borrowers was reported by the informal lender respondents. Credit both in cash and in kind were extended to rice and non-rice farmers. Of the total borrowers, 386 or 94% were rice farmers; majority of which (65%) availed credit from storeowners/merchants (Table 3).

*Amount of Informal Credit Extended*

For the duration of this study, the total informal cash loan extended was

Table 2. Criteria for selecting borrowers and collateral required by different types of lenders in Saint Bernard, Southern Leyte, 1986<sup>1</sup>.

Item	Type of Informal Lender <sup>2</sup>				Weighted Average
	RM (n=1)	SO (n=10)	PL (n=4)	FD (n=4)	
	<u>In Percent</u>				
Criteria					
Relative/Kinship ties	100	20	50	25	32
Personal character	100	80	100	50	79
Capacity to pay	100	100	100	100	100
Social tie-up	100	10	25	0	16
<i>Suki</i> system	100	80	50	25	63
Collateral					
Verbal promise	100	100	25	50	74
Written promissory	100	50	75	50	58
Guarantor	100	20	75	0	32
Market tie-up	100	20	50	0	26
Land title	100	40	50	25	42

<sup>1</sup>Multiple responses

<sup>2</sup>RM = Rice miller, SO = Storeowner, PL = Professional, FD = Friend

Table 3. Type and number of borrowers served by different types of informal lenders in Saint Bernard, Southern Leyte, 1986.

Type of Lender	Type of Borrower				Total	
	Rice Farmer		Non-Rice Farmer			
	No.	%	No.	%	No.	%
Rice miller	12	3	0	0	12	3
Storeowner	252	65	10	40	261	64
Professional	47	12	15	60	62	15
Friend	76	20	0	0	76	18
Total	386	100	25	100	411	100

P214,635. The storeowners and friends contributed 42 and 40% of the total amount, respectively. A total of

P8,450 credit in-kind, e.g. fertilizer, pesticides was extended mostly by storeowners/merchants (Table 4).

**Table 4.** Amount of informal credit extended by type of lender, crop year 1985-1986.

Type of Lender	Mode of Credit		Total	Percent of Total
	Cash (P)	In-kind <sup>1</sup> (P)		
Rice miller	1,000	1,450	2,450	1
Storeowner	87,235	7,000	94,235	42
Professional	37,600	0	37,600	17
Friend	88,800	0	88,800	40
Total	214,635	8,450	223,085	100
Average <sup>2</sup>	522	21	543	

<sup>1</sup>Fertilizer and chemicals

<sup>2</sup>Based on 411 borrowers.

Results show that storeowners and friends supplied the largest amount of informal credit in Saint Bernard, Southern Leyte. This is comparable to that observed by TBAC (1981) in their study on informal financial markets in Bulacan, Pangasinan and Camarines Sur.

#### *Lending Rate by Credit Arrangements*

Two major credit arrangements were employed by the informal lenders. The first credit arrangement is locally termed *butang* system and the second is called *plete* system.

*Butang.* One variant of this arrangement requires borrowers to pay one cavan of palay within 2 to 5 months

for a cash loan ranging from P50 to P100. For this variant, an average cash loan of P74 is paid with one cavan of palay within 4 months. The lending rate in this credit arrangement ranges from 180 to 384% per annum or an average of 244%. The second variant requires borrowers to pay from 2 to 4 cavans of palay for every bag of urea fertilizer within 3 months or one cavan of palay for every P80 or P100 worth of pesticides. Thus, 3 cavans is the average payment for every bag of urea fertilizer borrowed or one cavan of palay for P90 average worth of pesticides. The highest annual lending rate in this scheme is 432% whereas the lowest is 16%; the average rate is 213% per year.

*Plete*. This arrangement requires borrowers to pay an interest of 0.6 to 4.0 cavans of palay for every P1,000 cash loan after every harvest or after every 5 months, or a monthly interest rate of 5 to 20%. The average lending rate for every P1,000 cash loan is 2.6 cavans of palay payable after every harvest until the principal is fully paid. On the other hand, the informal lenders charge an average monthly interest of 12.5% for every cash loan whenever the borrowers opt to pay in cash.

### Collection Practices

Table 5 shows the different collection practices of informal lenders. Most lenders (95%) collect their payments during the harvest season. For non-rice farmer borrowers, about one-

third of the lender-respondents just wait for the borrowers to deliver their payment. Some lenders (26%) visit their borrowers without prior notice to collect payment. The rest (5%) send notices indicating the manner of collection to their borrowers. Usually, the lenders particularly those adopting the two variants of the *butang* scheme require their borrowers to pay at one time but this is generally not followed.

### Paying Performance

The paying performance of borrowers is an indicator of the performance of the lenders in the informal credit market in Saint Bernard, Southern Leyte. Two categories were

Table 5. Collection practices employed by type of informal lenders, Saint Bernard, Southern Leyte, 1986<sup>1</sup>.

Collection Strategies	Type of Lender <sup>2</sup>				Weighted Average
	RM (n=1)	SO (n=10)	PL (n=4)	FD (n=4)	
	<u>In Percent</u>				
Visit to collect	0	30	50	0	26
Visit to collect during harvest	0	100	100	100	95
Wait for borrowers to deliver payments	100	20	75	0	32
Send notice to borrowers	0	10	0	0	5

<sup>1</sup>Multiple responses

<sup>2</sup>RM = Rice miller, SO = Storeowner, PL = Professional, FD = Friend

employed to compute the paying performance of borrowers. The first category which falls under short term loans include the cash-to-commodity and the commodity-to-commodity credit arrangements under the *butang* credit scheme. Under these arrangements, borrowers are expected to pay both the principal and interest after harvest of

palay. Thus, the interest under this category is computed by dividing the total value of the payments made by the total amount due. In the second category (*plete* credit scheme), borrowers are either required to pay a specified quantity of palay after harvest or a certain rate on a monthly basis as interest of the loan. Consequently, the maturity

**Table 6.** Total amount due, amount collected and payment rate by type of credit arrangements and type of informal lenders, Saint Bernard, Southern Leyte, 1986.

Credit Arrangement/ Type of Lender	Amount (P)			Annual Payment Rate (%)
	Extended	Due	Collected	
<i>Butang</i> System (Cash-Commodity and Commodity-Commodity)				
Rice miller	2,450	3,903	3,267	84
Storeowner	63,600	124,512	90,657	73
Professional	13,600	27,992	26,136	93
Friend	3,800	8,940	4,455	50
Sub-total/Average	83,450	165,347	124,515	75
<i>Plete</i> System (Cash-Commodity and Cash-Cash)				
Rice miller	0	0	0	0
Storeowner	30,635	8,669	6,255	72
Professional	24,000	9,742	8,167	84
Friend	85,000	37,868	32,522	86
Sub-total/Average	139,635	56,729	46,944	83
Total/Average	223,085	222,076	171,459	77

of the principal was mostly not agreed. Therefore, the relevant indicator of the lender's paying performance is the percent total interest collected.

For the cash-to-commodity and the commodity-to-commodity credit arrangements which fall under the *butang* scheme, none of the lenders collected 100% of the credit due but all lenders managed to collect more than the total amount extended to farmer-borrowers (Table 6). The professionals collected an amount which was almost 100% more than the loan whereas storeowners got more than 40%. Considering the total amount due, the professionals had the highest payment rate (93%) followed by the rice miller (84%) and the last was those classified as friends (50%). In the *plete* credit scheme, lenders generally could not collect the interest due for the period covered by the study. In terms of paying performance, friends had the highest rate (86%) followed by professionals (84%).

### *Implications*

Informal lenders play an important role in rural financial markets as indicated in this study. The amount lent during the duration of this study provided the inputs, and other farm and household needs to rice farmers.

The high interest rates charged on informal loans was a business operational strategy to capture a fair return on capital and to serve as an allowance for the high risk of non-payment. This implies that lenders who can operationally reduce the risk in interest charged get the highest net return from the amount extended. The high risk factor is probably the reason that many prospective investors in the informal credit sector are hesitant to be exposed despite the very attractive interest rates. Consequently, this is also the basic reason for the indifference of private commercial/industrial sector of the financial markets to expose themselves into agricultural lending despite their high liquidity position.

## LITERATURE CITED

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