



**CRITICAL REVIEW OF ISSUES IN FINANCING OF
SMALL AND MARGINAL FARMERS OF KASHMIR: A
CASE FOR ISLAMIC VALUE - CHAIN FINANCE**

BY

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ABSTRACT

Agriculture and farming has been the oldest primary occupation of man. Besides providing for livelihood for the people, it ensures food security and sustainability of a nation. In most developing economies majority of agriculture holdings are small. In India, the total number of small and marginal farm land holdings is about 85% of the total operational holdings under agriculture. Correspondingly, in the Kashmir division of the state of Jammu & Kashmir, India, majority of agriculture land holdings are categorized as marginal and small. The total percentage of cultivators and agriculture labourers is 39.79% in relation to the total worker population, portraying the dependence on agriculture of majority of the rural Kashmiri population. These small and marginal farmers face a number of issues such as lack of irrigation, road, transportation, storage facilities, lack of proper fertilizers, pesticides, agricultural machinery, sparse coverage of arable land, and limited formal credit availability. These issues in-turn affect the food productivity and agriculture sustainability of the nation. Consequently, small farmers' income growth, development and sustainability are also affected by the lack of infrastructure, market and credit. Among the prominent issues identified for small farmer growth and development is timely, affordable and effective credit facility. As such, this research appraises the value chain financing approach which comprehensively provides for timely and effective credit at each stage of the value chain for small farmers. Moreover, the use of Islamic financial contracts for value chain financing for small farmers is evaluated. Islamic financial contracts share the risk sharing approach innate to value chain financing. The value chain financing approaches the farmer as an entrepreneur in the agriculture business sector rather than an individual entity isolated from the real economic scenario, as evident in current conventional financing practices. As such, the three characteristics of flexibility, proximity and representativeness are common to Islamic finance as well as value chain financing that can lead to sustainable and comprehensive development of small and marginal farmers of Kashmir.

خلاصة البحث

. تعتبر الزراعة والاشتغال بها أقدم عمل أساسي للإنسان. فبالإضافة إلى توفيرها لسبل العيش للشعب فإنها تضمن الأمن الغذائي والاستدامة للأمة. ففي أغلب الاقتصاديات النامية معظم الحيازات الزراعية صغيرة. ويصل العدد الإجمالي للحيازات الزراعية الصغيرة والهامشية في الهند حوالي 85% من إجمالي الحيازات التشغيلية في إطار الزراعة. في المقابل، تصنف غالبية حيازات الأراضي الزراعية في قسم كشمير -بولاية جامو وكشمير الهندية- هامشية وصغيرة، وتصل النسبة الإجمالية للمزارعين وعمال الزراعة إلى 39.79% بالنسبة إلى مجموع السكان العاملين، مما يوضح اعتماد غالبية السكان في المناطق الريفية في كشمير على الزراعة. ويواجه هؤلاء المزارعين الصغار والهامشيين عددا من المشاكل مثل نقص الري، والطرق، والنقل، ومرافق التخزين، ونقص الأسمدة المناسبة والمبيدات الحشرية، والآلات الزراعية، وتغطية متفرقة من الأراضي الصالحة للزراعة، ومحدودية توافر الائتمان الرسمي. هذه القضايا تؤثر بدورها على إنتاجية الأغذية والزراعة المستدامة للأمة. ونتيجة لذلك، يتأثر نمو دخل صغار المزارعين، كما تتأثر التنمية والاستدامة أيضا بسبب عدم وجود البنية التحتية والسوق والائتمان. من بين المشاكل البارزة التي تم تحديدها لنمو صغار المزارعين والتنمية التسهيلات الائتمانية في الوقت المناسب، وبأسعار معقولة وفعالة. وهكذا يثمن هذا البحث منهج تمويل سلسلة القيمة والذي يتيح الحصول على الائتمان في الوقت المناسب والفعال وبشكل شامل في كل مرحلة من مراحل سلسلة القيمة لصغار المزارعين. وعلاوة على ذلك، يتم تقييم استخدام العقود المالية الإسلامية لتمويل سلسلة القيمة لصغار المزارعين. فالعقود المالية الإسلامية تشترك بشكل طبيعي مع سلسلة تمويل القيمة في نَهج تقاسم المخاطر. فتمويل سلسلة القيمة يتعامل مع المزارع كصاحب مشروع في قطاع الأعمال الزراعية بدلا من كيان فردي معزول عن السيناريو الاقتصادي الحقيقي، كما هو واضح في ممارسات التمويلات التقليدية الحالية. وهكذا فإن الخصائص الثلاثة المرونة، والقرب والتمثيلية خصائص مشتركة بين التمويل الإسلامي وتمويل سلسلة القيمة مما يمكن أن يؤدي إلى الاستدامة والتنمية الشاملة لصغار المزارعين والهامشيين بكشمير.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Master of Science in Islamic Banking and Finance.

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Islamic Banking and
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DECLARATION

I hereby declare that this research paper is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Horiya Hussain

Signature.....

Date.....

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I dedicate this research in the way of Allah to all those who envisaged and struggle to establish Islamic finance for the betterment of humanity.

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LIST OF ABBREVIATIONS

RBI	Reserve Bank of India
KCC	Kissan Credit Card
SHG	Self Help Group
J&K	Jammu & Kashmir
NABARD	National Bank for Agriculture and Rural Development
NSSO	National Sample Survey Organisation
PNB	Punjab National Bank
SBI	State Bank of India

CHAPTER ONE

INTRODUCTION

1.1.INTRODUCTION

This chapter includes a brief introduction of the current research project. It provides for the background and purpose of the study, the problem statement, the research objectives and research questions and the significance & the limitations of the study. Also, this chapter includes particular definitions used in the research as well as portrays the layout of the thesis.

1.2.BACKGROUND OF THE STUDY

Agriculture and farming has been the oldest primary occupation of man. Besides providing for livelihood for the people, it ensures food security and sustainability of a nation. Agriculture employs around 1.3. billion people in the world, about 40% of the total global employment(FAO stats 2011, as cited in Momagri, 2015). Intriguingly, the small and marginal farmers form a considerable portion of those employed in agriculture - producing about 70-80% of food in developing economies of South Asia and Sub-Saharan Africa (IFAD UNEP report, 2013). These small land farmers constitute the majority of rural population who are also categorized as poor according to global standards set by the FAO of United Nations Organisation (Crowley, 2013).

In most developing economies majority of agriculture holdings are small(Sadr, Kafaie, & Haidari, 2008)(Kopparthi & Kagabo, 2012). In India, the total number of small and marginal farm-land holdings is about 85% of the total

operational holdings under agriculture. The Agriculture Census Report 2011 explains the criteria of small and marginal land, to be below 0.5 to 1.0 hectares of land for marginal land size, whereas for small land holding it is 1.0 to 2.0 hectares of land (Agriculture Census, 2011). Also, the Census of India 2011 reports 24% and 30% for percentage of total cultivators and agricultural labourers, respectively. The Census reports a decrease in the number of cultivators from 1951-2011 and vice versa an increase in the number of agricultural labourers over the same period, depicting a shift in occupation from cultivators to agricultural labourers' overtime (Census of India, 2011). This shift in occupation hints towards the insufficiency of current situation of farming avenues to provide for livelihood for majority of the rural population.

In the Kashmir division of the northern most state of Jammu & Kashmir, India, around 70% of the population is directly or indirectly dependent on agriculture and its allied sectors, which is the most prominent sector of the economy. The total contribution of Agriculture to the state GDP as in 2013-2014 is 20.22%(J&K Economic Survey, 2014). Out of total number of workers, 50% of the Marginal workers are associated with agriculture and allied sectors, and contribute marginally to the total agriculture production. The total percentage of cultivators and agriculture labourers is 39.79% in relation to the total worker population, and 13.23% in relation to the total population of the Kashmir division¹ (Census of India, 2011). Also, as per the National Sample Survey Office (NSSO) 66th report, out of every 1000 persons, 597 and 110 people are dependent on agriculture in rural and urban areas respectively (NSSO, 2013). These figures depict that considerable portion of the population are dependent directly on farming and agriculture.

¹ Refer to appendix A

These small and marginal farmers face a number of issues which affect the food productivity and agriculture sustainability of the nation. Among the problems identified are the following:

1. Limited access of small and marginal farmers to formal sources of agriculture credit(Sadr, Kafaie, & Haidari, 2008).
2. Infrastructural limitations in terms of irrigation, roads, transportation, storage etc. resulting in loss post-production (J&K Economic Survey, 2013).
3. Technological limitation in terms of lack of proper fertilizers, pesticides, agricultural machinery etc. resulting in loss of production(Dev, 2012).
4. Environmental limitations in terms of sparse coverage of arable land, lack of rainfall, diverse regional topologies, and prone to natural hazards(Dev, 2012), and,
5. Limited access to proper markets and lack of market mechanism.

In order to address these problems many agricultural development policies focusing on institutional reform, public investment, incentives and reforms & globalization have been formulated by the Government of India(Dev, 2012). However, the issue of credit availability to small and marginal landholders remains extant given the fact that the agriculture production is sustained by these small and marginal farmers.

The lack of timely, sufficient and affordable credit has immense impact on agriculture productivity especially for small landholders(Sadr et al., 2008). It is also among the scare resources available to the agriculture sector due to credit market imperfections as well as the inherent risks involved in agriculture(Kopparthi & Kagabo, 2012). Consequently, focus on the value chain financing which comprehensively provides for timely and effective credit at each stage of the value

chain needs to be addressed. This is so as credit needs of small and marginal farmers cannot be studied in isolation to the big picture of infrastructural set-up which provides the necessary links for efficient, profitable and sustainable agriculture and livelihood to these small and marginal farmers(Miller & Jones, 2010)(Kopparthi & Kagabo, 2012)(Soundarrajan & Vivek, 2015).

In the same backdrop, in pursuant with the need for credit in order to enhance the productivity and efficiency of agriculture as well as to address the issue of poverty alleviation and financial inclusion of the small and marginal farmers, the Reserve Bank of India (RBI) in its priority sector lending policy has categorized agriculture as one of priority sector lending areas for scheduled commercial banks (RBI Priority Sector Lending guidelines, 2015). Under the new Guidelines on Priority Sector Lending Categories issued in April 2015, small and marginal farmers have been identified as a sub sector for targeted lending by commercial banks under the agriculture sector. The targets for agriculture in general and small & marginal farmers in particular are 18% and 8% (7% to be reached by March 2016) respectively (RBI Priority Sector lending guidelines, 2015). Yet the issue of poverty alleviation and financial inclusion of small and marginal farmers remains.

Therefore, owing to the important role credit availability plays in sustainable growth, asset formation and poverty alleviation of these small and marginal farmers, new approach is required in order to attain a comprehensive development in agriculture sector as well as of the small farmers.

1.3.PURPOSE OF THE STUDY

The current study focuses on the financing needs of small and marginal farmers of Kashmir. As such, the purpose of this study includes determining the role of credit disbursement practice in Islamic finance for value chain financing in comparison to the current practice of credit advancement through commercial banking sector to small farmers. Consequently, the study aims to assess that how Islamic Financial contracts can be utilized in the light of risks faced in the agriculture value chain and subsequent impact of risks on small farmers as well as the banks in financing the agriculture value chain using Islamic financial contracts.

1.4.PROBLEM STATEMENT

In India, two fold problem in the agriculture is prevalent, viz. the agricultural and the agrarian. Where the former relates to the problem of inadequate resources and developmental issue, the latter relates to the crisis for sustenance and livelihood of small and marginal farmers that form majority in Indian agriculture production(Mishra, S. and Reddy, 2011). Correspondingly, similar scenario is present in the Kashmir division - where lack of infrastructure, market and credit is evident; affecting both the state agriculture sector as well as the individual farmer. The prevalence of informal credit at unusually high rates of interest affecting the very livelihood of these small and marginal farmers leaving them in the vicious cycle of indebtedness is among the other factors affecting the small farmers sustainability(Pradhan, 2013)(Shah, Rao, & Shankar, 2007). Formal credit disbursement avenues are being addressed by the priority sector lending by Scheduled Commercial Banks, yet 26.34% of rural people (about 1/5th of the State's population),

where majority constitute the category of small and marginal farmers, are ranked as living Below Poverty Line (Digest of Statistics, 2011-2012). These small and marginal farmers are categorized as having lower income, less savings and low capital formation (Saboor, Hussain and Munir, 2009). The lack of timely and affordable credit mars the productivity, income generation and asset formation for sustainable livelihood of small and marginal farmers of Kashmir.

1.5. RESEARCH OBJECTIVE

The objective of this research is to assess the prospective use of Islamic Financial contracts using value chain financing approach through current agriculture lending custom by commercial banks of Kashmir.

The supplementary objectives of the research are

1. To identify the products offered by the leading bank in Kashmir division, i.e. the Jammu & Kashmir Bank Pvt. Ltd. (J&K Bank), for financing of small and marginal farmer under value chain approach.
2. To assess the opportunities and challenges of using Islamic financial contracts for value chain financing for small and marginal farmers.

1.6. RESEARCH QUESTIONS

Based on the research objectives, following research questions are formed:

1. What are the current financing avenues for small and marginal farmers of Kashmir through the formal sector?
2. How does the current financing practice of J&K Bank satisfy value chain financing approach for small and marginal farmers?

3. How can Islamic financial contracts for agriculture suit the current needs of small and marginal farmers under value chain financing approach?
4. What risks factors are faced by small farmers in agriculture value chain and how these risks affect financing disbursed by J&K bank using Islamic financial contracts?

1.7.SIGNIFICANCE OF THE STUDY

Owing to the dependence of a considerable population of Kashmir on agriculture, as well as the fact that the agricultural production mainly lies in the hands of small and marginal landholders, it is a necessity to address the problems and issue faced by the small and marginal farmers for availing sufficient credit in order to ensure poverty reduction, food security and equitable livelihood. The current study, therefore, has adopted a comprehensive value chain financing approach to assess the credit disbursement for small farmers to address the issue of income sustainability and comprehensive development of small farmers.

Additionally, there are other various aspects of significance of the study. Firstly, the study contributes to the existing pool of academic research literature in the field of Islamic finance as no previous study has been undertaken to address the value chain financing using Islamic financial contracts. Secondly, the study is first of its kind to assess the issues faced by small and marginal farmer of Kashmir in the light of both Islamic financial contracts as well as value chain financing approach. Thirdly, the study provides as basis for policy formulation for the government to consider the introduction of Islamic finance through the banking sector. Fourthly, the Kashmir division comprises of majority Muslim population which portrays great relevance of the study with regard to the religious consideration of the small and marginal farmers

in particular and the whole population in general. Lastly, the study is among the limited researches that have taken into consideration Islamic financial approach to value chain financing for small and marginal farmers.

1.8.LIMITATIONS OF THE RESEARCH

There is lack of micro data on the farming activity of small and marginal farmers. This implicates as lack of information on current value chain structure for small and marginal farmers. Also, scattered secondary data is another limitation which makes it difficult to get the appropriate data as the sources are scattered. The lack of electronized detailed secondary data on agriculture in Kashmir, with special reference to issues faced by small and marginal farmers of Kashmir is another factor which limits the study to a few resources thus threatening the authenticity of the data.

1.9.DEFINITIONS USED IN THE RESEARCH

There are few terminologies that are peculiar to the study which have mention in several places. Hence following are the related definitions of the terms used:

1. Marginal farmers: these are those land holders for agriculture cultivation with the landholding size ranging from below 0.5 hectares to 1.0 hectares (Agriculture Census, 2011).
2. Small farmers: are agriculture cultivators with the landholding size ranging from 1.0 hectares to 2.0 hectares of land (Agriculture Census, 2011).
3. Main worker: those workers who had worked for major part of the reference period (i.e. 6 months or more) (Census of India 2011).

4. Marginal workers: those workers who had not worked for major part of reference period (i.e. less than 6 months). (Census of India 2011).
5. Cultivators: a person engaged in cultivation of land owned or held from government of India or from private persons for payment of money, kind or share. A person who has given his/her land to another person for cultivation for money, kind or share is not a cultivator. Also, a person working on another person's land for wages is not a cultivator. (Census of India 2011).
6. Agriculture laborer: a person working on another person's land for wages, in cash or kind. (Census of India 2011).
7. Adjusted Net Bank Credit(ANBC): for the purpose of Priority Sector lending ANBC is the outstanding Bank credit in India defined under RBI act 1934 minus bills discounted with RBI and other approved financial , plus permitted non LSR bonds in Held to Maturity category plus other investments eligible to be treated as part of priority sector lending(RBI, 2014).
8. Scheduled Commercial Banks: are commercial banks included in the second schedule of the Reserve bank of India Act 1934. Four categories of scheduled commercial banks include 1) Public Sector Banks, 2) Private Sector Banks, 3) Foreign banks and 4) Regional Rural Banks (RBI Publications, 2012).
9. Riba: any increase over the loaned amount is traditionally termed as Riba. However, Riba also exists in exchange transaction of certain commodities whereby inferior quality is exchanged for superior quality in different amounts or the exchange of either commodity is deferred (Ayub, 2007).
10. Gharar: is the excessive uncertainty with regard to the pillars of contract as formulated under Islamic Law. This includes excessive uncertainty as to the subject matter, price or end result of a contract (Ayub, 2007).

1.10. THESIS STRUCTURE

This thesis is structured into various chapters. Each chapter follows different themes of the proposed study. There are seven chapters in total which are organized as under:

- | | |
|-----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Chapter 1 | This chapter includes the background of the study, problem statement, research questions, significance and limitations of the research. |
| Chapter 2 | this chapter provides a review of literature on the issues faced by small and marginal farmers, with elaboration on prevalence of informal credit and issues in availing formal finance for small farmers. |
| Chapter 3 | provides for the elucidation on need and importance of credit for productivity, sustainable growth and development of small framers. Also, the current formal sources of finance are discussed in this chapter. |
| Chapter 4 | Explanation on Islamic financial contracts for agriculture finance is provided in this chapter. Also, introduction to value chain finance as an efficient approach for small farmer development is provided. |
| Chapter 5 | This chapter includes the conceptual framework and research methodology of the study. Also, the |