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An Analysis of the Effect of Low Interest Rate on Bank Credit in Ajmer Region

Mahesh Chadra Babu Jampala[1] Teena Shivnani[2]

Lack of access to finance is often quoted as a key reason for "why poor people remain poor". The burden of indebtedness risk in rural India is great, and falls mainly on rural working people. Agricultural and non-agricultural activities in rural areas are usually based on weather conditions and rural people need credit for cyclical variations in incomes and expenses. Earlier local money lender was fulfilling the money need of rural people at high rate of interest. The key determinant of rural development in any country is the number of people attach to Banking system. Rural Banking and Credit Institutions play an important role to fulfill financial needs of rural people. The rural banking provides loans to rural working people at lower rate of interest. Since the commencement of rural banking system, regional rural banks (RRBs) have taken deep roots and have become a sort of inseparable part of the rural credit structure in India. In this direction, RRBs help rural people to shift their borrowing from moneylenders to banks thus to reduce the exploitation. This step will help rural people to manage their financial needs in a significant manner. The present paper will discuss the effect of this Rural Banking on rural credit with reference to Ajmer Region.

Key words: *Rural Banking, rural development, RBI, RRBs, Priority Sector, Ajmer Region.*

INTRODUCTION

The banking system is central to a nation's economy. Banks are special as they not only accept and arrange large amounts of uncollateralized public funds in a fiduciary capacity, but also leverage such funds through credit creation. In India, prior to nationalization, banking was restricted mainly to the urban areas and neglected in the rural and semi-urban areas. Large industries and big business houses enjoyed major portion of the credit facilities. Agriculture, small-scale industries and exports did not receive the deserved attention. Therefore, inspired by a larger social purpose, 14 major banks were nationalised in 1969 and six more in 1980. Regional Rural Banks have been in existence for around three decades in the Indian financial scene. Inception of regional rural banks (RRBs) can be seen as a unique experiment as well as experience in improving the efficacy of rural credit delivery mechanism in India.

With joint share-holding by Central Government, the concerned State Government and the sponsoring bank, an effort was made to integrate commercial banking within the broad policy thrust towards social banking keeping in view the local peculiarities. The genesis of the RRBs can be traced to the need for a stronger institutional arrangement for providing rural credit. The Narsimham committee conceptualized the creation of RRBs in 1975 as a new set of regionally oriented rural banks, which would combine the local feel and familiarity of rural problems characteristic of cooperatives with the professionalism and large resource base of commercial banks. Subsequently, the RRBs were set up through the promulgation of RRB Act1 of 1976.

[1]Assistant Professor at Department of Applied Arts Manipal University, Jaipu, E-mail: jampalamahesh@gmail.com

[2]Assistant Professor at Department of Business & Commerce Manipal University, Jaipur

Rural households need credit for a variety of reasons. They need it to meet short-term requirements for working capital and for long-term investment in agriculture and other income-bearing activities. Agricultural and non-agricultural activity in rural areas are typically seasonal, and households need credit to smooth out seasonal fluctuations in earnings and expenditure. Rural households, particularly those vulnerable to what appear to others to be minor shocks with respect to income and expenditure, need credit as an insurance against risk. In a society that has no free, compulsory and universal education or health care, and very few general social security programmes, rural households need credit for different types of consumption. These include expenditure on food, housing, health and education. In the Indian context, another important purpose of borrowing is to meet expenses for a variety of social obligations and rituals.

If these credit needs of the poor are to be met, rural households need access to credit institutions that provide them a range of financial services, provide credit at reasonable rates of interest and provide loans that are unencumbered by extra-economic provisions and obligations.

RURAL BANKING

Rural Banking is providing financial facility previously unbanked area to weaker section for specific activities for enhancement of their economic and social status. It worked for raising their standard of living or Upliftment of weaker section of society. Financial facility is including all types of financial services (deposit, borrowings, money transfer etc.). The basic outcome of Rural Banking is to

Supply led inexpensive formal credit was necessary to displace "evil" moneylenders who charge the high rate of interest from poor people thus they were net contributors to the rural poverty.

Presently the concept of banking is changed. PM Narendra Modi has initiated the digital banking concept everywhere in India. This concept has change the life style of rural people.

Efforts by RBI towards Rural Banking

In the field of Rural Banking some efforts has been done by RBI to promote rural development. These are as follows:-

First, the RBI lowered the cost at which the rural poor had access to credit. Commercial bank interest rates were kept below the average interest rates in rural areas, and to ensure that commercial banks don't simply use rural deposits to increase urban lending the RBI regulated that a credit-deposit ratio of roughly 60% be satisfied by all rural and semi-urban branches of commercial banks.

Second, the RBI identified sectors which it felt did not have access to organized lending market or could not afford to pay the interest at the market rate. It then skewed bank lending towards these "priority" sectors, which included agriculture, small businesses and entrepreneurs. It did so by introducing priority sector lending requirements wherein banks had to meet specific targets in terms of percentage lent to certain sectors.

Finally, the centerpiece of Rural Banking was the use of state control of bank placement to reach populations that had previously had no access to formal financial institutions.

The Reserve Bank of India (RBI) issued specific directives with respect to Rural Banking. These included setting targets for the expansion of rural branches, imposing ceilings on interest rates, and setting guidelines for the sectoral allocation of credit. Rural credit was an important component of the "green revolution" package; the first post-nationalization phase of expansion in rural banking saw a substantial growth in credit advances for agriculture. Specifically, a target of 40 per cent of advances for the "priority sectors," namely agriculture and allied activities, and small-scale and cottage industries, was set for commercial banks.

In December 1969, the branch expansion program was revamped and RBI announced that future banking development will be judged in terms of population served per bank office. Moreover, branch expansion will be explicitly skewed towards unbanked rural and semi-urban locations. Between 1970 and 1992 over 50,000 new bank branches were built predominantly in unbanked, rural locations. The number of banks opened in unbanked locations in a state in any given year was driven by the RBI policy rules. We see that expansion into unbanked areas has a significant positive impact on the growth of non-agricultural output. This is our first indication that branch expansion may have had different effects on different sectors of the economy. Expanding the number of banks in rural, unbanked areas appears to have encouraged the setting up and growth of small manufacturing units. And this form of diversification can be an important means of increasing the productivity of rural people and lifting them out of poverty (Lanjouw and Lanjouw, 1995). The Indian branch expansion programme significantly lowered rural poverty and increased non-agricultural output. And the fact that the marginal impact on poverty is higher for branches built in unbanked as opposed to banked locations is suggestive that the rural focus of the program is justified at least from a social perspective.

It is useful to recall that rural banking was traditionally a monopoly of the money lenders, till the colonial government enacted Co-operative Societies Act in 1904 with a view to making the co-operatives as premier institutions for disbursement of credit. The Process of a three-tier structure commenced in 1915. Government was also providing agricultural loans usually called Takkavi loans, which have since been discontinued. The RBI Act vested a unique responsibility of rural credit to the central bank. All India Rural Credit Survey (1951) of the RBI opined that the co-operatives were "utter failure" in providing rural credit, but added they had a vital role in agriculture credit. The Imperial Bank was nationalised as SBI, which was visualised as a vehicle for rural banking. A rural credit survey of 1966 also concluded the ineffectiveness of co-operatives but stressed the importance of their succeeding. Many State governments legislated the registration and regulation of money lenders but with little emphasis on implementation. Nationalisation of banks in 1969 gave a boost to expansion of banks and banking in rural areas. Expansion into unbanked locations significantly lowered the household borrowing from moneylenders but raised borrowing from banks. This is a significant finding in so far as an important stated aim of the Rural Banking experiment was to displace moneylenders which were viewed as counterproductive given the high interests rates charged and the extent to which rural residents were perceived to be indentured servants of moneylenders.

After Independence the Indian central bank (henceforth RBI) sought to expand rural access to formal credit via the cooperative movement. However, by the mid-1960s it became apparent that increasing the quantum of financing of credit cooperatives by the RBI could not address the central problem that the bulk of rural India remained without a source of formal credit. This, combined with political demand for the use of commercial banks as agents of change in rural areas, led to the government initiated “Social control of banking”. RBI used these banks as a vehicle to launch a unique experiment in Rural Banking. Between 1970 and 1992 the number of bank branches in India increased sevenfold to roughly 65,000. Much of this increase was achieved by the banking of unbanked locations in rural areas — over this period the number of banked locations in India rose from under 5,000 to over 25,000. Rural branches constituted roughly 60 percent of bank branches by 1992, as against 22 percent at the time of nationalization in 1969. Equally striking is the fact that post- 1992 branch building in rural and unbanked locations went to pretty much zero, while branch building in urban and metropolitan locations increased. Alongside it skewed bank lending towards the so called priority sectors of agriculture, small scale industry and entrepreneurs.

Bank nationalization was intended to allow the state to target financial backwardness as a means of promoting social objectives. A central aim was to reduce and equalize the average population per bank branch across Indian states.

To achieve this, Indian central bank adopted an area approach whereby unbanked locations—census locations with no prior presence of commercial banks were targeted (Desai 1987).

The priority status assigned to financially less developed states, combined with a common definition for unbanked locations across Indian states, meant that more unbanked locations were targeted in financially backward states. In every Indian district a commercial bank was designated as the Lead Bank and made responsible for identifying unbanked locations (based on the criteria set by the central bank). Every three years new (district-wise) lists of unbanked locations were drawn up by the central bank (in consultation with Lead Banks and state development authorities) and made available to commercial banks working in a district. The Lead Bank was responsible for coordinating branch expansion into these locations with other commercial banks working in the district.

Between bank nationalization in 1969 and the onset of financial liberalization in 1990 bank branches were opened in over 30,000 rural locations which had no prior presence of commercial banks (henceforth, unbanked locations). Alongside, the share of bank credit and savings which was accounted for by rural branches rose from 1.5 and 3 percent respectively to 15 percent each.

However, the Rural Banking experiment in India did not solely consist of skewing branch placement toward unbanked locations. A second major objective of the program was to skew lending towards priority sectors. That is the policy makers wanted to change the composition of lending with a view to reaching groups which were typically excluded from formal finance. The principal target groups were agriculturists, small businessmen and entrepreneurs. This was a type of affirmative action program where varying proportions of total lending were “reserved” for these groups whereas the residual was unreserved. The Reserve Bank of India used its control over the banking sector via the lead bank scheme to ensure that these targets were enforced. And because branch expansion into unbanked locations was used to fulfill these targets the two interventions are related. However, they capture different aspects of Rural Banking — branch placement is locational whereas priority sector lending is compositional. These results are interesting as they confirm that Rural Banking appears to have mainly benefited the non-agricultural sector and there is a suggestion that priority sector lending has a larger impact on expansion of this sector than non priority sector lending.

In an earlier research, (Banerjee and Duflo) tested these predictions by taking advantage of recent changes in the “priority sector” rules: all banks in India are required to lend at least 40 percent of their net credit to the priority sector, which includes small-scale industry, at an interest rate no more than 4 percentage points above their prime lending rate. Banks that do not satisfy the priority sector target are required to lend money to specific government agencies at low rates of interest.

More recently, since 2004, vigorous efforts have been made to more than double the credit flow to agriculture. Emphasis has been laid on sound credit culture, effective credit delivery and appropriate credit pricing. New instruments for financial inclusion such as General Credit Cards and no-frills accounts were initiated. Above all, as per the Government of India announcement in 2005, it has been decided to subsidies the commercial banks and NABARD to enable provision of short-term credit at 7% interest rate to the major segment of the farmers.

In brief, there have been vigorous and determined efforts towards expansion of rural credit, especially through Rural Banking.

RRBs

Regional Rural Banks (RRBs) were established in 1975 under the provisions of the Ordinance promulgated on the 26th September 1975 and followed by Regional Rural Banks Act, 1976 with a view to develop the rural economy and to create a supplementary channel to the 'Cooperative Credit Structure' with a view to enlarge institutional credit for the rural and agriculture sector.

The Government of India, the concerned State Government and the bank, which had sponsored the RRB contributed to the share capital of RRBs in the proportion of 50%, 15% and 35%, respectively. The area of operation of the RRBs is limited to notified few districts in a State. The RRBs mobilize deposits primarily from rural/semi-urban areas and provide loans and advances mostly to small and marginal farmers, agricultural labourers, rural artisans and other segments of priority sector.

As of 31.3.2015 total 56 RRBs are working in India. It clearly shows that Indian banking system is working towards rural development.

Priority Sector

One of the objectives of banking policy after nationalization was to expand the flow of credit to agriculture and small industries, or what were termed “priority sectors.” As Appendix Table 2 shows, the share of priority sectors in the total credit outstanding of scheduled commercial banks rose from 14 per cent in 1969 to 21 per cent in 1972 and then went up to 33 per cent in 1980. The RBI set a target of 40 per cent for priority sector lending and by the mid-1980s this target was met. From 1985 to 1990, in fact, the target was over-achieved, that is, more than 40 per cent of total credit outstanding went to priority sectors. From 1991 to 1996, the share of priority sector credit fell, in line with the recommendations of the Narasimham Committee. At first glance, the direction in priority sector lending appears to have been reversed over the last five years. This is, however, a reversal by redefinition: “priority sector” lending now includes advances to newly-created infrastructure funds, to non-banking finance companies for on-lending to very small units, and to the food processing industry.

Table 1 shows share of priority sector in gross credit outstanding of all scheduled commercial banks, India, 1969 to 2015 (in per cent)

TABLE 1
Percentage of priority sector in credit outstanding

	% of Priority sector in credit outstanding
Years	(Cumulative % of 5 years)
1969 - 75	107.3
1976 - 80	142.9
1981 - 85	186.1
1986 - 90	211
1991 - 95	179.4
1996 - 2000	171.8
2001 - 05	195.2
2006 - 10	202.4
2011-15	220.00

Source: Banking Statistics, different years.

Lead Bank Scheme

Reserve bank of India came out with a lead bank scheme in 1969. The main objective of scheme is to reduce the credit gaps and provide adequate banking facilities through area approach. In 1969, Reserve Bank of India declared Bank of Baroda as a lead bank amoung all government Banks. Lead bank works as a consortium leader in the priority sector in invoking Co- operations of other banks and develop agencies for the overall development of the area. Lead bank does not have the monopoly of banking business in the lead districts nor is responsible for its development.

According to Reserve bank of India lead bank scheme, some specific area is allotted for working to every lead bank. For this study, the research area is Ajmer Region. In the Ajmer region five districts will be included:

- Ajmer District
- Bhilwara District
- Bundi District
- Jhalawar District
- Kota District

Kota & Jhalawar does not have any rural branch. Bank of Baroda have total 50 Rural branches in Ajmer Region. For this study secondary data has collected from all rural branches area people to find out the effect of rural banking on Rural Credit through lowering the rates of interest.

Bank of Baroda is financing 80% of their total financing to Priority Sector in Ajmer region and it clearly indicates that bank of Baroda lead all the other five banks in priority sector lending.

METHODOLOGY

The data for the study was collected from secondary sources from all the rural branches about the loans towards the priority sectors. In terms of geographical scope the study is confined to Ajmer region, where the banking facilities have been provided by Bank of Baroda to the rural people.

OBJECTIVE

To find out whether the rural banking has lowered the household borrowings from moneylenders but increased borrowings from banks in unbanked area or not.

HYPOTHESIS

Rural banking has increased Rural Credit through lowering the rates of interest.

DATA ANALYSIS

Interest rate plays a major role in increasing loan facilities in the society. As per the sample profile it is clear that respondents are from rural areas. Most of the respondents are from lower and middle class and facing the problem of low per capita income. After analyzing before and after loan situations, it is found that amount of loan taken has increased. To evaluate the reason, the study has measured the important factor of interest rate of total advances, Agricultural advances, and advance to priority sector. To analyze this aspect the study has based on secondary data of the last 3 years of all 50 rural branches of Ajmer Region. Secondary data consists of total advances, advance to priority sector and agriculture in rural areas along with the rate of interest. As mentioned above Ajmer Region coveres Ajmer, Bhilwara and Bundi District. Banking sectors adopted liberal policies to enhance loans with the lower rate of interest as per the last five years monetary policy of government of India. With this, the correlation is calculated to analyze the effect of interest rate on Loans. For this purpose the study has covered Ajmer Region. (Ajmer, Bhilwara and Bundi District). The following table 2 shows the correlation between the total loan amount & rate of interest in Ajmer Region.

In case of Ajmer district result (Rate of Interest Total Advances) shows P value 0.003 which is less than (.05) which proves the significant relationship at the 95% confidence level. For Bhilwara and Bundi districts correlation analysis shows highly significant results with P value

TABLE 2
Correlation between Loans disbursed & Rate of Interest in Ajmer Region

	Total Loans in Ajmer		Total Loans in Bhilwara		Total Loans in Bundi		Total Loans in Ajmer Region	
	Pearson Correlation	Sig. (2-tailed)	Pearson Correlation	Sig. (2-tailed)	Pearson Correlation	Sig. (2-tailed)	Pearson Correlation	Sig. (2-tailed)
Rate of Interest_ TA	-.982(**)	0.003	-.990(**)	0.001	-.993(**)	0.001	-.991(**)	0.001
Rate of Interest_ A	-0.813 (*)	0.094	-0.825 (*)	0.086	-0.864(*)	0.059	-0.844(*)	0.072
Rate of Interest PS	-0.790	0.210	-0.834	0.166	-0.828	0.172	-0.820	0.180

**Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.1 level (2-tailed)
Note: TA = Total Advances, A = Agricultural, PS = Priority Sector

0.001 which is also less than (.05) at the 95% confidence level. Overall the study proves that the Interest Rate; Total Advances and Banking Loans have significant high relationship at the 95% confidence level. As per the table above explores the significant relation between the interest rate and Loans level. This shows that Banking Loans increased due to decreasing rate of interest in the majority in three districts of Ajmer Region.

CONCLUSION

With the objective of developing rural economy through promotion of agriculture, trade, commerce, industry and extending credit facilities particularly to small and marginal farmers, agricultural labourers and small entrepreneurs, Rural Banking over the years, has reached out to larger part of rural India. In this paper, we attempted to show that access to low-interest, timely credit and freedom from extra-economic coercion in the credit market is an essential component of the income and livelihood security and the general freedom of the rural poor. Forced location of banks in erstwhile unbanked rural locations was the centerpiece of the Indian Rural Banking experiment. We find that the arrival of bank branches in unbanked locations seems to have been in part responsible for risk management diversification into nonagricultural production and employment, a reduction in rural poverty and a reduction in rural inequality. In the end it can be concluded that rural banking plays a vital role in risk management by providing credit and other financial services to the poor. Thus it helps in raising the standard of living of rural people and contributes to social development as a whole. Government has taken many initiatives for the development of rural banking. This is just the beginning and a lot of work still needs to be done as development of rural people is synonymous to social development of the nation as a whole.

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