

Viability of demand for Agricultural Credit



Economics

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ABSTRACT

At lowering interest rate, supply of credit may be made viable through enhancing business volume.

Introduction

Viable demand for agricultural credit may exist only when a viable credit cycle exists. An improvement of viability of demand for credit shows that FBI (farm business income) is increasing.

Literature review

Desai and Mellor (1993) study shows that in India, average transaction, administrative and financial cost has been declining due to scale and scope economies over the period. This implies that RFIs would improve financial viability through expansion in the business volume rather than the increase in the gross margin as suggested by A.M.Khusro (1980). The study of Desai (1994), Gandhi (1990) and Banwarilal (1992) shows that RFIs have enabled farmers to adopt land, labour, and investment for technological changes through cheap credit.

Objective

To know the situations in which demand for credit may be made viable.

Methodology

Viable borrowers are those who are ready to borrow credit at market interest rate. Viable suppliers are those who are able to generate positive net margin on lending which is equal to difference between interest spread and transaction cost. $\text{Net Margin} = (\text{Lending Interest earning}) + (\text{earning on bonds, securities-bill}) - (\text{Deposit interest cost}) - (\text{transaction cost}) - (\text{Stationary cost}) - (\text{default money}) - (\text{collection cost of dues})$.

Analysis

A strong credit cycle (i.e. Deposit, Lending, and Recovery) needs existence of viable borrowers and viable suppliers. There are following methods by which RFIs can be made viable.

1. Improving Scale and Scope economies of RFIs through lowering marginal cost less than or equal to average cost. An increase in scale economies resulted as an increase in demand for credit for different purposes which generated Scope economies. Due to scale and scope economies, average cost of making loan decreases more rapidly than average cost of collecting dues and deposits. When more and more loans are provided, marginal cost of inputs decreases due to increase in demand through Scope economies.
- (2) Applying multi agency approach of credit to improve competition and make viable.
- (3) Improvement in capital base of RFIs -Increase in capital base of RFIs would make them financially independent and hence they can make loan even when interest rate is lowered. Their capital base may be increased by (a) equity capital of customers (b) business in ordinary debenture, rural debenture and so on.
- (4) Vertically integration of organization-integrating market network with rest of the economy
- (5) increasing density of field offices
- (6) decreasing delinquency rate -Delinquency rate is the percentage of loan overdue to demand for credit.
- (7) Improving Staff co-operation
- (8) increasing the net margin

Conclusion

From above, it is clear that a positive net margin shows a viable supply of credit. A decrease in lending rate and increase in deposit rate enhance the viability of supply of credit. Through scale and scope economies, average transaction cost may be lowered by scale and scope economies. It suggests that even at lowering interest rate, supply of credit may be made viable through enhancing business volume.

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