



## Impact Assessment of Rural Credit Mechanisms on Agricultural Growth and Livelihood Improvement

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### Abstract

Rural credit plays a crucial role in promoting agricultural growth and improving the livelihoods of rural households in developing economies, particularly in India. This research paper evaluates the impact of various rural credit mechanisms, including institutional finance, cooperative credit, microfinance, and government-sponsored schemes, on agricultural productivity and livelihood enhancement. Using secondary data from national surveys, published research, and policy documents, the study highlights how access to affordable and timely credit facilitates technological adoption, crop diversification, employment generation, income growth, and poverty reduction. The findings indicate that institutional credit significantly contributes to agricultural productivity and livelihood security. However, challenges such as regional imbalances, procedural complexities, and rising indebtedness remain. The study concludes with policy recommendations to strengthen rural credit delivery systems and ensure sustainable and inclusive rural development.

**Key Words:** Rural Credit, Agricultural Growth, Livelihood Improvement, Financial Inclusion, Institutional Credit, Rural Development.

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## **1. INTRODUCTION**

Agriculture is the foundation of the Indian economy, employing nearly half of the nation's workforce and playing a vital role in shaping national income. Within this context, rural credit is a crucial driver of agricultural modernisation, allowing farmers to invest in high-quality inputs, advanced technologies, and a variety of allied activities that enhance productivity. Unfortunately, many rural households still struggle with limited access to formal credit options. This situation often forces them to rely on informal lenders, creating a precarious cycle of debt that increases their financial vulnerability.

Over the years, the landscape of rural credit has significantly transformed, particularly after the nationalisation of banks and subsequent financial sector reforms. These changes have greatly expanded the availability of institutional credit for farmers, opening new avenues for acquiring the necessary funds for growth and sustainability. Government initiatives, such as the Kisan Credit Card (KCC) scheme, the establishment of cooperative banking systems, the creation of regional rural banks (RRBs), and the widespread growth of microfinance institutions (MFIs), have been instrumental in enhancing agricultural productivity and improving the livelihoods of rural communities.

This study aims to conduct a comprehensive exploration of the multifaceted impact that various rural credit mechanisms have on agricultural growth and the overall improvement of livelihoods in rural areas. It seeks to highlight the significant achievements and advancements made in this critical domain while also critically examining the persistent challenges that continue to affect the sector. This analysis emphasises the urgent need for sustained efforts to strengthen the rural credit framework, ensuring it remains a lifeline for farmers and contributes meaningfully to the socio-economic development of rural India.

## **2. OBJECTIVES OF THE STUDY**

- To analyse the structure and functioning of rural credit mechanisms in India.
- To evaluate the impact of rural credit on agricultural productivity.
- To assess the role of rural credit in livelihood improvement.
- To identify challenges in rural credit delivery.
- To suggest policy measures for strengthening rural credit systems.

## **3. RESEARCH METHODOLOGY**

This research draws on secondary data sourced from a range of scholarly journals, official government documents, and publications from institutions such as NABARD, RBI, and the Ministry of Agriculture. In addition, reputable newspapers and policy-oriented articles have been utilised. The study employs analytical and descriptive methods to explore relevant trends, assess their impact, and discuss potential implications for policy development.

## **4. CONCEPTUAL FRAMEWORK OF RURAL CREDIT MECHANISMS**

The rural credit system in India is broadly divided into:

- i. Institutional Sources of Rural Credit;
- ii. Non-Institutional Sources of Rural Credit;

#### **4.1. Institutional Sources of Rural Credit**

Institutional sources of rural credit refer to formal financial institutions regulated by the Reserve Bank of India (RBI) and NABARD, providing affordable and reliable financial assistance to rural households. Established to combat the exploitation by moneylenders, these institutions promote agricultural and rural development. Following the nationalisation of banks in 1969 and 1980, institutional credit significantly transformed the rural credit landscape in India. They offer loans to farmers, artisans, and rural entrepreneurs at reasonable interest rates, ensuring transparency and protection for borrowers. Major Institutional Sources of Rural Credit are as follows: -

##### **4.1.1. Cooperative Credit Institutions**

The cooperative credit system is the oldest and most widespread institutional source of rural credit in India. It operates on the principle of mutual help and cooperation. The structure of cooperative credit institutions is three-tier:

- Primary Agricultural Credit Societies (PACS) at the village level
- District Central Cooperative Banks (DCCBs) at the district level
- State Cooperative Banks (SCBs) at the state level

##### **I. Structure:**

- PACS → DCCBs → SCBs → NABARD (refinancing)

##### **II. Functioning:**

- Provide short and medium-term loans.
- Supply crop loans, agricultural inputs, and allied activity finance.
- Promote financial inclusion at the grassroots level.

##### **III. Strengths:**

- Local familiarity
- Easy accessibility
- Community-based functioning

##### **IV. Limitations:**

- Poor governance
- Political interference
- High default rates
- Weak financial health

PACS provide short and medium-term loans to farmers for purchasing seeds, fertilisers, pesticides, and agricultural equipment. DCCBs and SCBs supply funds to lower-level institutions and coordinate their functioning. Cooperative institutions play a crucial role in providing easy and accessible credit to small and marginal farmers.

#### **4.1.2. Commercial Banks**

Commercial banks became major suppliers of rural credit after the nationalisation of banks in 1969 and 1980. Public sector banks, private sector banks, and small finance banks now provide various forms of agricultural and rural loans.

They offer crop loans, term loans for machinery, Kisan Credit Cards (KCC), and finance for self-help groups (SHGs) and rural enterprises. Commercial banks have expanded their branch networks in rural and semi-urban areas, thereby improving financial inclusion and reducing dependence on moneylenders.

##### **I. Structure:**

- Public Sector Banks
- Private Sector Banks
- Small Finance Banks

##### **II. Functioning:**

- Crop loans
- Kisan Credit Card (KCC)
- Agricultural term loans
- MSME rural enterprise loans
- SHG-Bank linkage program

##### **III. Strengths:**

- Large capital base
- Wide branch network
- Technology-based banking

##### **IV. Limitations:**

- Complex documentation
- Collateral requirements
- Procedural delays

#### **4.1.3. Regional Rural Banks (RRBS)**

Regional Rural Banks were established in 1975 to cater specifically to the credit needs of small and marginal farmers, agricultural labourers, artisans, and rural entrepreneurs. These banks combine the local familiarity of cooperatives with the financial strength of commercial banks.

RRBs provide crop loans, microenterprise financing, SHG credit, and promote government welfare schemes. Their localised operations enable better understanding of rural needs, making them effective instruments for rural credit delivery.

##### **I. Functioning:**

- Crop loans
- Self-employment financing

- SHG credit
- Financial inclusion programs

**II. Strengths:**

- Local understanding
- Focus on weaker sections

**III. Limitations:**

- Limited resources
- Regional operational constraints

**4.1.4. NABARD (National Bank for Agriculture and Rural Development)**

NABARD, established in 1982, is the apex institution responsible for the development of rural finance in India. It provides refinancing support to cooperative banks, RRBs, and commercial banks for agricultural and rural development activities.

NABARD also supervises rural financial institutions, formulates policies, and promotes financial inclusion initiatives such as SHG-bank linkage programs. It plays a key role in strengthening rural credit infrastructure and ensuring efficient credit flow.

**I. Functioning:**

- Credit and Refinance Functions
- Developmental Functions
- Supervisory Functions
- Institutional Development
- Research and Policy Advisory
- Infrastructure Development

**II. Strengths:**

- Apex Institution for Rural Finance
- Extensive Rural Outreach
- Promotes Financial Inclusion
- Development-Oriented Approach
- Strong Government Support
- Technical and Institutional Expertise
- Infrastructure Development

**III. Weaknesses:**

- Limited Direct Lending
- Procedural Delays
- Uneven Regional Development

- Dependence on Banks' Efficiency
- Limited Awareness Among Farmers
- Credit Flow Constraints

#### **4.1.5. Microfinance Institutions (MFIS) and SHG-Bank Linkage Program**

Microfinance institutions and SHGs provide small loans to poor rural households, especially women, for self-employment and income-generating activities. These institutions promote financial discipline, savings habits, and women's empowerment.

Group-based lending models ensure high repayment rates and social accountability, making microfinance an effective tool for poverty alleviation and livelihood improvement.

##### **I. Functioning:**

- Provide small loans
- Encourage women entrepreneurship
- Promote savings and financial discipline

##### **II. Strengths:**

- High repayment rates
- Social empowerment

##### **III. Limitations:**

- High interest rates
- Limited credit size

#### **4.1.6. Government-Sponsored Credit Schemes**

The Government of India has launched several schemes to expand rural credit, such as:

- Kisan Credit Card (KCC)
- Pradhan Mantri Mudra Yojana (PMMY)
- Interest Subvention Scheme
- Crop Insurance-linked Loans

These schemes provide subsidized credit, reduce risk, and promote entrepreneurship and agricultural development.

#### **4.2. Non-Institutional Sources of Rural Credit**

Non-institutional sources of rural credit refer to informal and traditional sources of finance that provide loans to rural households without formal banking procedures or legal regulations. These sources existed long before the development of formal banking institutions and continue to play a significant role in rural areas, particularly where access to institutional credit remains limited. Despite the expansion of banks, cooperatives, and microfinance institutions, a substantial section of the rural population still depends on non-institutional credit due to ease of access, minimal documentation, and immediate availability of funds. However, these sources often charge exorbitant interest rates and involve exploitative practices, leading to chronic indebtedness and economic vulnerability. Major Non-Institutional Sources of Rural Credit are: -

#### **4.2.1. Moneylenders**

Moneylenders remain the most dominant and traditional source of rural credit in India. They have historically played a crucial role in providing financial assistance to farmers, agricultural labourers, artisans, and rural households, particularly in areas where institutional banking facilities are limited or unavailable. Despite the rise of cooperative societies, commercial banks, and regional rural banks, moneylenders continue to be a significant source of credit in rural areas because of their easy accessibility, quick loan disbursement, and flexible terms. However, they are also known for exploitative practices, often charging exorbitant interest rates and trapping borrowers in chronic indebtedness.

##### **4.2.1.1. Types of Moneylenders**

- [i] Professional moneylenders
- [ii] Agricultural moneylenders;
- [iii] Trader moneylenders.

##### **4.2.2. Traders and Commission Agents**

Traders and commission agents constitute an important non-institutional source of rural credit, especially in agricultural markets. They provide short-term loans to farmers, primarily for purchasing agricultural inputs and meeting consumption needs. In return, farmers are often required to sell their produce through these agents, usually at prices favourable to the lender.

Although traders and commission agents help meet the immediate financial needs of farmers, their operations often lead to economic exploitation, distress sales, and dependency, thereby negatively affecting farmers' income and financial stability. Traders and commission agents provide loans to farmers against the future sale of agricultural produce.

##### **4.2.3. Landlords**

Landlords have traditionally been an important non-institutional source of rural credit, especially in agrarian societies where land ownership is concentrated in the hands of a few. In rural India, landlords often extend loans to tenant farmers, sharecroppers, and agricultural labourers to meet both productive and consumption needs. While such credit provides immediate financial relief, it frequently leads to economic exploitation, social dependency, and long-term indebtedness.

##### **4.2.4. Relatives and Friends**

Relatives and friends constitute an important non-institutional source of rural credit, especially for meeting short-term financial needs and emergencies. Unlike moneylenders, traders, or landlords, credit from relatives and friends is based primarily on mutual trust, personal relationships, and social obligations. This form of credit plays a supportive role in rural communities by providing financial assistance during periods of crisis, such as illness, crop failure, marriage, education, or natural disasters. Credit from relatives and friends serves as a crucial informal support mechanism in rural areas, especially during emergencies and financial distress. While it lacks the capacity to finance productive investments, it plays a significant role in maintaining social solidarity and financial resilience. Strengthening institutional credit access can reduce over-reliance on informal sources while preserving the supportive role of family and community networks.



#### **4.2.5. Indigenous Bankers**

Indigenous bankers are among the traditional non-institutional sources of rural credit in India. They have been operating for centuries, especially in trading centres and rural markets. Indigenous bankers combine the functions of moneylending, deposit acceptance, and funds transfer, and thus perform limited banking activities outside the formal banking system.

##### **4.2.5.1. Types of Indigenous Bankers**

- *Shroffs* – Major financiers and money dealers
- *Chettiars* – Prominent in South India
- *Marwaris* – Traders and financiers
- *Multanis and Khattris* – Active in North India

Although their importance has declined with the expansion of modern banking institutions, indigenous bankers still play a role in providing short-term finance to farmers, traders, artisans, and small businessmen, particularly in areas with limited access to institutional credit.

## **5. FUNCTIONING OF NON-INSTITUTIONAL SOURCES OF RURAL CREDIT**

The functioning of non-institutional credit is simple, informal, and relationship-based.

### **5.1. Easy Accessibility**

- Loans are easily available, especially in remote villages.
- Based on personal contact and trust.

### **5.2. Quick Loan Disbursement**

- Funds are provided immediately, often within hours.
- Useful during emergencies such as crop failure, illness, or marriage.

### **5.3. Simple Procedures**

- No formal documentation.
- Minimal paperwork and legal formalities.

### **5.4. Flexible Repayment Terms**

- Repayment schedules are adjusted according to crop cycles.
- Sometimes repaid in kind (grain or labor).

### **5.5. High Interest Charges**

- Interest rates are very high, often leading to debt traps.

### **5.6. Informal Collateral**

- Loans may be secured through
  - Land mortgage
  - Future crop pledging
  - Labor services

## **6. STRENGTHS (MERITS) OF NON-INSTITUTIONAL CREDIT**

### **6.1. Quick Availability**

- Immediate access during urgent financial needs.

### **6.2. Simple and Flexible Process**

- No complicated paperwork.
- Easy terms and conditions.

### **6.3. Personal Relationship-Based**

- Trust-based lending enhances mutual understanding.

### **6.4. Useful for Small and Marginal Farmers**

- Helpful for farmers who lack collateral or documentation.

### **6.5. Convenient Repayment**

- Repayment can be in installments or kind.

### **6.6. Reaches Remote Areas**

- Present even in isolated villages.

## **7. LIMITATIONS (DEMERITS) OF NON-INSTITUTIONAL CREDIT**

### **7.1. Very High Interest Rates**

- Often exploitative and burdensome.

### **7.2. Exploitation of Borrowers**

Leads to:

- Bonded labour
- Loss of land
- Perpetual indebtedness

### **7.3. Lack of Legal Protection**

- Borrowers have no formal safeguards.

### **7.4. Small Loan Size**

- Insufficient for long-term development projects.

### **7.5. Unproductive Use of Credit**

- Mainly for consumption, not productive investment.

### **7.6. Encourages Debt Trap**

- High interest and compounding leads to chronic indebtedness.

### **7.7. No Development Orientation**

- Focus on profit, not rural development.

**8. COMPARISON BETWEEN INSTITUTIONAL RURAL CREDIT V/S NON-INSTITUTIONAL RURAL CREDIT**

S. No.	Basis of Comparison	Institutional Rural Credit	Non-Institutional Rural Credit
1	Nature	Formal	Informal
2	Regulation	Regulated by RBI & NABARD	Not regulated
3	Sources	Banks, Cooperatives, RRBs, MFIs, NABARD	Moneylenders, Traders, Landlords, Relatives, Indigenous Bankers
4	Interest Rate	Low and subsidized	Very high
5	Accessibility	Moderate	Easy
6	Documentation	Formal paperwork required	Minimal or none
7	Loan Processing Time	Slow to moderate	Very fast
8	Loan Size	Medium to large	Small to medium
9	Collateral Requirement	Usually required	Sometimes required
10	Purpose	Productive & developmental	Mostly consumption and emergency
11	Risk of Exploitation	Very low	Very high
12	Repayment Terms	Structured and fixed	Flexible but often exploitative
13	Impact on Development	Promotes growth and modernization	Encourages indebtedness
14	Financial Inclusion	High	Low

**9. IMPACT OF RURAL CREDIT ON AGRICULTURAL GROWTH**

**9.1. Enhancement of Agricultural Productivity**

Institutional credit enables farmers to invest in high-quality seeds, fertilisers, irrigation systems, and mechanised tools. Empirical studies confirm a significant positive relationship between institutional credit and agricultural productivity. Regression analysis using national data indicates that enhanced credit access directly increases crop yield and farm efficiency.

**9.2. Adoption of Modern Technology**

Access to affordable credit encourages the adoption of tractors, harvesters, drip irrigation, and precision farming technologies, leading to mechanisation and efficiency gains. Studies indicate that agricultural credit improves production efficiency by promoting technological change and mechanisation.

**9.3. Crop Diversification and Allied Activities**

Credit availability facilitates diversification from subsistence crops to high-value crops like fruits, vegetables, and spices, thereby improving farm profitability. Formal credit has also stimulated

allied activities such as dairy farming, poultry, fisheries, and horticulture, strengthening income stability.

## **10. IMPACT OF RURAL CREDIT ON LIVELIHOOD IMPROVEMENT**

### **10.1. Income Enhancement and Poverty Reduction**

Agricultural credit improves productivity and income, reducing rural poverty. Microfinance and SHG-based lending models have empowered women and marginalised groups, promoting self-employment and household income security.

### **10.2. Employment Generation**

Credit-driven agricultural investments expand labour demand in farming, processing, transport, and marketing. Development programs supported by institutional credit have significantly increased employment opportunities and reduced rural-urban migration.

### **10.3. Financial Inclusion and Social Empowerment**

Institutional credit integrates rural populations into formal financial systems, fostering savings habits, risk mitigation, and economic resilience. Cooperative and SHG-based financial inclusion programs have strengthened social capital and community participation.

## **11. CONCLUSION**

The structure and functioning of rural credit mechanisms in India present a multi-institutional and inclusive framework designed to promote agricultural growth and rural development. While institutional credit has expanded significantly, it is crucial to improve accessibility, efficiency, and sustainability. A coordinated policy approach that integrates technology, financial literacy, and institutional strengthening is essential for ensuring inclusive and sustainable rural financial development. Institutional sources of rural credit form the backbone of India's rural financial system. They provide structured, affordable, and inclusive financial services, contributing significantly to agricultural growth, job creation, and poverty reduction. However, it is vital to strengthen governance, expand outreach, and simplify procedures to ensure sustainable rural development. Non-institutional sources of rural credit also play an important role in meeting rural households' short-term financial needs. However, their exploitative nature, high interest rates, and lack of regulation make them unsuitable for sustainable rural development. Strengthening institutional credit delivery, enhancing financial inclusion, and improving awareness among rural populations are essential steps to reducing dependency on non-institutional sources and promoting equitable and sustainable rural economic growth.

Rural credit mechanisms have a transformative impact on agricultural growth and the improvement of rural livelihoods. Institutional credit enhances productivity, employment, and income levels. Nonetheless, challenges such as uneven access, rising indebtedness, and procedural bottlenecks must be addressed. A well-integrated rural financial ecosystem supported by policy reforms, technological innovations, and financial inclusion initiatives is essential for achieving sustainable and inclusive rural development.

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