Priority Sector Lending: Trends, Issues and Strategies

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ABSTRACT

Priority sector lending has become an important component of national agenda after the nationalization of banks. It is a scheme which is proposed for the important sectors of the economy i.e. agriculture, small scale industries, education loan, housing, weaker sections etc. The present paper is an attempt to study the trends of priority sector advances by public, private and foreign banks during 2011-12 to 2012-13. This study is based on the parameters like lending to priority sector by public, private sector and foreign banks as well as on the targets achieved by public, private sector and foreign banks while lending to priority sector. On the base of these parameters the study concludes that both public sector and private sector banks could not achieve the target which was fixed by RBI for development of priority sectors whereas foreign banks achieved all over target of 32% during the study period. This paper also highlights the issues faced by banks and strategies to overcome these issues.

Key words:
Priority sectors lending, agriculture, weaker sections, small scale industries.

1. INTRODUCTION

Priority sector lending and social banking concepts have been developed and adopted for the purpose of credit deployment. Priority sector lending quota for the commercial banks has provided a major tool for allocation of financial resources to agriculture, small scale enterprises and to the schemes for self-employment. Commercial banks play important role in financing the priority sectors of the economy. In 1967-1968, government of India initiated social control over banks with a view to provide help to agriculture and small scale industries. It was emphasised in the meeting of the National Credit Council held in 1968 that commercial banks should increase their contribution in the financing of the priority sectors, viz., agriculture and small scale industries. On the basis of report submitted by informal study group, description of the priority sectors was formalised. Reserve Bank of India issued certain guidelines that indicate the scope of the item to be included under the various categories of priority sector on the basis of this report. The description of the priority sector was formalized in 1972 on the basis of the report submitted by the informal study group on statistics relating to advances to the priority sector, constituted by the Reserve Bank. Although initially there were no specific goals fixed with respect to priority sector lending in November, 1974. Public sector banks were advised that their priority sector lending should reach a level of not less than one-third of the outstanding credit by March 1979. In November, 1978, the private sector banks were also advised to send a minimum of 33% of their total advances to the priority sector by the end of March 1980. Subsequently, the target was enhanced to 40% of aggregate advances. In achieving this overall target, sub-target for lending to agriculture sector and weaker sections were also stipulated for the banks. At present, banks are required to lend at least 18 and 10% of their net bank credit (NBC) to the agriculture sector and weaker sections respectively. Foreign banks operating in India were also advised to progressively increase their advances to reach a level of 15% of their NBC by the end of March 1992. In April, 1993, this ratio was further raised to 32% of NBC to be achieved by March 1994. Within the enhanced target of 32%, two sub-targets of 10% for SSI and 12% for export were fixed. On the basis of revised guidelines on lending to the priority sector, the priority sector lending target/sub-target have now been linked to adjusted net bank credit (ANBC) or credit equivalent amount of off-balance sheet exposures, whichever is higher, with effect from 30 April, 2007.

Priority Sector Lending

Priority sector lending is a scheme which is proposed to give loans to the important sectors of the economy i.e. agriculture, small scale industries, education loan, housing loan, weaker sections. It is an active instrument of our financial policy which aims to restore sectoral balance with in credit disbursement and to develop the weaker sections within these sectors.

Priority Sectors

Priority sectors include those sectors of economy which may not receive timely and adequate loans in the absence of this special privilege. Usually these include small value loans to farmers for agriculture and for allied activities, micro and small enterprises, to poor people for housing, to students for education and to other low income groups and weaker sections.
2. CATEGORIES UNDER PRIORITY SECTORS

Agriculture
Direct finance to agriculture contains short, medium and long term loans given directly to individual farmer, self-help groups or joint liability groups for raising crop, agriculture and allied activities and pre as well as post-harvest activities.

Indirect finance is given to corporate, partnership firm and institution that is engaged in agriculture. It includes loans given to agriculture and allied activities.

Small scale industries
Direct finance to small scale industries contain loans given to those units engaged in the manufacture, processing or preservation of goods and whose investment in plant and machinery (original cost) excluding land and building does not exceeds Rs. 5 crore.

Indirect finance is given to those persons who support the decentralized sectors by supplying inputs to artisans, village and cottage industries as well as by marketing the output.

Education loan
Education loans include loans and advances to individual for education including vocational courses up to Rs. 10 lakh for studies in India and Rs. 20 lakh for studies in abroad.

Housing loans
It includes loans given to individual up to Rs.25 lakh in metropolitan centres and Rs. 15 lakh given to other centres for purchase and construction of a house.

3. REVIEW OF LITERATURE

Joshi (1972) projected the RBI to give clear and specific definition of different components of priority sector because some of the banks are not clear about the exact scope of agriculture lending.

Angadi (1983) observed the consideration of Priority sector lending in general and agriculture advances in particulars in some states because of repaid branch expansion, deposit mobilization, privileged cropped area, adoption of high yielding variety etc.

Patel (1996) analyzed the progress of commercial banks regarding various components of the priority sector lending i.e. agriculture, small scale industries and other priority sector advances comprised of rural artisans, transport operators, education etc. The study found that tendency declined from 100 percent for small holding group households to 70.15 percent for medium holding household.

Namaśivayam & Ganesan (2008) used Friedman’s test to analyse the performance of different classified commercial banks in financing SSI, Madurai district, Tamil Nadu. The study found that higher range of performance has been shown by state bank groups as compared to national commercial banks and private sector banks.

Ahmed (2010) considered different factors that may affect the scheme of bank financing to priority sectors. The study found that 97% variation in bank financing of agriculture in the three districts of Barak valley Assam was explained by independent variable. Positive interest rate is shown under coefficient while business volume of bank was negative at the same, but both were not statistically significant. The study suggested that proper recovery of loan schemes should be used otherwise banks will have to face liquidity crisis for recycling the fund.

Sharma (2012) analysed the similarity of practice of priority sector lending for private as well as public sector banks and also studied which one is more committed. The result indicated that total lending amount by the two sectors differ from each other but the proportion of the amount was almost similar.

4. OBJECTIVES OF THE STUDY

1. To study the trends of priority sectors lending by public, private and foreign banks.
2. To compare the target achieved by the public, private and foreign banks in study period.
3. To study the issues and prepare strategies to develop the priority sector lending.

5. RESEARCH METHODOLOGY

Indian banks were used as universe of the present study during 2011-12 to 2012-13. The secondary data collected from RBI trends, reports and annual reports has been considered for the purpose of this study. Growth rate analysis has been used to assess the growth of the lending during two years. The Indian banking has been divided into three major bank groups namely: 1) Public sector banks; 2) Private sector banks; 3) Foreign banks.

6. RESULT AND DISCUSSION

Priority sector lending by public sector banks
Table1 indicates the priority sector advances by the public sector banks. The outstanding advances by public sector banks in priority sectors were at Rs. 12836 billion as on March 2013. Advances to agriculture, weaker section, and small scale enterprises constituted 15.8%, 9.8%, and
13.5% respectively of ANBC during 2013. Priority sector lending by public sector banks marginally fell short of the target of 40% in 2013 but amount lent in 2013 increased as compared to 2012. Public sector banks could not achieve the all over targets as well as sub targets during the study period.

Table 1. Priority sector lending by public sector banks (Amount in billions)

<table>
<thead>
<tr>
<th>Sectors</th>
<th>2012</th>
<th>2013</th>
<th>Growth rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Priority sector advances</td>
<td>11307</td>
<td>12836</td>
<td>13.52</td>
</tr>
<tr>
<td>Agriculture</td>
<td>4786</td>
<td>5306</td>
<td>10.86</td>
</tr>
<tr>
<td>Weaker section</td>
<td>2888</td>
<td>3473</td>
<td>20.25</td>
</tr>
<tr>
<td>Small scale enterprises</td>
<td>3966</td>
<td>4784</td>
<td>20.62</td>
</tr>
</tbody>
</table>


Priority sector lending by private sector banks
Priority sector lending by private sector banks has been shown in table 2. It is clear from the table that an amount of 3 thousand 274 billion has been given as advances to priority sector lending as in 2013 as compare to 2864 billion as at 2012 but still target of RBI regarding priority sectors has not been achieved by private sector banks. At present, banks are required to lend at least 18% and 10% of their adjusted net bank credit to the agriculture sector and weaker section of society respectively but during study period private sector failed to achieve the targets and sub-targets of priority sector lending.

Table 2. Priority sector lending by private sector banks (Amount in billions)

<table>
<thead>
<tr>
<th>Sectors</th>
<th>2012</th>
<th>2013</th>
<th>Growth rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Priority sector advances</td>
<td>2864</td>
<td>3274</td>
<td>14.31</td>
</tr>
<tr>
<td>Agriculture</td>
<td>1042</td>
<td>1119</td>
<td>7.38</td>
</tr>
<tr>
<td>Weaker section</td>
<td>389</td>
<td>505</td>
<td>29.83</td>
</tr>
<tr>
<td>Small scale enterprises</td>
<td>1105</td>
<td>1417</td>
<td>28.23</td>
</tr>
</tbody>
</table>


Priority sector lending by foreign banks
Table 3 indicates that priority sector advances by foreign banks increase from Rs. 805 billion to 1033 billion as at 2013 which constituted 35.2% of adjusted net bank credit. Foreign banks achieved the overall targets which were 32% of ANBC but could not achieve the sub-targets during the study period.

Table 3. Priority sector lending by foreign banks (Amount in billions)

<table>
<thead>
<tr>
<th>Sectors</th>
<th>2012</th>
<th>2013</th>
<th>Growth rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Priority sector advances</td>
<td>805</td>
<td>1033</td>
<td>28.32</td>
</tr>
<tr>
<td>Agriculture</td>
<td>1</td>
<td>72</td>
<td>71.00</td>
</tr>
<tr>
<td>Weaker section</td>
<td>-</td>
<td>55</td>
<td>30.41</td>
</tr>
<tr>
<td>Small scale enterprises</td>
<td>217</td>
<td>283</td>
<td></td>
</tr>
</tbody>
</table>


7. ISSUES AND PROBLEMS
Various issues have been created for the Indian banking industry due to the preference of RBI to priority sector advances. So, a need arises for a quick resolution. These problems have badly affected the profitability of banks and have increased NPAs of banks. These issues are discussed below.
Low Profitability
A wide range of factors have affected the profitability of banks such as increasing proportion of deposit resources under statutory liquidity pre-emption at lower rates, the shift of the savers' preference to long term deposits and the incidence of the non-performing assets. In most countries banking is not a high profit area, profitability has been low particularly in India. Increasing involvement of banks in providing mandatory credit entailing rigid target setting has become one of the important reason for declining profitability.

High NPAs
People who borrow from the bank do not repay the loans in time which increase non-performing assets of the banks. The sustainability of priority sectors depend upon the efficient use of the credit of the priority sector lending and the later is directly related to the issue. Thus priority sector lending has created anxiety among Indian banks which discourages them to go slow in disbursement of credit to these sectors.

Quantitative targets
An erosion of quantitative aspects of lending has been caused due to the concern for achieving quantitative targets within stipulated frame of time despite of assessed potential or demand which affects viability of lending institutions.

Government interferences
Government interference in the working of the banks is one of the major problem and especially public sector banks face this problem. Therefore, loans are delivered in the hands of rich rather than weaker sections of the society.

Transaction cost
Sanctioning and monitoring of large number of small loans is time consuming and manpower intensive thus, increases the transaction cost. Deficiencies in pre-sanctioning of the loan and unlimited application in case of lending under poverty alleviation programmes at the last moment by sponsoring agencies also compound the problem. These deficiencies have resulted in the lowering the overall quality of credit and the effectiveness of its delivering.

8. STRATEGIES

Rate of interest
Reserve Bank of India issues various guidelines regarding interest rate for priority sectors lending schemes. Banks should follow these following guidelines of RBI; 1) In respect of direct agricultural advances; banks should not compound the interest in the case of current dues, i.e. Crop loan and instalment should not fall in respect of term loan, because the agriculturalist do not have any regular income source other than sale proceed of their crops; 2) Banks can add interest to the principal amount when crop loan and instalment under term loan becomes overdue; 3) Bank should extend the period of loan or reschedule the instalment under term loans where default is due to genuine reason. Once this type of relief has been extended then bank should not compound interest and overdue becomes current due.

Discretionary powers
Without government interferences, all branch managers of banks should be vested with discretionary power of sanction proposal from weaker section.

Recovery of the NPAs
Bank should follow the following measures for the recovery of NPAs; 1) Debts Recovery Tribunal should implement to recover the NPAs; 2) Banks should be very careful in considering compromise proposal; 3) Bank should try to introduce a system of internal audit before disbursement of the loan.

Qualitative targets
Banks should fix quantitative as well as qualitative target so that feasibility of banks could be enhanced.

9. IMPLICATION

Although RBI has fixed some targets regarding priority sector lending but some banks could not achieve the target as they are not in position to achieve this. The implicit of this paper is that RBI should carry out strict measures against these banks that are not properly providing priority sectors advances.

10. CONCLUSION

Thus, the study reveals that priority sector lending of public sector and private sector banks have not achieved all over targets. A large number of public and private sector banks are not able to reach the prescribed target of lending to priority sectors during study period. In nutshell, shrinking share of real priority sector, neglect of agriculture, neglect of small scale industries and weaker sections, are some important serious issues which need immediate attention of policy maker. Therefore, it is essential that the priority sector lending behaviour of these banks should be closely monitored in the national interest.

REFERENCES

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