Priority Sector Lending: Issues and Strategies

CHINMAY MODI
Research Scholar, SD School of Commerce
Gujarat University, Ahemedabad

Abstract
Lending to priority sectors became an important part of the national program after the nationalization of the banks. This is a program that is offered to major industries like Agriculture, Small Industry, Education Loans, Housing, Weaker Sections, etc. This paper attempts to examine trends in the progress of the priority sectors. This study is based on parameters such as lending to the priority sector by public, private and foreign banks. Based on these parameters, the study comes to the conclusion that both public and private banks have not achieved the target set by the RBI for the development of priority sectors. This document also highlights the problems facing banks and the strategies for overcoming them
Keywords: *priority sectors lending, agriculture, weaker sections, small scale industries, education*

Introduction

Senior sector lending and social banking concepts have been developed and adopted for lending purposes. The priority sector credit quota for commercial banks has been an important tool for allocating finance to agriculture, small businesses and self-employment programs. Commercial banks play an important role in financing priority economic sectors. In 1967-1968 the Indian government instituted social control over banks to support agriculture and small-scale industries. The 1968 National Council of Credit emphasized that commercial banks should increase their contribution to financing priority sectors, namely agriculture and small industry. On the basis of the report submitted by the informal study group, the description of the priority sectors has been formalized. The Reserve Bank of India has issued some guidelines indicating the scope of the position to be included in the various priority sector categories based on this report.

The description of the priority sector was formalized in 1972 on the basis of the report of the Informal Study Group on Statistics on Progress in the Priority Sector prepared by the Reserve Bank. Although no specific target was originally set for senior sector lending from November 1974 onwards, public sector banks were advised that their lending to the senior sector was expected to reach at least one-third of the outstanding loans by March 1979, as of November 1978 It also recommended that private sector banks pay at least 33% of their total priority sector lending till March-1980. As a result, the target was raised to 40% of total advances. To achieve this overall target, a sub-target has also been set for loans to the agricultural sector and the lower ranges for banks. At present, banks are required to lend at least 18% and 10% of their net bank credit (CNB) to the agricultural sector or the weaker social classes. Foreign banks operating in India were also asked to gradually increase their advances to reach 15% of their ABC level by the end of March 1992. In April 1993 this ratio was increased further to 32% of the NBC, to reach by March d '1994. Under the enhanced target of 32%, two sub-targets of 10% for the ISS and 12% for export have been set. Based on the revised Priority Sector Lending Guidelines, the Priority Sector Credit Target / Sub-target is now linked to the Adjusted Net Bank Credit (ANBC) or the credit equivalent of the off-balance sheet exposures depending on the highest amount with effect from April 30, 2007.

Priority Sector Loans

Priority Sector Loan is a program proposed to provide credit to key sectors of the economy, namely agriculture, small industry, educational loans, home loans, and weaker sections. It is an active tool of our fiscal policy aimed at restoring sectoral balance with loan disbursements and developing the weakest areas of these sectors.

Priority Sectors

The priority sectors include sectors of the economy which, without this special privilege, may not receive adequate credit in a timely manner. These are usually low-value loans to farmers for agriculture and related activities, micro and small businesses, poor for housing, students for education and other low-income groups, and to the weakest sections.

Categories Under Priority Sectors

Agriculture

The direct agricultural financing includes short, medium and long-term loans that are granted directly to individual farmers, self-help groups or joint responsibility groups for cultivation, agriculture and related activities as well as activities before and after the harvest.

Indirect financing is granted to companies, partnership companies and institutions active in agriculture. It includes loans for agriculture and related activities.

Small industries

The direct financing of small industries includes loans to entities involved in the manufacture, conversion or maintenance of goods whose investments in equipment and machinery (cost), excluding land and buildings, do not exceed Rs. 5 crores.

Indirect funding is given to people who support decentralized sectors by providing inputs to artisans, village and home industries and marketing the outputs.

Student Loans

Student loans include loans and advances to individuals for educational purposes, including professional courses up to 10 lakh for study in India and 20 lakh for study abroad.

Home loan

It includes loans to individuals up to 25 lakhs in major cities and 15 lakhs to other centers for the purchase and construction of a house.

Review of Literature

Joshi (1972) predicted that the RBI would clearly and precisely define the various components of the priority sector, as some banks do not have precise knowledge of the exact size of agricultural loans.

Angadi (1983) observed the inclusion of loans to the priority sector in general and agricultural advances in particular in certain states due to the expansion of branches repaid, the mobilization of deposits, the privileged cultivation area, the introduction of high-yielding varieties, etc.

Patel (1996) analyzed the progress of commercial banks on various components of lending to the priority sector, namely agriculture, small-scale industry and other advances in the priority sector including rural artisans, transport companies, education, etc. Keeping group households at 70.15 percent for average households.

Namasivayam & Ganesan (2008) used Friedman's test to analyze the performance of various commercial banks classified in SSI Financing, Madurai District, Tamil Nadu. The study found that groups of state-owned banks had a higher performance range than domestic commercial banks and private banks.

Ahmed (2010) examined various factors that could influence the bank financing pattern of priority sectors. The study found that the 97% variation in bank financing for agriculture in the three districts of the Barak Valley in Assam was explained by an independent variable. A positive interest rate is shown under the coefficient • while the bank's business volume was negative but both were not statistically significant. The study suggested taking an adequate recovery from lending systems, otherwise banks will face a liquidity crisis in order to recycle the fund.

Sharma (2012) analyzed the similarity of priority lending practices for private and public banks, and also examined which are more engaged. The result shows that the total loan amount of the two sectors is different from each other, but the proportion of the amount is almost the same.

Objectives of the Study

- To study the issues and prepare strategies to develop the priority sector lending.

Issues and Problems

Various problems have arisen for the Indian banking sector as the RBI favors priority advancement in the sector. So there is a need for a quick fix. These issues severely affected banks 'profitability and increased banks' NPAs. These questions are discussed below.

Low Profitability

A variety of factors have affected banks 'profitability, such as the increase in the proportion of deposit-taking resources under statutory liquidity prevention at lower interest rates, the shift in savers' preference over long-term deposits, and the frequency of non-deposit assets. In most countries, the bank is not a high profit area, profitability has been poor, especially in India. The increasing involvement of banks in the granting of compulsory loans in the context of setting rigid targets has become one of the main reasons for the decline in profitability.

High NPAs

Individuals who borrow from the bank are unable to repay loans in a timely manner, increasing the banks' distressed assets. The sustainability of the priority sectors depends on the efficient use of the credits from loans to the priority sector, and the priority sector is directly related to the issue. As a result, senior sector lending has caused concern among Indian banks, which is preventing them from slowing the disbursements of loans to these sectors.

Quantitative Goals

An erosion of the quantitative aspects of lending has been caused by concerns about meeting quantitative targets in a timely manner despite assessing the potential or demand that is affecting the viability of credit institutions.

Government Intervention

Government interference in the functioning of banks is one of the main problems and public sector banks are particularly faced with this problem. Hence, credit goes into the hands of the wealthy rather than the weaker classes of society.

Transaction Cost/Processing Fees

Sanctioning and monitoring large numbers of small loans requires time and manpower, which increases the cost of the transaction. The problem is also exacerbated by deficiencies in credit precautionary measures and the unrestricted use of last-minute poverty alleviation programs by sponsorship agencies. These shortcomings have resulted in a decline in credit quality and delivery efficiency.

Strategies

Interest Rates

The Reserve Bank of India issues various guidelines on interest rates for senior sector loan programs. Banks should follow the following RBI guidelines. 1) In terms of direct agricultural advances; Banks should not increase interest rates on regular contributions, i. H. Crop loans and down payments should not go down in relation to the term loans as the farmer has no other regular source of income other than the proceeds from the sale of his crops. 2) Banks may pay interest on principal if the farm loan and the term loan installment are overdue. 3) The bank should extend the loan term or postpone the payment of term loans if the default is for a real reason. Once this type of relief is extended, the bank should run out of compound interest and the arrears will fall due.

Discretionary Powers

Without government intervention, all bank branch managers should have the discretion of the weaker section to propose a sanction.

NPAs Recovery

The bank should follow the following measures to restore NAPs: 1) The debt collection court should conduct the recovery of APMs. 2) Banks should be very careful when considering compromise proposals. 3) The bank should try to put in place an internal audit system before the loan is disbursed.

Qualitative Targets

Banks should set quantitative and qualitative targets so that bank feasibility can be improved.

Implication

Although the RBI has set some targets for senior sector lending, some banks have not been able to meet that target because they cannot. This document implies that the RBI should take strict action against those banks that fail to properly advance priority sectors.

Conclusion

The study therefore shows that senior sector lending by public and private sector banks did not meet all targets. Many public and private sector banks are unable to meet the mandatory target of lending to priority sectors during the period under study. In conclusion, the shrinking share of the real priority sector, the neglect of agriculture, the neglect of small industries, and weaker sections are important serious issues that require the immediate attention of policy makers. It is therefore important that the priority lending behavior of these banks is closely monitored in the national interest.

References

Ahmed, U. D. (2010). Priority Sector Lending By Commercial Banks in India: A Case of Barak Valley. *Asian Journal of Finance & Accounting*, *2*(1).

Angadi, V.B. (1983). Bank's Advances to Priority Sectors: An Enquiry in to the Causes of Concentration, *Economic & Political Weekly*, XVIII (13):503-510, March 26

Dasgupta, R. (2002). Priority sector lending: Yesterday, Today and Tomorrow. Economic andPolitical Weekly. pp.4239-4245.

Joshi, P.N. (1972). Financing of Priority Sectors by Commercial Banks, The Journal of IndianInstitute of Bankers, XLIII(1):27-34

Khundrakpam, J. K. (2000). Priority Sector Bank Lending: Some Important Issues. Economic andPolitical Weekly. pp.1209-1211

Namasivayam, N., Ganesan, S. (2008). Analysis of Financing Small Scale Industries by Commercial Banks in Madurai District, Tamil Nadu using Friedman's Test. Finance India, Vol. XXII No.3. pp.957-964

Patel, S. G. (1996). Role of Commercial Banks' Lending to Priority Sector in Gujarat-An Evaluation. Finance India, X (2). pp.389-393

Rikta, N. N. (2006). Institutional Lending and Financing Policy for SMEs in Bangladesh, Policy Note, Federation of Bangladesh Chamber ofCommerce and Industry. Dhaka

Sharma, N. (2012). Lending to Priority Sector in India: A study of Public and Private Banks. Paradigm, Vol.XVI, No.1. pp.11-17

Shajahan, K. M. (1999). Priority Sector Bank Lending: How Useful?.Economic and PoliticalWeekly. pp.3572-3574

Uppal, R. K. (2009). Priority sector advances: Trends, issues and strategies. Journal ofAccounting and Taxation, 1(5), 079-089.

www.rbi.org.in