

PRIORITY SECTOR Lending By INDIAN BANKS PRESENT SCENARIO

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Abstract

Priority sector lending has become an essential component of the national agenda after the nationalization of banks. The socialization of bank credit has been the theme of priority sector lending by commercial banks. Since the public sector banks touch the lives of millions, it is their topmost responsibility to help the government in achieving the different socio-economic priorities like growth of agriculture, small scale industries and exports, rise of employment, encouragement of entrepreneurs and development of backward areas. With the passage of time, with the public sector banks, other banks are also being given targets to achieve, for priority sector lending. For developing countries like India, priority sector lending plays an important role to strengthen the economy as a whole. The objective of the paper is to emphasize the present scenario of priority sector lending. Analytical type of research is carried out to reach the objective. For the purpose, ten years report on trends and progress of banking in India from 2000 to 2009 has been used.

INTRODUCTION

Some areas or fields in a country, depending on its economic condition or government interest, are prioritized and are called priority sectors such as industry and agriculture. Banks are directed by the state bank of the country to give loans on reduced interest rates with discounts to promote these fields. Such lending is called priority sector lending. Priority sector lending comprises of agriculture, small scale industries, small road and water transport operators, small business, retail trade, professional and self-employed persons, state sponsored organizations for ST/SC, education, housing, consumption loan, micro credit to self-help groups, venture capital financing and loans to software industries. An enunciation of the need to channelize the flow of credit to certain sectors of the economy, known as the priority sectors, in the larger interests of the country,

can be traced to the Reserve Bank's credit policy for the year 1967-68.

The nationalization of the 14 major commercial banks in July 1969, led to a considerable re-orientation of bank lending, especially to the priority sectors of the economy, which had not previously received sufficient attention from commercial banks. There was a greater involvement of banks in these and other socially desirable sectors. Moreover, institutional credit facilities at reasonable rates of interest were extended to a large number of borrowers of small means such as small farmers, small-scale manufacturers, retail traders, road transport operators, small businessmen, professionals and self-employed persons and also for education. The concept of priority sector lending was evolved further to ensure that assistance from the banking system flowed in an increasing measure to the vital sectors of the economy and according to national priorities.



Priority Sectors and Stipulations on Targets For Lending

The description of the priority sectors was formalized in 1972 on the basis of the report submitted by the Informal Study Group on Statistics Relating to Advances to the Priority Sectors constituted by the Reserve Bank in May 1971. On the basis of this report, the Reserve Bank prescribed a modified return for reporting priority sector advances and certain guidelines were issued in this connection in February 1972, indicating the scope of the items to be included under the various categories of the priority sector. 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 advised to lend a minimum of 33 $\frac{1}{3}$ % of their total advances to the priority sectors by the end of March 1980. In March 1980, all domestic scheduled commercial banks were advised to raise the proportion of the priority sector advances from 33 $\frac{1}{3}$ % to 40 percent of aggregate advances by March 1985. In achieving this overall target, the banks were asked to ensure that their direct advances to agriculture should be at least 15 % of net bank credit (NBC) by March 1985 and 16 % by March 1987. Further, it was stipulated that banks' advances to the weaker sections of society should reach 25 % of their total priority sector advances or 10 % of NBC by March 1985.

In 1980, Reserve Bank set up a Working Group on Priority Sector Lending and 20-Point Economic Programme (under the Chairmanship of Dr. K. S. Krishnaswamy, the then DG, RBI) to work out the modalities for implementation of two decisions taken in March 1980 by the Government of India, viz., that banks should aim at raising the proportion of their advances to the priority sector from 33 $\frac{1}{3}$ % to 40 % by 1985, and that the banks should actively promote the implementation of the 20-Point Programme which was aimed at improving the lot of the weaker sections of the population. The Group

identified the categories of beneficiaries requiring assistance from the banking system in pursuance of the 20-Point Programme and spelt out the manner in which assistance could be rendered. As most of the beneficiaries under the programme fell in the relatively under-privileged group within the priority sector, the group suggested certain changes in the approach to priority sector lending. In particular, it introduced the concept of 'weaker sections' within the priority sector and recommended separate sub-targets for lending to the weaker sections in the two main categories of the priority sector, agriculture and SSI, within the overall enhanced target of 40% for lending to the priority sector. Housing loans up to Rs 5,000 for construction of houses for SC/ST and weaker sections, assistance to any governmental agency for construction of houses for SC/ST and low-income groups (where loan component does not exceed Rs 5000 per unit) and pure consumption loans granted to the weaker sections under the Consumption Credit Scheme were recommended for inclusion in the priority sector. On acceptance of the recommendations of the Working Group, the Bank issued instructions on October 29, 1980 for implementing them. The important instructions were as follows:

- (i) Priority sector advances should constitute 40% of aggregate bank advances by 1985. For achieving the target, banks should ensure that a minimum of 40 % of the incremental credit plus such additional amounts should flow to the priority sector every year, so that they progressively reach the target of 40 % by 1985.
- (ii) Forty% of the priority sector advances should be earmarked for agriculture and allied activities. In other words, advances to the agricultural sector should be at least 16 % of total advances by 1985.
- (iii) Direct advances to the weaker sections in agriculture and allied activities (i.e. small and marginal farmers and landless

laborers) should reach a level of at least 50% of the total direct lending to agriculture (including allied activities) by 1983.

- (iv) Advances to rural artisans, village craftsmen and cottage industries should constitute 12.5 % of the total advances to SSI by 1985.

Stress was put on the banks so that the emphasis should not only be on the priority sector but also on the weaker and under-privileged groups within each sector. The classification of the various segments that comprise the priority sector was further restructured based on the report of the 'Working Group on the Role of Banks in Implementation of New 20-Point Programme' (Chairman: Shri A Ghosh, 1982). The recommendations made by the working group were accepted by the Government of India and Reserve Bank of India (with modifications) and instructions were issued to banks in February 1983. The various segments which were classified by the above Group's report under the priority sector were Agriculture (both direct and indirect finance), SSI, Small Road and Water Transport Operators, Retail Trade, Small Business, Professional and Self Employed Persons, State sponsored schemes for Scheduled Castes/Scheduled Tribes, Education, Housing and Consumption. Targets and sub-targets under the different priority sectors for different categories of banks have been reviewed and revised periodically. The sub-target for agriculture and allied activities (which was set at 15% of NBC to be achieved by March 1985) was subsequently raised to 16% by March 1987, 17% by March 1989 and 18% by March 1990. This sub-target was further bifurcated in October 1993 to a minimum of 13.5% for direct loans and a maximum of 4.5% for indirect loans. Foreign banks operating in India were advised to progressively increase their advances to the priority sector categories of borrowers and such advances were 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 per cent, two sub-targets of 10% in respect of SSI and 12% for exports were fixed. New private sector banks were advised to observe priority sector lending targets as applicable to other domestic commercial banks at 40 per cent. The Local Area Banks (LABs) in the private sector were also advised in August 1996 to observe priority sector lending targets as applicable to other domestic banks. Within this target, LABs are to adhere to the requirement of lending at least 25% of their priority sector deployment (10% of Non Banking Company) to weaker sections. Primary co-operative (urban) banks are also required to attain a priority sector lending of 60% of their total advances, of which at least 25% should be to weaker sections.

PRESENT SCENARIO

(A) Priority Sector Advances by Private, Public and Foreign Banks for the last 10 years

It has been seen that in case of public sector banks, in all the years under study i.e., from 2000 to 2009 advances are more than 40% of Net Bank Credit but it is of a fluctuating nature. In case of private sector banks apart from the first two years, it is more than 40% and it is also fluctuating in nature. In case of foreign banks, priority sector lending is more than the target 32% of NBC and it is also fluctuating in nature. Coefficient of variation is the highest in foreign banks i.e., 55.17% and lowest 31.57% in public sector banks and after that it is private sector banks where the coefficient of variation is 48.75%. But in case of private sector banks, priority sector advances have grown by 10.36 times during the 10 years period under study followed by public and private sector banks which have grown by 5.63 and 5.59 times respectively.

(B) Segregation of total priority sector lending to public, private and foreign banks

The public sector banks are contributing most to the priority sector lending. But in public



sector banks, it has decreased from 81.87% to 74.56% from the year 2000 to 2009 whereby it has increased from 11.77% to 19.7% during the 10 years under study for private sector banks. Foreign banks are showing somewhat similar contribution to the priority sector lending during the period under study. As it is the public sector banks whose Net Bank Credit is the highest, their contribution to the priority sector lending is the highest (40% of NBC), followed by private and foreign banks.

(C) Rural Infrastructure Development Fund (RIDF)

There has been an increasing trend in the number of projects sanctioned under RIDF since the inception of the fund. However, loans disbursed as a percentage of loans sanctioned under each branch have shown a declining trend over this period. Under RIDF, the ratio of loans disbursed to loans sanctioned is declining from 92.4% to 20.5% from 1995 to 2008. As there has been a decrease in the ratio of loans disbursed against loans sanctioned, the situation is to be given due consideration. The reason may be that, these loans are given in a phased manner if the reason for utilization is not the same as that of loans given, the loan may be stopped. Borrowers may not be interested to take a loan in this scheme. So the disbursed amount is not equal to that of the loan sanctioned.

(D) Non-performing Asset in Priority Sector Lending

Non-performing Assets (NPAs) in case of public sector banks are much higher than those of the private sector banks. In case of public sector banks, it is on an average of 51.23% for the 10 years under study. It has touched 63.62% in the year 2008 and it was lowest in the year 2002 i.e., 44.49%. In case of private sector banks, the average NPA for the 10 years under study is 25.67% with a minimum of 20.61% in 2003 and highest being 31.22% in 2007. The data in the above

table has shown a grim situation regarding the growing level of NPAs in the priority sector lending. Here two serious observations are made - first, the % share of priority sector NPAs turns out to be quite high as compared to its share in Net Bank Credit and second, it has shown a significant growth too. However, this may be due to a high volume of NPAs being carried forward to the succeeding years.

(E) Number of accounts under priority sector lending by public sector banks

The number of accounts under priority sector lending of public sector banks is increasing. From 265 lakhs in the year 2000, it has reached 431 lakhs i.e., it has increased 62.64 times during those 10 years and at the same time per account volume of advances is also increasing i.e., the productivity has increased 264 times. Highest % increase in the per account volume of advances was in the year 2002 (25%). As the volume of transactions of the banks is increasing, though 40% is the same as the target, the volume of priority sector advances is increasing and various sectors are also increasing with the passage of time. As new sectors are being introduced, the number of accounts are increasing so is the volume of advance.

(F) Priority sector lending by public sector banks in different segments

The volume of priority sector lending by public sector banks has increased by 20.3%. In agriculture the growth is 22.1%, in small scale units the growth is 15.4% and in other sectors the growth is 23.2%. On an average it has contributed 15.51% in agriculture, 11.16% in small scale units and 14.89% to others out of Net Bank Credit. The volume of lending under priority sector lending in public sector banks is above the norms of 40% of NBC in all years under consideration. In case of agriculture, it could not meet its desired target of 18% in any of the years from 2000 to 2009 but it is still an increasing trend. As agriculture is the foundation of the Indian

economy, it should be the first responsibility of the public sector banks to deploy required finances to this sector.

(G) Priority sector lending by private sector banks in different segments

In private sector banks, the volume of priority sector advances has grown at 28.7%. The volume of agricultural lending under priority sector lending has grown at 34.2%, small scale units has grown at 19% and other sectors have grown at 30.4%. The average share of priority sector lending from 2000 to 2009 is 43.09 %, the average agricultural credit is 13.79, it is 10% in case of small scale units and 19.11% for others. In case of private sector banks, priority sector lending as a percentage of Net Bank Credit is increasing from 2000 to 2009 of the period under study. It can be said that private sector banks have taken the responsibility towards priority sector lending very seriously and they are doing well in that. Like public sector banks, private sector banks are also lagging behind the desired 18% target in agricultural loans. As new sectors are coming under priority sector lending, contribution in other priority sector lending is increasing.

(H) Priority sector lending by foreign banks in different sectors

The volume of priority sector lending under foreign banks has grown at a 20.2 % rate. The volume in case of export credit has increased at 19.5% and in case of small scale industries it has grown at 20.4%. In case of total priority sector advance as a percentage of Net Bank Credit it has shown average of 34.76% , the average is 19.66% in case of export credit and 10.54% in case of small scale industries. Priority sector advances of foreign banks is well above its desired target of 32% in all the years from 2000 to 2009. Export credit which is exclusively for the foreign banks is above its desired 12% target in all years under study and the same is the case with small scale industries which is above the desired target of

10% in all the years. So the foreign banks are performing well in priority sector lending. The reason is that in their case agriculture is not in the priority sector lending and as their area of operation is limited, it is easier to achieve the target.

(I) Number of Kisan credit cards issued

Total number of Kisan credit cards issued by cooperative banks during 2000 to 2009 is 36.2 million, by RRBs it is 11.5 million and by commercial banks it is 37 million. Percentage share in total Kisan credit card issued is 13.5% in case of RRBs, 42.7% in case of cooperative banks and 43.8% in commercial banks. The highest number of Kisan credit cards is issued by the commercial banks and throughout the year it is showing an increasing trend. Cooperative banks are also doing well in this aspect but its trend has shown fluctuating nature. The share is the lowest in case of RRBs and has not increased so much during the years under study.

(J) Disbursement by public sector banks under special agricultural credit plans

Disbursement by public sector banks under Special Agricultural Credit Plans has increased from 21913 crores to 144302 crores from 2000 to 2009. Achievement of target is 99.41% on an average under the 10 years under study. Annual growth in disbursement is the highest in 2005 (54.5%) and lowest in the year 2009 (8.3%). Correlation between the target and the disbursement is 0.9932, i.e., these are highly correlated. The special agricultural credit plan of public sector banks is performing very well and it is proved by the data regarding achievement of target as it is more than 90% only other than 2008 (87.6%) and is more than 100% in 2000, 2005, 2006 and 2007. Yearly volume of disbursement is also increasing. The correlation between the target and disbursement is .9932 which is showing that they are highly correlated. As the target of disbursement has been exceeded in some years, it shows the success of this plan.

**(K) Disbursement by private sector banks under special agricultural credit plans**

In case of private sector banks, the achievement of the target is more than 100% from the starting year 2006 i.e., 128.8% and after that it is 108.5%, 115.5% and 104.3%. The annual growth in disbursement is 41.3%, 8.5% and 25% respectively from 2007 to 2009. Special agricultural credit loan has done extremely well in case of private sector banks. Disbursement is always more than 100% of the target. The growth rate of the disbursement is also quite satisfactory in all the years.

(L) No-frills accounts

With a view to providing financial inclusion, the Reserve Bank advised all banks in November 2005 to make available a basic banking 'no-frills' account either with 'nil' or low minimum balances as well as charges. The basic idea behind this was that extending banking services to lower income groups would trigger a virtuous cycle whereby access to banking services would enable more equitable distribution of the benefits of high economic growth, resulting in improvement in the level of income of the lower income groups. In case of public banks, the number of no-frill accounts has increased by 88.70 times. It is 20 times in the case of private banks and for foreign banks the increase is 180 times when we compare 2006 with 2009. In case of no frills accounts, all the banks i.e., public, private and foreign banks are doing extremely well from when they have started. The borrowers are showing interest in the case of no-frill accounts.

(M) SGH-bank linkage programme (SBLP) approach

A Self Help Group (SHG) is a small homogenous affinity group of about 15 to 20 people who join together to address common issues. Voluntary thrift activities are undertaken on a regular basis by the group and these pooled savings are used to make interest bearing loans to the group members.

Apart from inculcating the habit of thrift, the SHG activity also imbibes concepts like financial intermediation and handling of resources. Once the group is stabilized, it gets linked to the banks and avails of financial services from banks. It was initiated in 1991-92. From the table it is clear that in case of commercial banks, the amount of bank loans disbursed under SBLP has increased from Rs.1150 crores to Rs. 8061 crores from 2003 to 2009. In case of RRBs, the amount has increased from Rs. 727 crores to Rs. 3193 crores and the amount has increased from Rs. 172 crores to Rs. 999 crores for cooperative banks. The total amount has increased from Rs. 2049 crores to Rs. 12254 crores from 2003 to 2009 i.e., it has increased 6 times during these years. Commercial banks are contributing the highest in SBLP i.e., 60.36 on an average during 2003 to 2009 followed by Regional Rural Banks (RRBs) whose disbursement average is 30.76 and for cooperative banks the average is 8.89.

OTHER RELEVANT OBSERVATIONS

The commercial banks are performing well compared to RRBs and cooperative banks. The general reason is that RRBs are of sponsored banks, of some other banks and financially weaker than commercial banks. In case of cooperative banks they are limited to some areas and to some groups of people only. The banks appear to have been doing reasonably well at the surface level with regard to priority sector lending as in all the years under study, the desired target has been achieved i.e., for domestic banks it is 40% of its Net Bank Credit and for foreign banks it 32% of its Net Bank Credit. Probably this high ratio of priority sector advances is on account of a number of guidelines coming from RBI from time to time, evolving different methods through which advances from direct priority sector lending can take place. It is the public sector banks whose Net Bank Credit is the highest, their contribution to the priority sector lending is the highest (40% of NBC), followed by private and foreign banks. There has been a decrease in the ratio of loans

disbursed to loans sanctioned, the situation is to be given due consideration. The reason may be that as these loans are given in a phased manner if the reason for utilization is not same as that of loans given, the loan may be stopped. Borrowers may not be interested to take loan in this scheme. NPA in public banks are higher than those of private banks in priority sector lending. It is because of this that the volume of loan is also higher in public banks than in private banks. As the volume of transactions of the banks are increasing, the volume of priority sector advances is also increasing. Again various sectors are included in priority sector lending; with the passage of time, it has resulted in an increase in the number of accounts under the priority sector from 265 lakhs in 2000 to 431 lakhs in 2009.

In case of domestic banks, the overall target is achieved but not in case of agricultural loans which is below the target of 18% and in case of foreign banks the target is achieved in both export credit and small scale industries. The highest numbers of Kisan credit cards are issued by commercial banks and throughout the years have shown an increasing trend. The cooperative banks trend is declining and RRBs' share is the lowest but shows an increasing trend. Both public and private sector banks are performing well in disbursing loans under the Special Agricultural Credit Plan. Achievement of target is 99.41% on an average under the 10 years under study for public banks and it is 114.28% for private banks. In case of no frills accounts, all the banks i.e., public, private and foreign banks are doing extremely well from when it has been started i.e., they are increasing tremendously. Commercial banks have performed well, compared to RRBs and cooperative banks. It is a general reason that RRBs are of sponsored banks, some other banks and financially weaker than commercial banks. In case of cooperative banks, they are limited to some areas and to some groups of people only. From testing hypotheses it has been found that there is significant difference between different sectors of banks namely Public, Private and

Foreign sector banks in quantum of priority sector lending out of Net Bank Credit. There is a significant difference in the recovery performance among the banks i.e., Public and private sector banks. From the study it has been seen that although many other factors are there, priority sector lending which is working for the development of the whole economy is also one of the factors to take economic indicators in a positive direction. To increase the customer base, there is ample scope to include the poor section of people in the banking stream as those are below Rs. 50,000 p.a. income .75% of them borrow from informal sources and they charge a higher interest rate than the formal source of finance (more than 36% interest from more than 60% of the borrowers).

Strategies for the Priority Sector

The Government of India and Reserve Bank of India had initiated several policy measures for increasing and improving credit flow to the Priority Sector which broadly included agriculture, small and medium enterprises. The banking industry has been responding positively to these initiatives. However, during the last few years, domestic banks are not able to achieve the targets particularly in lending to agriculture and the amount of NPA is also increasing. Thus, presently, Commercial banks are experiencing dual problems of increasing credit flow and outreach under the Priority Sector as well as reducing NPAs. In this conflicting situation, banks have to formulate and implement workable strategies for improving outreach and efficiency of their rural lending portfolios.

After studying the priority sector lending in India for the last 10 years (2000 to 2009) the following suggestions are being made:

(a) Strategies for increasing flow of credit and outreach to emerging areas of priority sector lending

- High-value agriculture, agribusiness, agro-food processing, agril-Infrastructure, etc.
- Small and medium enterprises in farm



and non-farm sector : Innovative approach models – Contract farming, agro-expert zones, food parks, supply-chain financing

(b) Strategies for reduction of NPAs in priority sector lending

- Developing a risk scoring model for lending to priority sector activities
- Negotiating skills in recovery management
- Analysis of magnitude and movement of non-performing advances of banks under priority sector lending
- Analyze the impact of Agricultural Debt Waiver Scheme on the NPA of Priority sector

(c) Rural people should be made aware of

the various financial products, various incentives for them so that they can reap the maximum benefit. More and more bank branches should be opened in rural and semi urban areas so that banking becomes a regular practice for rural and semi-urban people.

CONCLUSION

RBI's policy and banks' initiatives are working in a positive direction as banks are able to achieve the desired target with regard to priority sector lending. Agricultural finance is showing a shortfall because of non-availability of mortgage or a lower number of sponsors. In case of public banks, NPA is a matter of concern. NPA should be handled crucially by private banks too. The Number of priority sector accounts in public sector banks is increasing which shows the popularity of priority sector lending in the nation and its

success. New initiatives like No-Frill accounts are also very successful in priority sector lending and this is evident from its tremendous increase since inception. The economic parameters are also in a positive direction in the period under study i.e., from 2000 to 2009. It may have some effect on priority sector lending. Still today, there is ample scope for priority sector lending, if we consider the people of lower economic conditions as a huge percentage still depend on informal sources of finance and pay more for the finance. If proper steps are taken to manage NPA in priority sector lending, increase the flow of credit and outreach to emerging areas of priority sector lending and capture the people who are outside the purview of priority sector lending, the success of priority sector lending can be enhanced.

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