

Priority Sector Lending- A Challenges to Public Sector Banks

Manjushree S.

Assistant Professor

Government First Grade College,

Narasimharajapura,

e-mail:manjushrees1986@rediffmail.com

Cell No: 9741883810

Dr. Giridhar K.V.

Assistant Professor,

Sahyadri Arts and Commerce College,

Constituent College of

Kuvempu University,

Shivamogga-577203.

e-mail: giridhar.malnad@gmail.com

Cell No. 9980647833

Abstract:

This study provides a platform to understand the priority sector lending by the banks and its recent issues on priority sector lending certificate. The sectors which provide the basic needs of a mankind and are crucial for the development of the economy are called as priority sectors. These sectors are not only for the government, RBI or bank but also for priority of each and every individual. These sectors need not require any benchmark stipulation by the regulator. The modest attempt has been to understand priority sector advances, shortcoming of priority sector advances, challenges in agricultural lending, recent guidelines and present issues of priority sector lending.

Keywords: Nonperforming assets, Targets, NBFC etc.

Introduction

The objective of priority sector lending is to ensure that timely and adequate credit is available to vulnerable sections of the society. priority sector loans include small value of loans to farmers for agriculture and allied activities. During 2015-2016, the RBI intensified its efforts towards expanding formal banking facilities covering hitherto excluded section of the society. Greater focus was placed on ensuring adequate credit flow to various segment in the priority sectors. Measures such as introduction of priority sector lending certificate.

During 2015-2016, PSLCs were introduced as a mechanism for incentivising bank having surplus in lending to different categories of the priority sector thereby enhancing lending to these sectors. PSLCs will allow the market mechanism to drive priority sector lending by leveraging the comparative strength of different banks. For trading purpose, a dedicated portal was launched in April 2016.

The concept of priority sector lending is mainly intended to ensure that assistance from the banking system flows in an increasing manner to those persons and sectors of the economy. It has been in the post 1969 period that priority sector lending and adopted for the purpose of credit deployment. The term 'Priority sector' indicates those activities which have national importance and have been assigned to priority for development. When the concept of priority sector was created, a group of economic activities were classified as priority sectors. Over a period, there have been changes in these sub categories. In 1967-68, agricultural, small scale industries were classified as priority sectors. And in 1972, differential rates of interest under which one per cent of the advances were to be given at a very concessional rate of interest.

Agricultural finance is a sectoral concept which comprises financial services for agricultural production, processing and marketing, such as short, medium and long-term loans, leasing, and crop and livestock insurance. Recently, the concept of agricultural value chain finance was introduced to emphasise the vertical dimension of agricultural finance to and between different segments of agricultural value chains. Although agricultural finance can largely be regarded as a subset of rural finance, some larger companies operating on both ends of agricultural value chains are also located in bigger towns and cities.

Classification of Priority Sector Advances

Classification containing the list of items in different segments of priority sector advances.

1. **Agriculture:** Agriculture has always been a most neglected sector as far as bank credit is concerned. That is why, right from 1968, Government of India directed the banks to improve their lending to the agricultural sector. Extant guidelines stipulate that banks achieve total agriculture lending of 18% of Adjusted Net Bank credit or Credit Equivalent of Off-Balance Sheet Exposure, whichever is higher, within which indirect lending should not exceed 4.5%.
 - i. Direct agricultural loans: Under this category, loans are directly given to the farmers in form of tractor loan, dairy loan, crop loan etc. These loans are given either for a short term period (which is not more than 12 months) or for a medium and long term period (which is not more than 36 months).
 - ii. Indirect agricultural loans: Here farmers are provided loans at concessional rates of interest. Indirect agricultural loans benefit the farmers in the long run. These loans are given for cattle feed, warehouse, seeds, pesticides, rural electrification, subscription of bonds issued by NABARD, boring equipment.
2. **Small scale industries loans:** Small Scale industries constitute an important and crucial segment of the industrial sector in most of the developing countries like India. They play an important role in employment creation, resource utilisation and income generation and help to promote changes in a gradual and phased manner. They have been given an important place in the framework of Indian planning since beginning both for economical and ideological reasons. The reasons are obvious. The Small Scale Industries Board in 1955 defined, "Small- scale industry as a unit employing less than 50 employees if using power and less than 100 employees if not using power and with a capital asset not exceeding Rs. 5 lakhs". Loans given to small-scale and ancillary industries are treated as priority sector. These industrial units are those which undertake manufacturing, processing and preservation of goods.
3. **Education loan:** Educational loans should include only loans and advances granted to individuals for educational purposes and not those granted to institutions and will include all advances granted by banks under special schemes, if any, introduced for the purpose.
4. **Housing loan:** Loans up to Rs.20 lakh for construction of houses by individuals (excluding loans granted by banks to their own employees) and loans given for repairs to the damaged

houses of individuals up to Rs.2 lakh in rural and semi-urban areas and up to Rs.5 lakh in urban areas.

5. **Micro credit loans:** Provision of credit and other financial services and products of very small amounts not exceeding Rs. 50,000 per borrower to the poor in rural, semi- urban and urban areas, either directly or through a group mechanism, for enabling them to improve their living standards, constitutes micro credit.

Table1 Showing Targets and Sub targets of Priority Sector Lending

Categories	Domestic commercial banks / Foreign banks with 20 and above branches (As percent of ANBC or Credit Equivalent of Off-Balance Sheet Exposure, whichever is higher)	Foreign banks with less than 20 branches (As percent of ANBC or Credit Equivalent of Off-Balance Sheet Exposure, whichever is higher)
Total Priority Sector	40	32
Total agriculture	18	No specific target.
Advances to Weaker Sections	10	No specific target.

Table 2 Showing Outstanding credit to Priority Sector Lending by PSBs Rs in Crore

Year	PSB	As% of ANBC
2001	146546	43
2002	171185	43.1
2003	203095	42.5
2004	245672	44
2005	310093	43.2
2006	410379	40.3
2007	521180	39.6
2008	608963	44.6
2009	719497	42.5
2010	864562	41.7
2011	1028615	41.3

2012	1129990	37.4
2013	1284880	36.4
2014	161897	39.4

Sources: RBI trends and progress in banking in India

The share of priority sector advances in NBC of PSBS increased to 44% in 2003 -04 from 42.5% in 2002-03. The growth in priority sector advances of banks was fuelled by surge in the loans and advances to various other priority sectors other priority sector and massive growth of credit to agriculture.

Direct Finance to Agriculture

The following point portrays the direct advances to agricultural sectors:

- i. Loans to individual farmers including Self Help Groups (SHGs) or Joint Liability Groups, i.e. groups of individual farmers engaged in Agriculture and Allied Activities, *viz.*, dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture.
- ii. Loans to corporate including farmers' producer companies of individual farmers, partnership firms and co-operatives of farmers directly engaged in Agriculture and Allied Activities, *viz.*, dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture up to an aggregate limit of Rs.2 crore per borrower.
- iii. Loans to small and marginal farmers for purchase of land for agricultural purposes.
- iv. Loans to distressed farmers indebted to non-institutional lenders.
- v. Bank loans to Primary Agricultural Credit Societies, Farmers' Service Societies and Large-sized Adivasi Multi-purpose Societies ceded to or managed/ controlled by such banks for on lending to farmers for agricultural and allied activities.

Indirect Finance to Agriculture

The following points portrays the indirect advances to agricultural sectors:

- i. If the aggregate loan limit per borrower is more than Rs.2 crore in respect of para. (4) (ii) above, the entire loan will be treated as indirect finance to agriculture.
- ii. Loans upto Rs.5 crore to Producer Companies set up exclusively by only small and marginal farmers under Part IXA of Companies Act, 1956 for agricultural and allied activities.
- iii. Bank loans to Primary Agricultural Credit Societies (PACS), Farmers' Service Societies (FSS) and Large-sized Adivasi Multi-Purpose Societies (LAMPS).

Problems of Priority Sector Lending

Despite a remarkable growth of priority sector lending by the commercial banks in recent years, some basic problems and shortcoming are found in this system.

1. **Unduly broad based classification of priority sector:** under the existing system, the classification of priority sector advances has remained broad based, so that even big borrower could avail of the benefits of priority treatment provided by the banks.
2. **Need to identify priority sector appropriately:** it is necessary to identify appropriate sector within the priority sectors on a rational basis. So that preferential treatment can be availed by defined and target persons.
3. **Need to examine the viability of project under priority sector:** while granting credit to artisans, cottage industries etc., the bank should examine the viability of the marketability point of view if not so this loan will pose the problems of recovery for the banks.
4. **Efficacy:** There is always the problem of ensuring the effective end use of the loans given to the priority sectors.
5. **Need to re-look at target:** there is time need to review the target fixed at the inception of scheme, for example 40% of total bank credit to priority sector and other sub target. At present time it should be revised on rational basis.
6. **The problem of bad debts:** another problem is the problem of bad debts arising from indiscriminate lending by banks, keeping an eye on the fulfilment of the stipulated targets.

Priority Sector Lending Certificate

A scheme of Priority sector lending certificates was introduced in April 2016. The RBI has provided a platform to enable trading in the certificates through its core banking solution portal (e- Kubber). All scheduled commercial banks including RRBs, urban co-operative banks , small finance banks(when they become operational and local area banks are eligible to participate in trading. Some of the main features of the scheme are as fallows

- The purpose of PSLCs is to achieve the priority sector lending targets and sub targets by purchase of these instruments in the event of shortfall and at the same time incentivize the surplus banks; thereby enhancing lending to the categories under priority sector.

- Four kinds of PSLCs: Agriculture, small and marginal farmers, micro enterprises and general can be bought and sold via the platform
- The certificate will have a standard lot size of Rs.2.5 million and its multiples
- There will be no transfer of credit risk on underlying assets as there is no transfer of tangible assets or related cash flows
- Bank will be permitted to issue PSLCs up to 50 percent of the previous year's priority sector lending achievement without having the underlying in their books. Banks should meet priority sector targets through direct lending and net PSLCs
- Bank may be required to invest in the rural infrastructure fund/ other funds to the extent of the shortfall.
- A bank with a shortfall in achieving any sub target will have to buy specific PSLCs to achieve the target. However, if a bank has a shortfall only with respect to the overall target, it could buy any PSLC.
- PSLCs will not be valid beyond the reporting date (March 31), irrespective of the date of first sale.
- A bank's priority sector lending achievement will be computed as the sum of outstanding priority sector loans and the net nominal value of the PSLCs issued and purchased. Such computation will be done separately where sub target are prescribed as on the reporting date.
- The settlement of funds will be done through the platform as explained in the Kuber portal.
- The nominal value of PSLCs would represent the equivalent of the PSL that would get deducted from the PSL portfolio of the seller and added to the PSL portfolio of the buyer. The buyer would pay a fee to the seller which will be market determined.
- The fee paid for purchase of the PSLC would be treated as an expense and the fees received for the sale of PSLCs would be treated as Miscellaneous Income.

Recent RBI Guidelines on Priority Sector Lending

RBI revised guidelines for lending to the priority sector on March 2015 with loans to medium enterprises, sanitation and renewable energy sectors coming under the ambit of priority sector lending. The target for lending to the redefined priority sector is retained uniformly at 40%

of Adjusted Net Banking Credit (ANBC) or Credit Equivalent of Off-Balance Sheet Exposure (CEOBE), whichever is higher, for all scheduled commercial banks. Foreign banks will however be given time to comply with the revised norms, the RBI added without specifying on a time period. The target for lending to the agriculture sector has been retained at 18% of ANBC, but the RBI recommended sub target of 8% of ANBC for small and marginal farmers, which is to be achieved in a phased manner.

Conclusion

The study concludes that priority sector advance of banking groups are increasing. In spite of increasing advances, Indian banks have not achieved some targets fixed by RBI tending to priority sector creates many problems for Indian banks like profitability, high NPAs, transaction cost *etc.* The bank should take necessary steps to reach the target fixed by RBI regarding priority sector lending. The priority sector advances effects on banker's efficiency and profitability as various percentage targets are fixed by RBI from time to time which becomes troublesome to various banks to maintain their advance demand profitability, efficiency by taking into following point under consideration. Each branch has to maintain minimum CRR and SLR which remains with the Government. As the result, percentage of lending after Priority Sector Advances was very few for Non- priority sector advances which affects the profitability and efficiency of the bankers directly. Priority sector lending is notable initiative of the Government of India to strengthen the social banking concept.

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