SYNOPSIS

Introduction

The financial policy in India is influenced by the objective of restoring sectional balance within credit disbursement and for channeling to the weaker sections within these sectors. Priority sector bank lending has been an instrument of this financial policy. The Bank Company Acquisition Act 1969 leading to the Nationalization of the 14 commercial banks has implicitly made it clear in its preamble.

“The banking system touches the lives of millions and has to be inspired by larger social purpose and has to sub-serve national priorities and objectives such as rapid growth of agriculture small scale industries and exports raising employment levels, encouragement of new entrepreneur and development of backward regions. For this purpose it is necessary for the Government to take direct responsibility for the extension and diversification of banking services and forth working of a substantial part of the banking system”.

There has been a substantial reorientation of banking policy after the nationalization of banks in 1969. This has been accomplished through social orientation of banking and administrative intervention by way of stipulating targets, sub-targets, credit guarantee and refinance facilities for financing the preferred sectors of the economy known as priority sectors, where agriculture, small industries, small business and small transport operators, retail traders and education were given priority status.
Need for Priority Sector Lending

The objectives underlying the priority sector lending relate to ensuring the assistance from the banking system flows in an increasing measure to those sectors of the economy which though contributing significant proportion of national product have not received adequate support of institutional finance in the past. This inter-alia implied flow of required funds to various sectors of the economy in accordance with the national planned priorities. The social control on banks was imposed as a measure to employ prudently and socially desirable channels with the objective of achieving economic growth combined with stability and social justice.

Even decades after independence, more than 70 percent of borrowing by cultivators was from informal sector. Lending from commercial banks was directed towards large industrial houses. Agricultural sector, small scale industries and weaker sections were more neglected because of both risk factor and urban bias. Although co-operative sector was there to serve the needs of agricultural sector it was unable to meet the credit demand of farm community. There was a need for ensuring an equitable and purposeful distribution of credit keeping in view relative priorities of developmental needs.

The Thrust Areas of Priority Sector Lending

The edifice of the priority sector lending that has emerged in the period after the nationalization of banks in 1969 is based on the following pillars.
1. The system of priority sector lending has envisaged setting up of targets and sub-targets for financing of specific sectors. The share of priority sectors in total banks advances is 40 percent. Sub-targets for agriculture and weaker sections are fixed at 18 percent and 10 percent of total advances respectively.

2. The interest rate policy under priority sector and non priority sector has been stipulated. Concessional rates of interest for the priority sector advances and relatively higher rate of interest for other sectors have been special features. This is known as cross subsidization policy. Here the losses arising on concessional loans are met out of the profits from other loans. This has facilitated flow of credit to the weaker sections of the society and neglected sections of the economy at relatively lower rates of interest.

3. Financing of loan accounts under priority sector may entail risk of default. Hence a separate insurance scheme guaranteeing a part of the loan of commercial banks was introduced in 1970 and the DICGC of India was established. The Corporation also provides deposit insurance to the depositors up to a prescribed limit. The Corporation operates various credit guarantee schemes relating to guarantee support to eligible credit institutions for their priority sector advances to small borrowers and small scale industries.

4. Priority sector lending implies deliberate diversion of funds of the banks from the other sectors and that too at lower interest. To
mitigate the ill effects of this on bank resources and on profitability the schemes of refinance were formulated by NABARD in particular. Its advances about 42% to 45% of the ground level rural credit disbursed by banks.

**Changing Criteria of Priority Sectors**

In the post nationalization of 14 commercial banks in 1969 period the Reserve Bank of India was compelled to lay down targets for lending to specified sectors. Each major bank was given targets for lending to these sectors. A more comprehensive definition of priority sector was adopted in 1977. These were mainly in terms of sectors. It was realized in the early 1980s that even within priority sectors credit flow was more to the affluent sections. So the concept of weaker section was adopted within priority sector. It was categorically stated that the maximum benefit should be available to these weaker sections. By 1980s definition and quantitative targets had fully crystallized.

There emerged the political interference to make use of these developments for vote bank politics for misuse of credit. As a result neither banking institutions nor the neglected sectors and sections were benefited. Thus the priority sector lending was effected. Financial sector reform became imperative. Thus the Narashimhan Committee suggested for bringing down the priority sector target from 40 percent to 10 percent. This was not accepted by the Government.
The Pre and Post Reform Period

Following are some of the major features of priority sector targets and classifications.

- Targets of 40, 18 and 10 percent of net bank credit for total priority sector credit, sub targets of agricultural and weaker sections respectively remain same in both the periods.

- Targets of 12 percent of export credit and 10 percent of SSI credit have been introduced for the foreign banks which were not there earlier even for domestic banks.

- In the pre-reform period agricultural credit was earmarked directly for farmers but majority of whom, were small and marginal farmers. Agricultural credit was mainly for agricultural purposes, production, storage and transportation of agricultural or allied product.

- In the post reform period ceiling of short term credit to be considered under priority sector has been increased to Rs. 1 lakh. Earlier credit to plantation crop was restricted to only small and marginal farmers, but it is given irrespective of size.

- In the category of direct advances to agriculture new acquisition of jeeps, pick up vans, mini buses, etc., have been included. These naturally will not be acquired by small and marginal farmers.

- Indirect finance to agriculture was not a part of priority sector target earlier. Now finances to dealers, commission agents, non-banking financial companies, state electricity board and investing in selected bonds and depositing in apex level are not going to help farmers directly.
• Inclusion of food and agro processing in the priority sector will give impetus and boost up the production of food crops.

• Scope of small business under priority sector has been expanded to include business under enterprises with original cost price of equipment used for the purpose of business up to Rs. 10 lakhs from Rs. 2 lakhs earlier.

• Professionals like accountants and solicitors are included in priority sector. These are not employment generating activities. They do not belong to weaker sections either.

• Transport and road network are included in priority sector.

• Housing was earlier exclusively for very poor segments. Now the ceilings up to Rs. 5 lakhs which can very well cover requirements of middle class people even in urban areas.

• Education loan is considered under priority sector loan. Similarly consumption loan too is covered by priority sector credit.

The above changes in the post bank reform era have led to the following aspects of priority sector credit by banks as of March 2001.

a) Agriculture (direct and indirect)

b) SSI (including the setting up of industrial estates and covering units with original cost of plant and machinery not exceeding Rs. 10 million)

c) Small business (original cost of equipment used for the business not exceeding Rs. 1 million and a working capital of Rs. 50,000)

d) Small road and water transport operators owning 10 vehicles.

e) Retail trades (up to Rs. 50,000)
f) Professional and self employed persons (up to Rs. 50,000)

g) State sponsored organizations for scheduled castes and scheduled tribes.

h) Education (educational loans granted to individuals)

i) Housing loan (direct and indirect) upto Rs. 50,000.

j) Consumption loan under the consumption credit scheme for weaker sections.

k) Refinance by banks to RRBS.

l) Micro credit (direct and indirect)

m) Software industry (up to Rs. 10 million)

n) Agro and food processing sector and

o) Venture capital.

**Need for Research and Statement of the Problem**

The social objective of nationalization of commercial banks was to concentrate more attention on the remote, backward and hilly areas of the country and on the higher to neglected sectors of the society, such as agriculture small and cottage industries, marginal farmers, landless labourers, SC/ST, self employed persons, village artisans, small traders, needy students and exporters. The post nationalization period witnessed a phenomenal increase in the operations of commercial banks in India particularly for the benefit of the higher to neglected sectors namely the priority sector. However some of the sub-sectors under the priority sector still remained neglected. They got a negligible share of the total finance secured by the priority sector out of the total credit advanced by commercial banks.
The priority sector lendings by the commercial banks are further constrained by some other inadequacies. Misuse of funds by some borrowers under the scheme and misdirection or diversion of funds to unproductive directions has been indicated by a few studies. Further the credit absorption capacity of a few borrowers has been found inadequate. There are the problems of inadequacies on the part of commercial banks in the administration of priority sector advances. A few banks have been faulted in the identification of right type of customers as beneficiaries under the priority sector lendings. Further the quality of supervision in the post disbursement period is poor in case of some commercial bank leading to accumulation of overdues. There is a general trend of opinion among the official of the commercial banks that high level of Non-performing Assets (NPAm) of commercial banks is largely due to directed credit like the priority sector lending.

The above issues of inadequacies associated with the priority sector lending by the commercial banks need a proper and an in-depth study for ascertaining the extent to which these inadequacies have been persisting with the scheme implementation by the concerned banks and if found vindicated the extent to which the constraints are affecting the scheme of priority sector advances to the beneficiaries. This major issue led the researcher to take up the present research study. Further case studies in the area of priority sector by the commercial banks in the study area have not been done. Hence the need for the present research was felt by researcher. The
study is an attempt to analyze and evaluate the implementation and the impact of the priority sector lendings in the study area. Hence the research study is stated as under “Priority Sector Lending”, by commercial Banks – A Case Study of Haveri District.

**Objectives of the Research Study**

The research study has the following objectives:

1. To study the growth trends of the priority sector loans advanced by commercial banks to different categories of beneficiaries in the study area.

2. To examine procedural aspects of priority sector advances to the borrowers by the selected commercial banks in the study area.

3. To evaluate the utilization of loans by the borrowers under the priority sector lending by the selected commercial banks in the study area.

4. To assess the supervision and recovery aspects of priority sector loans provided by commercial banks in the study area.

5. To evaluate the impact of priority sector advances on the borrowers.

**Hypotheses**

The researcher has framed the following hypotheses relating to the priority sector lending by commercial banks in the study area.

1. Larger volumes of priority sector advances by commercial banks are made to farm sector.

2. The priority sector advances of commercial banks have not reached the targets during the last five years.
3. Borrowers have diverted the funds advanced by commercial banks under priority sector lending.

4. There is a positive impact of priority sector loans on the borrowers.

5. Priority sector loans advances are inadequate leading to additional borrowing from private sources.

6. Utilization of loans under priority sector is considerably low among borrowers.

**Methodology**

The research study is an empirical survey. The research is carried out covering two types of respondents viz., (i) Bank official involved in the bank operations relating to priority sector lendings and recovery and (ii) borrowers of the commercial banks covered by the study. Personal interviews were held with the selected bank officials and the selected borrowers under the priority sector lendings in the study area. The information has been collected as per the well structured questionnaires addressed to the respondents. The questionnaires addressed to the bank officials and the borrowers have been prepared keeping in view the objectives of the research study.

**Selection of the Area**

The study covers all the seven talukas of Haveri district of Karnataka State. The district is predominantly agricultural oriented. However places like Haveri, Byadagi, Ranebennur are good commercial centers in the northern part of Karnataka state. The district is well served by good number of branches of commercial banks. The researcher selected the district for his research work on
grounds of proximity to his work place and his familiarity with the economy of the district for the last many years.

**Selection of the Banks**

A total number of 15 commercial bank branches have been selected for an intensive study of the priority sector lending by the branches of the 6 commercial banks covered by the study.

Three branches (3) of each bank have been selected taking the total to 15 respondent banks in the district. The selected commercial banks are (1) Syndicate Bank, (2) Canara Bank, (3) State Bank of India, (4) State Bank of Mysore, (5) Vijaya Bank and (6) Karnataka Bank. Of these six commercial banks Karnataka Bank is the private commercial bank while the other five are public sector commercial banks.

Talukawise the branches of different commercial banks are selected for the study as specified below.

2. Hirekerur – Canara Bank and State Bank of India
3. Ranibennuru – Carrara Bank and State Bank of India
4. Shiggaon – Vijaya Bank and Canara Bank
5. Byadagi – Syndicate Bank and State Bank of Mysore
6. Savanur – Karnataka Bank and Vijaya Bank
7. Hangal – Karnataka Bank and Vijaya Bank
Selection of Respondent Borrowers

A total number of 150 respondent borrowers under the priority sector lendings by commercial banks have been selected for personal interviews relating to their borrowing and repayment aspects. A sample of 10 respondent borrowers, have been selected for each branch of the commercial bank covered by the study. Thus the total number of respondents selected from 15 branches is 150.

Sources of Information

The data is collected from both the primary and secondary source. The primary data is collected from the sample respondents of 150 borrowers belonging to different categories of priority sector. The information was solicited through a structured questionnaire on different aspects of loans under the scheme. Personal interviews were held with the selected borrowers and the veracity of the data was cross checked through searching questions.

The secondary data was collected from published sources of the respondent banks like their annual reports and balance sheets, etc. Other sources of secondary data included the publications of Reserve Bank of India, NABARD, etc. Reports of Committees and other government publications on banking and priority sector, etc., were referred to.

Data Analysis

The data collected from the primary and secondary sources has been computed and presented in suitable statistical tables. The same have been analyzed and interpreted to draw suitable inferences and conclusions.
The researcher has used simple statistical tools like percentages, average and growth indices, etc. Charts and graphical representations have been provided to highlight some significant trends.

**Review of Literature**

A good number of studies have been made by academicians, bankers and other experts in the area of banking and credit development in general and the priority sector lending in particular. A good number of research papers have been published providing sufficient amount of insight into the area of priority sector lendings by commercial banks in India.

The researcher has made a review of some of the research publications on the priority sector lendings which have a direct bearing on the present study and reviews have given necessary information and knowledge on the research topic.

*Rajaram Dasgupta* in his paper “Priority Sector Lending Yesterday, Today and Tomorrow” has advocated a new approach to priority sector lending. Suggesting among other things the reduction of mandatory credit to a larger number of sectors and section, including marginal farmers, cottage industries, small trade and services and low income housing. The Author has pleaded for incentives to improve credit flow to small scale industries and food crop agriculture as well as temporary credit to assure to new industries and new professions by the non-poor sections.
Commenting on the Narasimhan Committee suggestion for bringing down the priority sector target from 40 to 10 percent the author has observed that as expected the suggestion was not accepted and approved by political masters. Target of 40 percent was not touched, but monitoring of the fulfillment of target was not taken seriously in the post reform period. There is a regular revision of priority sector list. It includes both new sectors, new segments and the entire focus of priority sector is lost. The author has been critical when he says that politicians, bankers and even central banking authorities seem to be happy as all are able to serve their own interests. He has extorted that a new approach is needed to ensure flow of credit to ‘priority’ sector for the benefit of banking industry, people and the economy.

D.N. Ghosh in his article “Bank Profitability and Priority Sector Lending - From Populism to Impressionism” has observed that the curtailment of the target of priority sector lending to 10 percent as urged by the committee on financial system (Narasimhan Committee) will send an unfortunate signal to the dispensers of credit that the basic objective for which priority sector lending was developed being diluted. The author comprehends that policy makers in developing countries will from time to time find that they have to reconcile conflicting objectives, but they can not afford to let crucial economic agents such as banks and financial institutions, choose the easy way out of such situations.
**K.V. Patel and N.B. Shete** in their article “Priority Sector Lending by Commercial Banks in India – An Overview” have made an analysis of the priority sector lending by scheduled commercial banks between 1959 and 1980. They have analyzed the lendings both in terms of the volume of loans (year wise) and the share of different priority sectors in the total outstanding advances. The trends in priority sector advances outstanding and share of different states in the priority sector advances etc are other aspects analyzed by the authors.

Based on their study the authors have observed that the analysis of the priority sector advances by the commercial banks gives mixed feelings quantitatively a very impressive coverage is achieved. They have however mentioned that qualitatively a very impressive coverage is achieved. They have however mentioned that qualitatively it raises the issues of quality of lending, cost of services and the tempo to be maintained in future. It is these areas in which the opinions and perceptions differ. Therefore it deserves the attention of the agencies and executives who are involved in this.

**T.R. Bishnoi** in his article “Policy Constraints and Banks Profitability Impact of Priority Sector Credit” has examined the impact of priority sector credit on public sector banks profitability during 1974-1986. The author has referred to the interest subsidy rates on credit to priority sectors, income loss and its impact on banks profitability etc. His findings have revealed that interest subsidy rates varied across the priority sectors and increased over the period. The
author has found that the absolute interest income loss to public sector banks in increased from Rs. 33.44 crore in 1974 to Rs. 607.39 crore in 1986 due to combined effect of increase in interest subsidy rates and rise in the amount of priority sector credit. He has further observed that both the income loss rates are substantially higher than the profitability ratios in all these years and difference between them has increased. The author has suggested that in view of these finding the entire gamut of priority sector scheme and system of credit delivery needs to be reviewed and revised in order to have some trade off between social and commercial considerations of priority sector credit.

K.M. Shahajahan in his paper “Priority Sector Bank Lending Some Important Issues” has perceived priority sector bank lending as an active instrument of our financial policy with an aim to restore sectional balance within credit disbursement and to channel credit to the weaker sections within these sectors. The author has however observed that banking sector reforms initiated as part of the priority sector lending policy to halt. The author has mentioned that the position of the poorer states in regard to priority sector targeting has been done by linking to total bank credit rather than to bank deposits.

**Organization of the Study**

The research study is presented in the following six chapters.

**Chapter-I : Introduction and Research Design**

The first chapter provides an introduction to the topic of research. The chapter contains objectives and hypotheses of the study, need for
research, methodology, limitations, etc. A comprehensive review of some relevant literature is presented in this chapter.

**Chapter-II: Evolution and Implementation of Priority Sector Lending by Banks**

The second chapter examines different aspect of the policies of priority sector, their implications and the practical significance of the policy parameters.

**Chapter-III: Profile of the Study Area and the Borrowers of the Priority Sector Loans in Haveri District**

The Chapter provides a brief account of the economic scenario of the Haveri district which is the study area. Financial and physical aspects of the commercial bank are covered by the study is provided in this chapter. Further a brief profile of the selected borrowers of loans under the priority sector lendings by the commercial banks in the study area has been provided.

**Chapter-IV: Priority Sector Lending by Commercial Banks**

This core chapter provides an analysis of the data obtained by the selected commercial bank branches relating to different aspects of priority sector lending in the study area.

**Chapter-V: Priority Sector Borrowings, Responses of Borrowers – An Analysis**

Another core chapter contains details of the borrowing under the priority sector lendings by the commercial banks. The data collected from the selected respondent borrowers have been analyzed here.
Chapter-VI : Summary of Findings, Conclusions and Suggestions

The details in this chapter provide a summary of major findings, conclusions and a few suggestions based on the study.

References


R.V. Hegadal
Research Scholar

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Research Guide
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