A clear picture about the priority sector lending and recovery is given in this chapter.

“Though India has one of the oldest banking sectors in the world yet the growth of the sector has been very lopsided.” ¹ The main reason for such an imbalanced growth was that the commercial banks were in the hands of the private sector. As such, they provided short-term finance to trade and industry based on the security offered by the borrowers. “This security-oriented approach resulted in a large chunk of bank credit being utilised only by big industrial houses and traders. Banks were unknown institutions to small entrepreneurs, agriculturists, artisans, transport operators and a host of people with small means.”² These vital sectors, which made the largest contribution to the Gross National Product [GNP] and provided the bulk of employment, were totally ignored by the banking sector. Hence, after independence, it was felt that in order to achieve balanced regional growth in the
country, it is essential to develop these neglected sectors, for which it is essential to channelise the necessary financial resources.

For attaining the goal of self-sufficiency and for ensuring sustained economic growth, the All India Rural Credit Survey Committee in 1954, recommended for the development of a State sponsored commercial banking system. “It was in this background that the State Bank of India was formed, which set up more than 400 branches in rural areas. This was followed by nationalization of 14 banks in 1969 and social control over banks was introduced.”

The main objective of nationalization of commercial banks was to provide finance to the hitherto neglected sectors of the economy like agriculture, small-scale industries, small entrepreneurs, artisans, etc. As these sectors received priority in availing financial assistance, they were known as priority sectors.

“The concept of priority sector lending was evolved 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. 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 sector.”

Priority sectors include agriculture [both direct and indirect], small scale industries, small road and water transport, small business, retail trade, professional and self-employed persons, state sponsored organisations for scheduled castes/scheduled tribes, education, housing [both direct and indirect], consumption loans, micro-credit, loans to software and food and agro-processing sector.”

Initially, there were no targets fixed on the priority-sector lending. It was just emphasized that commercial banks should increase their involvement in the financing of priority sectors. 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 lend a minimum of 33 1/3 per cent of their total advances to the priority sector by the end of
March 1980. Subsequently, the target was enhanced to 40 per cent of aggregate advances. In achieving this overall target, sections were also stipulated for the banks. At present, respectively, of their Net Bank Credit [NBC] to the agricultural sector and weaker sections of the society, respectively. Foreign banks operating in India were also advised to progressively increase their advances to the priority sector to reach a level of 15 per cent of their net bank credit by the end of March 1992. In April 1993, this ratio was further raised to 32 per cent of NBC to be achieved by March 1994. Within the enhanced target of 32 per cent, two sub-targets of 10 per cent in respect of Small Scale industries and 12 per cent for exports were fixed. On the basis of the revised guidelines on lending to the priority sector, the priority sector lending target/sub-targets 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 April 30, 2007.

During the initial period, only agriculture, small-scale industries, small and marginal farmers and artisans
and exports were included in the priority sector. Later on, based on the recommendations of the Narasimham Committee Report, 1991, housing, education, consumption, profession, I.T sector and food processing not falling under SSI were also included under the category priority sector.

In 1991, the Narasimham Committee pointed out many problems relating to priority sector lending, the most important one being that a large part of the non-performing assets come from priority sector lending. Thus, the committee recommended reduction of priority sector target to 10 per cent and expansion of the coverage of priority sector to include more sectors. However, the target of priority sector was not reduced but the definition of priority was expanded to include more sectors like education, consumption, profession, I.T sector and food processing not falling under SSI. Also, a provision was made such that, banks that cannot meet the priority sector targets can deposit funds in the financial institutions like National Bank for Agriculture and Rural Development [NABARD] under Rural Infrastructure Development Fund [RIDF] or some banks can do so in the Small Industries
Bank of India [SIDBI] for lesser interest rates, which in turn will be lent out to the priority sectors.

The broad categories of priority sector for all scheduled commercial banks are as under:

[i] **Agriculture (Direct and Indirect Finance)**

Direct finance to agriculture includes short medium and long term loans given for agriculture and allied activities directly to individual farmers, self-help groups (SHGs) or joint liability groups (JLGs) of individual farmers without limit and to others (such as corporate partnership firms and institutions) up to Rs. 20 lakh for taking up agriculture allied activities. Indirect finance to agriculture includes loans given for agriculture and allied activities.

[ii] **Small-scale industries (Direct and Indirect Finance)**

Direct finance to small scale industries (SSIs) includes all loans given to SSI units which are engaged in manufacture, processing or preservation of goods and whose investment are in plant and machinery (original cost) excluding land and building.
[a] Small Scale Industries

Small-scale industries are 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 exceed Rs. 5 crore.

[b] Micro Enterprises

Small scale units whose investment in plant and machinery (original cost) excluding land and building is up to Rs. 25 lakh, irrespective of the location of the unit, are treated as Micro Enterprises.

[c] KVI Sector

All advances granted to units in the KVI sector, irrespective of their size of operations, location and amount of original investment in plant and machinery come under the category small-scale sector. Such advances will be eligible for consideration under the sub-target (60 per cent) of the SSI segment within the priority sector.

Indirect finance

Indirect finance in the small-scale industrial sector will include credit to:
[a] Persons involved in assisting the decentralised sector in the supply of inputs to and marketing of outputs of artisans, village and cottage industries.

[b] Advances to cooperatives of producers in the decentralised sector viz. artisans village and cottage industries.

[c] Subscription to bonds issued by NABARD with the objective of financing exclusively non-farm sector (not eligible for classification under priority sector lending with effect from April 1, 2007).

[d] Loans granted by banks to NBFCs for on lending to SSI sector.

[iii] Small business/service enterprises

It includes small business, retail trade, professional and self-employed persons, small road and water transport operators and other enterprises.

[a] Small Business

Small business would include individuals and firms managing a business enterprise established mainly for providing any service other than professional services
whose original cost price of the equipment used for the business does not exceed Rs.20 lakh.

[b] Retail Trade

Advances granted to retail traders dealing in essential commodities (fair price shops), consumer co-operative stores and private retail traders with credit limits not exceeding Rs.10 lakh.

[c] Professional & Self-employed Persons

Loans to professional and self-employed persons include loans for the purpose of purchasing equipment, repairing or renovating existing equipment and/or acquiring and repairing business premises or for purchasing tools and/or for working capital requirements to medical practitioners including dentists, chartered accountants, cost accountants, practicing company secretary, lawyers or solicitors, engineers, architects, surveyors, construction contractors or management consultants come under the category priority sector loans.
[d] Small Road and Water Transport Operators (SRWTO)

Advances to small road and water transport operators owning a fleet of vehicles not exceeding ten vehicles, including the one proposed to be financed constitutes priority sector loans. Loans advanced by commercial banks to NBFCs for the purpose of providing finance to truck operators and SRWTOs other than truck operators satisfying the eligibility criteria is also included under the category priority sector loans.

[iv] Micro credit

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.

[v] Education loans

Education loans include loans and advances granted to individuals for educational purpose, up to Rs. 10 lakh
for studies in India and Rs. 20 lakh for studies abroad and this does not include those granted scholarship by the institutions.

[vi] Housing loans

Loans up to Rs. 15 lakh provided 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. 1 lakh in rural and semi-urban areas and up to Rs. 2 lakh in urban areas constitute priority sector loans.

[vii] State sponsored organization for scheduled castes/scheduled tribes

Advances sanctioned to State Sponsored Organisations for Scheduled Castes/Scheduled Tribes for the specific purpose of purchase and supply of inputs to and/or the marketing of the outputs of the beneficiaries of these organizations constitute priority sector loans.

[viii] Consumption Loans

Pure consumption loans granted to the weaker sections of the community under the Consumption Credit
Scheme should be included in this item. These include loans financial assistance provided to NGOs and Self help groups.

[ix] Food and Agro-based Processing Sector

Food and agro based processing sector would be eligible for classification as priority sector loans by banks like fruit and vegetable processing industry, food grain milling industry, dairy products, processing of poultry and eggs, meat products, fish processing, bread, oilseeds, meals (edible), breakfast foods, biscuits, confectionery (including cocoa processing and chocolate), malt extract, protein isolate, high protein food, weaning food and extruded/other ready to eat food products, aerated water/ soft drinks and other processed foods, special Packaging for food processing industries and technical assistance and advice to food processing industry. With regard to the size of the units within this sector, it is clarified that food and agro-based processing units of small and medium size with investment in plant and machinery up to Rs.5 crore would be included under priority sector lending.
[x] **Software Industry**

Loans to software industry with credit limit up to Rs.1 crore from the banking industry is categorised as priority sector loans.

[xi] **Venture Capital**

Investment in Venture Capital will be eligible for inclusion in priority sector, subject to the condition that the venture capital funds/companies are registered with SEBI. However, fresh investments that may be made by banks on or after July 1, 2005 shall not be eligible for classification under priority sector lending and the investments, which have already been made by banks up to June 30, 2005 shall not be eligible for classification under priority sector lending with effect from April 1, 2006.

[xii] **Leasing and Hire purchase**

Para-banking activities such as leasing and hire purchase financing undertaken departmentally by banks will be classified as priority sector advances, provided the ultimate beneficiary satisfies the criteria laid down by RBI for treating such advances as advances to priority sector
[xiii] Loans to urban poor indebted to non institutional Lenders

Loans to distressed urban poor to prepay their debt to lenders in the informal sector would be eligible for classification under priority sector. Urban poor for this purpose may include those families in the urban areas who are below the poverty line. Such loans to urban poor may be classified under weaker sections within the priority sector.

[xiv] Weaker Sections

In order to ensure that more under-privileged sections in the priority sector are given proper attention in the matter of allocation of credit, it should be ensured that the advances to weaker sections reach a level of 25 per cent of priority sector advances or 10 per cent of net bank credit. The weaker sections under priority sector shall include the following:

(a) Small and marginal farmers with land holding of 5 acres and less and landless labours, tenant farmers and share croppers
(b) Artisans, village and cottage industries where individual credit limits do not exceed Rs.50,000/–,

c) Beneficiaries of Swarnjayanthi Gram Swarojgar Yojana (SGSY),

(d) Scheduled Castes and Scheduled Tribes,

e) Beneficiaries of Differential Rate of Interest (DRI) Scheme,

(f) Beneficiaries under Swarna Jayanti Shahari Rojgar Yojana (SJSRY),

(g) Beneficiaries under the Scheme for Liberation and Rehabilitation of Scavangers (SLRS),

(h) Advances to Self Help Groups,

(i) Loans to distressed urban poor to prepay their debt to non-institutional lenders against appropriate collateral or group security, subject to the guidelines to be approved by their Boards of Directors

(i) Loans to distressed urban/rural poor to prepay their debt to non-institutional lenders, against appropriate collateral or group security.
[xv] Export Credit

This category will form part of priority sector for foreign banks only.

Commercial banks attaining targets by investing in special bonds

As per the recommendations of the Narasimham Committee report, the commercial banks can fulfil their targets by making investments in special bonds issued by specified institutions as a part of priority sector advances subject to the following conditions:

[i] State Financial Corporations (SFCs)/State Industrial Development Corporations (SIDCs)

The commercial banks can subscribe to bonds exclusively floated by SFCs and SIDCs for financing SSI units and this will be eligible to be included under priority sector as indirect finance to SSI.

[ii] Rural Electrification Corporation (REC)

Subscription to special bonds issued by REC exclusively for financing pump-set energisation programme in rural and semi-urban areas and the System Improvement Programme under its Special Projects Agriculture (SI-SPA)
will be eligible for inclusion under priority sector lending as indirect finance to agriculture.

[iii] NABARD

The banks can subscribe to bonds issued by NABARD with the objective of financing exclusively agriculture/allied activities and the non-farm sector will be eligible for being included under the priority sector as indirect finance to agriculture/SSI, as the case may be.

(iv) Small Industries Development Bank of India (SIDBI)

Commercial banks can subscribe to bonds exclusively floated by SIDBI for financing of SSI units and will be eligible to be included under priority sector as indirect finance to SSIs.

[v] The National Small Industries Corporation Ltd. (NSIC)

Subscription to bonds issued by NSIC exclusively for financing of SSI units will be eligible for inclusion under priority sector as indirect finance to SSIs.
[vi] National Housing Bank (NHB)

Subscription to bonds issued by NHB exclusively for financing of housing, irrespective of the loan size per dwelling unit, will be eligible for inclusion under priority sector advances as indirect housing finance.

[vii] Housing and Urban Development Corporation (HUDCO)

Subscription to bonds issued by HUDCO exclusively for financing of housing, irrespective of the loan size per dwelling unit, will be eligible for inclusion under priority sector advances as indirect housing finance. Investment in special bonds issued by HUDCO for providing finance to artisans, handloom weavers, etc. under tiny sector will be classified as indirect lending to SSI (Tiny) sector.

Recovery of Priority sector loans by commercial banks

The two primary functions of commercial banks are to accept deposits from the public and lend money to the borrowers. The deposits are to be repaid on the due dates or on demand depending on the nature of deposits. Likewise, the money lent should be repaid on the due dates
or on demand depending on the nature of advances. In the pre-nationalisation period, that too before 1969, recovery of loans was not much a problem for the bankers. This was because the traditional bankers were conservative in their approach and they knew their customers personally. However, recovery of loans during the post-nationalisation period has not been smooth for the commercial bankers especially due to priority sector lending. This is because priority sector loans are granted to borrowers of small means who are not usually in a position to offer adequate security to the bankers.

"The success of any Government sponsored scheme should be measured not by 100 per cent disbursal but by 100 per cent recovery. The motto of 100 per cent recovery is meant for bankers, Government servants and the borrowers as well. In case of priority sector lending too, 100 per cent recovery is a must. It should not be misconstrued as a pressurizing act to demand 100 per cent recovery for even priority sector advances. Priority is for giving the loans and not for exempting them from recovery."\(^6\) This chapter throws an insight into the
various alternatives available to the banker for the recovery of loans advanced by him. It highlights the following issues:

[i] importance of recovery of loans.

[ii] factors contributing to poor recovery.

[iii] steps in recovery of loans.

[iv] suggestions for improving recovery of loans.

**Importance of recovery of loans**

The importance of recovery of loans need not be over-emphasised. There is a general saying that in a bank, any person can grant advances but only a wise person can recover the loans. Following are some of the reasons for the importance accorded to recovery of loans:

[i] Non-recovery of loans erode profitability of lending banks.

[ii] The funds, which have been provided as loan, cannot be recycled and to that extent, the more deserving customers will be deprived of bank credit.
[iii] A bank saddled with huge overdue loans portfolio will suffer in its image and may lose public confidence.

[iv] A loan, which has been considered as bad, when recovered increases the profitability of the bank.

[v] Overdue advances results in a lot of correspondence and paper work. A good recovery percentage will avoid this wastage of time and energy.

[vi] A good recovery percentage qualifies the branch for a better inspection rating.

**Factors contributing to poor recovery of loans**

Innumerable factors contribute to the poor recovery of loans by banks. [See Diagram No.3.1]
All these factors can be broadly classified as follows:

[i] **Borrower-oriented**: The following factors result in non-recovery of loans and these factors are borrower oriented:

[a] **Poor generation of revenue**: The inability of the borrower to effect payment of dues due to poor cash generation and/or failure of the project, be it industry, trade or agriculture, resulting from influence of external or internal factors.

[b] **Unwillingness of the borrower**: The borrower may not be willing to repay the loans because of diversion of funds borrowed to other avenues of investment.

[c] **Wilful default**: The borrower, for no valid reason, may not be willing to repay the loans in spite of having sufficient funds at his disposal.

[d] **Political influence**: The borrower may be politically influenced not to repay the loans in the expectation of waiver of loans, which often takes place in case of agricultural loans.
[e] Misutilisation of funds borrowed: The borrowers with a false optimism of earning sizable sum out of an intermediate investment, may mis utilise the borrowed sum and divert the loan proceeds. When the loan borrowed is not ultimately utilised for the concerned project, the borrowers find it difficult to repay, especially when their estimation of yield from alternate source fails.

[f] Lack of interest: The borrower may not have any personal interest in the project for which the loan is borrowed.

[g] Other personal reasons: The borrowers may not repay the loan properly because of gross negligence and defiant line of the thinking, questionable character of borrowers, lack of expertise and the burden of maintaining the self and the family.

[ii] Banker-oriented: The bankers, on their part should discharge their obligations properly failing which it results in non-recovery of loans. The below-mentioned factors contribute to poor recovery of loans:
[a] Lack of follow-up by banks: After providing the loans, it is the duty of the bankers to follow-up at periodical intervals and at times of difficulty for the borrowers, lend a helping hand to solve their problems.

[b] Inadequate project appraisal by banks: The banks attempt half-heartedly in the matter of appraising a project, be it agriculture or industry leading to sub-standard lending. The project becomes improperly implemented and insufficient finance ends in total failure of the project. Poor or inadequate appraisal of the project regarding the financial feasibility, technical feasibility and economic viability results in non-recovery of loans.

[c] Under-financing: The bankers have to provide loans in accordance with the financial requirements of the borrowers. If the bankers resort to under-financing, the borrowers may borrow the balance amount from outside sources at exorbitant rate of interest. This may be another reason for non-recovery of loans.

[d] Unrealistic repayment schedules: The bankers, before, deciding the repayment schedules for the borrowers should
make an in depth study about the borrowers’ repayment capacity. If the repayment schedules are unrealistic, recovery of loans becomes difficult for the borrowers.

[e] Delayed initiation of recovery measures: The banker should take immediate remedial action once he notices any warning signals. If there is any delay in initiating the recovery measures, it will result in non-recovery of loans.

[f] Other factors: Apart from these factors, factors like handling large number of advances, poor staff involvement and other constraints and indiscreet lending under Government schemes also contribute to poor recovery of loans.

[iii] Project-oriented: Non-recovery of loans may be because of the project chosen by the borrower. The following factors contribute to poor recovery of loans:

[a] Project failure: When a project is not suitable to Indian conditions, the project fails. Failure of project results in non-recovery of loans.
[b] **Technically unviable:** If a project is not technically viable, it will be a total failure. This contributes to poor recovery of loans.

[c] **Lack of experience in marketing:** Many of the products fail not because of sub-standard quality but because of inexperience of the manufacturer/borrower in marketing the products. If the borrower is inefficient in marketing the product he produces, he will be unable to repay his dues.

[d] **Severe competition:** If the borrower is unable to face severe competition, he will not be able to repay his loans.

[e] **Other factors:** Problems like erosion of inventories and securities, accumulated losses, wrong selection of products, external factors beyond the control of the borrowers and substandard products are other factors contributing to poor recovery.

[iv] **Government-oriented:** Government is also responsible for non-recovery of loans. The under-mentioned factors contribute to poor recovery of loans:
[a] **Target approach:** The Government fixes certain targets to be attained by the bankers which the bankers attain without making proper appraisal of loans. This results in non-recovery of loans.

[b] **Waiver of loans:** The Government, in order to create a good image about its party, waives the loans borrowed. This results in non-recovery of loans.

**Steps in Recovery of loans**

"Recovery of loans, that too at the right time, plays a vital role in credit management as it strengthens the resource position through recycling of funds and exercises favourable impacts on the cost of funds and profitability. Recovery of the loans granted has, therefore, to be managed effectively so as to ensure continuous flow of credit, without which banks liquidity would be in jeopardy as also production cycles, income generation, employment opportunities etc. would be adversely affected."  

There are three steps, the bankers used to follow in order to recover the loans advanced. These steps are depicted in Diagram No.3.2:
[i] **Persuasion:** Persuasion is the first step in the process of recovery. The recalcitrant borrowers are persuaded by the bankers to repay the loan amount. This is done by means of sending proper notices to the borrowers. If the borrowers ignore notices, registered notices are sent to the borrowers. Still, if there is no reply from the borrowers, the next step is to contact the borrowers personally or over phone. After this, the banker contacts the borrowers informally with the elite of the place of the defaulting borrowers to create psychological pressures. Next, the banker tries to convince the borrower to obtain a new loan as against full repayment of the existing loan, which is overdue over a period of time.

[ii] **Negotiation:** “The lending banker adopts the next step if persuasion fails to evoke the desired result. Both the lending banker and borrower have to make certain sacrifices in their mutual interest. The banker may have to accept revision in the repayment schedule, interest concessions and margin reduction and waivers. All these can be negotiated across the table.
[iii] **Litigation:** The last resort for the lending banker to effect recovery is to initiate legal actions by filing civil suits in the court of law.” ⁸ “Such a step is taken particularly with incorrigible borrowers with whom all the other techniques of recovery are exhausted. When it is confirmed that recovery is impossible, suit may be filed after consulting the bank’s appropriate authority and the legal adviser because each case needs a separate treatment.

The procedure followed may differ from bank to bank but general guidelines are given below:

[a] Prepare the case history.

[b] Extract the balances from the ledgers and prepare a statement of account.

[c] See that all documents are in order.

[d] Decide upon the limitation period, i.e. whether documents are not time barred.

[e] Consult the legal adviser after having obtained permission from the appropriate authority of the bank.

[f] Serve legal notice on the borrower.
[g] File a suit in the court through the legal adviser.

[h] File claim with the DI and CGCI.”

**Legal measures adopted by commercial banks**

“Indian banks suffer from large debt arrears, which adversely affect their current cash flow position and reduce profits.”

[i] **Establishment of Debt Recovery Tribunals [DRTs]**

To recover bad debts, a new Act known as, the ‘Recovery of Debts due to banks and financial institutions Act, 1993’ has been passed to set up Debt Recovery Tribunals. Such tribunals have been set up at major centres.”

For recovery of debts of Rs.10 lakhs and above, banks can approach DRTs under the Recovery of Debts to Banks and Financial Institutions Act, 1993. For recovery of advances, 75 per cent of the debt in dispute is deposited. Debt Recovery Appellate Tribunal entertains no appeal against DRT’s order.
Banks have adopted multi-pronged strategies to bring down the volume of bad loans. These interalia include aggressive provisioning, Corporate Debt Restructuring [CDR], write-offs and recoveries. The SARFAESI Act, 2002 enabled banks to quicken recovery process by directly attaching assets of defaulters.

The Act empowers creditors to issue notices to the defaulting borrowers/guarantors under Sec 13 [2] calling upon them to discharge their liabilities in full on failure to discharge the dues, the secured creditors can take recourse to one or more of the measures under Sec 13 [4].

The Lok Sabha cleared the enforcement of Security Interest and Recovery of Debts Laws [Amendment] Bill to arm banks to recover dues from defaulting borrowers on December 7, 2004.
[iii] Setting up of Asset Reconstruction Companies

[ARCs]

“SARFAESI Act enables to set up ARCs under the Companies Act, 1956. Of the three proposed ARCs, one ARC of India Ltd [ACRIL] is already functioning. NPAs of the banks can be transferred to ARCs at a price for further recovery by them. It is expected that the process of price determination of NPAS would be more transparent.”

“The legislation provides for setting up Asset Reconstruction Companies, which will take possession of secured assets of the borrowers. They will have the right to lease out, sell and realise the secured assets of the borrowers and take over the management of the borrower.”

[iv] Setting up National Company Laws Tribunal

[NCLT]

By amending the Companies Act, NCLT has been set up to look after restructuring of advances. NCLT will replace Board of Industrial and Financial Reconstruction
[BIFR], which was looking after restructuring of advances for sick companies under SICA.
References


3. ibid, p.83.


5. Report on Trend and Progress of Banking in India, 2005-06.


7. ibid, p.271.

8. ibid, p.274.


11. ibid, 669-672.
