Journal of Advances and Scholarly Researches in Allied Education

Vol. XI, Issue No. XXI, April-2016, ISSN 2230-7540

AN INTERNATIONALLY INDEXED PEER REVIEWED & REFEREED JOURNAL

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Vol. XI, Issue No. XXI, April-2016, ISSN 2230-7540

Are Banks Serious About Lending to Priority Sector?

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Abstract – Here's some festival cheer for medium enterprises. Rather than an encouragement, this act of generosity is rather self-serving. I am referring to a recent notification by the Reserve Bank of India (RBI), which has allowed scheduled commercial banks to treat lending to medium enterprises as priority sector lending. This means, not only will more funds be available to medium enterprises; it also means that these businesses can avail a subsidized rate of interest on these loans. Till the notification was issued, loans only to micro and small enterprises were classified as priority sector advances with a credit limit of Rs 5 crore. Medium enterprises were not provided this cover. The recent notification has not only brought medium enterprises under its ambit; it has also revised the credit limit for micro and small enterprises to Rs 10 crore, which is also the credit limit for medium enterprises. (A medium enterprise is one where investment in plant and machinery is up to Rs 10 crore or Rs 5 crore in equipment) This new notification will be applicable to loans extended after November 13, 2013, and till the end of the current financial year. Regional rural banks have been excluded from including such advances in that category. In this study an attempt has been made to evaluate the priority sector lending of banks and the reality behind the minimum lending to priority sector by different banks.

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INTRODUCTION

The Indian banking can be broadly categorized into nationalized (government owned), private banks and specialized banking institutions. The Reserve Bank of India acts a centralized body monitoring any discrepancies and shortcoming in the system. Since the nationalization of banks in 1969, the public sector banks or the nationalized banks have acquired a place of prominence and seen tremendous progress. The need to become highly customer focused has forced the slow-moving public sector banks to adopt a fast track approach. The unleashing of products and services through the net has galvanized players at all levels of the banking and financial institutions market grid to look anew at their existing portfolio offering. Conservative banking practices allowed Indian banks to be insulated partially from the Asian currency crisis. Indian banks are now quoting al higher valuation when compared to banks in other Asian countries (viz. Hong Kong, Singapore, Philippines etc.) that have major problems linked to huge Non Performing Assets (NPAs) and payment defaults. Co-operative banks are nimble footed in approach and armed with efficient branch networks focus primarily on the 'high revenue' niche retail segments.

The Indian banking has finally worked up to the competitive dynamics of the 'new' Indian market and is addressing the relevant issues to take on the multifarious challenges of globalization. Banks that employ IT solutions are perceived to be 'futuristic' and proactive players capable of meeting the multifarious requirements of the large customer base. Private Banks have been fast on the uptake and are reorienting their strategies using the internet as a medium The Internet has emerged as the new and challenging frontier of marketing with the conventional physical world tenets being just as applicable like in any other marketing medium.

The Indian banking has come from a long way from being a sleepy business institution to a highly proactive and dynamic entity. This transformation has been largely brought about by the large dose of liberalization and economic reforms that allowed banks to explore new business opportunities rather than generating revenues from conventional streams (i.e. borrowing and lending). The banking in India is highly fragmented with 30 banking units contributing to almost 50% of deposits and 60% of advances. Indian nationalized banks (banks owned by the government) continue to be the major lenders in the economy due to their sheer size and penetrative networks which assures them high deposit mobilization. The Indian banking can be broadly categorized into nationalized, private banks and other banking institutions.

Reserve Bank of India is the foremost monitoring body in the Indian financial sector. The nationalized banks (i.e. government-owned banks) continue to dominate the Indian banking arena. Industry estimates indicate that out of 274 commercial banks operating in India, 223 banks are in the public sector and 51 are in the private sector. The private sector bank grid also includes 24 foreign banks that have started their operations here. Under the ambit of the nationalized banks come the specialized banking institutions. These co-operatives, rural banks focus on areas of agriculture, rural development etc.

What Is Priority Sector Lending?

During the heady post-Independence years, even before the initial set of bank nationalization in 1969, the RBI had identified agriculture and small industries as priority sectors where growth could be catapulted with Government help. Based on a report that defined 'priority sector', the RBI in 1972 prescribed guidelines that applied to the various categories of priority sector. The RBI then made it mandatory for banks to lend money at a subsidized rate of interest to such enterprises.

REVIEW OF LITERATURE

Sandesara (1993) studied the performance of SSIs producing reserved items collecting data from the second census conducted by the Ministry of SSIs. The study examined the null hypothesis that the SSI firms producing reserved category items should perform better than the SSIs producing non-reserved items. The study result revealed that capacity utilization in 1987-88 and aggregate change in production in 1987-88 were both lower for reserved than for unreserved items. The author observed that this could be due to the entrance of excess SSI firms into the protected areas.

Sonia and Kansai (2009) studied the effects of globalization on Micro, Small and Medium Enterprises (MSMEs) during pre and post liberalization from 1973-74 to 2008-09. They used four economic parameters namely number of units, production, employment and export and interpreted study results based on Annual Average Growth Rate (AAGR) calculation. AAGR in pre liberalization period (1973-74 to 1989-90) was higher in all selected parameters than that of post liberalization period (1991-92 to 2007-08). They concluded that MSMEs failed to put up an impressive performance in post reform era.

Bhavani (2010) highlights the issue of quality employment generation by the SSIs and negates the short term attitude of increasing the volume of employment generation compromising with quality. The author argues that employment generation by the SSIs may be high in quantitative term but very low in quality. Technological upgradation would enable the small firms to create quality employment improving remuneration, duration and skill. This structural shift may reduce the rate of employment generation in the short run but would ensure high-income employment generation in the long run.

Subrahmanya (2011) has probed the impact of globalization on the exports potentials of the small enterprises. The study shows that share of SSI export in total export has increased in protection period but remain more or less stagnated during the liberalization period. However, the correlation co-efficient in liberalization period is higher than that of protection period suggesting that the relationship between the total export and SSI export has become stronger in liberalization period. This may be due to the drastic change in composition of SSI export items from traditional to non-traditional and growth in its contribution to total export through trading houses, export houses and subcontracting relation with large enterprises. Thus, the current policy of increasing competitiveness through infusion of improved technology, finance, and marketing techniques should be emphasized.

OBJECTIVES OF THE STUDY

The main objective of the present study is to know the reality behind bank's commitment regarding lending to priority sector.

RESEARCH METHODOLOGY

Methodology is the systematic and theoretical analysis of the methods applies to a field of study, or the theoretical analysis of the body of methods and principles associated with a branch of knowledge. The present study is descriptive in nature. In the present study secondary sources has been used like books, articles in various newspapers and research articles published in different scientific journals. This study is based on the results of the studies that have already been published in the field of banking sector.

FINDINGS AND DISCUSSION

Chasing Targets

The thought behind issuing the recent RBI notification has likely come from the regulator's annual report for the previous financial year ending March 31, 2013, which states that neither public nor private sector banks had achieved their priority sector lending targets for that year. The target is 40 per cent for domestic banks and 32 per cent for foreign banks. Among public sector banks, 16 of the 26 were unable to achieve the target, and among private sector banks, 50 per cent. Interestingly, among foreign banks in India, only 2 of 41 were unable to meet the target. These figures must be viewed along with the observation by the report that credit to micro and small enterprises from banks had grown almost 30 per cent last year over the previous year. Obviously, at a time when companies in those sectors have been crying out for funds or to at least reduce the financial burden, banks have not disbursed the full amount due to priority sectors. Although note that the unutilized portion of bank funds goes towards funds like the Rural Infrastructure Development Fund set up with NABARD, funds set up by Small Industries Development Bank of India and the National Housing Bank. Interestingly, in its press release stating that medium enterprises are now eligible for priority sector funding, the RBI has listed delayed settlement of receivables from large corporate, public sector undertakings and government departments as one of the reasons for the cash crunch faced by SMEs, in addition to the economic slowdown.

Legally, the Micro, Small and Medium Enterprises Development Act, 2006 provides recourse to enterprises facing such issues. The Act allows for recovery of amounts due from the buyer. More specifically, Section 15 of the Act pertains to the liability of the buyer to make payments. It also talks about a levy of interest where payments are delayed. Any dispute shall be referred to the Micro and Small Enterprises Facilitation Council. The Prime Minister's Task Force on MSMEs has recommended that banks achieve a 20-per cent year-on-year growth in credit disbursals to MSEs, where at least 60 per cent of the advances go to micro enterprises. Alongside this notification, the RBI has also announced a refinance package of Rs. 5,000 crore to SIDBI.

How dreadful is The Lending?

A bitter truth: Last month, Dr K C Chakrabarty's keynote address on credit scoring models for MSE lending stated that only 5.18 per cent of MSE units availed funding from institutions. Due to the time-consuming nature versus not-so-attractive profits derived from loaning to MSEs, banks have been somewhat reluctant to conduct due diligence and thereby provide finance. Moreover, banks have neither used the system of credit scores to judge the suitability of MSE enterprises as recommended by the RBI five years ago. So whether banks are really interested on lending to micro, small and medium enterprises may not seem a question mark. RBI's unmotivated push gives the answer away. In 2012-13, it invested $1.4 billion in India, of which over $900 million was in loans, nearly $350 million in equity, and $150 million in other products such as guarantees and PPP mobilization. Michel Botzung, Principal Operations Officer at IFC's India office, who initiated the corporation's work on banks' non-financial services for SMEs, and has been instrumental in integrating its SME work in investment deals, explains, in an e-mail interaction with T E Narasimhan, the corporation's approach to SMEs. Edited excerpts

Why are financial institutions, especially banks, averse to lending to this sector?

There are a couple of reasons. IFC is working at addressing these issues. First, products and services for MSMEs often need significant collateral to back them up as a way to manage both the risk in this sector, as well as the transaction cost of serving this segment. However, the majority of entrepreneurs do not have access to sufficient levels of collateral.

Second, financial institutions also have limited access to relevant credit information on MSMEs. IFC is leveraging its global experience with credit bureaus to grow the use of credit information for SMEs in South Asia. This will include supporting existing credit bureaus to increase use of non-traditional credit information (such as utility bills) to develop a comprehensive credit picture for small business owners.

CONCLUSION

For the conclusion we can say that to help create a stimulating and enabling environment that promotes SME growth, IFC works with governments to introduce reforms that make it easier for SMEs to operate. For example, IFC worked in Bihar to simplify business tax for small and large enterprises. It resulted in enhancing the number of tax payers filing e-returns to 92,000 by September 2013 (at the closure of the project), from a base of 149 only in 2009 when the intervention started. This has been possible by the introduction of a payment gateway which the team recommended, that allows over 40 banks to accept tax payments. The revenue from small tax payers alone increased from Rs 300 million in 2008 to Rs 1,550 million in 2013.

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