Article No. 6

THE NECESSITY TO RESTRUCTURE THE BANKS TO MEET THE EXPANDING NEEDS OF THE ECONOMY

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Abstract: Following the nationalization of a number of significant banks, obligatory lending to priority industries achieved its goal. However, the political class sabotaged the entire process; the rural people were exploited for political benefit, and these institutions are now burdened with rising non-performing assets. Despite all of the technological advancements in the agricultural industry, it remains reliant on the rain gods, with the monsoon's whims wreaking havoc on our country's poor farmers. The reports of heavily in debt farmers committing suicide as a result of crop failure and their inability to meet their obligations are heartbreaking, and they necessitate a dedicated group of bank offices who can understand and appreciate the plight of these farmers, acting as a friend, philosopher, and guide to the distressed farmers. This necessitates a shift in mindset at all levels of financial institutions. This papers attempts to present the effect of the transition in the PSL needs, reforms in the current context of shifting value systems and the necessity to build our banks along the sound lines to meet our economy's expanding needs.

Keywords: priority sector lending; economy; financial institutions; financial institutions

Introduction

Since the nationalization of banks in 1969, commercial banks have been required to lend a specific amount of their lendable resources to the 'priority' sector, with the goal of enabling the poor and underprivileged to improve their standard of life by entering productive occupations. The Reserve Bank of India (RBI) directed that this financing to the priority sector be used to replace village moneylenders who charged outrageous interest rates by providing need-based loans at 'reasonable' interest rates.

The aims behind directed lending were admirable, as it significantly aided in satisfying the financial needs of agriculturists and village artisans, and opened the way for significant changes in the village economy during the last (over) four decades. While mandatory lending to priority sectors served the intended purpose in the early years of implementation, the entire philosophy was torpedoed by the political class, and it became an instrument of exploitation of the rural population for political gain, at the expense of lending banks, who quietly swallowed the bitter pill to appease their masters, despite the negative consequences on the state of our country's banking institutions. The central government fueled the flames by announcing populist initiatives such as waiving bank loans to agriculturists on a regular basis, among other things. These debt-forgiveness schemes effectively encouraged loan defaults, eroding loan repayment ethics and, as a result, destroying the fundamental fundamentals of lending, causing irreversible damage to our country's economy. This resulted in several public sector banks going into the red, and when they reached a level of negative net worth, the Central government bailed them out with taxpayers' money, despite the fact that it bloated the budgetary deficit year after year.

Objective of The Study

- To present the effect of the transition in the PSL needs & reforms in the current context of shifting value systems
- To highlight the necessity to build our banks along the sound lines to meet our economy's expanding needs.

Research Methodology

The research is based on secondary information. Secondary data is gathered from numerous journals, publications, and websites to investigate the effect of the transition in the PSL needs, reforms in the current context of shifting value systems.

The First Narasimham Committee Report Of 1991

The first Narasimham Committee report, published in 1991, urged that banks take a fresh look at priority-sector lending and make tangible proposals to gradually phase down directed lending so that the banking system can continue to grow on healthy lines.
The Committee's positions on these matters were as follows:

- In terms of directed credit programmes, the committee believed that they had served a valuable purpose in broadening the banking system's reach to include previously underserved sectors. Despite a large amount of unproductive lending, there were evidences that the bank's credit had an impact on agricultural and small-business growth. This necessitated a rethinking of the current relevance of directed credit programmes, at least in terms of those who could stand on their own two feet and for whom directed credit programmes with an element of interest concession was sanctioned became the source of economic rent.
- The Committee noted that banking and credit policies had been used to redistribute wealth over the last two decades. The Committee, on the other hand, believed that the fiscal system, rather than the credit system, should have been employed to achieve such goals.

RBI's Stand and Modifications To The Priority Sector Lending Guidelines

For obvious reasons, the RBI did not embrace these proposals, but it did make certain changes to the priority sector lending criteria and continued the policy of target-oriented priority sector lending by both domestic and international banks operating in the country.
The RBI went even further, imposing a penalty on banks that failed to meet their targets, requiring them to deposit the difference in the low-yielding Rural Infrastructure Development Fund (RIDF) established by the National Bank for Agriculture and Rural Development (NABARD) or other RBI-approved institutions.

Banks who lent to the priority sector and met their targets suffered from mounting non-performing assets (NPAs), while those that did not meet their targets were forced to invest in the low-yielding funds. It was thus a no-win situation for the commercial banks, which meekly succumbed to RBI's directives for the simple reason that they had no say in the issue and were effectively forced to either put up or shut up, which they dutifully did in their own enlightened self-interest.

The Demerits Of The Policy Directed Towards Target-Oriented Lending

The target-oriented lending policy has its own problems, and it has resulted in unacceptable practices in many banks, resulting in the accumulation of nonperforming assets (NPAs). The objectives for which these policies were created were defeated due to faulty implementation, as a significant quantity of bank loans did not reach the intended beneficiaries or were not employed for productive purposes, despite bank branch records indicating otherwise.

To put it briefly, what is generally happening today in commercial banks is that they show lip sympathy to priority sector credit seekers, and lend money somewhat reluctantly, only due to pressure from the top, without the real determination on the part of the ranking and file to increase the whole lot of the inadequate and the underprivileged members of our society.

The fundamental reason for this attitude is because branch managers are neither effectively taught in the art of lending to the priority sector, nor are they protected when loans go bad due to circumstances beyond their control. And, in retrospect, any decision made by the branch manager can be questioned and criticized, especially because today's bank manager is expected to perform a wide range of functions in addition to lending to the priority sector, such as banking, insurance, mutual funds, investments, and wealth management.

The strategy to give a greater push and focus to the priority sector lending without aching the banks

The Reserve Bank of India (RBI) has formed a committee, chaired by MV Nair, Chairman and Managing Director of Union Bank of India, to reassess existing standards and offer updated norms for priority-sector lending and related issues. As a result, this article provides some food for thought for the committee members as well as a few out-of-the-box suggestions for radically changing the current system with the goal of encouraging a dedicated and committed band of banking institutions to continue to do trailblazing work in the area of uplifting the village economy and improving the lot of our society's most vulnerable members. This can be accomplished in two steps, which are explained below.
The first step is to shift commercial banks' attitudes on priority sector lending, and the following steps are suggested to accomplish this goal.

- Every bank should train a group of senior and middle-level personnel in the art of lending to the priority sector, including agricultural and small-scale industries, and encourage them to keep up with the latest innovations in this field of lending.
- Rather than making priority-sector lending facilities available in all branches, every bank should establish specialized branches in all potential centers and extend priority-sector lending exclusively through these branches, where trained manpower should be deployed to ensure proper sanction and monitoring of these loans and advances.
- The RBI should abandon the current system of target-oriented lending to the priority sector and provide banks the freedom to lend to all deserving and productive businesses according to their own lending standards, rather than spoon-feeding them.
- The current system of allocating 40% of a bank's lendable resources to the priority sector should not be enforced, and all penalties for failing to achieve this level of lending to the priority sector should be removed, allowing banks to develop a portfolio of their choice in the interest of improving asset quality.

- Instead of the current penalty-based system, which penalizes banks that fail to meet their targets, the RBI should implement an incentive-based system to encourage lending to the priority sector, as an incentive-based system will receive better receptivity at all levels, giving priority-sector lending the necessary boost. And the incentives could be along the lines of the following.

  a) Although banks do meet the broad PSL norm of 40 per cent of adjusted net bank credit, there are slippages in meeting sub-sectoral targets (18 per cent of ANBC for agriculture, 10 per cent for weaker sections and 7.5 per cent for micro enterprises) The incentives proposed could be tiered, with inbuilt rewards for attaining the sub sector targets.

  These percentages can be related to branch licensing and CRR/SLR regulations.

  b) Staff working in specialized branches that lend to the priority sector can be given appropriate incentives based on the amount of money lent to the priority sector at each branch.
  c) For banks that reach specified levels of lending to the priority sector, a specific amount of profit can be excluded from income tax.
  d) Any other incentive that encourages lending to the priority industry could be considered.

- All current subsidies to banks for lending to particular priority sectors should be phased down, and adequate fiscal incentives should be introduced in their place to reduce paperwork and exploitation of the subsidy system.
- To encourage commercial bank employees to enhance lending to the priority sector, bank managements, particularly in the public sector, should adjust their attitudes and adopt the main premise followed by banks around the world: "mistake of judgment is not neglect." All loans granted by branch managers should be accessed through this lens, and sufficient protection should be provided to the operating employees when loans default due to circumstances beyond their control. This will provide the necessary comfort to employees at all levels, significantly altering their attitudes about priority-sector lending and assisting banks in improving their performance in this area of banking.
- The farmer community in our country requires a great deal of counseling, and bank personnel involved in this activity should be taught in the skill of giving advice and counsel when needed, as well as considering the borrowers' wishes with a humanitarian touch.

The second step in this direction is to create and nurture a few specialized institutions dedicated solely to lending to the priority sector, and the following proposals, if implemented, will be extremely helpful in this regard.

- NABARD (National Bank for Agriculture and Rural Development) should be in charge of financing the country's whole agricultural operations. To accomplish this, all Regional Rural Banks (RRBs) now operating in our county should be transferred to NABARD, and all RRB branches should serve as NABARD's lending arms. The RRBs should be entirely owned and controlled by NABARD, and all direct loans to agriculture and related occupations should be routed through RRB branches, which should be subsidized to the extent necessary by NABARD.

- NABARD should be repositioned as the country's exclusive source of agricultural finance, and new RRBs should be established in districts that are currently unserved by RRBs, so that over the next five years, the entire country will be under NABARD's control for agricultural and related lending.
- The Small Industries Development Bank of India (SIDBI), which should play a more aggressive and important role in growing India's small scale industries, is the second institution that demands comprehensive reorientation. This organization shall serve as the central agency for directly financing micro, small, and medium-sized firms (MSMEs) in India, with the added obligation of continuing to refinance existing loans.
- SIDBI should establish a nationwide branch network with the stated goal of financing small scale industries' whole needs, including their working capital requirements, so that small business owners do not have to rely on various banks for their financial needs as they do now.
- Within the next three years, SIDBI should establish full-fledged branches in all district headquarters across India and promote direct funding of all viable MSMEs and other microfinance institutions.
- SIDBI has amassed a loan portfolio of slightly over 1, 78,547 crore during the course of its 32-year existence, the majority of which has been used to refinance banks and other financial institutions. Because the financial requirements of small scale enterprises in our nation are rather high, this institution will need to take a visionary approach in order to have an impact on the development of MSMEs, which can be a game-changer for our country's economy.
- Commercial banks, on the other hand, will continue to lend to eligible and desirable borrowers in all sectors, including the priority sector, as they have done in the past, and will benefit from the incentives offered in relation to lending to socially desirable sectors, but without being compelled to lend a certain percentage of their lendable resources to any specific sector, as is the case now.

Conclusion

By enhancing the roles of two specialized institutions—NABARD and SIDBI—in the areas of agriculture and small-scale industry, respectively, the entire economy of our country will gain the necessary momentum in meeting the financial needs of this priority sector and providing the much-needed impetus to improve the lot of our society's underprivileged sections. This will also help to improve the village economy and give job opportunities in our country's villages and smaller cities. The current difficulties in the system of commercial banks lending to the priority sector would be abolished since these two all-India institutions would be dedicated to their mission without being excessively influenced by the valuation of their shares, as they are wholly owned by the Indian government.

Commercial banks, on the other hand, will be able to play a considerably larger part in the development of our economy, which is on track to become the world's third largest in the near future. With GDP expected to rise at a rate of 9.2%, banks in our country will be forced to tighten their belts in order to meet the economy's growing demands. The Indian banking industry is underutilized, as the loan-to-GDP ratio is now reported to be 56.075% in India, compared to 112.693 % in Brazil and 182 % percent in China. In addition, with the implementation of Basel III, Indian banks would require significant extra capital, which they will have to raise from the capital markets. The strengthening of bank balance sheets as a result of improved profitability and lower non-performing assets (NPAs) will result in better bourse valuations, allowing banks to more easily raise required capital and meet the needs of the growing economy without having to rely entirely on taxpayer money.

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