

RBI UNLEASHES POLICY FEDERALISM BY MATCHING SOCIAL INCLUSION WITH BANK LENDING

Issue No. 43, FY21

Date: 04 September 2020

The RBI released today the revised priority sector lending norms. With the change in definition in 2015, the performance of banks in achieving PSL targets has significantly improved. In FY20, all the bank-groups (Public, Private & Foreign banks) have been able to achieve the overall target of 40% lending (Public: 41.05%, Private: 40.32% and FBs 40.81%).

The most notable policy changes are including bank finance to start-ups (up to ₹50 crore); loans to farmers for installation of solar power plants for solarisation of grid connected agriculture pumps and loans for setting up Compressed Bio Gas (CBG) plants as fresh categories eligible for finance under priority sector.

The inclusion of start-ups in PSL will reduce their cost of capital by allowing them better access to bank credit. Going forward, equity infusion will not be the only route to follow when start-ups need funds for working capital requirements, and this will greatly ease the risk of ordinary shareholders being wiped out due to 'down-rounds'. However, to boost lending to start-ups it is also imperative to set in place an institutional mechanism. As an example, start-ups don't have collateral and performance evaluation mechanism matrix and hence it will be interesting to see how the lenders can diversify their risk appetite and lend to start-ups which do not meet traditional security/collateral/cash flow requirements. We believe a suitably structured guarantee scheme from the Government could be helpful in the current scenario to give an impetus to lend to start-ups.

Loans to farmers for installation of solar power plants is also a policy enabler. In an effort to boost the agriculture sector, the Indian government has set an ambitious goal to double farmers' income by 2022. Novel approaches and innovations in farming will be required to achieve this ambitious goal and this is one of the policy options to boost farmers income.

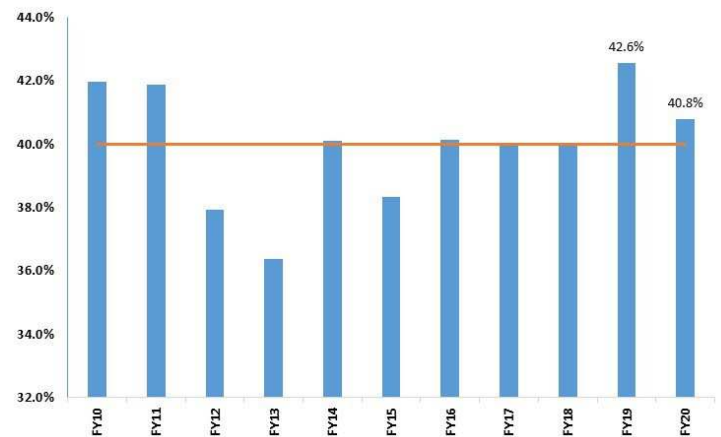
However, most importantly, to address the regional disparities in the flow of PSL credit, RBI has put in place an incentive framework for banks, in which higher weight will be assigned for incremental PSL credit in the identified districts where credit flow is comparatively lower and a lower weight would be assigned to incremental PSL credit in identified districts where the credit flow is comparatively higher. We believe that this is an ideal example of policy federalism adopted by RBI in promoting financial and social inclusion in line with the Central Government's agenda of providing financial inclusion to backward districts in the country.

Finally, there could be some more policy options to further improve lending under PSL, in areas of Education, Housing, Export Credit and Financial Inclusion.

REVISITING PRIORITY SECTOR LENDING (PSL)

- ◆ The RBI released the revised master guidelines on PSL lending by banks, highlighted in the 'Developmental and Regulatory Policies' in the 06 Aug'20 policy statement. The revised guidelines aim for better credit penetration to credit deficient areas; increase the lending to small and marginal farmers and weaker sections; boost credit to renewable energy, and health infrastructure.
- ◆ To broaden the scope of Priority Sector Lending (PSL), RBI has announced to include (i) start-ups, (ii) enhanced borrowing limits for renewable energy sectors; (iii) increased the targets for lending to 'small and marginal farmers' and 'weaker sections'; (iv) assigned higher weightage to incremental priority sector credit in 'identified districts' (v) higher credit limit has been specified for FPOs/FPCs undertaking farming. With the change in definition, this will help banks to achieve the targets and credit would be available to desired sectors.
- ◆ With the change in definition in 2015, the performance of banks in achieving PSL targets has improved but declined in the FY20 to 40.8% from 42.6% in FY19. In FY20, all the bank-groups (Public, Private & Foreign banks) have been able to achieve the overall target of 40% (Public: 41.05%, Private: 40.32% and FBs 40.81%).
- ◆ **New Categories under PSL:** Bank finance to start-ups (up to ₹50 crore); loans to farmers for installation of solar power plants for solarisation of grid connected agriculture pumps and loans for setting up Compressed Bio Gas (CBG) plants have been included as fresh categories eligible for finance under priority sector.
- ◆ **Start-ups:** In India, we have around 4.2 lakh Start-ups, of which 34,569 are DPIIT recognised. Generally, initially start-ups are funded by venture capital funds, and foreign funds. There are also some state government funds to promote start-ups. However, there was a need for permanent source of funds for the growth of the start-ups.
- ◆ We believe that the inclusion of start-ups in PSL will reduce their cost of capital by allowing them better access to bank credit. Going forward, equity infusion will not be the only route to follow when start-ups need funds for working capital requirements, and this will greatly ease the risk of ordinary shareholders being wiped out due to 'down-rounds'.

Performance in Achievement of PSL Targets



Source: SBI Research

Targets /Sub-targets for Priority Sector (% of ANBC)

	Domestic commercial banks + Foreign banks with more than 20 branches	SFBs	RRBs	FBs with less than 20 branches
Total Priority Sector	40%	75%		40%
Agriculture	18% (of which, 8% to SMF by FY21, 9% by FY22, 9.5% by FY23 & 10% by FY24)			NA
Micro Enterprises	7.50%			NA
Advances to Weaker Sections	10% by FY21, 11% by FY22, 11.5% by FY23 & 12% by FY24		15%	NA

Source: RBI

- ◆ However, to boost lending to start ups it is also imperative to set in place an institutional mechanism. As an example, start ups don't have collateral and performance evaluation mechanism matrix and hence it will be interesting to see how the lenders can diversify their risk appetite and lend to start-ups which do not meet traditional security/collateral/cash flow requirements. We believe a suitably structured guarantee scheme from the Government could be helpful in the current scenario to give an impetus to lend to start ups. Nevertheless, if funding to startups increased, this will help small companies, which will boost employment in the economy.
- ◆ **Higher weightage assigned to 'identified districts':** To address the regional disparities in the flow of PSL credit, RBI has put in place an incentive framework for banks, in which higher weight will be assigned for incremental PSL credit in the identified districts where credit flow is comparatively lower and a lower weight would be assigned to incremental PSL credit in identified districts where the credit flow is comparatively higher. **This is a perfect bottom-up approach of addressing development issues where the district at bottom will be given priority over other districts.**
- ◆ RBI has provided list of 389 districts arranged in the categories of high PSL credit and low PSL credit compared to other remaining districts. We believe that this is an excellent approach adopted by RBI in promoting financial and social inclusion in line with the Central Government's agenda of providing financial inclusion. For example, we look at the distribution of PMJDY accounts and PMUY Ujjawala) connections, the linkage with social inclusion is stark. Of the 184 districts that are currently receiving low PSL credit, 77 are in 8 NE states and remaining are majorly in Bihar, UP, Chhattisgarh, etc.
- ◆ **Enhanced credit limit for FPOs/FPCs:** Higher credit limit of up to ₹5 crore per borrowing entity has been specified for Farmers Producers Organisations (FPOs)/Farmers Producers Companies (FPCs) undertaking farming with assured marketing of their produce at a pre-determined price. The primary producers have skill and expertise in producing. However, they generally need support for marketing of what they produce. The FPOs bridge this gap. The enhancement in the borrowing limits will help in better functioning of the FPOs, in terms of procurement of inputs and supply of goods, as they deal with the impact of COVID.
- ◆ **Credit Limit for Health Infrastructure Doubled:** For improvement of health infrastructure, credit limit for health infrastructure (including those under 'Ayushman Bharat') has been doubled to ₹10 crore per bank borrower for building health care facilities in Tier II to Tier VI centres. In case of UCBs, this limit is applicable only in centres having a population of less than one lakh. The pandemic has made it glaringly obvious that our health infrastructure is woefully inadequate and this step is expected to augment the health infrastructure capacity building exercise that the Centre and States are undertaking.

Mapping of RBI's List of PSL Districts with PMJDY & PMUY						
States / Union Territories	PMUY (Jul-19)		PMJDY (Aug-20)		Number of Districts with comparatively	
	No of Connections	Share in Total	No of Accounts (in Lakh)	Share in Total	High PSL credit	Low PSL credit
Andhra Pradesh	354260	0.5%	107	2.7%	11	0
Bihar	7993305	10.9%	467	11.6%	1	28
Chhattisgarh	2691168	3.7%	150	3.7%	2	15
Delhi	74366	0.1%	46	1.1%	9	1
Goa	1074	0.0%	2	0.0%	2	0
Gujarat	2611345	3.6%	155	3.8%	12	2
Haryana	693382	0.9%	77	1.9%	16	1
Himachal Pradesh	115920	0.2%	14	0.4%	5	0
J&K + Ladakh	1106240	1.5%	23	0.6%	8	0
Jharkhand	2940541	4.0%	148	3.7%	1	12
Karnataka	2880102	3.9%	149	3.7%	14	0
Kerala	222263	0.3%	45	1.1%	13	0
Madhya Pradesh	6549699	8.9%	342	8.5%	11	11
Maharashtra	4129228	5.6%	283	7.0%	6	1
NE States (8)	3590495	4.9%	205	5.1%	3	77
Odisha	4305397	5.9%	165	4.1%	1	6
Punjab	1211672	1.6%	72	1.8%	19	0
Rajasthan	5880717	8.0%	281	7.0%	9	0
Tamil Nadu	3164409	4.3%	108	2.7%	32	0
Telangana	969685	1.3%	101	2.5%	9	1
Uttar Pradesh	13352869	18.2%	679	16.8%	6	22
Uttarakhand	362980	0.5%	27	0.7%	4	3
West Bengal	8142466	11.1%	387	9.6%	3	3
Remaining States/UTs	36605	0.0%	7	0.2%	8	1
All India	73492401	100.0%	4040.7	100.0%	205	184

Source: RBI, SBI Research

SUGGESTIONS TO FURTHER INCLUDE IN PSL

- ◆ In the last couple of years, RBI has revisited the PSL guidelines with the changing economic environment and included a number of new sectors. In the ambit of PSL. However, we have a few suggestions to improve the credit support to the desired sectors of the economy.
- ◆ **Swachh Credit:** Promoting Swachhata activity through earmarking sub-targets under priority sector lending. This can be included under the social infrastructure sub head of PSL.
- ◆ **Education:** Loans upto ₹20 lakh need to be covered under Priority sector Lending. This will help a number of students to get the loans easily.
- ◆ **Housing:** Alignment of priority sector and affordable housing definitions.
- ◆ **Export Credit:** Increasing weightage for export target under Priority Sector Lending (PSL) from 2% of Adjusted Net Bank Credit (ANBC).
- ◆ In the last couple of years, banks have opened around 40 crore of PMJDY accounts by putting huge efforts and made the programme a huge success. In our view, Government should fix a target for each bank to open and service PMJDY accounts in a year. If any bank opens more number of accounts, that can be converted into Priority Sector Lending Certificates (PSLC). This move will incentivise banks to open and maintain more number of PMJDY accounts (Overdrafts under Jan Dhan accounts are under PSL norms).

Disclaimer:

The Ecowrap is not a priced publication of the Bank. The opinion expressed is of Research Team and not necessarily reflect those of the Bank or its subsidiaries. The contents can be reproduced with proper acknowledgement. The write-up on Economic & Financial Developments is based on information & data procured from various sources and no responsibility is accepted for the accuracy of facts and figures. The Bank or the Research Team assumes no liability if any person or entity relies on views, opinion or facts & figures finding in Ecowrap.

Contact Details:

Dr. Soumya Kanti Ghosh
 Group Chief Economic Adviser
 State Bank of India, Corporate Centre
 Nariman Point, Mumbai - 400021
 Email: soumya.ghosh@sbi.co.in
 gcea.erd@sbi.co.in
 Phone:022-22742440
 @kantisoumya