Ethical Perspective on Indian Banking System with reference to Agriculture and SME advances.

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Abstract

Ethical banking is a system of banking where a bank is concerned with the social impact of its activities. In case of India, ethics based banking is having a robust banking network which caters to all the segments of the society while being conscious of the holistic wellbeing of the economy. In this essay I have dealt with the ethical issue of whether we would be justified in blaming the agriculture and the SME for the growing Non-performing Assets (NPAs) in Indian banks.

1.1. Introduction

The Banking system in India was originally private with few corporate families and trusts owning the banks. This led them to finance their own activities by raising funds. As such the access to banking facilities was limited to the upper class and select upper-middle class with majority of the Indian populace dependent on private money lenders who charged high rate of interest. This led to not only the economic exploitation of the population but also widening of the rich-poor divide in India.

To overcome this problem the Government of India under Prime Minister Indira Gandhi undertook the Nationalization of 21 banks in India making banking accessible to everyone irrespective of their social class. This was in keeping up with the spirit of Indian Constitution which provides for equitable distribution of wealth and Socialist state of activities. As such the motto of working of the Public Sector Banking was to cater to the 'mass' and not to the 'class'.

With the opening of Indian Economy to globalization and privatization, the structure of financial institutions across the nation saw a radical change. The advent of Multinational and private sector banking institutions led to the change of perspective of Indian banking sector, making profit lucrative. Banks began to cater and attract the Corporate sector, the new-rich middle class and generation Y and Z, who had tremendous purchase power and whose activities was driving the Indian Economy.

In this zeal to make profit and the rise of competition between the Public and Private sector banks, the mass (farmers and Small and Micro Enterprises) began to lose. They seemed to be an unwanted drag in the quest of profit making. Rural branch posting was looked as 'punishment posting'.

But is this ethical? Do we have to sacrifice the needs of the masses that are in need banking facilities the most in order to make profit? Why does the government want the public sector banks to be profit making cash-cows it can milk whenever necessary? Are the growing NPA's in Public sector and other banks caused by Agriculture and MSE loans?

2.1 What is banking?

Banks were born out of the necessity of humans' enterprising nature. Today the banking industry is one of the most complex and hugely diverse commercial enterprises offering a portfolio of a large number of financial services. Commercial banks are an important stimulant of the economy by managing institutional credit to their customers. Today banks are large and complex organizations. Their clients range from individuals and corporate institutions, other banks, and governments of entire nations. Banking is a service industry, which means that they don't produce physical products but provide services to their clients. They deal with all types of money transactions, borrowing it, lending it, and many other related activities.

With this we see, banking is not a simple job but a vocation, it is a calling which requires an individual with highest regards for ethical behaviour not only in professional life but also in his private life as many a times the boundary between these two overlaps in more ways than one.

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2.2. The definitions of Banking.

“A banking company is the one which transacts the business of banking which means accepting, for the purpose of lending and investment of deposits of money from the public, repayable on demand or otherwise and withdrawals by cheques, draft, order or otherwise.“- Section 5(b) of the Banking Regulation Act; India.

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2.3. Ethical banking

The banking system in India is regulated by the Reserve Bank of India (RBI), through the provisions of the Banking Regulation Act, 1949. We have also begun a right step in ethical banking by the formation of the Banking Codes and Standards Board of India (BCSBI) which is collaboration between the Indian Banks' Association (IBA), Reserve Bank of India (RBI) and member banks. It has evolved two codes - Code of Bank's Commitment to Customers and the Code of Bank's Commitment to Micro and Small Enterprises - which set minimum standards of banking practices for member banks to follow when they are dealing with individual customers and Micro and Small Enterprises. The central objective of the Codes is promoting good banking practices, setting minimum standards, increasing transparency, achieving higher operating standards and above all, promoting a cordial banker-customer relationship which would foster confidence of the common man in the banking system (BCSBI, 2018). These need to be enforced by the RBI in stricter sense as currently they are voluntary on the member banks. We need to make Indian banking an agriculture and MSE sector friendly so as to ensure that these sectors receive the boost and thereby serve in the development and growth of the rural and semi-rural areas.

3.1. Non Performing Assets (NPAs)

Simply understood, an NPA is an asset, including a leased asset, which becomes non-performing when it ceases to generate income for the bank. A non-performing asset (NPA) is a loan or an advance where interest and or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan (loan given on a fixed term).

3.2. The causes of the growing NPAs.

The growth of NPAs is a threat to the Indian banking system and the Indian economy as whole. The Indian private and public sector banks are equal contributors to corporate debts, but according to the Financial Stability Report June 2016, the public sector has more serious NPAs than the private sector banks. The root causes of the higher NPAs in PSBs is the political influence and corruption that helps large corporations for sanctioning and waiving off the loans, least accountability on the board members of PSBs, lax nature of the PSBs employees and administration (Harani & Mutyala, 2019). Therefore, lately the government proposed to privatize some of the major public sector banks for reducing stressed assets. This latest trend of privatization goes against the thought process of public welfare which resulted in the nationalization of the banks in 1969. Instead of understanding the root causes of growing NPAs and taking strict remedial measures, the government seems to wash its hands off its responsibility. There is a common failure to understand that only the government owned PSBs will be able to cater to the poor and the marginalized while privatizing them will only cause the disenfranchisement and alienation of the majority of poor Indians.

The NPAs of priority and non-priority sectors from FY 2010 to 2017, the non-priority sectors performed poorly throughout the selected years. Despite of these evidences the banks extend loans quite easily to the non-priority sectors (Goyal, 2020; Mohanty, 2020). The rapid growth of NPA is also the result of over dependence of corporate sector on PSBs mainly because they provide advances on lesser rate of interests. The banks also rely on non-priority sectors to earn interest income than on priority sectors because as the ticket size of corporate advances is high; it also means that the interest earned is correspondingly high.

3.3. The effects of NPA on the Indian Economy.

The accelerating rate of NPAs in Indian banking system has been prevailing since it was recognized officially on the recommendations of Narasimham Committee in 1991. The recommendations of this committee once enforced mandated that a certain provisioning be made from the banks own profit, for the stress assets. Stress assets mean the loans which have not yet become NPAs but are showing some signs of slipping into the segment. In addition to the stress assets, banks were also obliged to make provisioning for the accounts which have already become NPAs based on the duration of the account being labelled as NPAs. The stressed assets in the books of

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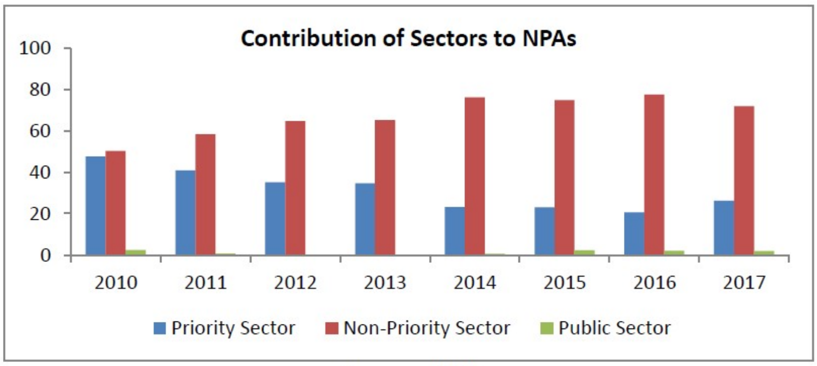
banks are mostly the result of corporate defaults. Recently, the NPAs have been mounting due to the multiple factors such as the increasing number of wilful defaulters, the strict NPA recognition norms and economic slowdown caused due to the outbreak of COVID-19. There is a near unanimity among the economists that asset quality is a critical determinant of sound functioning of the banking system. NPAs affect the operational efficiency, which in turn affects profitability, liquidity and solvency position of banks (Michael et al., 2006). The consequences of NPAs would be reduction in interest income, high level of provisioning, stress on profitability, gradual decline in ability to meet steady increase in cost, increased pressure on net interest margin (NIM) thereby reducing competitiveness, steady erosion of capital resources and increased difficulty in augmenting capital resources (Batra, 2003). The NPAs generate a vicious cycle of effects on the sustainability and growth of the banking system, and if not managed properly could lead to bank failures.

Empirical evidence indicates a relationship between bank failures and higher NPAs worldwide (Chijoriga, 2000; Dash & Kabra, 2010). The issue is of particular importance after the recent global financial crisis and the failure of some large institutions and bailouts that followed. In the Indian context also empirical research suggests that asset quality is one of the main determining factors of credit, besides time deposits and lending interest rate (RBI, 2008).

4.1. Can the Agriculture and SME sector be blamed for the growing NPAs in Indian Banking Sector?

One study was conducted by Khushpat S. Jain and Rahul G. Chopra whose objective was to analyze the trends in NPAs in the Indian Banking Sector from 2004-2011, to assess the contributing factors to the NPA in the Indian Banking Sector and to suggest measures to halt and curtail the rising burden of NPAs, the authors mainly dealt with the rising burden of NPAs in Indian financial system and their likely impact and measures to minimize such adverse impact on the Indian banking system in particular and Indian economy in general. **The authors arrived at a conclusion that the major contributor to the NPAs in banking sector was agricultural sector**. This conclusion according to me is highly biased as the data collected by the RBI and majority other researches conclusively disprove their conclusion. Let us look at a chart showing the contribution of different sectors to the NPAs. This chart is compiled from the data collected from the RBI website.



Sources: RBI

As seen from above the Non-priority sector has the higher contribution to the NPAs. Since the year 2000, the share of priority sector in total NPAs has averaged at 45 per cent, while the share of non-priority sector averaged at 55 per cent. Prior to the period of 2008, the share of priority sector in total NPAs was expanding, while that of non-priority sector was declining in line with the general decline in total NPAs. Disaggregated analysis reveals that, on an average, retail loans occupy the largest share in total NPAs followed by small scale industries (SSIs), agriculture, personal loans, housing loans, exports, credit cards and auto loans. This data includes agriculture and SSIs as a part of the priority sector which includes home loans, auto loans, personal loans etc.

Let us study the percentage of agriculture loans in priority sector. The disaggregated analysis of priority sector shows that over the last one decade, the average share of agriculture in total NPAs remains lower than the share of SSIs and other priority sectors However, the share of agriculture and other priority sectors in aggregate NPAs increased, while that of SSIs declined during the post crisis period.

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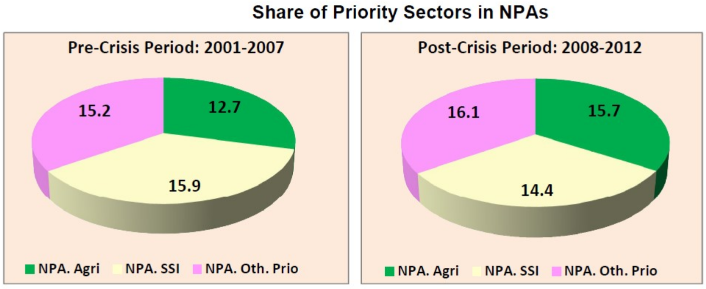

The growth in NPAs in agriculture, which was negative up to the year 2006, rose significantly by end-March 2008. The growth in NPAs in agriculture declined sharply in 2009 due to the implementation of the Agriculture Debt Waiver and Relief Scheme, 2008 (RBI, 2010). In the recent years, however, the growth in NPAs in agriculture has been high, averaging at over 28 per cent during 2007-2012. In fact, the growth in NPAs in agriculture was as high as 61 per cent by end-March 2011, although it decelerated subsequently to 49 per cent by end-March 2012. The high growth in credit to agricultural sector during the pre-crisis period might have contributed to the growth in agricultural NPAs in the subsequent years owing to the deterioration in credit quality.

Even the data for Micro and Small Enterprises (MSEs) for 2011 and 2012; show that the NPAs grew sharply at 24 percent. The rise in the growth of NPAs in the SSI sector was partly a reflection of the impact of the financial crisis and the economic slowdown that had set in thereafter. Thus, NPAs in Small Scale Industries sector have also contributed to rise in aggregate NPAs in the recent years (Lokare, 2014)

Now, the data I have presented from RBI and other sources paints a rather grim picture about the growing NPAs in agriculture and Small Scale Industries (SSIs). Although there is a trend of increase in the percentage of the NPAs in these two sectors, the fact is that the data speaks in terms of percentage of NPA loans rather than the actual amount of loan, which must be taken into consideration while deciding such a criteria. In agriculture and MSE loans, as their ticket size (amount of loan) is less, our exposure risk is also less. A percentage wise default in this sector is more does not mean that they have more exposure in terms of amount; on the contrary they are nowhere close to corporate and other sectors in terms of amount defaulted.

5.1. Conclusion

I strongly feel that although priority sector lending show increasing rate of NPAs, it will be absolutely dangerous for us to reduce lending to this sector or make receiving loan more difficult by increasing the paperwork and formalities. We should keep in mind the visionary mindset of our leaders in 1969 when they nationalized the banks in India. Nationalization of banks was a safe and sure way to keep a complete check on banking activities as well as to ensure that the benefits of government schemes reached their beneficiaries. In doing so it was a common knowledge that these banks would have to sacrifice their profits for the good of the society as whole. Although profit making is the need of the times to keep our banks healthy and matching the global standards of banking, but we should also keep in mind that India is a unique country with almost 58% people still dependent on agriculture and allied activities and their interests must be given equal importance if not precedence in any and all decision making process. Similarly, the SSI/MSE sector holds a key to providing employment for millions of our population especially the youth and can be our biggest strength in producing products which are in demand on national and global level, hence even this sector should not be ignored.

A planned approach is required with intensive hand holding measures while dealing with these sectors. Also, special products (advances and deposits) need to be tailor made for these sectors which are flexible and customer friendly in nature. We have to decide if the standard '*one-size fits all*' approach in categorizing them NPA is indeed logical or can we introduce different measurement criteria for them (S. E. Saldanha, 2024).

Similarly, I emphasise very strongly that we need an ethics based banking approach in Indian banking sector with the strict enforcement of BCSBI guidelines. This will ensure that the banking sector does not lose its focus on the needy while pursuing profit. I believe that while profit can be one of the aspects in deciding the worthiness of the bank, it should not be made the sole criteria for deciding the future of the public sector banks. Like other sectors banks need to be given incentives for their work for nation building and their contribution needs to be acknowledged by the government and the general public alike (S. Saldanha, 2023).

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