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Effect of Credit-Deposit Ratio and Priority Sector Advances to Total Advances Ratio on Profitability: A Case Study on HDFC Bank

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Abstract
Priority Sector Lending though unprofitable and risky but must be continued for greater interest of the Indian society. It becomes inevitable for the banks to improve overall lending quality. This paper aims to assess impact of overall lending policy and priority sector lending on profitability of HDFC bank.

Keywords: Priority Sector Lending, Credit- Deposit Ratio, Return on Assets

Introduction

s per Reserve Bank of India guideline updated on 20th October 2022[13] all scheduled commercial banks should lend minimum 40% of their adjusted net bank credit (ANBC) to priority sectors which include agriculture, micro enterprises and weaker section of the society. It is obvious that loan to agriculture and weaker section of the society may be quite risky from commercial point of view but needs to be carried out for greater interest of the society. As private sector banks may not get Government funding at the time of crisis should manage priority sector lending with due diligence and care. Further private sector banks need to maintain scrupulous lending policy for lending to other segments in order to recover the loss which they may suffer in priority sector lending.

Objective of the Study

This paper aims to assess effect of priority sector lending and overall lending on profitability of HDFC bank.

Research Methodology

This paper is based on secondary data. Data has been collected from compiled 'Performance Highlights' published by Indian Banks Association (IBA). This paper is based on Data on HDFC Bank during 2010-11 to 2019-20. For theoretical study journals and books have been consulted.

In order to measure profitability, overall lending and priority sector lending Return on Assets, Credit-Deposit ratio and Priority Sector Advances to Total Advances ratio has been used.

In 'Empirical Analysis' segment Linear Regression Model has been used.

Review of Literature

The valued opinion of Ramachandran and Swaminathan (2001) in this regard needs to be discussed in detail[1].Three broad phases of banking policy with regard to the Indian countryside can be observed: an early green revolution phase that followed the nationalization of major commercial banks; IRDP phase of credit-based poverty alleviation initiatives; and the most recent phase of liberalization and market-guided banking policy[1]. The first two phases witnessed a significant expansion and consolidation of banking infrastructure in rural areas and, correspondingly, a rise in rural deposit mobilization and advances to rural areas[1]. While the first phase concentrated on the expansion of credit to cultivators, particularly landlords and rich peasants in selected areas, the second phase included credit-based schemes for landless and asset-poor households[1]. The flow of formal sector credit to the rural areas, and specifically to the rural poor, peaked in the late 1980s[1]. The liberalization phase of banking policy has seen a sharp withdrawal of formal banking instruments and credit supply from rural areas[1]. The village data show that changes in national banking policy have had a rapid, drastic and potentially disastrous effect on the debt portfolios of landless labour households[1]. Rural credit markets in India abhor a vacuum: with the withdrawal of formal sector credit for the village poor, the informal sector has rushed in to fill the space[1].

The present study reaches in the conclusion that the performance of Commercial banks in Kerala improved after the implementation of economic reforms in many sectors except in Credit-Deposit ratio and the lower share of priority sector lending[2].

It can be concluded that overall credit risk has significant impact on the profitability of State Bank of India[3].

Well-capitalised banks tend to take on less credit risk[4]. This result is in
line with the 'moral hazard' hypothesis and with the portfolio approach (Flannery, 1989; Gennotte and Pyle, 1991) where well-capitalised banks are more risk-averse due to the relation between deposit insurance schemes and the risk-taking attitude of banks[4]. The results that well-capitalised banks are more risk-averse can also be supported by interpreting capital as a cushion against contingencies (Dewatripont and Tirole, 1994; Repullo, 2004)[4].

Study suggests that as measure for efficiency of risk management practices private sector banks maintain high credit-deposit ratio while public sector banks maintain low credit-deposit ratio[5].

The NPAs have always been a big worry for the banks in India[6]. It is just not a problem for the banks; they are bad for the economy too[6]. The money locked up in NPAs is not available for productive use and adverse effect on banks' profitability is there[6]. The extent of NPA is comparatively higher in propriety sector lending[6]. To improve the efficiency and profitability, the NPAs have to be scheduled[6]. The RBI and the Government of India have taken number steps to reduce NPAs of the Schedule Commercial Banks[6].

A comparison of NPAs in Priority Sector between Public and Private Sector Banks shows that NPAs have been more in public Sector Banks as compared to

Private Sector Banks[7]. This is because advances by public sector banks to the priority sector were high, whereas in Non-Priority Sector NPAs has been more in Private Sector Banks; this is because private sector banks preferred to lend the non-priority sector than to the priority sector[7].

Public sector banks have a major role to play in the development of any district as they provide financial assistance to the people who take up income-generating activity[8]. Shivamogga district is predominately agriculture oriented as such as majority of the population in the district is dependent on agriculture for livelihood[8]. The banks in the Shivamogga district should come up with the immediate and quick measures to prompt delivery of the loan[8].

Priority sector lending is a crucial and essential services of all the commercial banks to promote and develop the priority sectors who are basically the weaker sectors in the society due to lack of financial support and credit facilities[9]. The
nationalization of banks was a major and huge milestone in the banking history to provide a helping hand to these sectors[9].

On the basis of the study results, some recommendations can be offered for the Government in this respect[10]. Government should move early towards policy making and also should pave the way for smooth mobilisation of funds for priority sectors for the better achievement of Sustainable Development Goals (SDG) targets[10].

Looking at the costs incurred by banks in extending credit to priority sectors by opening more branches, and in light of a strong informal credit market competing with the formal credit due to comparative advantage of proximity to the borrower, this study recommends alternate channels of disbursing credit to these sectors specially agriculture[11]. Resetting Priority Sector Lending targets for banks based on their underlying business models will certainly enable them to meet their targets efficiently[11]. However, considering the costs of Priority Sector Lending for banks, credit availability to priority sectors in the long run can be sustained by making these sectors, especially agriculture, attractive for private sector investment and by strengthening specialized financial institutions like RRBs, cooperatives and MFIs to meet the credit needs of these priority sectors and stimulate positive feedback effect on the growth of these sectors[11].

This study deserves greater space in this paper[12]. The Government of India schemes supported by Priority Sector Lending shattered the perception that women are not creditworthy and challenged the view that women entrepreneurs are only 'pickle makers'[12].

This reversal of women's status from a financial perspective had an impact on the prevailing social norms about women's capacity to undertake not only income-generating activities but also become successful entrepreneurs in their own right[12]. Once this change took place, women's households were the first to experience a qualitative impact in terms of the standard of living[12]. Thereafter, women's status changed in the community and in the immediate environment, which encouraged them to participate actively in decision-making at all levels in matters that affected their lives[12].

Limitation of the Study
This study is based on secondary data which is major limitation of the study.

Scope for Further Research
A research project based on primary data from field survey regarding priority sector lending as well as lending to other segments may add value to this study.

Data Analysis
Table One: Return on Assets, Credit Deposit Ratio and Priority Sector Advances to Total Advances

Years	Return on Assets [y]	Credit-Deposit Ratio [x_1]	Priority Sector Advances to Total Advances [x_2]
2010-11	1.58	76.70	34.24
2011-12	1.77	79.21	32.68
2012-13	1.90	80.92	32.01
2013-14	2.00	82.49	29.58
2014-15	2.02	81.08	29.03
2015-16	1.92	85.02	30.52
2016-17	1.88	86.16	29.59
2017-18	1.93	83.46	26.65
2018-19	1.90	88.76	26.93
2019-20	2.01	86.60	26.00

Table Two: Summary Output [Adjusted R Square]

ultiple R	0.7459834
R Square	0.55649123
Adjusted R Square	0.42977444
Standard Error	0.09963748
Observations	10

Table Three: Summary Output [ANOVA]

	df	SS	MS	F	Significance F
Regression	2	0.087197	0.043598	4.391614	0.058098
Residual	7	0.069493	0.009928		
Total	9	0.15669			

Table Four: Summary Output [Coefficients, P-Value]

	Coefficients	Standard Error	P-Value
Intercept	3.00092006	1.785328	0.136673
Credit-Deposit Ratio	-0.00030089	0.015135	0.984693

Priority Sector Advances to Total Advances	-0.0365015	0.020539	0.118791

Significance of Positive Adjusted R Square [Adjusted R Square=0.4297744]

A positive Adjusted R Square signifies correct selection of independent variables, which would be able to forecast the dependent variable. In short, this Mathematical Model may be accepted.

Significance of Having Higher F Value than F Significance Value [F Value= 4.391614; F Significance= 0.058098]

If F value is greater than F Significance in any regression model, it could be inferred that regression model is significant at 5% (in this study) level of significance.

Significance of P Value (In this study at 5% level of Significance)

In regression model any independent variable including the intercept could be accepted if the concerned P value exceeds 0.05 (at 5% level of significance). As in this study all P values have exceeded 0.05, intercept and variables x_1 and x_2 have been included in the final model.

Significance of Negative Coefficient of x_1

In this study independent variable x_1 signifies credit-deposit ratio. Negative coefficient of independent variable x_1 Credit-Deposit Ratio implies that Credit-Deposit ratio (x_1) is having inverse relationship with dependent variable Return on Assets (y).

Result is quite significant. It implies HDFC bank has started getting negative return from its overall lending. It means HDFC bank has failed to develop profit-yielding lending policy. Matter is extremely serious and needs immediate corrective measurement from top Management. Entire lending policy must be changed and all people related to lending need to be told that situation is going in completely wrong direction.

Significance of Negative Coefficient of x_2

In this study independent variable x_2 indicates Priority Sector Advances to Total Advances. A negative coefficient of independent variable x_2 suggests inverse relationship between independent variable x_2 (Priority Sector Advances to Total Advances) and dependent variable y (Return on Assets). This result is not unexpected as priority sector lending is risky from commercial point of view. Still HDFC bank needs to find some work on this and should try to improve the result

Final Model

$Y= \quad 3.00092006--0.00030089x_1 -0.0365015x_2$

Where,

Y= Return on Assets

X_1= Credit-Deposit Ratio
X_2= Priority Sector Advances to Total Advances

Conclusion
Priority Sector Lending is important from societal aspect in India. It is very risky and unprofitable from commercial view point. Still, it must be continued for greater interest of the society. In this backdrop banks must try to improve the quality of lending to other segments.

This study strongly recommends that HDFC bank must re-visit its overall lending policy in order survive in the long run.

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