



Research Article

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## Trends of Priority Sector Lending in India

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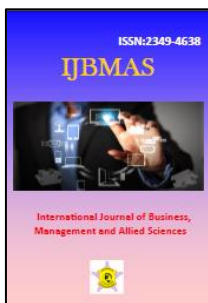
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### ABSTRACT

Priority sector lending (PSL) is mainly intended to ensure that the assistance from the banking system reaches those sectors of the economy which have not received timely and adequate financial support. The scheme is designed for the important sectors of the economy i.e. agriculture, small scale industries, education loan, housing, export credit, weaker sections and others. Given the stipulated guidelines by the Reserve Bank of India and the Government of India, the present paper tries to find out the trends of priority sector advances by public, private and foreign banks. This can be done by looking at two parameters; lending to priority sectors by public, private and foreign banks and targets achieved while lending. The study analyses the trends in credit supply to some major priority sectors like agriculture, micro and small enterprise (MSE) sector and exports. This study is among the very few studies to establish a relationship between overall PSL of SCBs in India and bank performance measures using regressions measures for small samples. It provides empirical support to the call for alternate measures for augmenting priority sector credit.

The focus of the study is to evaluate the impact of PSL on the financials of Indian commercial banks. It is believed that sectors like agriculture, SME units or education etc are riskier and give a low return on investment, which hampers the profitability of commercial banks. Our study tries to find out how far this is justified, by comparing share of priority sector's non-performing assets (NPAs) to total NPAs of banks and non priority sector's NPA through panel-regression analyses. The study also examines the

relationship between priority sector advances and some measures of bank profitability. The study concludes that as PSL is important for policy makers interested in improving priority sector performance, and given its role in squeezing bank profitability, there is a need to augment credit to the sector with other investment channels like PPP or FDI. With significant broadening of the scope of FDI there is ample scope to invest in innovative and technologically advanced all-round development of sectors like agriculture & allied activities or small scale industries, which would in turn help sustainable growth through high demand generation and give a significant push to the returns from the sector as well.

Keywords: Priority sector lending, NPAs, performance of SCBs, panel data regression.

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## I. Introduction

The term 'priority sector' indicates those activities which have national significance and have been assigned priority for progress and are relevant for inclusive social and economic development. Priority sector lending (PSL) is a directed lending programme (DLP) which is mainly intended to ensure that the assistance from the banking system reaches those sectors of the economy which otherwise do not receive timely and adequate institutional financial support as it may not be commercially viable. PSL featured in India's credit policy of 1967-68, in response to shortfalls in agricultural output and an industrial slowdown that caused severe imbalances in the economy. The PSL programme, in operation since 1969, is designed for the important sectors i.e. agriculture, small scale industries, education, housing, exports, weaker sections. The objective PSL has been to ensure that vulnerable sections of society get access to credit and there is adequate flow of resources to those segments of the economy which have higher employment potential and help in making an impact on poverty alleviation. Thus, the sectors that impact large sections of the population, the weaker sections and the sectors which are employment-intensive such as agriculture and micro and small enterprises were included in priority sector.

As per the extant guidelines, domestic banks are required to meet a target of 40 per cent of their Adjusted Net Bank Credit (ANBC)<sup>1</sup> or Credit Equivalent of Off-Balance Sheet Exposure (CEOBE) of the preceding March 31st, whichever is higher, for PSL (RBI, 2015). Foreign banks with 20 and above branches have also been brought on par with domestic banks *w.e.f.* July 20, 2012 and these banks have to achieve the targets over a period of five years. The prescription for foreign banks with less than 20 branches is 32 per cent of ANBC (Table 1). Furthermore, with a sub-targeted lending at 18 percent, agriculture has been receiving the highest share of PSL in India since 1988-89.

The available evidence on DLPs from various other countries suggests positive social and economic outcomes from these programmes. In certain cases, however, it raised concerns about the benefits from these programmes, not reaching the targeted sections and resulting in financial stress for the lenders. RBI (1999) inferred that the higher NPAs in priority sector advances have pushed up the overall proportion of NPAs of banks by about 3% to 4 %.

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<sup>1</sup> (total loans and advance minus bills rediscounted with RBI and other approved Financial Institutions plus investments made after August 30, 2007 in non-SLR bonds under HTM category). See Rao (2014) for a history of various committees and their recommendations on PSL.

**Table 1: Priority Sector Lending Targets and sub targets**

Categories	Domestic scheduled commercial banks and Foreign banks with 20 or more branches and above	Foreign banks with less than 20 branches
Total Priority Sector	<p>40 percent of Adjusted Net Bank Credit or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher.</p> <p>Foreign banks with 20 branches and above have to achieve the Total Priority Sector Target within a maximum period of five years starting from April 1, 2013 and ending on March 31, 2018 as per the action plans submitted by them and approved by RBI.</p>	40 percent of Adjusted Net Bank Credit or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher; to be achieved in a phased manner by 2020.
Agriculture#	<p>18 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher.</p> <p>Within the 18 percent target for agriculture, a target of 8 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher is prescribed for Small and Marginal Farmers, to be achieved in a phased manner <i>i.e.</i>, <b>7 per cent by March 2016 and 8 per cent by March 2017.</b></p> <p>Foreign banks with 20 branches and above have to achieve the Agriculture Target within a maximum period of five years starting from April 1, 2013 and ending on March 31, 2018 as per the action plans submitted by them and approved by RBI. The sub-target for Small and Marginal farmers would be made applicable post 2018 after a review in 2017.</p>	Not applicable
Micro Enterprises	<p>7.5 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher to be achieved in a phased manner <i>i.e.</i> <b>7 per cent by March 2016 and 7.5 per cent by March 2017.</b></p> <p>The sub-target for Micro Enterprises for foreign banks with 20 branches and above would be made applicable post 2018 after a review in 2017.</p>	Not applicable
Advances to Weaker Sections	<p>10 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher.</p> <p>Foreign banks with 20 branches and above have to achieve the Weaker Sections Target within a maximum period of five years starting from April 1, 2013 and ending on March 31, 2018 as per the action plans submitted by them and approved by RBI.</p>	Not applicable

Note: # Domestic banks have been directed to ensure that their overall direct lending to non-corporate farmers does not fall below the system-wide average of the last three years achievement.

Source: RBI, PSL-Targets & Classification.

The higher proportion of NPAs in priority sector advances was attributed to the directed and pre-approved nature of loans sanctioned under sponsored programmes, absence of any security, lack of effective follow-up due to large number of accounts, legal recovery measures being considered not cost effective, vitiation of repayment culture consequent to loan waiver schemes, etc. The World Bank (2004) blamed RBI's stiff PSL norms for foreign and domestic banks for the weak financial health of commercial banks. The report has indicated that government ownership in the banking sector led to insufficient competition in the Indian banking system that led to increased cost of intermediation, lowering capital allocation efficiency and under-lending to the private sector. In recent times business leaders and bankers have pointed to the problems of PSLs. For example, Rao (2014) noted that binding all banks to extend PSLs, irrespective of their capabilities to do so or independent of the credit-worthiness of the borrower, is either likely to result in gross shortfalls or a lot of bad loans or both. The RBI in recent times has revisited this problem and suggested several measures to overcome them.

Given these concerns, this paper analyses the trends in bank lending to the priority sectors of the Indian economy and its impact on banking sector performance. Given the stipulated guidelines by the Reserve Bank of India (RBI, 2015) the present paper traces and compares the trends in priority sector advances by public, private and foreign banks in India. A major focus of the study is to evaluate the impact of PSL on the financial performance of scheduled commercial banks (SCBs). It is widely believed that sectors like agriculture, SME units or education etc are riskier and give a low return on investment, which hampers performance. This study tries to find out how far this is justified, by comparing share of priority sector's NPAs to total NPAs and non priority sector's NPAs. The study also examines the relationship between PSL and some measures of bank profitability. The rest of the paper is organised as follows: Section II summarizes some important findings from the existing literature. Section III describes the data and methodology and presents the results of the graphical and regression analyses. Section IV concludes.

## II. Literature Review

Several studies have explored various aspects of priority sector lending. Among early studies, Angadi (1983) observed the concentration of PSL in general and agricultural advances in particular in some state because of rapid branch expansion, deposit mobilization, privileged cropped area, adoption of high yielding variety etc. The definition of Priority sector was not clear to the bankers and others in the economy about the scope of lending to banking sectors. Joshi (1972) had suggested to RBI to clarify the specific definition of different components of Priority sector. The paper found that the Working Group on the Modalities of Implementation of the Priority Sector Lending recommended that out of total advances to Priority sector, 40 per cent should be extended to agriculture and out of total direct lending at least 50 per cent should be to the weaker sections. Housing loans upto Rs 5000 for construction of houses for SC/ST and weaker sections, assistance to any governmental agency for construction of houses for SC/ST and low-income groups and pure consumption loans granted under the Consumption Credit Scheme was recommended for inclusion in priority sector. The group suggested a target of 14 per cent of total bank credit should go for direct finance to agriculture and allied activities against the existing target of 16 per cent for both direct and indirect finance. To facilitate the targets and sub targets the concept of branch expansion is come into forefront. Again Joshi (1986) identified weak fund management capacity of banks due to maintenance of targets of statutory liquidity ratio (SLR), cash reserve ratio (CRR) and PSL. He found that the low yield rate and rising cost

contributed a lot to the declining trend in profitability of banks. Singh (1987) identified many exogenous and endogenous factors for the strains and stresses of banking system. The major of them being continuous increase in the SLR, CRR, persistent emphasis on social goals like PSL, growing incidence of industrial sickness, rapid branch expansion in the under-banked areas etc. Rangarajan (1991) efficiency of banking system can be improved with the improvement in the quality of loan assets. The Narasimham committee (1991) has suggested that the priority sector should be redefined. It proposed that priority sector should be redefined to comprise the small and marginal farmer, the tiny sector of industry, small business and transport operators, village and cottage industries, rural artisans and other weaker sections and priority sector should be 10 per cent of aggregate credit. The Narsimham committee 1991 on financial sector reform has drawn attention to the problem of low and declining profitability and stated that there is need for gradual phasing out of the directed credit programme, i.e. the target of 40 percent of all credit to priority sector should be stopped. Rajagopal (1994) studied on the consequences of PSL in Indian banking and noted that concessional credit should be restricted only to the poorest of the poor and to the under privileged sections of the society, while commercial rate of interest should be charged from those who can afford it. Ganesan (2003) analyzed the impact of priority sector advances of public sector banks covering the period ranging from 1974 to 1999. He found that priority sector advances, concessional lending and cross subsidization of advances adversely affected the profitability of public sector banks.

Sooden and Kumar (2007) analyzed the priority sector lending in the post reform period and suggested the need for a balanced approach towards development and sustainability of directed lending keeping in view the quantum of NPA in priority sector advances. Ahmed (2010) compared the linear growth rate and compound growth rate (CGR) of priority and non priority sector NPAs. The overall CGR of NPAs during 1998-2007 of PSBs was 6.24 per cent while non-priority sectors CGR (8.86 per cent) outweighed the priority sector (4.37 per cent). Thus the non-priority sector is also considerably adding fresh NPAs over the years. On the other hand, higher NPAs in PSL have pushed up the overall proportion of NPAs by three to four percent. The reasons of higher proportion of NPAs in priority sector advances at the national level were attributed to the directed and pre-approval nature of loans sanctioned under sponsored programmes, lack of effective follow up due to large number of small accounts, non-cost effective legal recovery measures, vitiation of the repayment culture consequent to the loan waiver schemes, etc.

A study by Nathan Associates (2013) explored various dimensions of PSL and noted that while MSEs and export sectors have leveraged the increased supply of credit for higher growth, the agriculture sector's growth has not kept up with the growth in credit supply, with stagnating labour productivity, diminishing capital productivity, deteriorating asset quality, falling GDP to PSL ratio, primarily due to sector specific factors like dependence on monsoons and excessive fragmentation of land holdings. Further, after controlling for factors such as exchange rate, interest rate, area under cultivation, rainfall and number of MSEs, a 100 percent increase in the PSL to the export sector increases the export GDP by 76 percent. The same increase in PSL to MSE sector increases manufacturing GDP by 41 percent. However, in case of agriculture, a 100 percent increase in the PSL to the sector increases agricultural GDP only by 11 percent, thus indicating the inability of the sector to yield returns commensurate with the increased credit supply. The study recommended resetting PSL targets based on the business models of different types of banks - public sector, private sector and foreign. Export credit must be revitalized as a priority sector and promoted to stimulate economic growth; developing a risk minimization plan for agriculture by improving rural infrastructure, promoting contract farming, agro processing and agricultural insurance and making it more attractive to private investors; using innovative market driven instruments such as tradable priority sector lending certificates (to let the

market determine the institutions that are best equipped to lend to and service loans to these sectors, and those who can best diversify the risks from such lending) to make credit available to priority sectors, at the same time ensuring viability of commercial banks. Such recommendations have also been made by some business leaders (FICCI, 2014).

**III. Empirical Analysis**

Data provided by the RBI on targets and achievements of loans by various categories of banks to the priority sector and some specific sectors is analysed through tables and charts covering the period almost 1969 to 2014. Over the years, credit disbursed through the PSL channel has increased manifold, with the targets mandated on domestic as well as foreign banks mostly being achieved (Charts 1, 2, 3 and Tables 2, 3, 4, 5). In fact the share of PSL to total advances has been increasing for foreign banks and has exceeded that of public sector banks in recent years i.e., basically in 2010-13. However, NPAs from the priority sector account for over 50 per cent of total NPAs of public sector banks and about 30 per cent of private banks. NPAs from agriculture again account for about 15 to 20 per cent of total NPAs for public sector banks, while for private banks this share had grown from 5 per cent to 12 per cent between 2001 and 2014 (Table 6). Since 2010, the growth rates of NPAs have risen sharply and NPAs in agriculture have far exceeded the growth rate of NPAs in the overall priority sector.

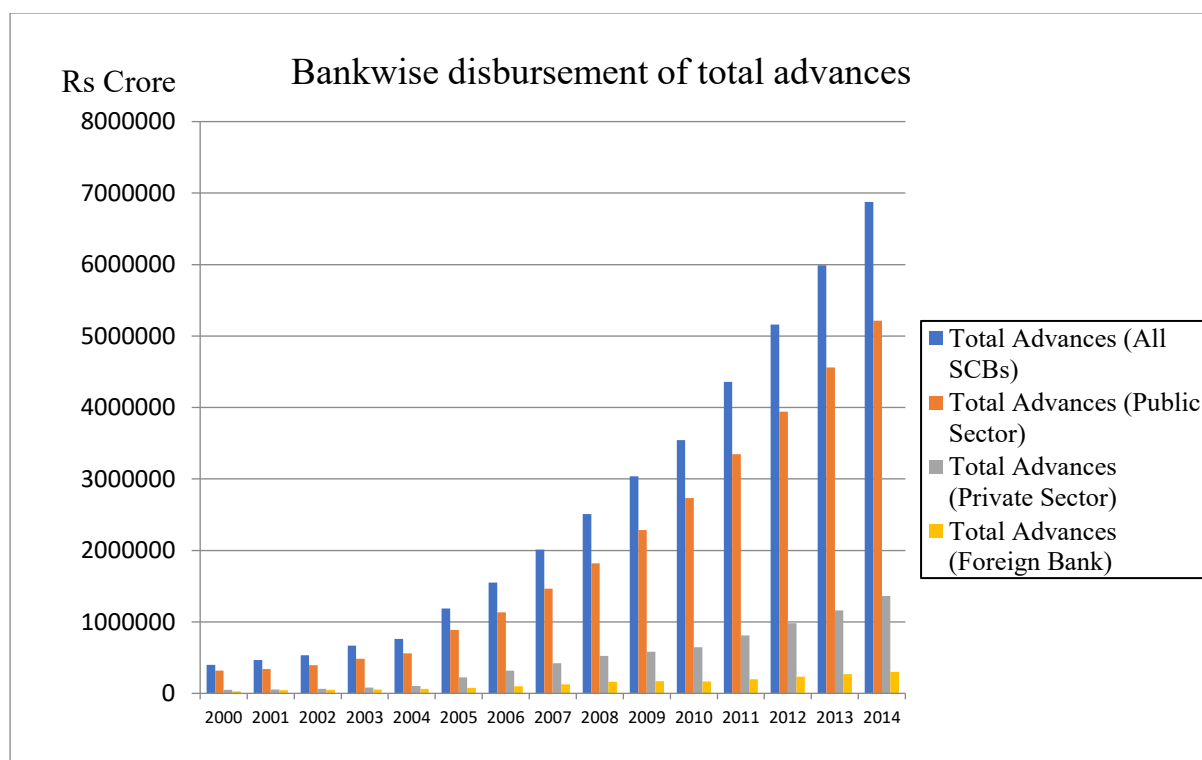


Chart -1

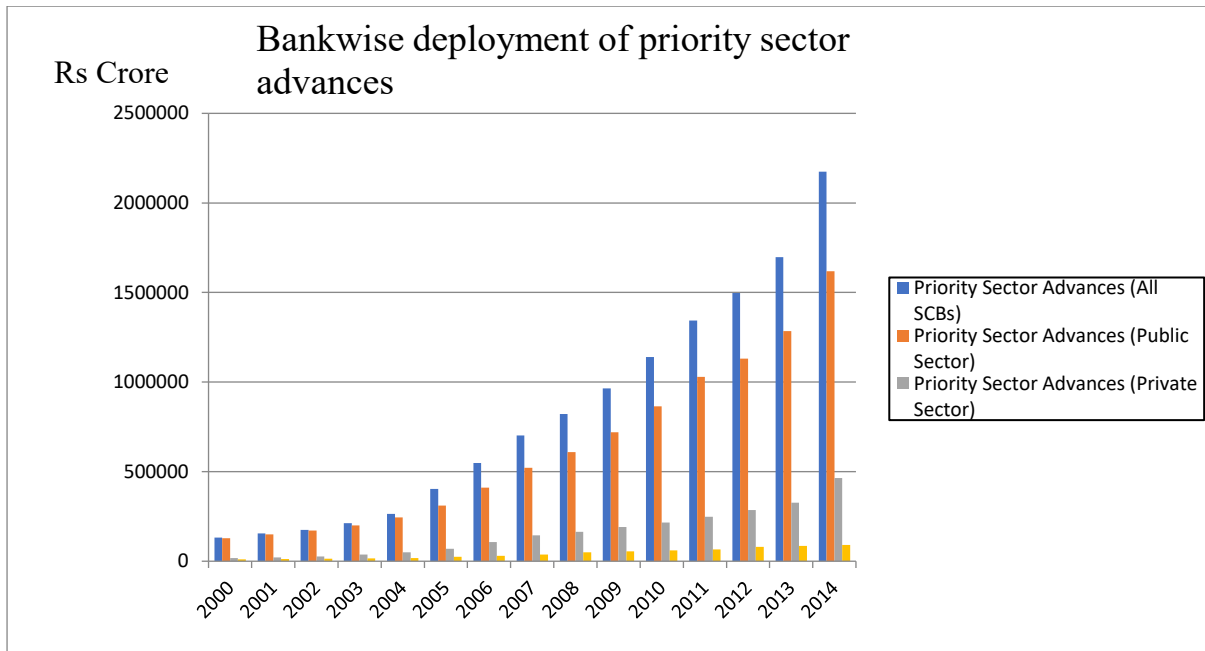


Chart -2

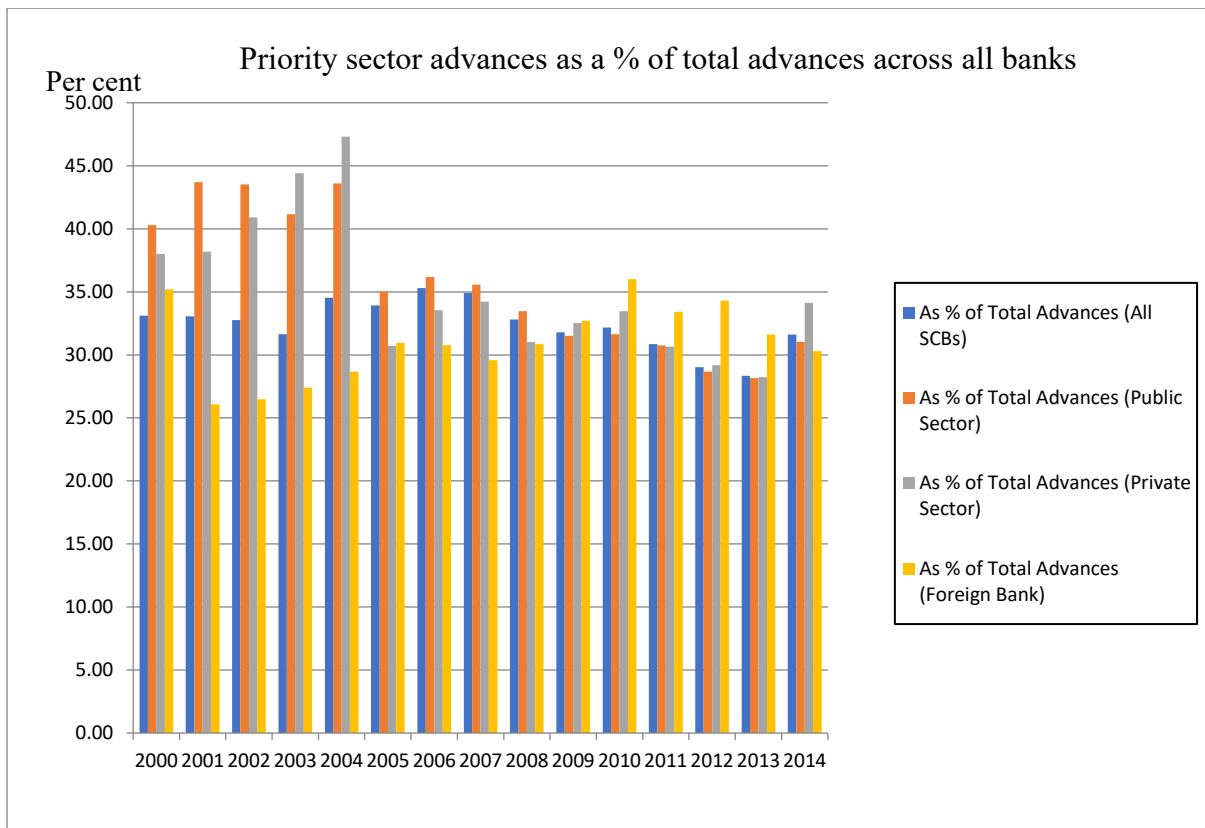


Chart -3

Since NPAs arise on account of both PSL and non PSL loans, we use regression analysis to test the hypothesis that PSL loans impose a higher cost on banks in terms of priority sector NPAs compared to the non PSL loans. The impact of PSL and non PSL loans on NPAs was estimated as follows:

1. Impact of PSL loans on NPAs generated in the PSL sector

$\text{Log (NPA (PSL))} = f(\text{Log (PSL loans (public bank, private bank, foreign bank)})$

2. Impact of PSL loans on total NPAs

$\text{Log (NPA (Total))} = f(\text{Log (PSL loans (public bank, private bank, foreign bank)})$

3. Impact of non-PSL loans on NPAs generated in the non-PSL sector

$\text{Log (NPA (non PSL))} = f(\text{Log (non PSL loans (public bank, private bank, foreign bank)})$

4. Impact of non-PSL loans on NPAs generated in the non-PSL sector

$\text{Log (NPA (Total))} = f(\text{Log (non PSL loans (public bank, private bank, foreign bank)})$

Pooled OLS (Ordinary Least Square) regression and panel data regression analyses (fixed effects) have been undertaken using STATA to study the relationship between PSL and NPAs. The panel consists of data from three categories of scheduled commercial banks (SCBs) namely public, private and foreign banks over the decade 2005-2014. The regression results show statistically significant and strong relationships between PSL and total NPAs and the NPAs of the priority sector (Table 6). Further, it is found that a 1 percent increase in PSL lending leads to a 1.1 percent increase in NPAs in priority sectors and 0.73 per cent increase in total NPAs. However, a 1 percent increase in the non-PSL loans is associated with a 0.5 per cent increase in NPAs in the non-PSL category and a 0.73 per cent increase in total NPAs. The difference in the magnitude of impact indicates PSL loans impose a greater cost on banks in the form of NPAs *vis-à-vis* the lending to non priority sectors.

**Table 2: Priority Sector Advances by Scheduled Commercial Banks**

	Total Advances (All SCBs)	Priority Sector Advances (All SCBs)	As % of Total Advances (All SCBs)
	(Rs crore)	( Rs crore)	
1969	3599	504	14.00
1979	19116	5906	30.90
1989	89080	38086	42.75
1999	339477	114611	33.76
2000	398205	131827	33.11
2001	467206	154414	33.05
2002	535063	175259	32.75
2003	668576	211609	31.65
2004	763855	263834	34.54
2005	1188600	403320	33.93
2006	1550600	547384	35.30
2007	2013100	702783	34.91
2008	2507900	822487	32.80
2009	3037500	965283	31.78

2010	3545000	1140403	32.17
2011	4357500	1344061	30.84
2012	5158900	1496949	29.02
2013	5988300	1697208	28.34
2014	6876818	2174150	31.61
<i>Source: RBI, Report on Trend and Progress of Banking in India, various issues, Database on Indian Economy</i>			

**Table 3: Priority Sector Advances by Public Sector Banks**

Years	Total Advances (Public Sector)	Priority Sector Advances (Public Sector)	As % of Total Advances (Public Sector)
	(Rs. crore)	(Rs. crore)	
1969	3017	441	14.62
1979	16233	5211	32.10
1989	78178	34874	44.61
1999	265554	104094	39.20
2000	316427	127478	40.29
2001	341291	149116	43.69
2002	394064	171485	43.52
2003	485271	199786	41.17
2004	560819	244456	43.59
2005	885600	310093	35.02
2006	1134000	410379	36.19
2007	1465100	521180	35.57
2008	1819100	608963	33.48
2009	2282800	719497	31.52
2010	2733500	864562	31.63
2011	3346500	1028615	30.74
2012	3942800	1129990	28.66
2013	4560100	1284220	28.16
2014	5215920	1618971	31.04

Source: RBI, Report on Trend and Progress of Banking in India, various issues, Database on Indian Economy

**Table 4: Priority Sector Advances by Private Banks**

Years	Total Advances (Private Sector)	Priority Sector Advances (Private Sector)	As % of Total Advances (Private Sector)
	(in crore)	(in crore)	
1989	3874	1422	36.71
1990	4311	1504	34.89
1995	15659	4226	26.99
2000	48337	18368	38.00
2001	56414	21550	38.20
2002	62858	25709	40.90
2003	82669	36705	44.40
2004	103425	48920	47.30
2005	225900	69384	30.71
2006	317600	106566	33.55
2007	420100	143768	34.22
2008	525900	163223	31.04
2009	585000	190303	32.53
2010	644200	215551	33.46
2011	811800	248828	30.65
2012	981400	286420	29.19
2013	1159200	327317	28.24
2014	1361323	464456	34.12

Source: RBI, Report on Trend and Progress of Banking in India, various issues, Database on Indian Economy

Table 5: Priority Sector Advances by Foreign Banks

Years	Total Advances (Foreign Bank)	Priority Sector Advances (Foreign Bank)	As % of Total Advances (Foreign Bank)
	(Rs. crore)	(Rs. crore)	
1992	9324	741	7.95
1993	10619	947	8.92
1994	11574	2234	19.30
1995	15183	3136	20.65
1996	22497	4470	19.87
1997	16284	6139	37.70
1998	20233	6940	34.30
1999	22351	8270	37.00
2000	28222	9934	35.20
2001	45395	11835	26.07
2002	50631	13414	26.49
2003	54184	14848	27.40
2004	62632	17960	28.68
2005	77000	23843	30.96
2006	98900	30439	30.78
2007	127900	37835	29.58
2008	163100	50301	30.84
2009	169700	55483	32.69
2010	167400	60290	36.02
2011	199400	66618	33.41
2012	234700	80538	34.32
2013	268900	85011	31.61
2014	299575	90723	30.28

Source: RBI, Report on Trend and Progress of Banking in India, various issues, Database on Indian Economy

With the knowledge that PSL loans hamper bank performance in terms of NPAs, we also look at the relationship between PSL and some profitability indicators for banks. Return on assets (ROA), the ratio of a bank's net income to its total assets, is a good indicator of profitability as the higher the

ROA of the bank or bank-group, the more efficiently the asset base is being managed. Similarly, return on equity (ROE) or the ratio of a bank's net income to its total assets, is another indicator of profitability. Net interest margin (NIM) or the ratio of net interest income to total assets is another important measure of banks' financial performance. The relationship between PSL and these profitability indicators are estimated as follows:

1.  $ROA = f(PSL/ANBC)$
2.  $ROE = f(PSL/ANBC)$  and
3.  $NIM = f(PSL/ANBC)$

The hypotheses of significant negative relationship of some measures of profitability like ROA and NIM with the share of PSL in advances are accepted, while its impact on return on equity is not found to be significant (Results 5, 6, 7).

**Table 6: Relationship between Advances & NPAs of public sector banks**

Years	PSA	Total NPA	Priority Sector NPAs
2001	149116	54672	24156
2002	171485	56473	25139
2003	199786	54090	24938
2004	244456	51537	23840
2005	310093	48399	23397
2006	410379	41358	22374
2007	521180	38968	22954
2008	608963	40452	25287
2009	719497	44957	24318
2010	864562	59926	30848
2011	1028615	74600	41245
2012	1129990	117839	NA
2013	1284220	165606	66900
2014	1618971	228074	79192
<b>Relationship between Advances &amp; NPAs of private sector banks</b>			
2001	21550	5963	1835
2002	25709	11662	2546
2003	36705	11782	2445
2004	48920	10381	2482
2005	69384	8782	2188
2006	106566	7811	2284

2007	143768	9256	2884
2008	163223	12997	3419
2009	190303	16926	3640
2010	215551	17639	4792
2011	248828	18100	4823
2012	286420	18768	NA
2013	327317	21071	5200
2014	464456	24542	6055
<b>Relationship between Advances &amp; NPAs of foreign sector banks</b>			
2005	23843	2192	NA
2006	30439	1928	NA
2007	37835	2263	331
2008	50301	2859	402
2009	55483	6444	649
2010	60290	7133	1170
2011	66618	5000	1141
2012	80538	6297	NA
2013	85011	7997	NA
2014	90723	11579	NA
<i>Source: RBI, Report on Trend and Progress of Banking in India, various issues, Database on Indian Economy</i>			

**Panel Regression Results:****Result 1**

Total NPA	Coefficient	Standard error	t	p> t
PSA	0.87	0.08	11.03	0.00
Constant	-0.26	0.41	-0.65	0.52

**Result 2**

Priority Sector's NPA	Coefficient	Standard error	t	p> t
PSA	1.08	0.13	8.45	0.00
Constant	-1.85	0.67	-2.75	0.01

**Result 3**

Total NPA	Coefficient	Standard error	t	p> t
PSA of non priority sector	0.73	0.12	6.10	0.00
Constant	0.37	0.64	0.58	0.57

**Result 4**

NPA of non priority sector	Coefficient	Standard error	t	p> t
PSA of non priority sector	0.51	0.11	4.84	0.00
Constant	1.32	0.56	2.35	0.03

**Result 5**

Net Interest Margin	Coefficient	Standard error	t	p> t
PSA % of ANBC	-0.95	0.02	-3.97	0.00
Constant	7.01	0.97	7.23	0.00

**Result 6**

Return on Asset	Coefficient	Standard error	t	p> t
PSA % of ANBC	-0.05	0.02	-2.67	0.012
Constant	3.36	0.76	4.41	0.00

**Result 7**

Return on Equity	Coefficient	Standard error	t	p> t
PSA % of ANBC	0.14	0.13	1.11	0.277
Constant	8.09	5.18	1.56	0.129

**IV. Concluding Observations**

The purpose of this paper is to analyse the trends in bank lending to the priority sectors of the economy and its impact on the Indian commercial banking sector. PSL is a directed lending programme which needs to evolve over time. In the past, the objective of PSL has been to ensure that vulnerable sections of society get access to credit and there is adequate flow of resources to those segments of the economy which have higher employment potential and help in making an impact on poverty

alleviation. An Internal Working Group (IWG) had been set up by the RBI in July 2014 to revisit the existing priority sector lending guidelines and suggest revised guidelines in alignment with the national priorities as well as financial inclusion goals of the country (RBI, 2015). The IWG observed that the Indian economy has not only undergone a structural transformation but has also been increasingly integrated into the global economy. The emphasis now, over and above lending to vulnerable sections, is to increase employability, create basic infrastructure and improve competitiveness of the economy, thus creating more jobs. While examining the broad superstructure of the PSL policy, the approach of the IWG has been to give emphasis on sectors that (a) have greater potential for employment generation, (b) address the considerations of social and economic equity, and (c) create a conducive infrastructure for improving the absorptive capacity of credit. Accordingly, while the existing sectors of agriculture and allied activities, MSEs, exports and socio-economically weaker sections have been considered for continuation by the Working Group, several newer sectors/segments, including agricultural and social infrastructure, medium enterprises, and renewable energy have also been recommended for addition to the existing sectors. The IWG has thus looked at the following sectors for priority sector status *viz.*, agriculture, Micro, Small and Medium Enterprises (MSMEs), exports, social infrastructure, renewable energy, educational loans and housing.

While there has been a growth of credit to priority sectors, there have been concerns about the distribution of credit and a persistent credit gap in these sectors. FDI inflows in the Indian agricultural services and machinery are allowed up to 100 percent and allowed through automatic route in India. The foreign direct investment (FDI) inflows in agricultural services and machinery sector during April 2000 - April 2014 stood at US\$ 2026.04 million respectively, as per data released by Department of Industrial Policy and Promotion (DIPP). The overall percentage of such foreign direct inflow in the Indian agricultural services and agriculture machinery is 0.80 and 0.16 per cent of the total quantum of the FDI inflow during the 2000-14, while for food processing industries it is at 2.53 per cent. FDI would also bring investment in post-harvest infrastructure that would increase the shelf-life of produce and minimize food wastage (now as high as 20-30%). Moreover, new investment would result in other positive externalities such as better seeds and stricter standards that would increase quality and productivity while lowering costs. For agriculture, while the IWG recommends retaining the agriculture target of 18 per cent, the approach and thrust has been re-defined to include (i) Farm Credit (which will include short-term crop loans and medium/long-term investment credit to farmers) (ii) Agriculture Infrastructure and (iii) Ancillary Activities and on-lending. The IWG observed that small and marginal cultivators (operating less than 5 acres of land) have not received their due share in the distribution of agricultural credit with the share dipping in recent years, despite the fact they account for more than 80 per cent of total cultivators in India. Considering the significant share of landholdings of small and marginal farmers and their contribution to the agriculture sector, the IWG recommends a sub-target of 8 per cent of ANBC for lending to them by March 2017, with the remaining 10 per cent for other farmers, agri-infrastructure and ancillary activities. Perceiving the huge need to create rural infrastructure and processing capabilities, the IWG decided not to put any caps on the loan limits for lending for agri-infrastructure and agri-processing.

The IWG recommends extending PSL status to Medium Enterprises (MEs) in addition to the Micro and Small Enterprises (MSEs). To ensure that the smallest segment within the MSME sector *i.e.* micro enterprises, is not crowded out with the inclusion of the medium enterprises, it recommends a target of 7.5 per cent of ANBC for lending to micro enterprises. Domestic and foreign banks irrespective of the branch network would be equal stakeholders in the PSL policy. Bringing all banks on par would also help in releasing greater resources towards the priority sectors. The Group has examined the possibility of introducing the Priority Sector Lending Certificates (PSLCs) to allow a more efficient

implementation of the priority sector lending mandate. The introduction of PSLCs will provide a mechanism to cover the priority sector shortfall and help banks specialize in certain sectors of the priority sector.

The purpose of our paper was to analyse the trends in bank lending to the priority sectors of the economy and its impact on the Indian commercial banking sector. Given the stipulated guidelines by the RBI the present paper traces and compares the trends in priority sector advances by public, private and foreign banks in India. With concerns expressed from researchers as well as the industry leaders, a major focus of the study is to evaluate the impact of PSL on the financials of Indian banks. We have tried to evaluate the impact of PSL on NPAs of the priority sector itself and on total NPAs of SCBs, and to compare it with the impact of non PSL loans. Further, we have estimated the impact of PSL on some bank performance ratios like the ROA, ROE and the NIM. Our findings show that PSL is not only directly proportionate with the level of NPAs in the priority sector; it increases NPAs of the banking sector as a whole. The results also support the hypotheses that a rising share of PSL in total advances leads to a decrease in some ratios of bank performance like the return on assets and net interest margins.

This study thus concludes that as PSL is important for inclusive social and economic development, and at the same time is found to hurt bank performance, there is a need to augment credit to the priority sector with other investment channels like PPP or FDI. With significant broadening of the scope of FDI by the government and the RBI's focus on supporting alternative investments in the priority sector as made clear from the above discussion, there is ample scope to invest in innovative and technologically advanced all-round development of sectors like agriculture & allied activities or small scale industries, which would in turn help sustainable growth through high demand generation and give a significant push to the returns from the sector as well, helping to improve performance of banks which lend to the sector.

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