

PRIORITY SECTOR LENDING AND NON- PERFORMING ASSETS: A STUDY OF PUBLIC AND PRIVATE SECTOR BANKS

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ABSTRACT

Priority sector lending (PSL) is continuously being used as a strategic instrument to allocate credit to priority sectors that impact large population, weaker sections and the sectors that are more labor intensive. The present study has been carried out to analyze the trend of priority sector lending in overall and on the sector basis and the incidence of non-performing assets of these sectors. It has revealed that domestic banks could not achieve the overall priority sector lending targets throughout the period of study. The Non-performing assets in overall priority sector shows a decreasing trend in public sector banks and foreign banks in initial years of the study but thereafter, it started increasing. However, NPAs in private sector banks are found declining continuously except in 2008 and 2010. NPAs in the agriculture sector for public sector banks lending has been growing at a higher rate compare to private sector banks. Similarly, the non-performing assets of public sector banks were noticed higher as compared to the private sector banks. In case of lending to micro and small enterprises, the private sector banks lending was growing into a higher pace in terms of CAGR followed by the public sector banks. Contrary to this, a higher growth rate has been registered in the non-performing assets of public sector banks as compared to private sector banks in this sector.

Keywords: *Priority Sector Lending, Non-performing Assets, CAGR, Public Sector Banks, Private Sector Banks.*

Introduction

Priority sector lending (PSL) is continuously being used as a strategic instrument to allocate credit to priority sectors. The priority sectors is confined to those sectors that impact large population, weaker sections and the sectors that are more labor intensive. This includes agriculture, education, export credit, housing, micro and small enterprises (MSME) among the others. Priority sector lending constitutes small value loans to farmers for agriculture and allied activities, micro and small enterprises, poor people for housing, students for education and the low income groups and weaker sections to aid the development. However, experience of the countries which have used priority sector lending strategically shows that the cost of implementing these programs is very high as compared to the consequent benefits. In India, initially no specific target was fixed in respect of priority sector lending. But in July, 1968 in a meeting of the national credit council it was emphasized

that commercial banks should increase their involvement in the financing of priority sectors viz., agriculture and small scale industries. In November, 1974 the banks were advised to raise the share of priority sector in their aggregate advances to the level of 33.3% by March 1979. It was further increased to 40 percent in 1985 and has since then been an essence to the bank lending in India as endorsed by various committees and working groups with renewed focus on newer sectors under the ambience of priority lending from time to time.

Priority Sector Lending

Priority sector lending is defined in terms of targets set for the banks depending on their domestic or foreign status and scale of operations. As on date the composition and constituents of priority sector lending is reported in table 1. According to RBI guidelines, if any bank i.e. domestic or foreign fails to attain the priority sector targets/sub-targets then it is required to deposit the shortfall in the Rural Infrastructure Development Fund (RIDF) set up with the National Bank for Agriculture and Rural Development (NABARD) and other funds set up with the Small Industries Development Bank of India (SIDBI) and the National Housing Bank (NHB) to the extent of amount of funds announced by the Government of India.

RBI issued a notification (2013) which authorized scheduled commercial banks to include lending to medium enterprises as priority sector lending, thereby, making more funds available to medium enterprises at a subsidized rate of interest. Erstwhile, this notification, medium enterprises were not covered under this criterion and loans given only to micro and small enterprises with a credit limit of Rs. 5 crore were considered as priority sector advances. The recent notification has brought medium enterprises under the area of priority sector lending and has also revised the credit limit for micro, small and medium enterprises to Rs.10 crore. The present study has been carried out to analyze the progress of banks working in India regarding overall lending to priority sector and lending to agriculture and micro and small industries. The relationship between priority sector lending and non-performing assets of these sectors has also been analyzed in the study.

Review of literature

Uppal (2009) in his study concluded that the target of 40% lending to priority sector had not been achieved by public sector banks while private sector banks had achieved the overall target during the study period. No private sector bank could achieve the 10% lending target to weaker sections. Further, foreign banks had achieved the priority sector lending target regarding small scale industries, and for export credit. Ahmed (2010) diagnosed various lacunas of priority sector lending by commercial banks selecting three districts viz, Cachar, Karimganj and Hailakandi of The Barak Valley (the southernmost region of Assam). It was found that the banks were able to maintain the PSL

prescription of 40% as per revised guidelines. Agriculture sector was found to be the single dominant sectors absorbing major portion of the bank credit. The recovery position was found very poor in almost all the sector in the area under study. On the other hand, Kaur and Silony (2011) concluded that the performance of private sector banks was better than public sector banks in respect of all the parameters of priority sector lending. Though, priority sector advances and agricultural advances had improved over the study period but still the targets set for agriculture sector had not been achieved. Rani (2011) analyzed the performance of the commercial banks during 1995-96 to 2009-10 and revealed that 3 public sector bank, 2 private sector banks and 3 foreign banks had not achieved the overall priority sector lending target. The study identified the increasing trend in priority sector advances of the commercial banks. It was also found that the level of non-performing assets was very high for priority sector advances from 2005-07. On the other hand, Kaur (2012) in her study found that the overall target of 40 per cent had been achieved by both public and private sector banks. Further, Priority sector lending of public and private sector banks was found higher than that of foreign banks. Kumar and Gambhir (2012) investigated the problems of priority sector lending of banks and found that public sector banks have made significant progress in priority sector lending in quantitative terms. It was found that NPAs, over dues and bad debts were the serious problems faced by the bank in respect of advances made to the weaker sections of society. In a more exhaustive manner, Patidar and Kataria (2012) concluded that the priority sector lending were increasing year by year and there was a significant impact of priority sector lending on total NPAs, but in case of private sector banks, no significant impact of priority sector lending on total NPAs was found. Raman (2013) analyzed financial assistance provided to priority sectors by various commercial banks of Tamil Nadu and found that priority sector advances by public and private sector banks as on March 2010 were above the prescribed norm of 40 percent. Further, the education loans reported a growth of 180% during the study period. It was further concluded that the Non-performing asset in India has adversely affected the profitability and efficient functioning of the banks. Shabbier (2013) made a regional analysis of priority sector advances by dividing the Country into six regions and found that lending was highest in the Southern region at all selected points of time whereas the North Eastern region occupied the lowest position. Shabbir and Mujoo (2014) in a comparative analysis between public and private sector banks of NPAs in priority sector found that NPAs in priority sector has been more in public sector banks as compared to private sector banks. The reason of more NPAs in public sector banks was that these banks have been enthusiastically following govt. norms and have been giving loans to the priority sector.

Objective of the study

- To analyze the progress of banks regarding priority sector lending.
- To study the incidence of non-performing assets in priority sector lending in India.

Research methodology

The present study has been carried out to evaluate the overall priority sector lending and sector wise lending by different bank groups working in India. The study is based on secondary data which has been collected from various annual reports of Reserve Bank of India and the Report on trend and progress of Banking in India. The study is descriptive and exploratory in nature and covers the period of seven years i.e. 2007 to 2013. Apart from descriptive statistics for analyzing the data, correlation and compound annual growth rate (CAGR) have been used as statistical tools for measuring the growth and relationship between priority sector lending and non-performing assets of different banks working in India. Compound annual growth rate is calculated using the following formula:

$$CAGR = \left[\frac{\text{ENDING VALUE}}{\text{BEGINING VALUE}} \right]^{\frac{1}{\text{NO. OF YEARS}}} - 1$$

Findings and Discussion

Table 2 shows that though lending to overall priority sector has been increasing in absolute figures from year to year but the percentage share of lending is decreasing continuously. The private sector banks are found leading in achieving the overall priority sector lending target of 40 per cent in five years out of seven years of the study followed by public sector banks. Here, it is important to note that there has also been increasing trend in the priority sector lending by foreign banks except few exceptions. The Non-performing assets of overall priority sector shows a decreasing trend in public sector banks and foreign banks in initial years of the study but therefore, it started increasing. However, NPAs in private sector banks are found declining continuously except in 2008 and 2010. Hence, it may be concluded that the recovery mechanism of private sector banks is effective as compared to the public sector banks.

Table 3 revealed that agricultural lending by the public and private sector banks has been showing an increasing trend in absolute terms but the proportion of the same is decreasing from year to year except in 2008 and 2010 regarding public sector banks. However, in case of private sector banks the percentage share is also found increasing in the initial years i.e. from 2007-10, and thereafter it started declining. The percentage decrease in agricultural lending is more in private sector banks as compare to public sector banks. The non-performing assets in agriculture sector of

public and private sector banks have shown a mixed trend. The percentage increase in NPAs of public sector banks is more comparing to the private sector banks. The NPAs of public sector banks are found consistent after 2010 but in case of private sector banks the same stated declining after 2011.

The lending to Micro and Small industries by public, private and foreign banks sector banks has increased continuously in absolute figures but in percentage terms there have been fluctuations as reported in table 4. The NPAs also shows fluctuating trends with increasing trend in most of the years of study. The percentage increase in NPAs of public sector banks has been more as compare to private sector banks. So it can be concluded that public sector banks are not efficient in recovering loans from micro and small industries.

The Compound Annual Growth Rate (CAGR) analysis as reported in table 5 about overall priority sector lending revealed that CAGR of foreign banks has been found highest(15.43%) followed by public sector banks (13.74%) and private banks are at the lower end with 12.39%. It may be concluded that foreign banks have given more consistent lending to priority sector as compared to the other counterparts during the study period. The non-performing assets were highest in public sector being the highest CAGR of 16.51%.

In agriculture sector the lending by public sector banks has been found growing at a higher rate compare to private sector banks. Similarly, the non-performing assets of public sector banks are also found more comparing to private sector banks. In case of lending to micro and small enterprises, the private sector banks are leading as a huge growth has been recorded with highest CAGR (40.46%), followed by public sector banks (24.61%) and the share of foreign banks is just 13.54%. Contrary to this, a higher growth rate has been registered in non-performing assets of public sector banks (25.34%) as compared to private sector banks (17.55%).

The correlation analysis (table 6) between priority sector lending and non-performing assets of public sector banks shows a moderate high degree negative correlation (-0.537). Further, a high degree negative correlation (-0.735) has been found between agricultural lending and non-performing assets of the same sector. Micro and Small industries are found to be moderately low degree negative correlated (-0.329). In case of private sector banks, a high degree positive correlation (0.797) has been found between overall priority sector lending and non-performing assets as depicted in table 7. Further, a moderate low degree positive correlation (0.441) has been found between the two in the agriculture sector. A high degree of negative correlation (-0.926) has been found between lending and non-performing assets of micro and small industry. The positive value of correlation means there is a direct relationship between priority sector lending and non-performing assets of the different bank

groups. It shows that if the specific sectors are provided more funds, loans are becoming non-performing assets in more quantity and where the correlation between the two is a negative it indicates negative relationship between these two. It shows that recovery of loans from these specific sectors has improved with employing more funds in these sectors.

Conclusion

From the above analysis it is concluded that majority of domestic banks could not achieve the overall priority sector lending targets. Though an increasing trend has been recorded in the priority sector lending by different bank groups working in India in absolute terms but the percentage share of the same is decreasing. A fluctuating trend has been noticed in the non-performing assets of different domestic banks. The non-performing assets of private sector banks are found low as compare to the public

sector banks. It means the loan recovery mechanism of private sector banks is more effective than public sector banks. The focus of the govt. policies is to develop overall priority sectors to aid the overall development of the economy. Accordingly, all banks including co-operative banks and RRBs, provided lending to agriculture sector of Rs.6,073.75 billion against the target of Rs. 5,750 billion during the year 2012-13 constituting 105.6 per cent of the target fixed as at the end of March 2013. However, domestic banks could not achieve the target of overall priority sector lending on 31 March, 2013 and as a result 16 public sector banks, 10 private sector banks and 2 foreign banks were not able to achieve the priority sector lending targets. The different bank groups working in India are required to reorient their policies to achieve the overall priority sector lending target with focus on reducing the non-performing assets.

Table 1: Composition and constituents of priority sector lending in India

Categories	Domestic commercial banks / Foreign banks with 20 and above branches *	Foreign banks with less than 20 branches*
Total Priority Sector	40 percent	32 percent
Sub targets		
Total agriculture	18 percent.	No specific target.
Micro and Small Enterprises (MSE)	Advances to MSE will be computed for priority sector target of 40%	10%
Export Credit	Export credit is not a separate category. Export credit to eligible activities under agriculture and MSE will be reckoned for priority sector lending under respective categories.	12%
Advances to Weaker Sections	10 percent	No specific target

Source: RBI, *Credit is the percent of ANBC or Credit Equivalent of Off-Balance Sheet Exposure, whichever is higher.

Table 2: Overall priority sector lending and non-performing assets

(Amount in Rs. Billion)

Years	Lending						Non-performing Assets					
	Public sector Banks		Private sector Banks		Foreign Banks		Public sector Banks		Private sector Banks		Foreign Banks	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
2007	5213.76	39.7	1445.49	42.9	378.31	33.4	229.54	4.40	28.84	1.99	3.31	0.88
2008	6104.50	44.7	1640.68	47.8	502.54	39.5	252.87	4.14	34.18	2.08	4.02	0.80
2009	7200.83	42.5	1902.07	46.8	554.53	34.3	243.18	3.38	36.40	1.91	6.49	1.17
2010	8645.64	41.7	2155.52	46.0	602.90	35.1	308.48	5.57	47.92	2.22	11.70	1.94
2011	10286.15	41.3	2488.28	46.6	665.27	40	413.00	4.02	48.00	1.93	11.41	1.72
2012	11307.00	37.2	2864.00	39.4	805.00	40.9	562.00	4.97	51.00	1.78	N.A.	N.A.
2013	12836.00	36.3	3274.00	37.5	1033.00	35.2	669.00	5.21	52.00	1.59	N.A.	N.A.

Source: Report on Trend and Progress of Banking in India, various issues.

*Lending is the percentage of ANBC or amount equivalent of off-balance sheet exposures, whichever is higher.

Table 3: Agricultural lending and non-performing assets**(Amount in Rs. Billion)**

Years	Lending				Non-performing Assets			
	Public sector Banks		Private sector Banks		Public sector Banks		Private sector Banks	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
2007	2026.14	15.4	520.34	12.7	65.06	3.21	8.61	1.65
2008	2493.97	18.3	585.66	17.1	82.68	3.32	14.68	2.51
2009	2994.15	17.6	761.02	18.7	57.08	1.91	14.41	1.89
2010	3724.63	17.9	907.37	19.4	83.30	2.24	20.23	2.23
2011	4149.91	16.5	921.36	15.7	145.00	3.49	22.00	2.39
2012	4786.00	15.8	1042.00	14.3	227.00	4.74	22.00	2.11
2013	5306.00	15.0	1119.00	12.8	280.00	5.28	22.00	1.97

Source: Report on Trend and Progress of Banking in India, various issues.

Lending is the percentage of ANBC or amount equivalent of off-balance sheet exposures, whichever is higher.*Table 4: Lending to micro and small industries and non-performing assets****(Amount in Rs. Billion)**

Years	Lending						Non-performing Assets			
	Public sector Banks		Private sector Banks		Foreign Banks		Public sector Banks		Private sector Banks	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
2007	1025.50	7.8	131.36	3.9	116.37	10.3	58.43	5.70	6.45	4.91
2008	1511.37	11.1	469.12	13.7	154.89	12.2	58.05	3.84	6.51	1.39
2009	1914.08	11.3	466.56	11.8	180.63	11.2	69.84	3.65	6.66	1.43
2010	2763.19	13.3	648.25	13.8	211.47	12.7	115.37	4.175	11.39	1.76
2011	3766.25	15.1	878.57	16.4	215.01	12.9	143.40	3.81	12.98	1.48
2012	3966.00	13.1	1105.00	15.2	217.00	11.0	174.00	4.39	17.00	1.54
2013	4784.00	13.5	1417.00	16.2	283.00	9.6	284.00	5.94	20.00	1.41

Source: Report on Trend and Progress of Banking in India, various issues.

Data regarding NPAs in case of foreign banks for Micro and Small industries is not available.

Lending is the percentage of ANBC or amount equivalent of off-balance sheet exposures, whichever is higher.*Table 5: Compound annual growth rate****(In percentage)**

Bank Group	Lending			Non-performing Assets		
	Overall	Agriculture	Micro and small industries	Overall	Agriculture	Micro and small industries
Public sector banks	13.74	14.74	24.61	16.51	23.18	25.34
Private sector banks	12.39	11.56	40.46	8.79	14.34	17.55
Foreign banks	15.43	-	13.54	-	-	-

Table 6: Relationship between priority sector lending and non-performing assets of public sector banks

		Overall		Agriculture		Micro and small industry	
		Lending	NPA	Lending	NPA	Lending	NPA
Lending	Pearson Correlation	1	-0.537	1	-0.735	1	-0.329
	Sig. (2-tailed)		0.213		0.060		0.471
	N	7	7	7	7	7	7
NPA	Pearson Correlation	-0.537	1	-0.735	1	-0.329	1
	Sig. (2-tailed)	0.213		0.060		0.471	
	N	7	7	7	7	7	7

Table 7: Relationship between priority sector lending and non-performing assets of private sector banks

		Overall		Agriculture		Micro and small industry	
		Lending	NPA	Lending	NPA	Lending	NPA
Lending	Pearson Correlation	1	0.797	1	0.441	1	-0.926
	Sig. (2-tailed)		0.032		0.322		0.003
	N	7	7	7	7	7	7
NPA	Pearson Correlation	0.797	1	0.441	1	-0.926	1
	Sig. (2-tailed)	0.032		0.322		0.003	
	N	7	7	7	7	7	7

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