Priority Sector Lending in India by Public and Private Sector Banks: A Comparative Analysis

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ABSTRACT

Priority sector lending is still and will continue to be an important focus and area of concern of all the commercial banks in the near future because of hard socio-economic realities of the Indian economy. The main objective of the paper is to analyse the level and structure of priority sector lending in India during the 21st century. The entire study is based upon secondary data, collected from the various relevant issues published by RBI. The study is stretched over the period 2001 to 2014. With a view to analyse the growth of various components of priority sector lending, exponential growth rate has been calculated. The behaviour of inter-year disparities in priority sector lending is explained with the help of co-efficient of variation. The performance of public and private sector banks in priority sector lending has been compared with t-test. The study points out that, although, on an average, the prescribed target of priority sector lending has been achieved, but, one important issue of concern is the shrinking share of priority sector credit in net bank credit over a period of time by both the public and private sector banks, which needs immediate attention of the policy makers. The public and private sector banks could not deploy 18 per cent of net bank credit in agriculture sector and thus, failed to achieve the stipulated target of agricultural lending.

Keywords: *Financial inclusion; Priority sector lending; Commercial banks; Exponential growth rate; Co-efficient of variation; Net Bank Credit (NBC).*

1.0 Introduction

Banking is an important segment of the tertiary sector and acts as a backbone of economic progress. The banks render vital services to the masses belonging to various sectors of the economy like agriculture, industry: whether small scale or large scale.

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The banking system is one of the few institutions that impinge on the economy and affect its performance for better or worse. They act as a development agency and are the source of hope and inspiration to the masses.

A developing economy faces many problems, like poverty, scarcity of capital, lack of entrepreneurship etc. The commercial banks can work as catalytic agents of growth by following the right kind of policies in their working, depending upon the socio-economic conditions prevailing in the country. They have stupendous investment potential and can make a significant contribution in eradicating poverty, unemployment and in bringing about progressive reduction in inter-regional and inter-sectoral disparities through rapid expansion of banking services.

Priority sector occupies a special place in the Indian economy and is an important feature of the Indian banking policies. Priority sector lending is the crux of social banking. Under the priority sector lending, bank credit is provided on liberal terms and conditions. The socialisation of bank credit is the theme of priority sector lending by the commercial banks. Priority sector is and will continue to remain, the bread and butter, both literally and figuratively, of Indian economic growth. Since priority sector are critical to high and sustained growth of GDP, it should be the business of public sector banks to support these sectors. In 1980, a major review of the components of priority sector was undertaken by a working group headed by K.S. Krishnaswamy. The group recommended the incorporation of weaker sections, so that, the concessions that are being offered to the priority sector as a class could be oriented to meet the needs of the weaker sections. Credit was earmarked for the weaker sections of the society i.e. small and marginal farmer, landless labourers, SC/ST etc. to achieve this task banks opened more branches in rural areas which had no banking facilities.

Financial inclusion has become central to the Indian policy-making over the past few years and various attempts have been made to expand its scope. Despite these attempts, the challenges to financial inclusion remain formidable. These attempts and challenges have to be not only examined in the context of an increasingly globalised economy, of expanding markets, and of growing state intervention, but, also of local variations. Equally daunting is the magnitude of the task that requires regulating the activities of service providers to millions of illiterate and poor people spread among culturally disparate groups.

A number of research studies have been conducted in India on various aspects of priority sector lending by the public and private sector banks. For example, Sooden and Kumar (2007) found that shrinking share of priority sector, neglect of agriculture coupled with its sub-optimum structure and neglect of small scale industries are some serious issues which need immediate attention of the policy makers. Kumar and Gupta

(2008) observed that agricultural lending by the public sector banks has somewhat stagnated. The percentage share of small scale industries in overall priority sector lending recorded a continuous decline and the percentage share of 'other priority sector' in the overall priority sector lending registered a continuous increase during the period under context. Uppal (2009) observed that whereas, public sector banks have failed to achieve the target of 40 per cent, private sector banks have succeeded in achieving the overall target. Shabbir (2013) found that public and private sector banks are fulfilling the overall priority sector lending target but not able to fulfil the sub target of 18 per cent for agriculture sector. This paper analyses the structure of priority sector lending in India over a period of time starting from 2001 to 2014.

2.0 Research Methodology

The main objective of the paper is to analyse the level and structure of priority sector lending in India during the 21st century. The entire study is based upon secondary data and all the required information is collected from the various relevant issues published by the Reserve Bank of India. Further, the period is sub-divided in to two parts i.e. Period I which includes the years 2001 to 2007 and Period II stretching over the years 2008 to 2014.

With a view to analyse the growth of priority sector lending, exponential growth rate has been calculated as follows:

$$Y_i = a_0 * b_i^t$$

$$\ln(Y_i) = \ln(a_0) + t * \ln(b_i)$$

$g = (b-1)$, where: Y_i is the value of i th indicator, a = constant, b_i = regression co-efficient of i th indicator, t = time period, $\ln$ = common log value, g = growth rate.

The structure of priority sector lending is examined by mean value of an indicator which, is calculated separately for first and second phase of the study.

$$\text{The combined mean (X)} = \frac{n_1X_1 + n_2X_2 + n_3X_3 + \dots + n_nX_n}{n_1 + n_2 + n_3 + \dots + n_n}$$

$$X_i = \frac{\sum_{i=1}^n n_i x_i}{\sum_{i=1}^n n_i} \quad i=1$$

Where, n_i stands for number of observations and X_i stands for mean value.

The behavior of inter-sector disparities in priority sector lending is explained with the help of co-efficient of variation (C.V.). The value of C.V. is ascertained as follows:

$$C.V. = \frac{\sigma_i}{X_i} \times 100 \quad \text{Where, C.V. stands for co-efficient of variation,}$$

σ_i = Standard deviation of i th indicator, X_i = Mean value of i th indicator.

The performance of public and private sector banks in priority sector lending during the first and second phase of the study will be compared with t-test. The value of t-test will be computed as follow:

$$t = \frac{X_1 - X_2}{S} \sqrt{\frac{n_1 n_2}{n_1 + n_2}}$$

where, n_1 and n_2 = size of two independent samples i.e. no. of years; X_1 and X_2 is the mean value i.e. mean value of priority sector lending by public and private sector banks. S =combined standard deviation of two samples i.e. priority sector lending. The null hypothesis is tested at 5% and 1% level of significance.

3.0 Priority Sector Lending by Public and Private Sector Banks

The priority sector credit by public sector banks, on an average, increased at a rate of 23.80 per cent during the first phase and this rate declined to 16.85 per cent during the second phase of the study (Table 1). The public sector banks, on an average, deployed 42.24 per cent of NBC in priority sector during the first phase. It was observed that in all the years (except 2007) of the first phase the prescribed target of priority sector lending was achieved by public sector banks. The analysis revealed further that the prescribed target of priority sector lending was also achieved during the second phase and on an average, 40.48 per cent of NBC was deployed in priority sector by public sector banks.

Further, the priority sector credit by the private sector banks, on an average, increased at a high rate of 38.81 per cent during the first phase and this rate declined by a big margin to 17.47 per cent during the second phase of the study (Table 1). The private sector banks, on an average, deployed 42.85 per cent of NBC in priority sector during the first phase. The analysis revealed that in all the years (except 2001) of the first phase the prescribed target of priority sector lending was achieved. During the second phase, the prescribed target of priority sector lending was also achieved (except the years 2012 and 2013) by private sector banks. During this phase, public sector banks, on an average, deployed 43.96 per cent of NBC in priority sector.

3.1 Sector-wise deployment of priority sector lending by public sector banks

Agriculture credit, on an average, recorded a rate of growth of 25.68 per cent during the first period, which declined to 17.50 per cent in the second phase (Table 2). So, study, due to new policy guidelines issued in 1991 under the umbrella of financial sector reforms. Under the new policy guidelines of 1991, the public sector banks in default in meeting the priority sector sub-target of 18 per cent of net bank credit to

agriculture would compensate the deficiency by contributing to Rural Infrastructure Development Fund (RIDF) and to the consortium fund of Khadi and Village Industries Commission (KVIC). In this way the banks could move away from their responsibility of direct lending to priority sectors especially the risky venture like agriculture.

Table 1: Credit Deployed to the Priority Sector

(Amount in ₹ Crore)

Years	Public Sector Banks			Private Sector Banks		
	NBC	Total PSAs	%age to NBC	NBC	Total PSAs	%age to NBC
Period I						
2001	340888	146546	42.99	56410	21549	38.20
2002	396954	171185	43.12	63012	25709	40.80
2003	477899	203095	42.50	82669	36705	44.40
2004	558849	245672	43.96	111521	52861	47.40
2005	717304	310093	43.23	160289	69886	43.60
2006	1017614	410379	40.33	248986	106566	42.80
2007	1317705	521180	39.55	336693	143768	42.70
Average	689602	286879	42.24	142797	65292	42.85
GR in %	25.43	23.80		36.78	38.81	
C.V. in %			3.89			6.71
Period II						
2008	1364268	608963	44.64	343627	163223	47.50
2009	1693437	720083	42.52	406425	190207	46.80
2010	2073290	864562	41.70	468589	215551	46.00
2011	2490593	1028615	41.30	533966	248828	46.60
2012	3021364	1129990	37.40	726954	286420	39.40
2013	3529890	1284880	36.40	872845	327317	37.50
2014	4109063	1618971	39.40	1057986	464456	43.90
Average	261170	1036581	40.48	630056	270857	43.96
GR in %	20.21	16.85		21.02	17.47	
C.V. in %			7.20			9.02

Source: Compiled on the basis of Relevant Issues of 'Report on Trend and Progress of Banking in India' and Statistical Tables Relating to Banks in India', Published by RBI.

As per the Reserve Bank of India norms, public sector banks are required to lend 18 per cent of net bank credit to agriculture sector since the year 1990 onwards. The public sector banks, on an average, deployed 15.16 per cent of net bank credit in agriculture sector and failed to achieve the stipulated target of 18 per cent of NBC during the first phase. Further, in none of the years of the second phase (except the year 2008), the prescribed target of agricultural lending was achieved. The public sector banks, on an average, deployed 16.93 per cent of net bank credit in agriculture sector.

Table 2: Sectoral Deployment of Priority Sector Credit by Public Sector Banks

(Amount in Rs. Crores)

Year	Agriculture			SSIs			'Other Priority Sector'		
	Credit	% to TPSAs	%to NBC	Credit	% to TPSAs	% to NBC	Credit	% to TPSAs	% to NBC
Period-I									
2001	53571	36.55	15.71	48400	33.02	14.20	40791	27.83	11.97
2002	58142	33.96	14.64	54268	31.70	13.67	59074	34.50	14.88
2003	70501	34.71	14.75	52646	26.92	11.02	76638	37.73	16.03
2004	84435	34.36	15.10	58311	23.73	10.43	101710	41.40	18.19
2005	109917	35.44	15.32	67800	21.86	9.45	125114	40.34	17.44
2006	155220	37.82	15.25	82434	20.08	8.10	163756	39.90	16.09
2007	202614	38.87	15.37	102550	19.67	7.78	206661	39.65	15.68
Average	104914	35.96	15.16	66630	25.28	10.66	110535	37.34	15.75
GR in %	25.68			12.68			30.24		
C.V. in %		5.16	2.44		21.45	23.63		12.75	12.71
Period-II									
2008	249397	40.95	18.28	151137	24.76	11.08	209842	34.38	15.38
2009	298211	41.41	17.61	191307	26.57	11.30	230507	32.01	13.61
2010	372463	43.08	17.96	276319	31.96	13.33	214996	24.86	10.37
2011	414973	40.34	16.66	369430	35.91	14.83	237092	23.05	9.52
2012	479400	42.43	15.87	396993	35.13	13.14	247755	21.93	8.20
2013	531701	41.38	15.06	478361	37.23	13.55	273349	21.27	7.74
2014	702541	43.39	17.09	593410	36.65	14.44	306956	18.96	7.47
Average	435527	41.85	16.93	350994	32.60	13.10	245785	25.21	10.33
GR in %	17.50			25.23			5.98		
C.V. in %		2.71	6.85		15.51	10.96		22.93	29.67

Source: Same as Table 1

An analysis of rate of growth of credit to SSIs revealed that it, on an average, increased at a rate of 12.68 per cent during the first phase, but, rose at a higher rate of 25.23 per cent during the second phase. However, the public sector banks, on an average, deployed 10.66 per cent of net bank credit to SSIs during the first phase. This share rose marginally to 13.10 per cent during the second phase, in the absence of any clear guidelines by RBI (as it is there in case of agriculture). It was so because, despite the fact that the public sector banks together have gradually increased the quantum of advances to small scale industries, but, the proportion in which net bank credit in priority sector has expanded, the relative share of small sector has not grown in the same ratio during the period of study.

The public sector banks 'other priority sector' credit, on an average, increased at a high rate of 30.24 per cent during the first phase (Table 2). However, this rate declined

and stood at 5.98 per cent per annum during the second phase. The public sector banks, on an average, deployed 15.75 per cent and 10.33 per cent of net bank credit in 'other priority sector' during the first and second of the study respectively in the absence of any clear guidelines by RBI.

3.2 Sector-wise deployment of priority sector lending by private sector banks

Agriculture credit, on an average, recorded a higher rate of growth of 45.45 per cent during the first period and this rate declined to 13.98 per cent in the second phase. The private sector banks as per the Reserve Bank of India norms are also required to lend 18 per cent of net bank credit to agriculture sector. These banks, on an average, deployed 12.01 per cent of net bank credit in agriculture sector and thus failed to achieve the stipulated target of lending in the first phase. During the second phase, in none of the years (except the year 2010), the prescribed target lending was achieved and private sector banks, on an average, deployed 15.56 per cent of net bank credit in agriculture sector.

An analysis of rate of growth of credit to SSIs revealed that it, on an average, recorded a moderate rate of growth of 7.04 per cent during the first phase, but, rose at a higher rate of 28.22 per cent during the second phase (Table 3). The private sector banks, on an average, deployed 8.29 per cent of net bank credit to SSIs during the first phase. However, this share rose marginally to 15.11 per cent during the second phase. An analysis of rate of growth of credit to 'other priority sector' revealed that it, on an average, stood as high as 50.96 per cent in the first phase. However, this rate declined to 9.96 per cent per during the second phase of the study. The percentage share of 'other priority sector' credit to net bank credit, on an average, stood at 20.63 and 12.69 per cent of during the first and second phase respectively.

4.0 Results and Discussion

4.1 Test of hypothesis of mean value of credit deployed to priority sector by the two bank groups

The null hypothesis states that there is no significant difference in the mean value of credit deployed by two bank groups ($H_0: \mu_1 = \mu_2$); whereas, the alternative hypothesis states that there is significant difference in the mean value of credit deployed by two bank groups ($H_1: \mu_1 \neq \mu_2$). Since, the calculated value of t-test during the first phase and second phase are 3.39 and 4.80 respectively (Table 4), which are more than the table value (for $v = 12$, $t_{0.05} = 2.17$) and are found significant at 1% and 5% level (significance, two tailed test=0.000 and 0.000), so the null hypothesis is rejected and

alternative hypothesis is accepted, and we conclude that there is significant difference in the mean value of credit deployed by public and private sector bank groups ($H_1: \mu_1 \neq \mu_2$) during the first and second phase of the study.

Table 3: Sectoral Deployment of Priority Sector Credit by Private Sector Banks

(Amount in ₹ Crores)

Year	Agriculture			SSIs			'Other Priority Sector'		
	Credit	% to TPSAs	% to NBC	Credit	% to TPSAs	% to NBC	Credit	% to TPSAs	% to NBC
Period-I									
2001	5634	26.12	9.60	8096	37.54	13.80	7219	33.47	12.30
2002	8022	31.20	8.50	8613	33.50	13.70	9074	35.30	14.40
2003	9924	27.08	12.00	8051	21.97	9.70	18673	50.95	22.50
2004	14730	30.11	14.20	7590	15.52	7.30	25786	52.71	24.90
2005	21636	30.96	13.50	8592	12.29	5.40	38797	55.51	24.20
2006	36712	34.44	13.60	10421	9.78	4.20	57777	54.20	23.20
2007	52034	36.00	12.70	13136	9.09	3.90	76919	53.21	22.90
Average	21242	30.84	12.01	9214	19.96	8.29	33464	47.91	20.63
GR in %	45.45			7.04			50.96		
C.V. in %		11.59	18.09		57.75	50.95		19.53	24.59
Period-II									
2008	58567	35.70	15.40	46912	28.60	13.70	58556	35.70	17.00
2009	76062	39.99	15.90	47916	25.19	12.00	66197	34.80	16.30
2010	90737	42.09	19.36	64825	30.07	13.83	59107	27.42	12.61
2011	92136	37.03	17.26	87857	35.31	16.45	68835	27.66	12.89
2012	104200	36.38	14.33	110500	38.58	15.20	71700	25.03	9.86
2013	111900	34.19	12.82	141700	43.29	16.23	73800	22.54	8.46
2014	146687	31.58	13.86	193900	41.74	18.33	123869	26.67	11.70
Average	97184	36.71	15.56	99087	34.68	15.11	74581	28.55	12.69
GR in %	13.98			28.22			9.96		
C.V. in %		9.54	14.22		19.97	13.97		17.18	24.62

Source: Same as Table 1

Table 4: t-test of Credit Deployed to Priority Sector by Two Bank Groups

Period I	Mean Value	Std. Dev.	t-test	d. f. (v)	Sig. (2-Tailed Test)
Public Sector Banks	11475.14	5476.84	3.39	12	0.000
Private Sector Banks	3840.71	2667.15			
Period II	Mean Value	Std. Dev.	t-test	d. f. (v)	Sig. (2-Tailed Test)
Public Sector Banks	41463.22	13877.92	4.80	12	0.000
Private Sector Banks	15932.79	6005.77			

Note: $n_1=7$ and $n_2=7$ (Number of years). Degrees of freedom, d. f. (v) = $n_1+n_2-2=7+7-2=12$.

The value of t-test for two tailed test for $v=12$ is $(t_{0.05})=2.17$.

4.2 Test of Hypothesis of Mean Value of Credit Deployed to Various Components of Priority Sector by Two Bank Groups:

The null hypothesis states that there is no significant difference in the mean value of credit deployed to agriculture sector by two bank groups ($H_0: \mu_1 = \mu_2$). Whereas, the alternative hypothesis states that there is significant difference in the mean value of credit deployed by two bank groups ($H_1: \mu_1 \neq \mu_2$). Since, the calculated value of t-test during the first and second phase are 3.40 and 5.64 respectively (Table 5), which are more than the table value (for $v = 12$, $t_{0.05} = 2.17$) and are found significant at 1% and 5% level (significance, two tailed test=0.008 and 0.000), so the null hypothesis is rejected and alternative hypothesis is accepted, and we conclude that there is significant difference in the mean value of credit deployed to agriculture sector by public and private sector bank groups ($H_1: \mu_1 \neq \mu_2$) during the both the phases of the study.

Table 5: t-test of Credit Deployed to Agriculture, SSIs and ‘Other Priority Sector’ by Two Bank Groups

Agriculture Credit					
Period I	Mean Value	Std. Dev.	t-test	d. f. (v)	Sig. (2-Tailed Test)
Public Sector Banks	4196.57	2222.81	3.40	12	0.008
Private Sector Banks	1249.51	1012.18			
Period II	Mean Value	Std. Dev.	t-test	d. f. (v)	Sig. (2-Tailed Test)
Public Sector Banks	17421.06	6118.18	5.64	12	0.000
Private Sector Banks	5716.71	1650.00			
Small Scale Industries (SSIs) Credit					
Period I	Mean Value	Std. Dev.	t-test	d. f. (v)	Sig. (2-Tailed Test)
Public Sector Banks	2665.19	19541.80	0.19	12	1.230
Private Sector Banks	542.01	1950.51			
Period II	Mean Value	Std. Dev.	t-test	d. f. (v)	Sig. (2-Tailed Test)
Public Sector Banks	14039.75	6292.06	7.84	12	0.010
Private Sector Banks	5828.66	3183.75			
‘Other Priority Sector’ Credit					
Period I	Mean Value	Std. Dev.	t-test	d. f. (v)	Sig. (2-Tailed Test)
Public Sector Banks	4421.39	2367.82	2.35	12	0.040
Private Sector Banks	1968.45	1531.92			
Period II	Mean Value	Std. Dev.	t-test	d. f. (v)	Sig. (2-Tailed Test)
Public Sector Banks	9831.41	1371.56	7.55	12	6.702
Private Sector Banks	4387.09	1323.59			

Note: Same as Table 4

In case of SSIs, the calculated value of t-test during the first phase is 0.19, which is less than the table value (*for* $\nu = 12$, $t_{0.05} = 2.17$) and it is found insignificant at 1% and 5% level (significance, two tailed test=1.230), so the null hypothesis is accepted and alternative hypothesis is rejected, and we conclude that there is no significant difference in the mean value of credit deployed to SSIs by public and private sector bank groups ($H_1: \mu = \mu_2$) during the first phase. However, during the second phase, the calculated value of t-test is 7.84, which is more than the table value (*for* $\nu = 12$, $t_{0.05} = 2.17$) and it is also found significant at 1% and 5% level (Significance, two tailed test=0.010), so the null hypothesis is rejected and alternative hypothesis is accepted, and we conclude that there is significant difference in the mean value of credit deployed to SSIs by public and private sector bank groups ($H_1: \mu_1 \neq \mu_2$) during the second phase first phase of the study.

Further, in case of 'Other Priority Sector', the calculated value of t-test during the first and phase are 2.35 and 7.55 respectively (Table 5), which are more than the table value (*for* $\nu = 12$, $t_{0.05} = 2.17$) and are found significant at 1% and 5% level (significance, two tailed test=0.040 and 0.000), so the null hypothesis is rejected and alternative hypothesis is accepted, and we conclude that there is significant difference in the mean value of credit deployed to 'Other Priority Sector' by public and private sector bank groups ($H_1: \mu_1 \neq \mu_2$) during the first and phase.

5.0 Conclusion and Policy Implications

It was observed that the priority sector lending by private sector banks registered a higher rate of growth vis-à-vis public sector banks, during both the phases of the study. From the analysis it was found that, on an average, the prescribed target of priority sector lending was achieved by public as well as private sector banks during the first and second phase. Although, on an average, the prescribed target of lending has been achieved, but, one important issue of concern is the shrinking share of priority sector credit in net bank credit over a period of time by both the public and private sector banks, which needs immediate attention of the policy makers. The inter-year disparities in priority sector lending in case of private sector banks are found to be higher as compared to public sector banks in both the phases. The public and private sector banks, on an average, could not deploy 18 per cent of net bank credit in agriculture sector and thus, failed to achieve the stipulated target of agricultural lending during the first as well as second phase. It was found that, within the priority sector, the share of agriculture and SSIs credit has increased while, that of 'other priority sector' by both the bank groups has decreased during the period under study.

Financial inclusion and priority sector credit are closely interconnected subjects as financial inclusion is the process and priority sector loans are the business effect/ end product of the same in the books of the banks. If we are doing financial inclusion, then these targets are achievable, if not, then these are not. We need to be consistent in our approach towards financial inclusion and priority sector lending. Any attempt to strengthen the priority sector lending is essentially a small step in a long journey of financial inclusion. This means that expanding financial inclusion requires, among other things, a paradigm shift that goes beyond opening bank accounts and facilitating direct cash transfers to the financial excluded. The banking sector, especially public sector banks, should lead efforts to expand inclusion as private sector initiatives to do so are likely to be curtailed by their objective of maximising shareholder profit rather than optimising stakeholder value.

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