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Interbank Variation In Priority Sector Credit In India: Synergies Between Financial Institutions

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Abstract

Priority Sector Lending (PSL) between public and private sector banks in India from 2019-20 to 2023-24. PSL is a crucial policy initiative by the Reserve Bank of India to ensure adequate credit flow to critical sectors, such as agriculture, small enterprises, and weaker sections. The study employs statistical methods, such as Mean, Standard Deviation, Coefficient of Variation, and Compound Annual Growth Rate, to analyze lending patterns across various PSL sub-sectors. Correlation tests are conducted to evaluate the relationship between public and Private Banks' lending activities. The findings reveal that private-sector banks exhibit superior growth rates across all PSL categories compared to public-sector banks. However, public-sector banks extend greater credit amounts in absolute terms. Private Banks demonstrate higher lending variability, whereas public banks show relative stability. Significant positive correlations were identified between the lending activities of both bank types across all the PSL categories. This study highlights the increasing involvement of private sector banks in PSL, although public sector banks maintain a predominant role. These findings suggest that future policies should leverage the strengths of both bank types to build a more inclusive and efficient PSL system in India. Ongoing monitoring and flexible regulations are crucial for ensuring that PSL effectively promotes inclusive growth and development.

Keywords: Priority Sector Lending (PSL), Public Sector Banks, Private Sector Banks, Reserve Bank of India (RBI), inclusive growth, financial inclusion, credit flow etc.

Introduction:

The Indian banking sector plays a crucial role in fostering economic development by channeling funds to various critical sectors for inclusive growth. Both public and private sector banks, with extensive branch networks spanning the country, are uniquely positioned to gather savings from economically surplus entities. This mobilization of savings on a short or medium-term basis is essential for a nation's economic advancement. To enhance the rate of capital formation, it is imperative to establish an efficient public and private sector banking system with sufficient coverage, not only facilitating savings mobilization but also promoting banking habits within society.

India has a vast network of financial institutions, with the co-existence of dual (formal and informal) financial systems that both operate in the rural credit market. A large number of formal institutional agencies include Co-operatives, Regional Rural Banks (RRBs), Scheduled Commercial Banks (SCBs), Non-Banking Financial Institutions (NBIs), Self Help Groups (SHGs), Micro-Finance Institutions (MFI) and Government Agencies. Several initiatives have been taken to strengthen the institutional mechanism of rural credit system which includes Nationalization of major commercial banks, establishment of National Bank for Agriculture and Rural Development (NABARD) and the financial sector reforms since 1991 onwards. Despite several other measures taken to strengthen formal credit program in India, special discussions on the issue of priority sector are, by and large, swayed by emotions and the empirical validations of the issues is often lacking. In this backdrop, this study was undertaken to examine critically the interbank variation in priority sector credit in India. Here are some statistical data regarding the research.

Sector-wise priority sector lending in India by Public Sector Banks from 2019-20 to 2023-24(in crore)

Year	Agriculture	Small and Marginal Farmers	Non-corporate Individual Farmers	Micro Enterprises	Weaker Section
2020-21	1068112	553455	769173	418763	727794
2021-22	1182377.52	648227.14	924640.55	442596.73	827895.58
2022-23	1277359	739768	998667	503933	933799
2023-24	1425554	832757	1105493	597854	1053784

Resource: Compiled by Researcher

Literature Review:

Sarvesh and Kanaujiya (2024) studied how public and Private Banks in India handle priority sector lending (PSL). They found that public banks usually led to PSL, but Private Banks were catching up. This change was due to new rules, competition, and strategy changes. The study shows that banking in India is changing, with Private Banks playing a larger role in helping more people through faster PSL growth.

Raman (2013) found that the rate of change in advances to priority sector both planned as well as achieved led to phenomenal growth not only in quantity but also quality. Social banking relies significantly on priority sector lending to foster the social and economic progress of rural India.

Pandva (2015-16) analyses the impact of priority sector advances in the profitability of Indian scheduled commercial banks. The study measures the variables such as priority sector advances to total assets, return on assets, return on investment, return on equity, ratio of operating profit to total assets and ratio of interest income to total assets.

Research Methodology:

Priority sector lending includes total agricultural advances, educational loan, housing loans, credit to micro and small enterprises (Direct + Indirect) and all other loans given to weaker section of society. In order to assess the interbank variation in priority sector credit in India, bank wise time series secondary data on total priority sector outstanding and also the data on various sub-heads of priority sector were collected from various published reports of different government sources. The year wise data were collected for the period from 2005 to 2017.

All the subsidiary banks of State Bank of India have merged to State Bank of India (SBI) which is widely accepted as the Government Bank since 1950s. The year-wise loan outstanding data on total priority sector along with its sub-sectors were collected and compiled. Similarly, the corresponding data for all the nineteen nationalized banks were collected separately and complied to make it comparable with those of S.B.I. In order to neutralize the volatility in the data, it was decomposed into three period, *viz.*, Period-I comprised the average of three years from 2005 to 2007, Period-II (2008 to 2012) and Period-III (2013 to 2017). Due to non-availability of authentic data for period prior to year 2005, average of three years was computed for Period.

Tabular analysis was extensively used to achieve the stated objective of study. Moreover, bar-diagrams, pie-charts, line-diagrams *etc.* were portrayed for the different periods for both the groups of banks. Relative share of different sub-sectors of priority sector credit within the bank during the different periods and also between the banks in different periods could be judged easily through various diagrams.

Results and Discussion:

After the nationalization of major commercial banks in India, the credit disbursement to priority sector has become mandatory. Since India's independence, the share of formal credit in India has increased considerably. In order to know the real picture of sources of different loans by formal and informal agencies, the data on distribution of loans by sources have been reproduced in Table 1. It can be seen from the table that nearly 64 per cent of the credit is from formal sources and the banks have been the dominant force (71%) in disbursement of formal credit, followed by co-operative societies (25.4%) and government sources (3.6%). Nonetheless, still the existence of an informal credit market with 36.44 per cent of the loan volume for agricultural households has attracted continuous attention to the policy makers. The dominance of professional money lenders in the total credit from informal sources (64%) is also a grave concern for all the stakeholders.

Distribution of loans by sources

Share of formal sources	%	Share of informal sources	%
Type		Type	
Government	3.61	Employer or landlord	2.34
Cooperative society	25.37	Agriculture professional or moneylender	64.05
Bank	71.02	Shopkeeper	4.93
		Relatives or friends	24.03
		Others	4.65
Total	100.00	Total	100.00
Formal sources as share of total loans	63.56	Informal sources as share of total loans	36.44

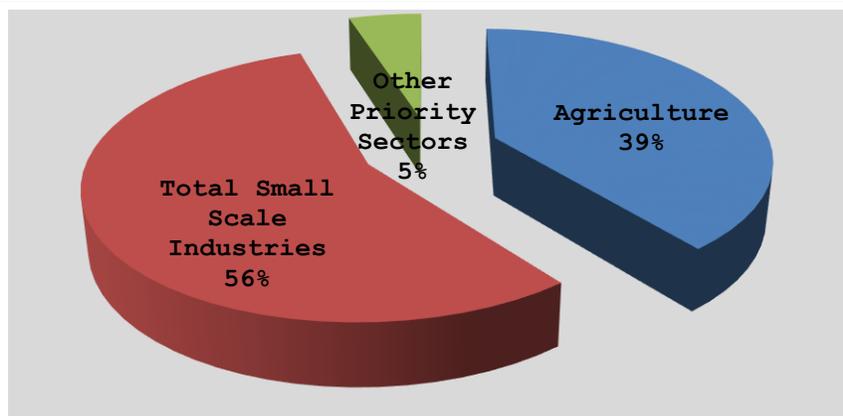
Source: Institutional versus non-institutional credit to agricultural households in India, Evidences on Impact from a National Farmers' survey. IFPRI Discussion paper 01614, March 2017.

Perusal of Table 2 and Fig. 1 indicate the sub-sector wise priority sector loan outstanding of SBI during 2005-2007 (Period-1). It can be observed from the table that the absolute amount of agricultural loan outstanding has slightly declined in 2007 compared to the year 2005. On the other hand, the loan outstanding of Small-Scale Industries increased nearly 3 times in 2007 as compared to the year 2005. The proportion of small-scale industries in the total priority sector lending of SBI during Period-1 was the highest (56 %), followed by agricultural sector (39 %) and other priority sectors (5%). This implies that the share of agricultural sector in total priority sector was found to be little less than the mandatory requirement.

Table 2: Priority sector credit by SBI during Period-I (2005-2007) (Amount in Rs. Billion)

Sector\Year	2005	2006	2007	TOTAL
Agriculture	33296	27173	33086	93555
Total Small-Scale Industries	22000	47633	63420	133053
Other Priority Sectors	2581	3817	5520	11918
Total Advances to Priority Sectors	96490	128469	166770	391729

Relative share of various sub-sectors in total priority sector credit by SBI during Period-I

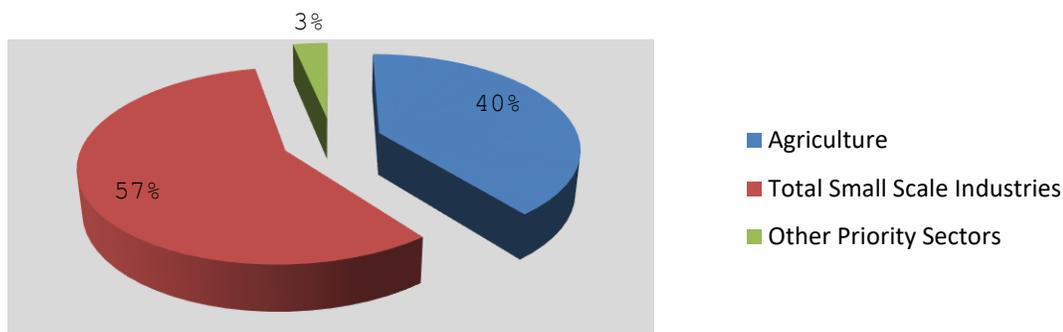


The year wise data on priority sector credit disbursed by all the nationalized banks together presented in Table 3 and the average proportion of magnitude depicted in Fig. 2 revealed that the loan outstanding amount of Small-Scale Industries was found to be dominated among all other sub sectors of priority sector. The absolute amount of agricultural sector was the highest (Rs. 79180 billion) in 2005 but it declined in the year 2006 but again increased in 2007. All other sub-sectors reported continuous rise in the loan outstanding from 2005 to 2007. The average proportion of credit for small scale industries remained at the top (57 %), followed by agriculture (40 %) and other priority sector (3 %). This leads to conclude that the proportion of loan disbursed to various sub-sectors of priority sector remained almost at par in both the groups of banks under study indicating thereby following the norms prescribed by Reserve Bank of India (RBI).

Priority sector credit by nationalized banks during Period-I (2005-2007) (Amount in Rs. Billion)

Sector\Year	2005	2006	2007	TOTAL
Agriculture	79180	55319	67991	202490
Total Small-Scale Industries	45634	106681	141673	293988
Other Priority Sectors	3664	4695	8463	16822
Total Advances to Priority Sectors	214237	281322	354411	849970

Relative share of various sub-sector in total priority sector credit by Nationalized banks during Period-I



The portfolio of priority sector advances has been diversified from 2008. It includes agricultural advances, educational loans, housing loans, direct and indirect credit to Micro and Small Enterprises (MSE), and others. Accordingly, year wise data were collected. The data furnished in Table 4 pertain to the sub-sector wise loan outstanding of SBI for the period from 2008 to 2012 (Period-2). The same was supported with the pie chart (Fig. 3). It can be observed that there was no consistency in the advances to agricultural sector over the years, whereas a continuous rise in educational loan, housing loan and total credit to Micro and Small Enterprises was noticed from 2008 to 2012. It is pertinent to note that the relative share of direct and indirect credit given to Micro and Small Enterprises was the highest among all the sub-sectors during Period-2 (27%), followed by housing loans (25 %), others (24 %), agricultural advances (20 %) and educational loans (4%). A paradigm shift was observed in lending to various sub-sectors of priority sector during Period-2 compared to Period-1. This could be attributed mainly to the several measures taken by the government to strengthen formal credit programmes in India. The banking sector's linkages with government-sponsored programmes targeted at the weaker section of the society is also one of the reasons for the changes in credit portfolio.

Priority sector credit by SBI during Period-II (2008-2012) (Amount in Rs. Billion)

Sector\Year	2008	2009	2010	2011	2012	TOTAL
Total Agricultural Advances	82558	9671	18848	12745	161700	285522
Educational Loans	6875	9469	12774	14451	15800	59369
Housing Loans	53372	58014	71113	75995	83100	341594
Credit to Micro and Small Enterprises (Direct +Indirect)	44882	55057	70894	110036	94700	375570
Others	11884	100321	98465	116709	100	327479
Total Priority Sector Advances (PSA)	199571	232532	272094	329936	355400	1389533

Relative share of various sub-sectors in total priority sector credit by SBI during Period-II



To have a comparative idea pertaining to institutional credit by SBI and all the nationalized banks together, sub-sector wise loan outstanding data of nationalized banks for the period 2008 to 2012 (Period-2) are given in Table 5. Obviously, the absolute values of the loans to various sub-sectors reported to the banks than SBI, because nationalized banks consisted of 19 major commercial banks of the country whereas SBI is an amalgamation of eight banks only. Akin to SBI, the loans outstanding for educational purposes, housing loans and credit to Micro and Small Enterprises was found to be continuously on the rise over the years. Contrary to this, an inconsistency in the agricultural advances and the other sectors was reported.

Fig. 4 portrays the average proportion of various sub-sectors in the total priority sector credit by nationalized banks during Period-2. As can be seen, the highest share of priority sector credit was captured by Micro and Small Enterprises (34%), followed by agriculture (30%), housing loans (18%), others (14%) and educational loan (4%). This implies that the nationalized banks gave more emphasis on agriculture and Micro and Small Enterprises compared to SBI, as their share in the total priority sector was substantially higher in case of nationalized banks.

Table 5: Priority sector credit by nationalized banks during Period-II (2008-2012) (Amount in Rs. Billion)

Sector\Year	2008	2009	2010	2011	2012	TOTAL
Total Agricultural Advances	166128	98139	151761	145766	316600	878394
Educational Loans	12969	17457	22518	26893	31000	110836
Housing Loans	94254	98585	102203	112271	118600	525914
Credit to Micro and Small Enterprises (Direct + Indirect)	103769	135911	207504	266591	301800	1015575
Others	32271	137144	108874	147159	6800	432248

Total Priority Sector Advances (PSA)	409391	487235	592860	698680	774800	2962966
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Relative share of various sub-sector in total priority sector credit by Nationalized banks during Period-I

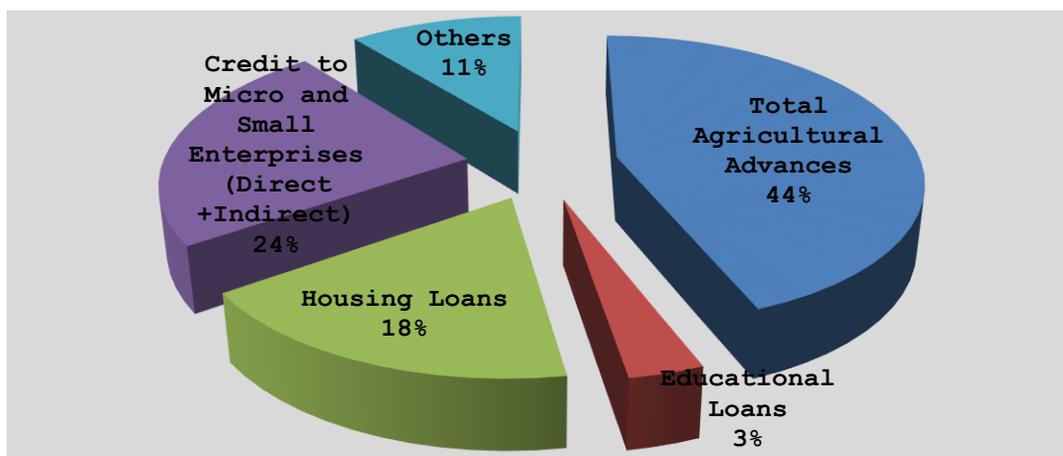


Period-3 pertains to the year 2013 to 2017. The loan outstanding data of SBI for various sub-sectors of priority sector for the Period-3 are reported in Table 6. It can be observed from the table that the loans outstanding of agricultural sector, Micro and Small Enterprises and housing loans continued to increase in all the years, except 2017, in which, a little decline in the credit to Micro and Small Enterprises was noticed.

Table 6: Priority sector credit by SBI during Period-III (2013-2017) (Amount in Rs. Billion)

Sector\Year	2013	2014	2015	2016	2017	TOTAL
Total Agricultural Advances	1728	2172	2250	2804	2897	11852
Educational Loans	175	184	181	187	175	902
Housing Loans	876	929	964	998	1074	4841
Credit to Micro and Small Enterprises (Direct + Indirect)	1110	1227	1273	1418	1383	6411
Others	2789	35	22	25	41	2912
Total Priority Sector Advances (PSA)	3899	4546	4691	5432	5570	24138

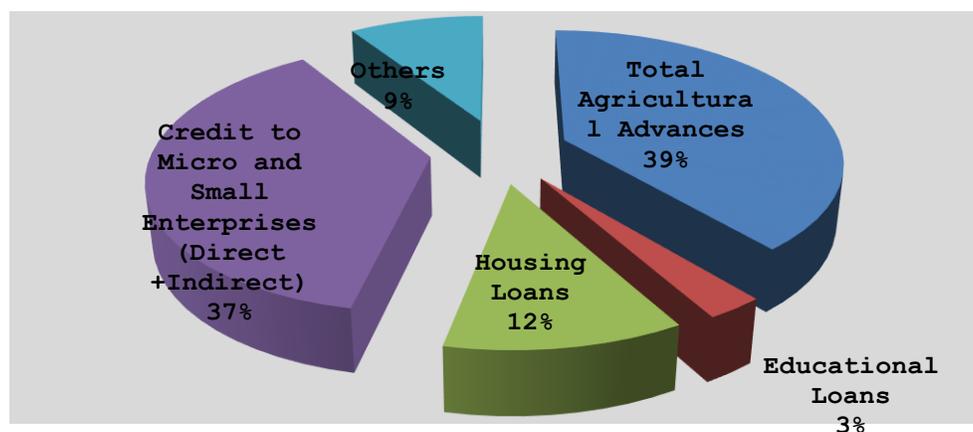
Relative share of various sub-sectors in total priority sector credit by SBI during Period-III



A wide fluctuation in the credit to other sectors was also found. Surprisingly, the average share of agricultural sector in the total priority sector credit was observed as high as 44 per cent, followed by Micro and Small Enterprises (24%), housing loans (18%) others (11%) and educational loans (3%). The share of agriculture has increased more than two times in Period-3 as compared to Period-2. There has always been a strong correlation between the performance of agricultural sector and that of overall economy. To achieve higher growth in GDP of India, agricultural sector needs to be a decisive driver. Realizing the importance of agricultural credit in fostering overall development of India's economy, the increased share of agriculture in the total priority sector credit is an appropriate decision of the banking sector. Similar trend was noticed in case of nationalized banks during Period 3 (Table 7 and Fig. 6) but the proportion of agricultural advances to total priority sector credit of the respective bank was found higher for SBI (44 %) than that of nationalized banks (39 %). On the other hand, the share of credit to Micro and Small Enterprises was found to be much higher in case of nationalized banks (37 %) as compared to their counterpart, *i.e.*, SBI (24 %). The credit for housing purpose was given more priority by SBI compared to nationalized banks.

Priority sector credit by nationalized banks during Period-I (2013-2017) (Amount in Rs. Billion)

Sector\Year	2013	2014	2015	2016	2017	TOTAL
Total Agricultural Advances	3578	4701	5312	6244	6571	26406
Educational Loans	335	367	390	407	425	1923
Housing Loans	1271	1427	1521	1745	1868	7832
Credit to Micro and Small Enterprises (Direct + Indirect)	3675	4647	5231	5922	5992	25467
Others	5264	502	365	103	9	6243
Total Priority Sector Advances (PSA)	8938	11644	12818	14421	14865	62686

Relative share of various sub-sector in total priority sector credit by nationalized banks during Period-III**Conclusions: -**

Institutional credit played pivotal role in priority sector lending for the overall development of economy in general and agriculture in particular. The results of this study revealed a wide variability in the credit to different sub-sectors of priority sector between the banks and between various periods. The share of various sectors in the total priority sector credit was found to be almost same both in case of SBI and nationalized banks during Period-1. A paradigm shift was noticed in Period-2 in which the share of agricultural sector has drastically declined. Housing loans and educational loans emerged as new sub-sectors of priority sector in Period-2 contributing jointly more than 20 per cent of the total priority sector credit. Institutional credit for the agricultural sector gained momentum in the last five years which accounted for nearly 40 per cent. Credit to Micro and Small Enterprises ranked second in case of both the groups of banks in Period-3. Several initiatives taken by the government to strengthen the flow of institutional credit with and explicit focus on rural sector have had a positive impact on the flow of agricultural credit. As a result, Indian agriculture developed over time and indicated all signs of resilience to natural calamities like droughts, famines, *etc.* Despite this, a continuous monitoring to fulfill the mandatory requirement for priority sector credit by various banks is utmost important.

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