Priority Sector Lending (PSL) and Non-Performing Assets (NPA) of Public & Private Sector Banks in India

Sebak K. Jana
Professor of Economics
Department of Economics
Vidyasagar University, Midnapore, West Bengal, India, PIN 721102

Atanu Mitra (Corresponding author)
Research Scholar
Department of Economics
Vidyasagar University, Midnapore, West Bengal, India, PIN 721102

Abstract*:* There is a view that Priority Sector Lending (PSL) contributes substantially to the Non-Performing Assets (NPAs) of Banks. It is also opined that for commercial Banks in India, lesser profitability, average low ticket size of the loan value, evasive borrowers, un-predictable productivity of the agricultural sector, government interventions etc. make deployment of credit to the priority sector un-attractive. It is important to note that every sub-sector of priority sector is not equally risky, thus creating a need to study that how various sub-sectors contribute towards NPA. This paper contemplates on how sector-wise lending in priority sector affects the NPA of the commercial banks in India. For finding the effect the researchers have applied regression analysis. The period of study is 2005 to 2020. The study finds that priority sector lending in various sub-sectors have significant impact on NPA of both public & private sectors in India.

Keywords: Priority Sector Lending, Non-performing assets, Private Banks, Public sector Banks, India

1. Introduction:

An asset (including a leased asset) which stops to generate income is treated as a non-performing asset (NPA). In India the concept of NPA came into being after the financial sector reforms, subsequent to the recommendations of the Report of the Committee on the Financial System (Narasimham, 1991). Non-performing assets (NPAs) are a key worry for banks in India. They are the best indicator of the health of the Banking system. A lessening of NPAs indicates that banks have bettered the credit appraisal processes with passage of

time. The increase in NPAs leads to the necessity of Provisioning, which brings down the overall profitability of banks. Thus to improve the efficiency and profitability of banks, NPAs need to be reduced and controlled.

Concept of Non-Performing Asset (NPA)

NPA is defined as an asset which is not generating any return to the bank. Banks earn by lending money to public at a rate higher than that paid on deposits. Hence, if the loan interest or principal or both remains unpaid (Shabbir & Mujoo, 2014), banks will lose a substantial part of its income.

An 'out of order account' is one in which the outstanding balance remains continuously in excess of the sanctioned limit / drawing power or the outstanding balance is less than the sanctioned limit / drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period.

'Overdue' is the unpaid amount due to the bank under any credit facility on due date. According to Reserve Bank of India an asset (leased asset also) becomes an NPA when it stops generating income for the bank.

NPAs are being classified, based on the period for which the asset has remained non-performing and realisability of the dues, into three categories as under:-

Table1: Classification of NPAs in India

No.	Category	Parameters
1	Substandard Assets	Remained NPA for a period not less than or equal to one year.
		In such cases, the current net worth of the borrower / guarantor or market value of the security charged is not enough to ensure recovery of the bank's dues;
		Likely to sustain some loss if deficiencies are not corrected.
2	Doubtful Assets	Remained in substandard category beyond 1 year;
		Recovery - highly questionable and improbable.
3	Loss Assets	Asset considered uncollectible and of little value but not written off wholly by the bank.
		Continuance as bankable assets although it may have some salvage or recovery value

Source: www.iibf.org.in

Concept of Priority Sector Lending (PSL)

Priority sector lending refers to those sectors of the economy which are not getting timely & adequate financial assistance from various financial institutions. The main motive is to achieve socio economic equality. Priority Sector Lending includes lending to Agriculture, Micro small & medium enterprises (MSME's), Other Priority Sectors (OPS) etc. The targets under PSL have been fixed by RBI for different types of banks.

As per extant instructions, the targets and sub-targets set under priority sector lending for domestic and foreign banks operating in India are given below:

Table 2: Norms of Priority Sector Lending in India

Categories	Domestic commercial banks & Foreign Banks	Foreign Banks with less than 20 branches	Regional Rural Banks	Small Finance Banks
Total Priority Sector	40% of ANBC / CEOBE**	40% of ANBC / CEOBE out of which up to 32% can be in the form of lending to Exports and not less than 8% can be to any other priority sector	75% of ANBC / CEOBE Lending to Medium Enterprises, Social Infrastructure and Renewable Energy shall be reckoned for priority sector achievement only up to 15 % of ANBC.	75% of ANBC / CEOBE.
Agriculture	18% of ANBC / CEOBE, A target of 10 % is prescribed for Small and Marginal Farmers (SMFs)	Not applicable	18% of ANBC / CEOBE, A target of 10% is prescribed for SMFs.	18% of ANBC / CEOBE, A target of 10% is prescribed for SMFs.
Micro Enterprises	7.5 % of ANBC / CEOBE	Not applicable	7.5 % of ANBC / CEOBE	7.5 % of ANBC / CEOBE
Advances to Weaker Sections	12 % of ANBC / CEOBE	Not applicable	15% of of ANBC / CEOBE	12 % of ANBC / CEOBE

Source: www.rbi.org.in

As the above table shows, it is mandatory to lend to priority sector. For fulfilling the targets commercial banks in India are lending money to this sector. It has been often commented that NPA of priority sector as compared to non-priority sector is high. In this paper the researchers try to find out the correlation between Priority sector lending and NPA.

2. Review of Literature:

Rangarajan (1991) usefulness of the Banking system can be improved with the gradual up-gradation in the quality of the loan assets. The Narasimham committee (1991) had suggested that the priority sector should be redefined. The Narsimham committee 1991 on financial sector reform has pinched attention to the problem of low and declining profitability and affirmed that there is a 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) recommended that concessional credit or low rate of interest should be restricted only to the poorest of the poor and to the underprivileged sections of the society and recommended that commercial rate of interest should be charged from those who can afford it. The Narasimham committee (1998) observed that directed credit had led to an increase in non- performing loans and had adversely affected the efficiency and profitability of banks. It was observed that 47 percent of all NPAs have come from the priority sector.

Department of Banking supervision (1999) studied the impact of priority Sector advances on NPAs & found that NPAs in priority Sector is much higher. Reddy (2001) remarked that the flow of credit to priority sector / rural areas has not been up to the mark due to accretion of losses in Public Sector Banks on account of high NPAs. Niranjana & Anbumami (2002) analyzed that due to the highly subsidized lending rates, there is a view among the Bankers that the advances to Priority Sector resulted in a loss of interest income. The World Bank (2004) in their report "Sustaining India's Service Revolution" made responsible the strict PSL norms of RBI for Foreign & Domestic Banks resulting in the weak financial health of the Commercial Banks in India. It observed that Govt. ownership of Banks in India tends to reduce competition, raises the cost of lending to the public and also under lending to the private sector.

The above studies find that there is a relation between NPA and PSL. PSL is a leading factor of NPA. PSL is divided into many sectors like Agriculture, MSME and OPS but according to the above mentioned studies and to the best knowledge of researcher, it is still to be sufficiently established that which sector of PSL is responsible for NPA and up-to what extent. This study is an attempt to find out role of the various Priority Sector constituents in increasing / decreasing the overall NPA levels.

3. Research Objectives, Methodology and Data Source

The major objectives of the present study are to assess the following for both Public sector Banks and Private sector Banks:

- The impact of Priority Sector Lending (PSL) on Total NPA.
- The impact of Priority Sector Lending to Agriculture on Total NPA.
- The impact of Priority Sector Lending to MSME's on Total NPA.
- The impact of Other Priority Sector Lending on Total NPA.

We have presented the summary statistics of the variables under consideration in Table 3.

**Table 3: Summary Statistics of the Variables (Rs. crore) under consideration**

Variables	Description	Average	Standard Deviation
PUBTOTNPA	Total NPA of the Public Sector Banks	292105	304705
PUBTOTADV	Total advance by the Public Sector Banks	3989705	2039735
PUBAGRI	PSL to agricultural sector public sector banks	563787	321604
PUBMSME	PSL to MSME sector public sector banks	470894	307936
PUBOPS	PSL to other sectors public sector banks	285573	91573
PUBTOTPSL	Total PSL by public sector banks	1320254	716999
PVTTOTNPA	Total NPA of the Private Sector Banks	53071	63901
PVTTOTADV	Total advance by the Private Sector Banks	1426262	1118591
PVTAGRI	PSL to agricultural sector Private sector banks	185821	168135
PVTMSME	PSL to MSME sector Private sector banks	202378	206966
PVTOPS	PSL to other sectors Private sector banks	90163	34206
PVTTOTPSL	Total PSL by Private sector banks	478363	402745

Source: Authors' calculation based on data from www.rbi.org.in

Line diagrams of NPA's of Public Sector Banks and Private Sector Banks in India (Rs. crore) during 2005 to 2020 have been presented in Fig. 1. Line diagrams of Percentage of NPA in total advance of Public Sector and Private Sector Banks during 2005 to 2020 have been presented in Fig. 2.

Fig. 1: NPA of Public Sector Banks and Private Sector Banks in India (Rs. crore)
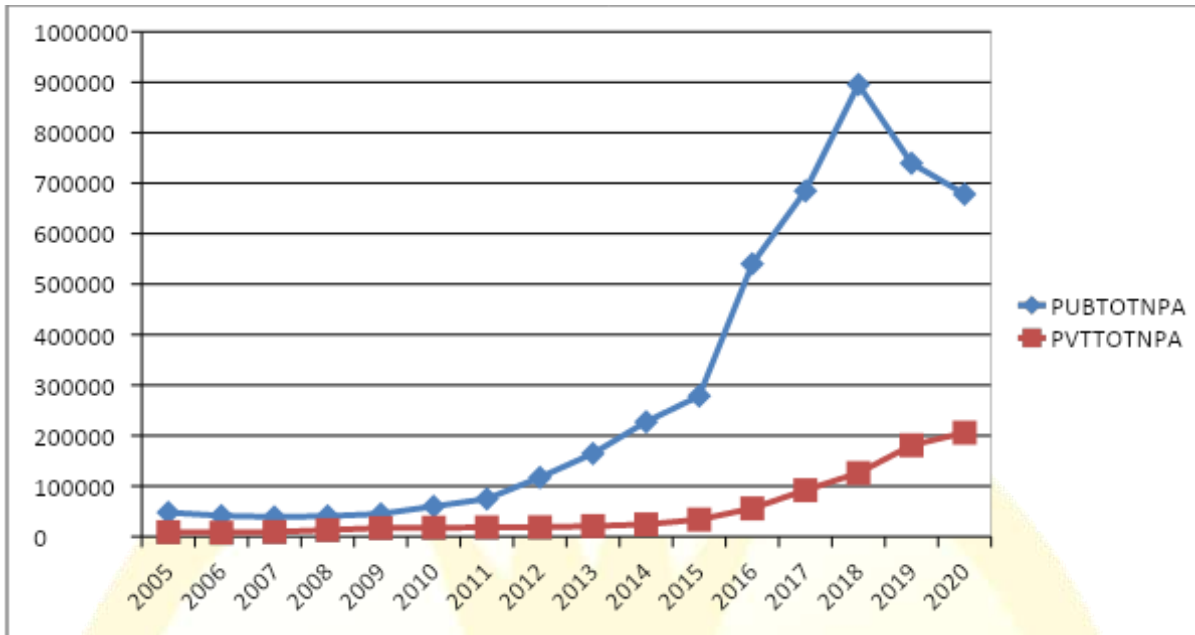
Source: based on data from www.rbi.org.in

Fig. 2: Percentage of NPA in total advance of Public Sector and Private Sector Banks
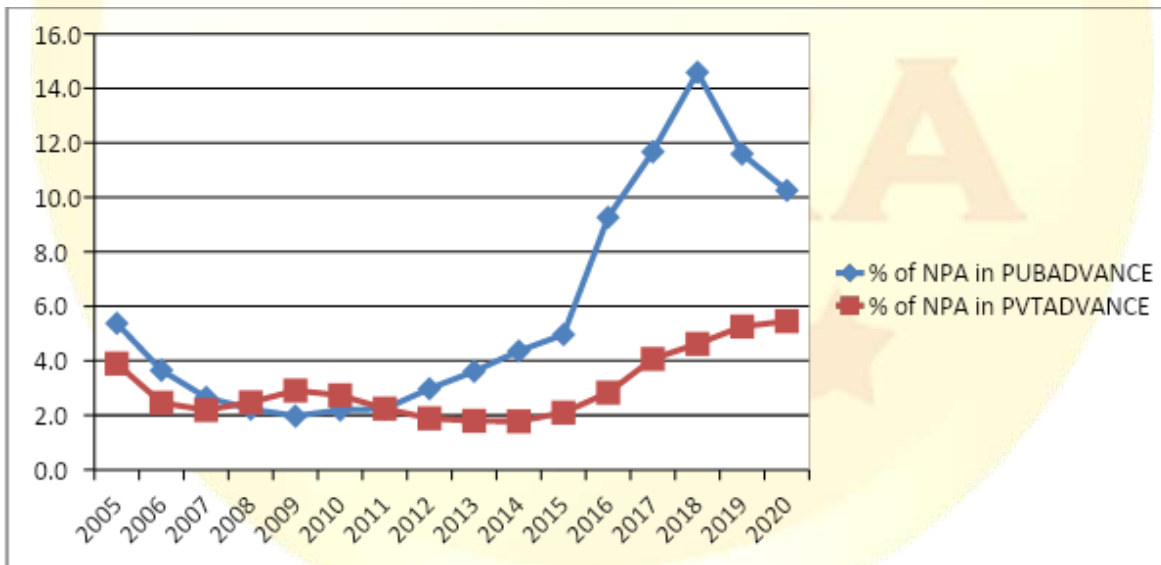
Source: based on data from www.rbi.org.in

The present Study assumes the linear relationship between NPA and PSL. The study also the linear relationship between different subcategories of PSL and NPA like Agriculture PSL and NPA, MSME PSL and NPA and Other PSL and NPA of both public and private banks. For this purpose regression analysis has been used. The general form of

OLS regression model used in the present study is given below. The linear relationship of between Priority Sector Lending (PSL) and total NPA is written as follows.

$Y = \alpha + \beta X_i + U$

Here Y= NPA, α = intercept, β = slope of line, X= PSL, U = random error term

The specific forms of OLS regression equations for public sector banks and private sector banks have been given through equations (1) to (8). The variables used in these equations have been described in Table 3.

Public sector banks:

$PUBTOTNPA = \alpha + \beta\ PUBAGRI + U$ (1)

$PUBTOTNPA = \alpha + \beta\ PUBMSME + U$ (2)

$PUBTOTNPA = \alpha + \beta\ PUBOPS + U$ (3)

$PUBTOTNPA = \alpha + \beta\ PUBTOTPSL + U$ (4)

Private sector banks:

$PVTTOTNPA = \alpha + \beta\ PVTAGRI + U$ (5)
$PVTTOTNPA = \alpha + \beta\ PVTMSME + U$ (6)
$PVTTOTNPA = \alpha + \beta\ PVTOPS + U$ (7)
$PVTTOTNPA = \alpha + \beta\ PVTTOTPSL + U$ (8)

Source of Data & Collection Method:

The data used for NPA and priority sector lending is taken for the period of 16 years i.e. 2005 to 2020. The data is collected through: www.rbi.org.in

4. Findings of the Study

Relationship between Total NPA and Priority Sector Lending of Public Sector Banks have been presented in Table 4. The estimation results of equations (1) to (4) have been presented in Table 4. For all these equations the dependent variable is Total NPA of the Public Sector Banks (PUBTOTNPA). The estimation results reveal that the priority sector credit given to different sectors by public sector banks represented by PUBAGRI, PUBMSME, PUBOPS, PUBTOTPSL have significant positive impact on total NPA. All the regression equation has high adjusted R^2 and significant F value.

Table 4: OLS Results of Public Sector Banks PSL (Sector wise) correlation with total NPA

	1	2	3	4
	PUBAGRI	**PUBMSME**	**PUBOPS**	**PUBTOTPSL**
Estimated value of intercept (α) with level of significance	-199381.8 (0.008)	-133648.5 (0.043)	-527061.8 (0.002)	-221408.2 (0.006)
Estimated value of the co-efficient (β) of the variable with level of significance	.8717599 (0.000)	.9041392 (0.000)	2.868502 (0.000)	.3889504 (0.000)
Adjusted R^2	0.8356	0.8231	0.7248	0.8261
F value with level of significance	77.26 (0.000)	70.79(0.00)	40.51(0.00)	72.24(0.00)

Source: Estimation by authors

Relationship between total NPA and Priority Sector Lending of Private Sector Banks have been presented in Table 5. The estimation results of equations (5) to (8) have been presented in Table 5. For all these equations the dependent variable is Total NPA of the Private Sector Banks (PUBTOTNPA). The estimation results reveal that the priority sector credit given to different sectors by private sector banks represented by PVTAGRI, PVTOPS, PVTTOTPSL have significant positive impact on total NPA. All the regression equations except (6) have high adjusted R^2 and significant F value.

Table 5: OLS Results of Private Sector Banks PSL (Sector wise) correlation with total NPA

	5	6	7	8
	PVTAGRI	**PVTMSME**	**PVTOPS**	**PVTTOTPSL**
Estimated value of intercept (α) with level of significance	-16323.99 (0.004)	-7735.809 (0.175)	-67912.47 (0.061)	-20650.27 (0.005)
Estimated value of the co-efficient (β) of the variable with level of significance	.3734522 (0.000)	.3004629 (0.000)	1.341829 (0.002)	.1541124 (0.000)
Adjusted R^2	0.9631	0.9432	0.4813	0.9394
F value with level of significance	392.27 (0.00)	250.3 (0.00)	14.92 (0.0017)	233.57(0.00)

Source: Estimation by authors

5. Conclusion:

The results of the study indicate that priority sector lending have significant positive impact on NPA both for public sector and private sector banks. For public sector banks, agriculture, MSME, other priority sectors and total priority sector credit – all contribute significantly for NPA of public sector banks. In case of private sector banks, all the above except MSME contribute significantly for NPA. So to reduce NPA, repayment of priority sector credit is important factor.

References:

1. Government of India (1991) Report of the Committee on Financial System, Ministry of Finance, (Narasimham Committee), December.

2. Government of India (1998) Report of the Committee on Financial System, Ministry of Finance, (Narasimham Committee-II), April.

3. Jaynal ud din Ahmed (2010), 'Priority Sector Lending by Commercial Banks in India- A case of Barak valley' Asian Journal of Finance & Accounting Vol. 2, No. 1: E5).

4. Mehta, L., & Malhotra, M. (2014). Empirical Analysis of Non Performing Assets Related to Private Banks of India. *International Journal of Management Excellence*, *3*(1), 386-391.

5. Najmi Shabbir and Rachna Mujoo (2014) Journal of Economics and Development Studies March 2014, Vol. 2, No. 1, pp. 241-27.

6. Patel, S. G. (1996). Role of Commercial Banks' Lending to Priority Sector in Gujarat-An Evaluation. *Finance India, X (2)*, 389-393.

7. Patidar, S., & Kataria, A. (2012). Analysis of NPA in priority sector lending: A comparative study between public sector banks and Private sector banks of India. *Bauddhik*, *3*(1), 54-69.

8. R. Kohli. (1997), 'Directed Credit and Financial Reforms', Economic and Political weekly, XXXII (42):2267-2276 October 18.

9. Rajaram Dasgupta. (2002), 'Priority Sector Lending –Yesterday, Today and Tomorrow', Economic and Political Weekly.

10. Rangarajan C. (1991), 'Banking Development since 1947; Achievement and Challenges', Financial System in India, II.

11. RBI, Department of Banking Supervision (1999), 'Some Aspects and Issues Relating to NPAs in Commercial Banks', RBI Bulletin, and LIII (7): 913-930.

12. Report of the Expert Committee on Rural Credit (V.S. Vyas Committee), 2001, NABARD, Mumbai, November 12.

13. S. Niranjana and Anbumani, V. (2002), 'Social Objectives and Priority Sector Lending', Banking and Financial Sector Reforms in India, Deep and Deep Publications, PP- 231.

14. Shabbir, N., & Mujoo, R. (2014). Problem of Non Performing Assets in Priority

Sector Advances in India. *Journal of Economics*, *2*(1), 241-275.

15. Subha.Rao.K.G.K. (2002), 'Cost of Credit of Commercial Banks in Deregulated Government', Economic and Political Weekly, (February 16, 2002).

16. Uppal, R. K. (2009). Priority sector advances: Trends, issues and strategies. *Journal of Accounting and Taxation*, *1*(5), 079-089.

17. V. Puhazhendhi, and B. Jagaraman (1999), 'Rural Credit Delivery; Performance and Challenges before Banks', Economic and Political Weekly, (January 16-23, 1999).

18. Veerakumar, K. (2012). Non-performing assets in priority sector: A threat to Indian scheduled commercial banks. *International Research Journal of Finance and Economics*, (93).