

Priority Sector Lending By Commercial Banks in India: A Case of Barak Valley

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Abstract

The priority sector lending is mainly intended to ensure that the assistance from the banking system to those sectors of the economy which has not received adequate support of institutional finance. The attainment of the socio economic priorities of the government like growth of agriculture, promotion of small entrepreneurs and development of backward area etc is the major responsibility of commercial banks. Since seventies, Reserve Bank of India and government of India have stipulated guidelines for priority sector lending by banks. The same was revised on April 30, 2007 and overall priority sector lending target was fixed at 40 per cent for domestic banks and 32 per cent for foreign banks. However, the banks are not able to reach the prescribed target of lending to priority sector. The small entrepreneurs and farmers are continued to be both credit and demand constraints. Thus, it can be observed that the demand for funds for priority sector viz., small entrepreneurs and agricultural sector is enormous. With this backdrop, the present treatise is an attempt to diagnose the various lacunas of priority sector lending by commercial banks in the area under consideration in the context of national scenario.

Keywords: Priority Sector Lending, Commercial Banks, Credit-Deposit Ratio, Barak Valley, India

JEL Classifications: G20, G21, O10, O14

1. Introduction:

The diversification of a large fraction of bank credit from the traditional sector to the priority sector is a remarkable feature of credit deployment in the post nationalization era. The concept of priority sector lending (PSL) is mainly intended to ensure that assistance from the banking system in an increasing manner to those sectors of the economy which has not received adequate support of institutional finance. The Reserve Bank of India (RBI) emphasized that the priority sector comprised of agriculture (direct and indirect finance), small scale industries (SSI), small road and water transport operators, small business, professional and self-employed persons, education, housing, micro-credit, weaker sections¹ etc. RBI monitors the PSL by commercial banks through periodical return received from the banks and the performance of banks is reviewed in various foray set up under the lead bank scheme (RBI, weblink, 2009)². Since seventies, RBI and government of India have stipulated some guidelines viz, financing in the priority sector on an increasing scale, more deployment of credit backward regions, preparation and implementation of credit plan and measures for enhancing productivity, employment and economic growth with social justice (Narasimham, 1994).

The banks, without insisting adequate security, have supplied advances to priority and other neglected sections of the society at a concession rate of interest. However, the banking statistics revealed that, this designated priority sector as well as neglected sections received about 15 per cent of the total bank credit at the time of bank nationalization (GoI, 1991)³. On the later period, proportion of advances to the priority sector has increased from 15 per cent to 33.3 per cent in 1974 and further to 40 per cent in 1980. The commercial banks have achieved the target and even surpassed it in quantitative terms. But in qualitative terms, there is an apprehension among the bankers that the advances to priority sector resulted in a loss of interest income due to highly subsidized lending rates. As a result, the profitability of banks has adversely affected besides maintaining additional manpower requirements for supervision of small loans, mounting over dues, poor recovery of advances and raising volume of non performing assets (NPAs) (Niranjana and Anbumani, 2002).

The Narasimham 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 stipulations that 40 per cent of all credit should go to the priority sector should be scrapped. The priority sector should be redefined and the proportion shall be fixed at 10 per cent of the aggregate credit. Subsequently, the committee (1998)⁴ indicated that timely and adequate availability of credit rather than its costs is very

¹ Weaker sections, which come under priority sector for lending purposes, hitherto included scheduled castes, scheduled tribes, small and marginal farmers, artisans and distressed urban poor indebted to non-institutional lenders. Within priority sectors, domestic commercial banks have to give 10 per cent of their net lending to weaker sections, but no such specific target is set for foreign banks., weblink: <http://news.indiamart.com/news-analysis/rbi-widens-priority--15730.html>, (Visited on 16/05/09)

² <http://www.rbi.org.in/scripts/faqview.aspx?id=8>, (accessed 15/05/09)

³ Govt. of India (1991a) *Report of the Committee on Financial System*, Ministry of Finance., December

⁴ Govt of India (1998) *Report of the Committee on Financial System, Ministry of Finance*, (Narasimham Committee-II), April

indispensable for intended beneficiaries. The impact of Narasimham committee recommendations with regard to lending to priority sector has not been encouraging (Majumdar, 2001). It appears that there is a growing anxiety that the process of financial sector reforms has by-passed the priority sector. In this respect, Dr. Y. V. Reddy (February 3, 2001), Deputy Governor of RBI, remarked that the flow of credit to priority sector/ rural areas has not been up to the mark owing to accumulation of losses in public sector banks (PSBs) on account of mounting NPAs. The internal working group was set up by RBI under the chairmanship of C.S. Murthy to examine the need of continuance of PSL prescriptions. On the basis of the recommendations of the working group, the guideline for PSL were revised on April 30, 2007 and overall target was fixed at 40 per cent of net bank credit (NBC) for domestic banks (PSBs and private banks) and 32 per cent for foreign banks. The target for agricultural advances fixed at 18 per cent for domestic banks and the target in case of SSI was fixed at 12 per cent for foreign banks (RBI, 2009)⁵.

The PSBs are not able to reach the prescribed target of lending to priority sector. The small entrepreneurs and farmers are continued to be both credit and demand constraints. It has been reported that the constraints facing by the bankers with regard to deployment of credit to priority sector are lack of viable credit products, implying lack of demand for credit etc (Shete, 2002). On the other hand, there exists an informal sector which provides credit to priority sector particularly agricultural credit at higher rates of interest, which indicates that there are no demand constraints. Thus, it can be observed that the demand for funds for priority sector viz., small entrepreneurs and agricultural sector is enormous. The present paper is an attempt to diagnose empirically the various lacunas of priority sector advances by commercial banks in the area under consideration in the context of national scenario.

2. Review of Related Literature:

There have been many researches and studies on priority sector lending by banks in India. A brief review of these studies is highlighted in the following paragraphs to highlight the importance of the study. Joshi (1972) proposed the RBI to give clear and specific definition of the different component of priority sector as some of the bankers are not clear about the precise scope of agricultural lendings. Chawala (1979) examined the dimension of credit flow to the priority sector during seventies and observed that the purpose of PSL by banks is not available for which it is meant for. 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. Joshi (1986) in his study identified weak fund management capacity of banks due to 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, growing incidence of industrial sickness, rapid branch expansion in the under banked areas, unfavorable change of deposit mix and growing incidence of

⁵ <http://www.rbi.org.in/scripts/faqview.aspx?id=8>, (accessed 15/05/09)

financial disintermediation.

Muhammed Yunus (1988) strongly underlined that credit without discipline is nothing but charity and charity in the name of credit will only destroy the poor, instead of helping them. He, however, stressed on the loan recovery mechanism rather than blaming the defaulters. Rangarajan (1991) pointed out that improving the quality of loan assets is the true test of improved efficiency of banking system. The Narasimham Committee (1991) has stated the need for gradual phasing out of the directed credit programme. Krishnaswamy (1992) criticized the recommendations of the committee on financial system. He pointed out the committee's report considered only the interest of industrialist and it essentially concerned with reducing govt. regulations and improving profitability. Rajagopal (1994) studied on the consequences of PSL in Indian banking and remarked that concessional credit should be restricted only to the poorest of the poor and to the under privileged sections of the society. Commercial rate of interest should be charged from those who can afford it. Patel (1996) in his paper realised that the traditional banking ethics were not compatible with the needs of economic development and that the balanced development was not possible without strengthening the hold of commercial banks in the backward and neglected areas. With a view to bring the down-trodden, hitherto neglected sector households to the mainstream, fundamental changes in the traditional banking norms were called for to move away from security based credit towards programme oriented credit.

The Narasimham committee (1998)⁶ pointed out that the sufficient credit to priority sector is very indispensable for intended beneficiaries. Kohli (1997) observed the existence of significant linkages between bank credit and investment in both agriculture and industries in India. He suggested that although directed credit programme for PSL is effective in India, affirmative support to small-scale units is required. Ajit (1997) examined the issue of para banking activities and suggested that bank should be allowed to undertake these activities, particularly use of capital as risk, from the experience of other countries like USA.

Department of Banking Supervision (1999)⁷ studied the impact of priority sector advances on NPAs and found that the incidence of NPAs in priority sector is much higher in view of the fact that priority sector advances constitute 30-32 per cent of the gross bank credit. Vyas committee (2001)⁸ also observed that commercial banks seem to have shied in extending rural credit as they are dealing vast number of small accounts. Niranjana and Anbumani (2002) observed that there is anxiety among the bankers that the advances to priority sector resulted in a loss of interest income due to highly subsidized lending rates. In the context of enormous demand for funds for priority sector, (Shete, 2002) examined priority sector advances by PSBs during the post reform years and found that the PSBs are not able to reach the prescribed target of lending to priority sector.

⁶ Govt of India (1998) *Report of the Committee on Financial System, Ministry of Finance*, (Narasimham Committee-II), April

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

⁸ Report of the *Expert Committee on Rural Credit* (V S Vyas Committee), 2001, NABARD, Mumbai, November 12.

The World Bank (2004)⁹ in its report, 'Sustaining India's Service Revolution' highlighted that government ownership of banks in India stifles competition and raises the cost of lending to the public. The World Bank has blamed RBI's stiff PSL norms for foreign and domestic banks for the weak financial health of commercial banks. The report has indicated that largest government ownership in the banking sector led to insufficient competition in the Indian banking system and hence, led to increased cost of intermediation, lowering capital allocation efficiency and under-lending to the private sector. RBI (2005)¹⁰ draft technical paper of internal working group identified the issues relating to necessity of PSL. The working group recommended the need for PSL prescriptions, the composition of priority sector which includes agriculture, SSI, small road and water transport operators, small business, professional and self-employed persons, education, housing etc. The existing system of computation of priority sector obligations in relation to NBC is based on the outstanding advances of banks. Linking the priority sector obligations to outstanding advances has its shortcomings as outstanding tend to decline as a result of better recovery, write-offs, etc. Moreover, a portion of outstanding comprises NPAs, which continue to get reflected in the achievement of banks in lending to priority sector. The disbursement during a given period is, therefore, a better indicator of banks' lending. In order to improve the flow of credit to the priority sector and to ensure that a certain proportion of funds out of the total bank credit flows to this sector, the computation of PSL obligations of banks could be linked to the total disbursements made by banks during the previous year.

Ahmed (2005) in a diagnosis observed that commercial banks together have gradually increased the quantum of advances to small industries but the proportion in which total bank credit in priority sector has expanded, the relative share of small sector has not grown in the same ratio during the reform regime. The weak infrastructure facilities may have prevented the greater flow of credit. The industrial campaign, awareness programmes and industrial training to the prospective entrepreneurs from the appropriate authority may be the remedy in this respect.

Bhati (2006) examined the lending climate for banks in emerging economies like India. The study found that due to the government policies, banks in India undertake many additional risks when they lend. This study focused on one specific aspect of lending relationship between branch manager and loan officer of bank branches in India and recommended social risk evaluation is therefore more appropriate for risk evaluation and reduction by banks in India. Rikta (2006) in a policy note on institutional lending and financing policy for small sector in Bangladesh examined the effectiveness of financial, fiscal, and related policies for financing the small sector. The study suggested that the financial institutions need to have the financial capacity to accept the lending risks along with access to appropriate funding which fulfill the clients' requirements. An assessment on the causes and consequences of NPAs of commercial banks, by Rajesham and Rajender (2007), concluded that a strong political will only be able to find satisfactory solution to the problem of mounting NPAs. Narasaiah and

⁹ World Bank (2004) *Indian Bank Profits Hit by Priority Sector Lending*, 15th June 2004, weblink: http://www.domain-b.com/finance/banks/world_bank/20040615_profits.html, (accessed on 13/05/09)

¹⁰RBI Internal Working Group (2005) *Priority Sector Lending*, Rural Planning and Credit Department Central Office, RBI, Mumbai, September

Naik (2007) observed that although great strides have been made in the last decade to ensure finance for micro enterprises, rare initiative has been taken to help SSIs. As a result, SSIs have been constrained to seek loans for new ventures from commercial banks. Sooden and Kumar (2007) analyzed the priority sector lending in the post reform period and suggested for a balanced approach as development agent and sustainability of directed lendings keeping in view the quantum of NPA in priority sector advances.

From the above review of earlier studies it is revealed that not many studies based exclusively on the priority sector lending by banks. Most of the studies relate to the institutional financing, nature and problems of PSL by banks. However, the studies relating to the practices and pattern of commercial banks for PSL remained un-researched in the study area.

3. Priority Sector lending by Banks: The National Scenario.

3.1. Deployment of Bank Credit to Priority Sector in India

The commercial banks played a significant role among the institutional sources of credit for priority sector in India. The significance of bank credit in the priority sector can be observed against the backdrop of increasing quantum of such credit to this sector. The table -1 presents total bank credit and the deployment of bank credit to priority sector in India during 1997-2006.

Table-1: Deployment of Bank Credit to Priority Sector in India

(Amount Rs. in crores)

Sl No	Priority Sectors	March 1997	March 1998	March 1999	March 2000	March 2001	March 2002	March 2003	March 2004	March 2005	March 2006
1	Total bank credit	2,58,991 (100)	3,00,283 (100)	3,42,012 (100)	4,00,818 (100)	4,69,153 (100)	5,36,727 (100)	6,69,534 (100)	7,64,383 (100)	10,40,909 (100)	14,45,837 (100)
2	Agriculture & allied	31442 (12.1)	34869 (11.6)	39634 (11.6)	44381 (11.1)	51922 (11.0)	60761 (11.3)	73,518 (10.9)	90,541 (11.8)	1,25,250 (12.0)	1,72,279 (11.9)
3	Small scale industries	35944 (13.9)	43508 (14.5)	48483 (14.2)	52814 (13.2)	56002 (11.9)	57199 (10.6)	60,394 (9.0)	65,855 (8.6)	74,588 (7.2)	90,239 (6.2)
4	Other priority sector	17494 (6.8)	21130 (7.0)	26494 (7.7)	34632 (8.6)	46490 (9.9)	57299 (10.7)	77,697 (11.6)	1,07,438 (14.0)	1,81,638 (17.4)	2,47,379 (17.1)

Figures in the parentheses indicate percentages to total bank credit deployed.

Source: Reserve Bank of India, Report on Currency and Finance, various issues

The outstanding bank credit of small scale sector increased from Rs.35, 944 crores in March 1997 to Rs. 90, 239 crores in March 2006 recording a 2.5 fold increase but the percentage share to total bank credit has declined from 13.9 per cent to 6.2 per cent. During the same period, the amount of bank advances to agriculture sector increased from Rs.31, 442 crores to Rs.1.72, 279 crores. There is a sudden jump of bank credit deployed to other priority sector during the period under consideration. The same has recorded an increase from Rs. 17, 494 crores in March 1997 to Rs.2, 47,379 crores in March 2006. It can be argued that the growth of advances to other priority sector in absolute figure has gone over the growth of bank credit

to small sector although the percentage share has remained lower throughout the period.

3.2. Priority Sector Advances: Bank Group-wise Comparisons.

The bank group wise distribution of priority sector advances and percentage share to total bank credit in India are furnished in table-3.

Table -2: Priority Sector Advances by Bank Groups in India

(Amount Rs in crores)

As on March	Public Sector Banks	Private Sector Banks	Foreign Banks
1995-96	61809 (36.6)	6049 (34.3)	4439 (29.0)
1996-97	68925 (37.8)	6283 (34.0)	5019 (32.1)
1997-98	79131 (41.7)	88321 (41.2)	6139 (37.7)
1998-99	91319 (41.8)	11614 (40.9)	6940 (34.3)
1999-00	107200 (43.5)	14155 (41.4)	8270 (37.0)
2000-01	127807 (43.6)	10819 (38.7)	9699 (34.5)
2004-05	307046 (42.8)	69886 (43.6)	23843 (35.3)
2005-06	409748 (40.0)	106586 (42.8)	30439 (34.4)
2006-07	521180 (39.6)	143768(42.7)	37835 (33.4)

Figures in parentheses indicate percentage to total bank credit.

Source: RBI, Statistical tables Relating to Banks in India. IBA Bulletins

It is clear that in the reform years percentage share of priority sector advances of PSBs has increased steadily from 36.6 in 1995-96 to 39.6 in 2006-07. Further during post reform era, PSBs lending in priority sector remains higher than the foreign banks. The PSBs did not achieve the priority sector target of 40 per cent till March 1999. The target was first achieved in 2000 and continued till 2005-06. The priority sector lending of PSBs, however, fell short of 40 per cent by 0.4 per cent in March 2007. The private sector banks were able to meet priority sector lending target of 40 per cent throughout the period from 1997-98 to 2006-07 except 2000-01. The 32 per cent target fixed for priority sector lending has been met by foreign banks over the years. This indicates that these banks, private banks in particular, lent larger quantity to the priority sector in recent years though the volume of advances are meagre than that of PSBs.

3.3. Level of NPAs in Priority Sector Advances of Banks:

The issue of sustainability of priority sector depends upon how efficiently the credit is recycled in the priority sector and the issue is directly linked with the level of priority sector NPAs. The priority sector NPAs of banks are presented in table-4. The sector-wise analysis of NPAs of PSBs revealed that priority sector added up a large proportion 46.4 per cent of total advances in March 1998 and increased to 59.5 per cent in March 2007. In the non-priority sector, the same has been decreased to 39.3 per cent in March 2007 from 50.6 per cent in March 1998. The public sector NPAs remain as minimum level throughout the period.

Table-3: NPAs of Priority Sector vis-a-vis Other Sectors
(Amount Rs. in crores)

Year (End March)	Priority Sector		Non-Priority Sector		Public Sector		Total
	Amount	Per cent	Amount	Per cent	Amount	Per cent	
1998	21184	46.4	23107	50.6	1362	3.0	45653
1999	22606	43.7	27608	53.4	1496	2.9	51710
2000	23715	44.5	28524	53.5	1055	2.0	53294
2001	24156	45.4	27307	51.4	1711	3.2	53174
2002	25150	46.2	28405	52.2	903	1.7	54458
2003	24939	47.2	26781	50.7	1087	2.1	52807
2004	23841	47.5	25698	51.2	610	1.2	50149
2005	21926	48.1	23249	51.0	444	1.0	45619
2006	22374	54.1	18664	45.1	341	0.8	41378
2007	22954	59.5	15158	39.3	490	1.3	38602
<i>b</i>	924.82		1911.3		- 18.03		2854. 28
<i>Cgr</i>	4.37		8.86		- 1.31		6.24

Source: Reserve Bank of India, *Trend and Progress of Banking in India*

In order to study the growth scenario of sector-wise NPAs, linear growth rate (b)¹¹ and compound growth rate (cgr)¹² has been considered. The 'cgr' of NPAs in non-priority sector is comparatively higher (8.86 per cent). The 'b' and 'cgr' became negative in the public sector. This exposes that the commercial banks have not considered loan to the public sector due to further NPAs menace over the years. Moreover, the overall 'cgr' of NPAs during 1998-2007 of PSBs was 6.24 per cent while non-priority sectors cgr (8.86 per cent) overweighs 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 priority sector advances 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 may be 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, willful defaulters and so on.

4. Objectives of the Study:

The foregoing discussions relating to the priority sector advances of banks at the national level revealed that there are a number of serious issues relating to the PSL which became great concern of the policy makers. Now the doubts relating to the sustainability of PSL may be studied in the backward area particularly to identify the real factors. In this respect, we have conducted an empirical study over twelve commercial banks operating in the study area. The major objectives are -

¹¹ For calculating linear growth rate (b), we have assumed the linear regression line $y = a + bt$ (where Y = quantum of NPAs corresponding to year 't' origin at 1998).

¹² Compound growth rate (cgr) =
$$\frac{b}{\text{Harmonic Mean (H.M) of } y} \times 100$$

$$= \frac{b}{n / \sum 1/y} \times 100$$

- (a) to study the reasons for poor quality of priority sector lendings in the area under study.
- (b) to study the level of NPAs in priority sector advances of commercial banks.
- (c) to study the recovery performance of priority sector advances of banks over the years.
- (d) to study the determinants of PSL by commercial banks over the years.

5. Hypotheses Framed:

The following operational hypotheses have been framed to meet the objectives of the study-

1. There exists an ample difference between deployment of bank credit to priority sector and development of backward region.
2. The priority sector advances have direct bearing on increasing quantum of non-performing assets of commercial banks.
3. The PSL led to significant increase in the volume of overdue over the years.
4. The mounting overdue has significantly restricted the bank's lending capacity to priority sector.

6. Methodology Adopted:

The secondary data collected from RBI Report on Currency and Finance, RBI Bulletins, RBI Annual Report, Regional offices of banks and Lead bank office of the study area has been considered for the purpose of the study. The entire study is subjected to statistical techniques like correlation analysis, regression analysis, growth rate analysis, parametric tests etc. The extent of credit channelization has been tested with the correlation matrix analysis. Linear growth rate and compound growth rate analysis have been used to assess the growth of bank credit in the area under study. A comparison of credit targets and actual achievements has been made to judge the credit performance. Besides this simple tabulation, percentage analysis has also been used. The banks lending capacity has been studied with the percentage of recovery in agricultural sector. Regression model has also been fitted to study the determinant of PSL by identifying independent variables which are mentioned in appropriate places.

7. Background of the Study Area:

The Barak valley is the southernmost region of Assam composed of three districts viz, Cachar, Karimganj and Hailakandi, covers an extensive area of 6922 sq. kms in Assam¹³. The topography of the valley is heterogeneous composed of high hills, low lands called 'beel' and 'hoar;' and level plains dotted with low ranges isolated hills called 'tillas'. The economy of the valley had been a periphery to the economic mainstream of Bengal during the British rule. The partition of the country in the wake of independence and the consequent emergence of East Pakistan (now Bangladesh) not only had shattered the traditional cheapest and quickest lines of transport and communication but also had snapped the age old channels of trade, commerce and transactions. The post independence phase did not adequately compensate the valley for all the loss inflicted on it by partition.

¹³ Govt. of Assam (2005) *Statistical Hand book*, Directorate of Economics and Statistics, Guwahati, Assam.

The population of the valley was 30.10 lakhs persons as on March 2001. The valley is characterized by thickly populated area with density of 360 persons per sq. km and urban population comprises about 9 per cent of total population. The work participation rate in the valley is 8.6 per cent which is much lower than the national average 25.7 per cent. The valley is agrarian biased. About 49 per cent of the geographical area is under agriculture and 36.9 per cent are under forest¹⁴.

The number of existing industries (factories and SSI) in the valley constituted about 8 per cent¹⁵ of the total number of industries state Assam during the period 1991-2007. The district industries centres (DICs) are imparting training to the rural artisans in trade, leatherwork, tailoring, bamboo work, carpentry etc. There were only two Industrial Training Institute (ITIs), one is at Srikona, Cachar district and another is at Karimganj district catering specialized training to the entrepreneurs of the valley¹⁶. The valley has 7.2 per cent¹⁷ of the road ways and 19.8 per cent¹⁸ of the railway network of the state Assam. 55 per cent of the total villages are electrified in the valley while 65 per cent in Assam¹⁹.

The institutional finance is essential for economic development of any area. But unfortunately, the rate of growth of flow of institutional finance in the valley has not shown significant rise. The valley has 12.5 per cent of the total bank offices of state Assam²⁰. At present, 12 PSBs, 1 regional rural bank (RRBs) and 3 private banks are operating with a net work of 147 branches. As on 31.12.2007, there are 147 numbers of branches of commercial banks operating in the valley. The district Cachar is bestowed with 72 branches (51PSBs, 19 RRBs and 2 private banks) while the district Karimganj got 52 branches (32 PSBs, 17 RRBs and 3 private banks) and 12 branches (13 public sector banks, 8 RRBs and 2 private banks) in the district of Hailakandi are taking the care of banking activities.

The analysis of the aforesaid indicators revealed that the valley is economically and industrially backward. The socio-economic backwardness of the valley is discerned by the symptoms like under utilization of resources, agrarian bias of population, low level of industrialization, fragility of prevailing infrastructure and high incidence of unemployment. Thus, development of infrastructure like transport, communication, power, education and banking network etc is urgently needed in the direction of industrial and agricultural development for overall development of the districts under study.

8. The Result and Discussions:

8.1. Sector-wise Break up of Bank Credit:

The socialization of bank credit has been the subject matter of PSL by the banks. The attainment of the socio economic priorities of the government like growth of agriculture,

¹⁴ Office of the *Joint Director of Agriculture*, South Assam Zone, Silchar

¹⁵ Calculated on the basis of data obtained from *Directorate Economics and Statistics & District Industries Centres* of the area under study

¹⁶ Superintendent, *Industrial Training Institute*, Karimganj, Assam.

¹⁷ Percentage of roadways is calculated on the basis of data obtained from *District Transport Office*.

¹⁸ Area Manager, *N.F. Railway, Badarpur*, Karimganj, Assam

¹⁹ Office of the *Electrical Division*, Karimganj, Assam

²⁰ Lead Bank Office, *United Bank of India*, Silchar, Assam.

promotion of small entrepreneurs and development of backward area etc is the major responsibility of commercial banks. Table -5 presents the data on the total bank advances to the priority and non-priority sector for the period between December 1998 and December 2007 in the districts of the valley.

Table - 4: Sector-Wise Break-Up of Bank Credit in Barak Valley (1998-2007)

(Amount Rs in lakhs)

Year (End December)	Karimganj district			Cachar district			Hailakandi district		
	Priority Sector	Non-Prior ity Sector	Total	Priority Sector	Non-Priorit y Sector	Total	Priority Sector	Non-Prior ity Sector	Total
1998	1693 (47.4)	1878 (52.6)	3571 (100)	3772 (57.7)	2585 (42.3)	6357(100)	1780 (57.6)	1307 (42.4)	3087(100)
1999	2010 (55.8)	1593 (44.2)	3603 (100)	4384 (58.1)	3161 (41.9)	7545(100)	1791 (56.7)	1363 (43.3)	3154(100)
2000	2022 (63.4)	1167 (36.6)	3189 (100)	4025 (57.0)	4200 (43.0)	8225(100)	1682 (51.3)	1595 (48.7)	3277(100)
2001	2038 (50.8)	1975 (49.2)	4013 (100)	4987 (52.5)	4511 (47.5)	9498(100)	1695 (49.8)	1705 (50.2)	3400(100)
2002	1875 (58.6)	1324 (41.4)	3199 (100)	5595 (49.0)	5821 (51.0)	11416(100)	1945 (53.5)	1688 (46.5)	3633(100)
2003	2159 (60.9)	1386 (39.1)	3545 (100)	5294 (47.0)	6060 (53.0)	11354(100)	2300 (49.8)	2314 (50.2)	4614(100)
2004	2980 (60.7)	1873 (39.3)	4853 (100)	6432 (48.9)	6934 (51.1)	13366(100)	2430 (50.8)	2393 (49.2)	4823 (100)
2005	3421 (64.0)	2309 (36.0)	5730(100)	6890 (51.2)	6700 (48.8)	13590 (100)	2751 (45.6)	3024 (54.5)	5775 (100)
2006	2653 (50.8)	2510 (49.2)	5163 (100)	7534 (48.0)	7890 (52.0)	15424 (100)	3230 (52.0)	3129 (48.0)	6359(100)
2007	3120 (57.9)	2751 (43.1)	5871 (100)	7834 (49.1)	7908 (50.9)	15742 (100)	3904 (56.6)	3079 (43.4)	6983 (100)
agr	4.0	2.2	3.3	3.4	14.7	8.0	6.1	5.6	3.8

Figure in the parentheses indicate percentage to total credit of the respective district.

Source: Lead Bank office, UBI, Cachar, Karimganj and Hailakandi districts

The percentage share of priority sector advances of banks in the region is much higher than the national level during the period. The banks in the study area are able to maintain the PSL prescription of 40 per cent as per revised guidelines. It is exposed from the table that the share of priority sector advances to total advances has been declined in the area under study except Karimganj district while the same has increased at the national level. It has also been observed that the average annual growth (agr) of priority sector advances was 4.0 per cent, 3.1 per cent and 6.1 per cent in the Karimganj, Cachar and Hailakandi district respectively during 1998-2007. This indicates a wide gap between deployment of bank credit to priority sector and the development of the backward regions. It is imperative to take appropriate strategy for financing priority sector like SSI, agriculture etc in the backward regions.

8.2. Deployment of Bank Credit under Annual Credit Plan:

The banks operating in the study area, keeping in view of their aim and objectives for the economic development under the lead bank schemes, have made an effort in providing financial support to agriculture and SSI. The PSL is done in the districts through annual credit plans. The sector-wise credit deployment under annual credit plan in the districts is shown in table- 6.

Table- 5: Bank Credit Deployment under Annual Credit Plan in Barak Valley
(Account in Nos. and Amounts Rs. in thousands)

Year (As on March)	Sectors						TOTAL	
	Agriculture and Allied		SSI and Rural Artisans		Trade and Services			
	Account	Amount	Account	Amount	Account	Amount	Account	Amount
Karimganj district								
1998	3884	21918	922	12778	1468	17005	6274	51001
1999	3797	18668	787	12374	1407	16736	5891	48378
2000	4132	21132	784	21285	1290	24832	6206	67249
2001	2496	24349	817	23541	1393	20800	4706	68690
2002	2560	26965	743	15833	1638	27754	4941	70602
2003	2189	26565	773	16954	1624	34393	4586	77912
2004	1444	15419	484	8771	1448	30339	3376	54529
2005	1238	15977	565	10571	1836	45026	3639	71574
2006	1453	16530	462	10923	1983	46312	3780	73765
Cachar district								
1998	3218	19878	916	9636	1495	16439	5629	45953
1999	2808	22530	816	6258	1490	21467	5099	54255
2000	2369	14673	624	14019	1635	31118	4628	59810
2001	2159	19609	952	20090	2022	40784	5133	80433
2002	2255	29517	648	19839	2869	65709	5772	115065
2003	2136	34412	796	24190	2965	79623	5890	135323
2004	2350	32378	1265	37584	3126	94407	6741	164369
2005	2450	33478	1528	39281	3028	83408	7006	156167
2006	2590	32598	1674	40965	3210	97502	7623	171065
Hailakandi district								
1998	2836	20968	823	12003	1407	11589	4319	44569
1999	3121	16312	729	10928	1218	24892	5068	52132
2000	2639	21862	613	24139	1123	23689	4106	69690
2001	2416	18674	580	21017	1359	12536	4355	52227
2002	1938	26312	728	12829	1439	18390	4105	57913
2003	1539	22392	791	15312	1408	17890	3738	55594
2004	2560	21831	865	18316	1506	27831	4931	67978
2005	1961	14326	871	15109	1458	26091	3490	55526
2006	1980	23564	901	16534	1643	27325	5424	67423

Source: Lead Bank Office, United Bank of India, Cachar, Karimganj and Hailakandi district

The table reveals that agriculture is one of the single dominant sectors that absorbed major portion of the credit outstanding. In March 1998, credit outstanding for agriculture was Rs 219.2 lakhs, Rs 198.8 lakhs and Rs. 209.7 lakhs for Karimganj, Cachar and Hailakandi district respectively. The same has declined to Rs 165.3 lakhs in March 2006 for Karimganj district and increased to Rs. 325.9 lakhs and Rs. 235.6 lakhs for Cachar and Hailakandi districts in March 2006. The bank credit deployed to SSI and service sector in absolute term has been increased throughout the period in the districts. The service sector has experienced relatively more deployment of credit in terms of quantum.

The growth of bank credit in different sectors may be assessed by compound growth rate (cgr) of bank credit sanctioned during the period. The results obtained are summarized in table- 7. The inter-sectoral growth rate analysis reveals that there is a significant decrease in respect of credit sanctioned in agriculture and allied activities (cgr = -0.43) while SSI (cgr = 2.45) and trade and service (cgr = 9.23) achieved an increasing trend in Karimganj district. On the other

hand, district Cachar experienced a positive growth rate of credit sanctioned in small sector (cgr = 13.08), agriculture and allied activities (cgr = 3.24) and trade and service (cgr = 11.58). It is therefore, evident from the growth rate analysis that the reform process had made a positive impact on the sectoral credit deployment.

Table- 6: CGR of Bank Credit Deployed

District	Agriculture and Allied	SSI and Rural Artisans	Trade and Service	Total Credit
Karimganj	- 0.43	2.45	9.23	11.27
Cachar	3.24	13.08	11.58	14.08
Hailakandi	1.29	0.32	6.05	4.71

The inter district growth rate analysis shows that the SSI and agriculture sector received comparatively less attention than that of trade and services during the period. This may be due to the negative attitude of banks towards the proposals submitted by small entrepreneurs and the farmers. As they had bitter experience of sanctioning more loan to these sectors since the volume of overdues have mounted over the years.

8.3. Recovery Performance of Banks in Priority Sector Lending:

The liquidity of banks largely depends on the recovery of advances. The recovery position of banks in the area is, quite unsatisfactory, presented in table-8. It has been observed that the recovery position was very much poor in almost all the sector in the area under study. In 1990, it was 14.9 per cent in agriculture and allied activities followed by 28.4 per cent in small sector and 19.9 per cent in trade and service sector for Karimganj district while 16.3 per cent, 22.9 per cent and 46.9 per cent in the respective sectors for Cachar district as on end June 1989. The recovery position in agriculture and allied activities is relatively discouraging to other priority sectors in three districts under consideration.

Table- 7: Sector-Wise Recovery Position of Banks in Barak Valley
(Amount Rs. in Lakhs)

Year	Agriculture & Allied			Small Sector & Rural Artisans			Trade & Service		
	Demand	Recovery	Overdue	Demand	Recovery	Overdues	Demand	Recovery	Overdues
Karimganj District									
31-12-90	292.3 (100)	43.8 (14.9)	248.5 (85.1)	92.3 (100)	26.3 (28.4)	66.0 (71.6)	1025.2 (100)	204.3 (19.9)	820.9 (80.1)
30-09-96	363.2 (100)	98.2 (27.0)	265.0 (73.0)	143.0 (100)	45.2 (31.6)	97.8 (69.4)	1530.8 (100)	345.6 (22.5)	1185.2 (77.5)
30-03-99	458.8 (100)	115.8 (25.2)	343.0 (74.8)	206.3 (100)	92.6 (44.8)	113.7 (55.2)	1960.3 (100)	558.2 (28.4)	1402.1 (71.6)
30-03-05	543.2 (100)	231.1 (27.9)	320.9 (72.1)	245.7 (100)	110.8 (43.6)	134.2 (56.4)	2134.0 (100)	602.8 (27.6)	1432.0 (72.4)
30-03-08	599.1 (100)	250.0 (35.4)	349.1 (65.6)	287.4 (100)	140.2 (45.8)	147.2 (55.2)	2359.0 (100)	879.0 (29.9)	1480.0 (70.1)
Cachar District									
30-06-89	325.6 (100)	53.3 (16.3)	272.3 (83.7)	118.3 (100)	27.7 (22.9)	90.5 (77.1)	524.6 (100)	246.3 (46.9)	278.3 (53.1)
31-12-94	638.3 (100)	113.0 (17.7)	525.3 (82.3)	299.2 (100)	45.8 (15.8)	253.4 (84.7)	853.2 (100)	424.6 (49.7)	428.6 (50.3)
31-03-98	758.6 (100)	215.6 (28.4)	543.0 (71.6)	345.2 (100)	96.2 (27.8)	249.0 (72.2)	1022.8 (100)	511.2 (49.9)	511.6 (50.1)
31-03-05	875.9 (100)	298.7 (27.9)	576.5 (72.1)	398.5 (100)	100.5 (32.1)	298.0 (67.9)	2563.9 (100)	1263.8 (48.1)	1300.1 (51.9)
30-03-08	915.8 (100)	314.7 (32.7)	601.1 (67.3)	450.5 (100)	210.2 (35.1)	240.3 (64.9)	3290.3 (100)	1687.0 (50.9)	1603.3 (49.1)
Hailakandi District									
31-12-91	192.0 (100)	20.2 (10.5)	171.8 (89.5)	62.8 (100)	19.2 (30.5)	43.6 (69.5)	302.7 (100)	145.6 (48.1)	157.1 (55.9)
31-03-94	258.3 (100)	45.0 (17.4)	213.3 (82.6)	85.3 (100)	41.6 (48.7)	43.7 (51.3)	512.6 (100)	213.9 (41.7)	298.7 (58.3)
31-12-99	482.9 (100)	102.9 (21.3)	380.0 (78.7)	90.6 (100)	45.2 (49.8)	45.4 (50.2)	418.2 (100)	219.0 (52.3)	199.2 (47.7)
31-03-05	879.6 (100)	278.6 (25.3)	601.0 (74.7)	201.6 (100)	95.3 (47.4)	106.3 (52.3)	657.2 (100)	321.1 (49.1)	336.1 (50.9)
30-06-08	970.8 (100)	290.1 (26.5)	680.7 (73.5)	234.8 (100)	103.5 (46.0)	131.3 (54.0)	879.4 (100)	432.1 (49.8)	445.3 (50.2)

Figure in the parenthesis indicates percentage to total.

Source: Lead Bank statements (LBS), Lead Bank Office, Cachar, Karimganj and Hailakandi districts of Assam

The lower recovery indicates erosion of banks profitability and blocking up bank credit from developmental project of the area. The gravity of the situation will be cleared when we found Rs. 250.0 lakhs (35.5 per cent) was realized against the total outstanding dues of Rs. 599.1 lakhs under agriculture sector in Karimganj district as on 30-03-08. While in Cachar district Rs. 314.7 lakhs (32.7 per cent) was realized against the total dues of Rs. 915.8 lakhs in 30-03-08 and in Hailakandi district Rs. 290.8 lakhs (26.5 per cent) was realised against total dues of Rs. 970.8 lakhs in 30.06.08. Similar trend was noticed in small sector and service sector in the districts. However, the recovery position of small sector (46.0 per cent) is relatively better that agriculture (26.5 per cent) in 2008. The service sector has experienced a recovery of 49.8 per cent as on June 2008.

A significant feature of banks lending is that, despite mounting over dues in each year, the agriculture and allied sectors enjoyed relatively major portion of bank credit. The

agriculturists and poor people of the area could not repay the loans because they spend their loan on consumption purposes rather than productive purposes without bothering the liability of making repayment because of illiteracy (UBI, 2008)²¹. Further, in the perspective of economic development, there have been many disparities in the area in the distribution of resources. The flow of institutional loans has particularly benefited the richer section. In that content, the priority sector lending provides privileges to the poor people in order to lift their economic structure and condition. They are provided loans for buying buffaloes, cows, pigs, to buy auto-rickshaw, to rear hen, and different machines for small scale industries. Indeed, they get subsidy by government on this loan. But they do not use the loan in the proper way for productive use. So, the loanee can not return loan. Constant failure of monsoon, natural calamities as famine flood etc, willful default, deficiencies in lending policies are the chief reasons for non-recovery of loans. The reasons for poor recovery may also be attributed to various other factors such as lack of supervision of end use of fund owing to lack of vehicle and paucity of staffs, defective processing of loan applications, political interference's, communication gap between banker and customer etc.

The loans sanctioning authority begins to take undue advantage from such people. No effort is made for recovery of such loan. The local leaders do not encourage them to pay it back. They assure them that govt. will exempt it. Consequently the loan is never recovered in future; it becomes difficult to pay it back due to heavy amount. As a result the mounting over-dues restricted the banks lending capacity. Therefore, an immediate action from appropriate authority to accelerate the recovery position in all sectors is necessary.

8.4. Inter-relationship between Non-Performing Assets and Priority Sector Advances:

Due to non-availability of information relating to priority sector NPAs in the area under study, an attempt has been made hereunder to study the relationship between NPA and PSL to identify with contribution of the same to total NPA. For this purpose, we have calculated 'r' between NPAs per branch (a) and priority sector advances per branch (b) and non-priority sector advances per branch (c) during the period 1998-2007. The table-9 presents the position of the variables relating to NPAs and priority, non-priority sector advances per bank branch.

The analysis reveals that the positive correlation 0.74 is statistically not significant at 1 per cent and 5 per cent level of significance at their respective degree of freedom for priority sector advances. The r value 0.65 for non-priority sector advances is significant at 5 per cent level but not at 1 per cent level of significance. This implies that with the increase of priority sector lending, there has been corresponding increase in the volume of NPAs. However, it can not be argued that PSL is the sole factor in enhancing the volume of NPAs in the area under study. The non-priority sector advances are equally responsible apart from other bank specific factors like credit deposit ratio, ration of NPA to advances, capital adequacy ratio etc for the present NPA scenario.

²¹ Information supplied by Lead Bank Manager, Lead Bank Office, United Bank of India, Silchar, Assam during the field survey of the study.

Table-8: Position of Priority and Non-Priority Sector NPAs of Commercial Banks
(Amount Rs in Lakhs)

Year	NPAs (Rs.)	Priority sector advances (Rs.)	Non-priority sector advances (Rs.)	NPA per branch (Rs.)	Priority sector advances per branch (Rs.)	Non-priority sector advances per branch (Rs.)
1998	538.2	7245	5135	5.9	79.6	56.4
1999	699.8	8185	4758	7.5	88.0	51.1
2000	761.8	8310	4608	5.8	89.3	49.5
2001	829.9	8720	6412	5.5	91.7	67.5
2002	1154.9	9135	6644	12.1	96.2	69.9
2003	1016.2	9753	8466	10.6	102.7	89.1
2004	1997.5	9980	9754	22.0	120.7	87.9
2005	3686.9	12780	9831	30.6	132.9	121.0
2006	2976.2	14328	10895	28.5	186.0	113.9
2007	5143.0	16453	11342	48.4	231.0	128.6

The results are summarized here under –

$$r_{ab} = 0.742.$$

$$\text{'t' value (cal)} = 3.123$$

$$\text{'t' value (tab) at 8 d.f.}$$

$$1 \text{ pc} = 2.896$$

$$5 \text{ pc} = 1.860$$

$$r_{ac} = 0.65$$

$$\text{'t' value (cal)} = 2.404$$

$$\text{'t' value (tab) at 8 d.f.}$$

$$1 \text{ pc} = 2.896$$

$$5 \text{ pc} = 1.860$$

8.5. Factors Influencing Priority Sector Lending by commercial banks:

The above analysis, therefore, shows that the bank credit support to priority sector is not satisfactory. Thus, it is very important to identify the factors affecting bank financing of priority sector. For this we have used regression analysis considering independent variables like percentage of overdue in priority sector, interest rate, performance of banks measured with Credit-Deposit (C/D) ratios, credit delivery centers, ie, branch expansion of banks and volume of business (deposit plus advance). The following multiple regression model has been employed for this purpose.

$$Y_t = \beta_1 + \beta_2 X_1 + \beta_3 X_2 + \beta_4 X_3 + \beta_5 X_4 + \beta_6 X_5 + U_t$$

where,

Y_t is the deployment of bank credit to priority sector.

X_1 is the percentage of overdue in priority sector.

X_2 is the interest rate

X_3 is the performance of credit delivery institution ie. C / D ratio

X_4 is the bank branch expansion.

X_5 is the volume of business (deposit plus advances) of banks.

U_t is the error term.

β_1 is the intercept.

β_i ($i = 1,2,3 \dots\dots 6$) is the regression coefficients.

The result obtained from the regression analysis is summarized in table-10.

Table - 9: Regression Summary of Independent Variables

Independent variables	' β ' value	't' stat	S E	F	R ²	Adjusted R ²
Intercept (β_1)	-	-				
Percentage of overdues (β_2)	0.1822	1.6280	0.0129			
Interest rate on credit(β_3)	0.0031	0.0006	0.0192	167.572	0.97306	- 0.865
Credit/Deposit ratio(β_4)	0.1983	5.1732	0.0035	(000 ^a)sig.		
Branch expansion of banks(β_5)	0.0252	2.5112	0.0093			
Volume of business (β_6)	- 0.3610	-1.1201	0.0253			

The analysis relating to determinants of PSL by banks shows a high degree of explanatory power ($R^2=0.973$). This indicates 97 per cent variation in the bank financing of agriculture in the district is explained by independent variables. It is further confirmed by 'F' ratio which turned to be statistically significant. This implies that the independent variables like mounting over dues, interest rate, credit-deposit ratio, branch expansion and volume of business are the perfect determinants of dependent variable viz., priority sector advances. The β (beta) value of mounting over dues, C/D ratio, and branch expansion are positive and statistically significant. However, the β coefficient of interest rate is positive and of business volume of bank is negative, but both are not statistically significant. The aforesaid analysis indicates that two factors viz., mounting overdues and C/D ratio, out of five identified factors are the most affecting factors of deployment of bank credit to priority sector. Higher recovery ensures bank to endorse higher quantum of credit to priority sector. The stumpy performance intensity of credit delivery institutions, ie, unhealthy C/D ratio, does present an impression that flow of credit to priority sector has come down substantially despite various measures undertaken. The adequacy of credit delivery centers i.e., branch expansion of banks, is also a credit supporting variable to activities relating to small business entrepreneurs and agricultures. It may be suggested that there should be proper recovery of loan amount from loanee in order to restore the performance of commercial banks in the area under study other wise banks would face liquidity crisis for recycling the fund.

9. Recommendation for Future Research:

The shrinking share of real priority sector, neglect of agriculture, falling number of accounts across the different categories of priority sector, loan recovery mechanism etc are some of the serious issues which need immediate attention of the policy makers. The overall discussion on priority sector advances by commercial banks is developed using secondary data. However, the analysis of priority sector NPAs in the study area viz, Barak valley has not been included due to non availability of information, rather the analysis in the paper is based on the interrelationship between the quantum of NPAs and quantum of PSL. The obtaining of such information is an imperative step for future work and, as such, would make an important contribution to this pivotal field.

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