



Impact of priority sector lending on socio-economic development in Shimoga City: A case study of selected public sector banks

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Abstract

Priority Sector Lending (PSL) serves as a vital institutional mechanism designed to channel credit into historically underserved segments of the economy, including agriculture, micro-enterprises, and education. By ensuring targeted financial access, PSL fosters inclusive financial growth, reduces regional disparities, and empowers marginalized communities. Ultimately, this structured deployment of bank credit acts as a powerful catalyst for grassroots socio-economic development, driving poverty alleviation and sustainable infrastructure development. This exploratory and analytical case study examines the impact of Priority Sector Lending (PSL) on the socio-economic development of Shimoga City, Karnataka, focusing on SBI, Canara Bank, and Bank of Baroda. Utilizing a mixed-methodology approach with a sample of 100 respondents, the research evaluates the effectiveness of targeted credit, segment-wise Non-Performing Assets (NPAs), and regional development goals. The findings aim to provide insights into banking credit efficacy, asset quality, and institutional lending's role in inclusive growth.

Keywords: Democracy, election and electioneering, election financing

Introduction

India is the second largest populous country in the world with a population of 135.26 crores people by the end of the year 2018. The independent India has inherited several problems like poverty, unemployment, and regional imbalances. Hence, the prime duty before the rulers of independent India was to overcome these problems and to lead the country towards progress. The per capita income is quite negligible compared to other developed countries and thus India is classified as an underdeveloped economy at the time of independence. Since the process of development has initiated now, it is being classified as developing economy according to U.N. definition. A developing country is considered as less developed country, if it is in the condition of low living standard, underdeveloped industrial base and low Human Development Index when compare to the other countries. Further, low per capita income, heavy population, low technology levels and illiteracy are directly responsible for the poor state of the country on the one side and the political, economic, and social factors are indirect hindrances on the other side.

Study background

The theoretical framework for Priority Sector Lending (PSL) centres on correcting market failures, where commercial banks often ignore high-social-impact areas like agriculture and MSMEs in favour of high-return sectors. This intervention is designed to maximize social welfare and ensure inclusive growth, often resulting in PSBs operating with a dual mandate of financial profitability and social development, creating a conflict analyzed through agency theory and public choice theory. Furthermore, this approach sits at the intersection of development economics, which views directed credit as an economic catalyst, and financial repression theories, which argue such measures can misallocate capital and cause operational inefficiencies. Priority Sector Lending (PSL) corrects market failures where banks, facing information asymmetry and high risk, underfund agriculture and small enterprises, necessitating

government intervention to maximize social welfare over private returns. The debate contrasts developmental state theory, which views directed credit as essential for equitable growth, with financial repression theory, which argues that mandated quotas distort market mechanisms and cause inefficiencies. Public sector banks operate under a dual mandate that often leads to high transaction costs and a failure to adequately price risk, leading to elevated Non-Performing Assets (NPAs). For further context, these theories can be explored in academic literature on development economics and financial regulation.

Priority Sector Lending is an arrangement which is planned to provide a loan to the imperative sectors of the economy like agriculture, small scale industries, social infrastructure, renewable energy, and education etc. By the priority sector lending maximum credit flow is ensured to the last person of the last village in the country by maintaining strong banking networks. Here, the priority sector targets, and sub targets are fixed to have a better flow of credit to the sectors would normally not get enough financial support. Priority sector lending is envisioned to achieve the following objectives:

- a. To Increase the production of agriculture and allied activities.
- b. Ensure the better standard of living of the people.
- c. To develop rural and non-farming sector.

Components of Priority Sector Lending by the Public Sector Banks

The components of Priority Sector Lending by Public Sector in Banks are discussed as below:

1. **Agriculture:** Under priority sector lending, public sector banks are lending credits to agriculture and its different activities. That includes the three sub-categories viz. Farm credit, Agriculture infrastructure and Ancillary activities. The regulations include:
 - a. Short term loans for raising crops are provided directly to the farmers. Against pledge/hypothecation of agricultural produce advances up to ₹ 5,000 are

provided but, it should not exceed three months. Further crop loans are provided both in short- and long-term basis, this will help farmers in fulfilling production and development needs.

- b. Advances for purchase of agricultural implements and machinery, purchase of trucks, bullock carts and other transport equipment's, purchase of plough animals. Development of irrigation through construction of shallow and deep tube wells, tanks etc., purchase of drilling units, constructing, deepening, and cleaning of surface wells, boring of wells, electrification of wells, purchase of oil engines and installation of electric motor pumps, construction of lift irrigation project, installation of sprinkler irrigation system.
- c. Financial assistance is provided under the scheme of reclamation and land development, moreover the scheme includes budding of farmlands, levelling of land, terracing, conversion of dry paddy lands into wet irrigated paddy lands, development of farm drainage, prevention of salinity of soil lands, reclamation of ravine lands, purchase of bulldozers etc.
- d. Construction of farm buildings like bullock sheds, implement sheds, farm stores etc. Construction and running of storage facilities like warehouse, godowns, silos and cold storages. Loans are provided for Production and processing of hybrid seeds of crops.
- e. Financial assistance is provided for Payment of charges for hired water from wells, tube wells and canal water, maintenance and upkeep of oil engines and electric motors, payment of labour charges, electricity charges, marketing charges, service charges to custom service units, payment of Development cess etc.
- f. Short-term loans are provided to non-traditional plantations and horticulture and for allied activities like dairy, fishery, piggery, poultry, beekeeping etc. Medium and long-term loans for all plantations, horticulture, forestry and allied activities like dairying and animal husbandry, fisheries, poultry, piggery etc. in all their aspects and development and maintenance of stud farms, sericulture etc.

2. **Micro-Small and Medium Enterprises:** Small-scale units are the industries which engaged in the manufacture, processing, and preservation of goods by having investment in their plant and machinery (original cost) not more than ₹ 35 lakhs. Further, it includes the units which engaged in mining or quarrying, servicing, and repairing of machinery and ancillary units with investment in plant and machinery (original cost) not more than ₹ 45 lakhs. Moreover, priority sector lending is providing indirect finance to the medium and small-scale industrial sector. Further, public sector banks provide credit to agencies who aids with supply of inputs and marketing of outputs of artisans, village and cottage industries etc. and loans are provided to setting up of industrial estates and credit to Government sponsored organizations that provide funds to weaker sections of the society.

3. **Export Credit:** During the pre-reform period though export credit was considered as a part of priority sector, it was not included for the purpose of lending targets to be achieved by the banks. Export Credit to SSI was included under SSI and concessional interest was considered for export credit. Export credit began to be considered as a separate category of priority sector from 1992, but only for foreign banks. Sub target of 10 percent of credit to export for foreign banks was fixed and shortfall was to be deposited with SIDBI for one year at an interest rate of 10 percent per annum (April 1993). This interest rate was later reduced to 8% per annum in (September 1994). Export credit sub-target under the priority sector for foreign banks increased to 12 percent to be achieved by March 1997 (November 1996). This sub-target of 12 percent of the net bank credit is continued till present.

4. **Education:** Education loans become a popular method of funding higher education in India with the cost of education degrees going higher. Educational loans include loans and advances granted to individuals for educational purposes and all advances granted by banks under special schemes for this purpose.

5. **Housing:** Direct finance to housing includes loans up to ₹ 5,000/- for construction of houses granted to scheduled castes/scheduled tribes and the weaker sections of the society irrespective of DICGC coverage and indirect finance include assistance given to any Governmental agency for the purpose of constructing houses exclusively for the benefit of scheduled castes/scheduled tribes and low-income groups and where loan component does not exceed ₹ 5,000/- per unit. Assistance to any Governmental agency for slum clearance and rehabilitation of slum dwellers subject to loan component below ₹ 5,000/- also to be considered under the indirect finance to housing.

6. **Social Infrastructure:** Under this head bank loans up to a limit of ₹ 5 crore per borrower for building social infrastructure for activities namely schools, healthcare facilities, drinking water facilities and sanitation facilities (including loans for construction of toilets and improvement in water facilities in the household).

7. **Renewable Energy:** Under this head bank loans up to a limit of ₹ 10 crores to borrower for the purposes like solar based power generators, biomass-based power generators, wind mills, micro-hydel plants and non-conventional energy based public utilities.

8. **Other Priority Sector:** Other priority sector includes Small Road and Water Transport Operators (SRWTO), Retail Trade, Small Business, advances to Professional and Self-Employed Persons, etc. Banks are providing loans and advances to these sectors too.

Literature Review

A study of the literature collected on the topic of the present study has revealed that a number of studies have been undertaken and completed, in the past, on different aspects of priority sector lending such as concept of priority sector lending, role and performance of public sector banks,

priority sector lending and non- performing assets, etc., in different parts of the world including India by many academicians, administrators, committees and researchers. The major literatures are reviewed as below:

Begum Syeda Musfia (2002) ^[1] examined the impact of priority sector lending. The study aims at analyse the quantum, share and effectiveness of priority sector lending and problem faced by bank to assess the impact of lending, 300 beneficiaries and 112 bank officials were selected as a sample size in the study area. The researcher recommended that banks in all the district come forward to achieve the balanced growth in disbursement of credit under the Mission made approach for reduction of inter- district disparity. Mutual cooperation and cordial relationship between banker and borrower as well Government agencies are the essence of success of any lending schemes. R.K Uppal (2009) ^[2] conducted to analyse priority sector advances by public, private and foreign banks. The study found that public sector bank has not achieved the target, private sector bank achieves the target except 10% target for weaker section and even foreign bank also achieved overall target. NPA of the bank have increased year by year because huge lending to priority sector lending. Lending to priority sector is going to create many problems such as High NPA'S, Low profitability, transaction cost many suggestions is gives for recovery of non-performing assets. Kajal Chaudhary and Monika Sharma (2011) ^[3] analyzed how efficiently public and private sector banks have been managing NPAs and it is come to an understanding that there is a huge difference of NPAs in private banks and public banks. The study has suggested that Banks need to follow the RBI norms and offer facilities to the borrowers as per the RBI norms and banks are required to reduce the interest rates by that borrowers will not feel burden on repayment and there is a chance of regular repayment of loans. Namita Rajput *et al* (2011) ^[4, 5] made an analytical study opined that level of non-performing assets in the banking sector can majorly affect the economy if NPAs are not properly taken care, it can lead to the financial and economical degradation. Secondary data has been collected with the objective to trace the movement of NPAs in Indian Public sector banks through their financial performance and the composition of NPAs in the stream of financial years shows rise in the proportion of the priority sector NPAs as the amount of NPAs has not found to decline, there is a requirement of Government interventions to curb the misuse of the lending policies and sufficient control measures need to be taken.

D. Ganesan and R. Santanakrishnan (2013) highlighted the non-performing assets are threatening the stability of the bank as well as demolish banks profitability through the loss of income and provision against the losses. This paper effort has been made to evaluate the NPA of SBI for the period of 2002 to 2012. Najmi Shabbir (2013) made a study on region wise priority Sector Advances. To know the region wise priority sector advances, region has been divided into six region viz Eastern region, Central region, southern region, northern region, north eastern region. The study concludes that region wise share of priority sector lending was highest in southern region and northern region occupied the lowest position. The reason is poor performance of regional wise share is because of worldwide recession in financial sector. Chandan Tiwari and Vivek Sharma (2015) ^[7] used Friedman test in their study to assess the causes of NPA and finds that

causes of NPA are fraudulent approach of borrower, non-availability of reliable market study to credit officer, submission of unrealistic project by the borrower, lack of critical presentation appraisal. Jaspreet Kaur and A.S. Arora (2015) ^[8] examined that the share of priority sector advances in total advances, sector wise growth of priority sector advances, share of NPAs in overall priority sector advances are calculated from 2001 to 2013. Their analysis reveals that share of NPAs is arises in private sector banks more compared to public sector banks. The outcome of this study reveals, the growth rate of NPAs in priority sector advances is more in private sector banks compared to public sector bank.

K.M Shahajahan (2017) ^[9] perceived that priority sector bank lending as an active instrument in our financial policy with an aim to restore sectional balance within the credit disbursement and to disburse credit to the weaker section within this sector. The author has however observed that banking reforms initiated as part of the priority sector lending policy to halt. G. Narayana Swamy and N. Gopinathan (2020) ^[10] evaluated the Effect of sectorial Advances on priority sector and non-priority sector NPA in ICICI bank. The study concentrates on how sector wise lending affects NPA in priority sector and non-priority sector. For the analysis, data has been collected from ICICI annual report for a period of six years. The regression and correlation analysis were used for analysis of data. The study finds that NPA in non- priority sector are contributing on average 93.27% in total NPAs and only 6.76% from priority sector NPA. In priority sector industrial sector has the major contribution to NPA. The study recommends that bank need to give maximum preference to priority sector and strengthen rules and procedure of issuing loans to non – priority sector

Research Gap

In view of this for the study more than 85 research works have been found and few studies have been reviewed. It is identified that most of the studies concentrated on all the major components of Priority sector lending that is Agriculture, SSI, and education but no studies have addressed all the components of priority sector lending, its function, success and its contributions to the overall development of the society. Further, the studies are referred to only certain bank/branch in some part of the country and taken only the perseverance of banker or customer. Hence, the present study is an attempt to fill the existing gap by analyzing policies and procedures of different public sector banks in the perspectives of customer.

Objectives of the Study

The study has been developed on the following two objectives:

1. To evaluate the impact of loan on priority Sector Lending in Public Sector Banks,
2. To assess the segment-wise Non-performing Assets in Public Sector Banks, and
3. To review the goals achieved through Priority Sector Lending.

Materials and Methods

The present study is exploratory, descriptive, and analytical in nature. The study is based on both quantitative and qualitative methodologies to investigate among different

paradigms hypothesized. Simple random sampling method has been used in the study. The sample size is 100 composed of bank officials and customers. The study is confined to Shimoga city of Karnataka State. Study covers SBI, Canara and Bank of Baroda Banks. MS excel and SPSS 21 was used for the purpose of data analysis.

Results and Analysis

The following tables objectively presents the facts and empirical data without personal interpretation:

Table 1: Impact of loan on priority Sector Lending

Impact of loan on priority Sector	WeightedAverages				Primary impact type
	Impact Statement (Variables)	SBI	Canara	BOB	
It affects the profitability of the bank	Possible to achieve financial inclusion	1.85	1.73	0.62	Socio-economic Opportunity
it accounts for huge-non-performing assets in banks	Government interference more	1.71	2.03	2.12	Operational Challenge
Government interference more	It accounts for huge NPAs in banks	2.71	2.01	2.5	Operational Challenge
It increases transaction cost	It increases customer base in banks	-0.42	1.43	1.56	Socio-economic Opportunity
There is liquidity crisis for recycling of credit	Promotes channelization of savings into investment	-1.42	2.00	2.00	Socio-economic Opportunity
It effects on maintain of CRR and SLR in bank	Increases sources of funds/ profitability	-1.42	2.15	1.18	Socio-economic Opportunity
It employs our workforce	It employs our workforce	1.57	1.41	1.5	Socio-economic Opportunity
It increases customer base in banks	It affects the profitability of the bank	1.28	1.98	2.5	Operational Challenge
Possible to achieve financial inclusion	There is liquidity crisis for recycling credit	2.28	2.13	2.62	Operational Challenge
Increases the sources of funds/ profitability in our bank	It increases transaction cost	0.71	1.51	2.31	Operational Challenge
Promotes channelization of savings into investment	It effects maintenance of CRR and SLR	1.00	2.11	1.75	Operational Challenge

Source: Field Survey

Note: Weighted Average Score is the Average of respondents' opinion of Strongly Agree, Agree, Neutral, Disagree and Strongly Disagree

From the above table, it can be understood that:

- Financial Inclusion & Customer Growth: All three banks strongly agree that PSL is a highly effective vehicle for financial inclusion (Highest overall segment score: 2.34). Bank of Baroda respondents are the most enthusiastic about this aspect (2.62), alongside a significant acknowledgment of expanding the bank's customer base (2.50).
- Macro-Economic Channelization: Respondents broadly agree that PSL successfully directs idle rural or semi-urban savings into formal investments (Average 1.62), driven heavily by Canara Bank's positive outlook (2.11).
- The Bureaucracy Burden: "Government interference more" emerged as the strongest consensus across the dataset (Highest individual average: 2.41). SBI respondents feel this pressure most acutely (2.71), followed closely by BoB (2.50).
- The NPA Distress: There is deep, shared concern regarding asset quality. Respondents strongly agree that PSL leads to huge Non-Performing Assets (NPAs) (Average 1.95). Bank of Baroda (2.12) and Canara Bank (2.03) show the highest anxiety regarding bad loans generated through mandate-driven lending.
- Liquidity and Recycling of Credit: While Canara Bank and BoB agree that PSL creates a liquidity crisis for credit recycling (both scoring 2.00), SBI respondents strongly disagree (-1.42). This indicates that SBI's colossal capital base allows it to absorb the long maturity cycles of priority sectors effortlessly.
- CRR, SLR, and Transaction Costs: SBI respondents indicate that PSL does not hamper their regulatory reserve compliance (-1.42) or spike transaction costs (-0.42). Conversely, Canara Bank (2.15) struggles significantly with reserve maintenance due to PSL allocations.

- There is a striking disagreement on how PSL impacts the bottom line. SBI and Canara Bank feel that PSL notably hurts profitability (scoring 1.85 and 1.73 respectively).
- Meanwhile, Bank of Baroda views PSL as a driver to increase profitability and fund sources (2.31), while strongly disagreeing that it has an adverse effect on general bank profitability (0.62). This implies BoB has successfully commercialized its priority sector products into high-margin or cross-selling opportunities.

Table 2: Segment Wise NPAs

Segment Wise NPAs	Weighted Averages		
	SBI	Canara	Bank of Baroda
Agriculture Loan	3.00	1.96	2.50
Housing Loan	-1.57	-0.31	-1.68
Education Loan	0.14	0.53	0.25
Small Scale Industry	1.57	1.30	2.37
Professional and Self employed	-0.14	1.41	1.37
Self-Help Group	-1.00	0.00	-0.62
Retail Trade	0.71	0.26	-0.12
Other Priority Sector	-0.57	0.55	0.50

Source: Survey Data N=164 Multiple Response Allowed

From the above table, it can be analyzed that Agriculture loans and Small-Scale Industries (SSIs) drive the highest perceived Non-Performing Assets (NPAs) across State Bank of India (SBI), Canara Bank, and Bank of Baroda, while Housing loans consistently show the lowest NPA risk according to respondent opinions. Because weighted average scores typically span from -3 (Very Low NPA) to +3 (Very High NPA) based on the qualitative scale, positive numbers indicate heightened concern and negative numbers indicate a safe, low-risk perception. The details are discussed as below:

- **Small Scale Industry (SSI):** SSIs represent a consistently high NPA risk profile. Bank of Baroda shows the highest anxiety here at 2.37, with SBI at 1.57 and Canara Bank at 1.30. Small businesses face high market volatility, leading to these elevated risk perceptions.
- **Housing Loans:** This segment is perceived as the safest across the board. SBI (-1.57) and Bank of Baroda (-1.68) show strong negative scores, indicating a "Very Low" to "Low" NPA risk. Canara Bank is also negative (-0.31), reflecting the secured nature of residential real estate assets.
- **Self-Help Groups (SHGs):** SBI manages this segment exceptionally well with a score of -1.00 (Low NPA risk), and Bank of Baroda stands at -0.62. Canara Bank sits at a perfectly neutral 0.00, indicating a highly stable repayment environment for community-led lending.
- **Professional & Self-Employed:** SBI stands out positively here with a negative score (-0.14), implying tight risk controls. Conversely, Canara Bank (1.41) and Bank of Baroda (1.37) experience much higher perceived NPA stress in this category.
- **Retail Trade:** Respondents view Bank of Baroda's retail trade favorably (-0.12), whereas SBI (0.71) and Canara Bank (0.26) lean toward elevated risk.

Table 3: Goals Achieved Through Priority Sector Lending

Goals Achieved Through Priority Sector Lending	Weighted Averages		
	SBI	Canara	BOB
Eradication of poverty	0.14	0.83	2.12
Upliftment of weaker section	1.85	1.56	2.25
Reduction of unemployment	0.85	1.10	2.00
It leads to growth of industrial Sector	0.85	1.70	2.62
Socio-economic growth	2.28	2.00	2.62
Creation of employmentOpportunity	2.57	2.13	2.37
Branch expansion in rural areas	2.42	1.70	2.25
Creation of women entrepreneurs	2.57	2.00	2.75
Growth of agriculture sector	2.28	2.13	2.12
Assistance given for export	-1.14	1.85	0.25
Increases per capital income	-0.57	1.70	0.37
Upliftment of living standard	1.85	1.85	1.50
Social responsibility	2.42	2.16	2.25

Source: Field Study

From the above table, it can be analyzed that Socio-economic growth, the creation of women entrepreneurs, and employment generation are perceived as the most successful goals achieved through Priority Sector Lending (PSL) across all three banks. Because these weighted average scores are based on a qualitative agreement scale (typically mapping from +3 for Strongly Agree to -3 for Strongly Disagree), higher positive values signify robust respondent consensus that the goal is being successfully met. Negative values indicate areas where the policy is failing to deliver. The details are discussed as below:

- **Agriculture Loans:** This is a major pain point for all three banks. SBI leads with a maximum score of 3.00 (Very High NPA perception), followed closely by Bank of Baroda (2.50) and Canara Bank (1.96). This reflects

widespread concern over structural issues, crop failures, or loan waivers impacting farm repayments.

- **Small Scale Industry (SSI):** SSIs represent a consistently high NPA risk profile. Bank of Baroda shows the highest anxiety here at 2.37, with SBI at 1.57 and Canara Bank at 1.30. Small businesses face high market volatility, leading to these elevated risk perceptions.
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- **Retail Trade:** Respondents view Bank of Baroda's retail trade favorably (-0.12), whereas SBI (0.71) and Canara Bank (0.26) lean toward elevated risk.

Discussion

- **SBI (State Bank of India):** Exhibits extreme polarization. It has the absolute worst perceived risk in Agriculture (3.00), yet showcases superior risk management in Housing (-1.57) and Self-Help Groups (-1.00). As per specific performance strategy is concerned, excels dramatically at direct, localized target achievements like building rural branch infrastructure (2.42), fueling employment (2.57), and supporting women entrepreneurs (2.57). However, it falls drastically short on broader macroeconomic goals, completely failing to impact Export Assistance (-1.14) or Per Capita Income (-0.57).
- **Canara Bank:** Tends to cluster closer to the neutral baseline across most segments. However, it struggles heavily compared to peers in the Professional and Self-Employed sector (1.41). As per specific performance strategy is concerned, maintains a highly balanced and uniform profile. It does not hit the extreme highs of its competitors in core social areas, but it acts as a critical engine for specialized corporate/macro elements like Export Support (1.85) and Industrial Growth (1.70).
- **Bank of Baroda:** Faces intense pressure in industrial and rural sectors, scoring poorly in both Small-Scale Industries (2.37) and Agriculture (2.50). Conversely, it commands the safest borrower profile for Housing (-1.68). As per specific performance strategy is concerned, commands the most uniformly positive sentiment. It scores above 2.00 on almost every single

development goal, marking its PSL pipeline as highly impactful in the eyes of respondents particularly for alleviating poverty and expanding small industrial growth.

Conclusion

The comprehensive analysis of Priority Sector Lending (PSL) across the three major public sector banks reveals a profound structural paradox: the sectors that achieve the highest developmental milestones are also the primary drivers of financial risk. Respondents heavily agree that PSL initiatives have successfully driven foundational social changes, particularly through the creation of women entrepreneurs, employment opportunities, and overall socio-economic growth, with Bank of Baroda leading the sentiment across most macro-developmental goals. However, this aggressive deployment of credit comes with significant costs. Agriculture and Small-Scale Industries (SSIs) emerge as severe Non-Performing Asset (NPA) hotspots across all three institutions, with SBI facing the highest perceived loan distress in agriculture despite its stellar record in rural branch expansion and job creation.

In terms of institutional strategy, each bank exhibits a distinct operational profile. SBI displays a highly polarized risk-and-reward ecosystem, demonstrating outstanding success in localized social metrics like community empowerment and housing loan safety, but suffering severe friction in agricultural asset quality and macroeconomic metrics like export assistance. Canara Bank maintains the most uniform and stable profile, mitigating risk by keeping its numbers close to the neutral baseline while serving as a vital engine for specialized corporate segments like exports. Meanwhile, Bank of Baroda commands the most robust positive sentiment regarding developmental outcomes—such as poverty eradication and industrial growth but it simultaneously carries the heaviest burden of perceived credit risk within the small business sector. Ultimately, while PSL successfully fulfils its mandate as a vehicle for equitable national growth, the data highlights an urgent need for these banks to implement sharper credit risk frameworks and monitoring mechanisms to safeguard their balance sheets without diluting their social responsibilities.

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