International Journal for Multidisciplinary Research (IJFMR)
E-ISSN: 2582-2160 ● Website: www.ijfmr.com ● Email: editor@ijfmr.com

Directed Lending System in India: A Review

Shanu Tyagi[1], Dr. Neha Goyal[2]

[1]Research Scholar, Department of Management Studies, JC BOSE UST, YMCA, Faridabad
[2]Assistant Professor, Department of Management Studies, JC BOSE UST, YMCA, Faridabad

Abstract
Directed Lending has grown in significance since the nation's banks were nationalized. Commercial banks' Directed lending quotas have given birth to a significant instrument for distributing capital to self-employment programs, small businesses, and farmers. Priority sector requirements mandate that scheduled commercial banks lend forty percent of their total loan volume to the designated directed sectors in accordance with RBI directions. Over the years, the RBI has implemented numerous modifications to the standards for Directed Lending. The issue of NPA is not exclusive to Indian public sector banks; it is prevalent across the whole banking sector. A significant proportion of non-performing loans in Indian banks originated from credit to the directed sector under the influence of officials in charge of government. Had banks adequately supervised their credits, the issue of bad debt might have been controlled, if not eradicated. To determine how effective and efficient banks were, the majority of researchers relied on the DEA model. Fixed and random effect model, t test, Tobit regression, CCR, BCC are used to get the desired result. It is also found in different studies that there is one major issue, which is NPA. In this study, we try to find out the reasons and suggestions regarding NPA.

KEYWORDS: Directed Lending, NPA (Non-Performing Assets), DEA model, PSL, CAGR

1. Introduction

Financial institutions play an essential role in driving economic growth, and the significance of bank loans in this process cannot be overlooked. In order to address poverty and promote fair income distribution, the Reserve Bank of India (RBI) has implemented different lending arrangements, one of which is known as Priority Sector Lending. In 1967, Sri Moraji Desai used the terminology of priority sector. In 1968, the bank's credit priorities were overseen by the National Credit Council because, before nationalization, no importance was given to agriculture. Earlier in PSL, there were only 2 sectors, which were agriculture and SSI. In November 1974, there were no predetermined objectives established for priority sector loans. In March 1979, public sector banks were instructed to ensure that at least one-third of their credit was allocated to direct lending. In November 1978, a directive was issued to PSBs, mandating that they contribute a minimum of thirty-three percent of their total advances to the directed sector by the last day of March 1980. Later on, the aim was increased to 40% of the total amount of advances. The government of India directed all foreign banks doing business in the country to lend a minimum of 15% of their Net Bank Credit (NBC) to the priority sector by the end of 1992. In April 1993, the percentage was increased to thirty-two percent of NBC, with the goal of reaching this target by March 1994. As of April 30, 2007, the directed lending goal and sub-target are now connected to ANBC or credit equivalent amount of off-balance sheet exposures, whichever is greater, according to the amended rules on credit to the directed sector. The priority areas encompass agricultural, micro, small, and medium enterprises (MSMEs), educational loans, housing loans, export credit, social infrastructure, small companies, and vulnerable segments of society, among others. The RBI periodically releases recommendations to promote financial inclusion in various industries. In keeping with this, the RBI has just announced new rules on September 4, 2020. The new PSL standards were implemented with the aim of enhancing loan access in areas with limited credit availability. In the revised guideline, the major change is in the foreign bank's target from 32% to 40%. The redesigned priority sector recommendations place greater emphasis on the advancement of agriculture, MSMEs, and marginalized parts of society. According to the categorization RBI, as of 31 March, 2004, loan accounts that have not made any interest or principal payments for a minimum of 90 days are referred to as NPA. Our banks' NPA level is elevated in comparison to global benchmarks. NPA's biggest reason is low profitability due to Priority Sector Advances.

2. Literature Review

Uppal (2009) discovered in his research that foreign banks have achieved the SSI's export credit and its overall objectives. PSB failed to meet the objective set by the RBI, which was 40%. Private sector banks (PVB) achieved their overall objective, but did not reach the 10% target for lending to the economically disadvantaged segment. The non-performing assets (NPAs) of public sector banks have increased due to their growing loans to the priority sector. The reason behind growth in Non Performing Assets (NPAs) at PSB can be attributed to the high level of priority sector advances. In his article, he also emphasized important concerns like inadequate profitability, high NPA, government involvement, transaction costs, and other challenges that come from Directed lending. Additionally, he provided suggestions to address these difficulties. The key implication of this research is that the RBI should take tough action against these banks that fail to provide priority sector credit adequately. The RBI should have restructured priority sector lending.

Kaur et al.(2022) aimed to examine the trends and performance patterns of PSL across India, with a focus on Punjab, from 2004-05 to 2017-18. In India and Punjab, the banks with more than 50% shareholding by government and private sector banks were compared, and the influence of the crisis period on PSL was investigated sector by sector. CAGR has been utilized to examine the lending patterns of India's Priority Sectors and Punjab. The Kruskal-Wallis test was used to examine bank-group differences and to distinguish clearly between the performance of the banks with more than 50% shareholding by government and private banks in India and Punjab. This research examines trends and performance, identifies issue areas, and makes policy recommendations to increase lending to key industries. Bank morale may be raised by awareness campaigns among bank employees, as well as the establishment of certain extra rewards by the RBI for exceptional achievements in the industry. This method aims to motivate staff through positive reinforcement rather than punishment.

Ota & Sarkar (2016) conducted a comprehensive study delineating the concept of Priority Sector Lending (PSL) and examining the pivotal role played by the banking sector in India. The investigation specifically focused on analyzing the impact of PSL initiatives on the economic development and growth of rural India.

S. Kumar et al.(2020), conducted a 12-year study from 2005 to 2016 to assess the impact of Priority Sector Lending (PSL) and Non-PSL Non Performing Assets on the overall Non-Performing Assets (NPAs) of public sector banks in India. Calculated the Compound Annual Growth Rate (CAGR) of outstanding lending to priority sectors for both public and private sector banks, revealing that private sector banks exhibited higher PSL lending. The study suggested that resetting PSL targets based on individual business strategies could enhance banks' ability to achieve their objectives more effectively. Examined the performance of priority and non-priority sectors using factors such as sector-specific growth of PSL, sector-specific PSL performance, and the ratio of NPAs in total PSL. Utilized data analysis techniques including simple percentage, yearly growth rate, and Compound Growth Rate (CGR), followed by Correlation analysis and Paired t-test. The findings indicated that during the research period, both public and private sector banks did not consistently meet all their PSL targets.

Mohit & sharma mamta(2019) had been carried out to examine the total Directed lending and sector-specific lending of private and public sector banks. Furthermore, non-performing assets at the overall and sectoral levels have been identified. It is based on secondary data obtained in 2017 and 2018. According to this research, the amount of Directed lending in the case of the banks with more than 50% shareholding by government and private sector banks decreased in 2018 compared to 2017.NPAs, on the other hand, rise in 2018 for both categories of banks when compared to NPAs in 2017.

Bano & Sharma(2020), Under the leadership of Shri U.K. Sinha and Shri M.K. Jain, they analyzed the new Priority Sector Advances guidelines announced by the RBI on September 4, 2020. They discussed different adjustments that have been made in Priority Sector Advances in accordance with the new rules. Major issues confronting the priority sector, such as agricultural finance issues, processing time and costs, and NPA issues, were also highlighted. After analyzing these recommendations, it was determined that more attention was placed on the weaker section of society.

M. Kumar et al.(2016) conducted a research initiative aimed at scrutinizing the patterns of Directed Lending by banks, with the primary objective of identifying the factors influencing these lending practices. The study is rooted in the analysis of secondary data encompassing lending activities in the priority sector spanning from 1998 to 2014 across 80 Indian banks. Additionally, insights were derived from a survey involving 97 loan officers from diverse banks. The research incorporated secondary data from 80 banks, categorized as 28 public sector banks (including the SBI group and nationalized banks), 20 private sector banks (PVB), and 32 foreign banks, for comprehensive trend analysis. Further, a subset of 46 banks, comprising 27 public sector banks (including the SBI group and nationalized banks), 19 private sector banks, and 18 foreign banks, was utilized for Principal Component Analysis (PCA) and panel regression analysis. The findings underscored disparities in adherence to sector-specific targets among various banking groups, highlighting variations in lending preferences and challenges faced by the banks. The study also pinpointed bank-specific characteristics, including ownership structure, size, performance, and other factors, as significant influencers shaping the trends in Directed lending.

Goyal et al.(2016b) researchers noted in their study that bank personnel exhibit reluctance to grant loans, while consumers encounter challenges when attempting to qualify for loans under the Priority Sector Lending program. The study revealed that the primary reasons for the low preference of Directed Lending among bank officials are non performing assets and retrieval problems, increased workload, political, social, and target pressures. On the other hand, the main factors contributing to the low inclination of clients towards Priority Sector Lending are the behavior of bank officials, lengthy and difficult procedures, bribes, lack of awareness, and diversion of loans. Statistical methods are employed to examine hypotheses and make inferences and conclusions about a relationship. The study inquiry included descriptive analysis, one-way ANOVA, and exploratory factor analysis. After conducting a thorough investigation, many proposals were proposed, which encompassed enhanced monitoring and supervision, stringent legal measures, and intensified recruitment of banking staff.

Dasgupta (2002) had done a comparative examination of the achievements in the Priority Sector, both prior to and during the reform era in 1991. The study's findings suggest that it would be advisable to reduce the obligatory credit requirements across various industries and for different demographic groups. This include those engaged in subsistence farming, small-scale handicraft businesses, microenterprises, and affordable housing for those with little financial resources. Furthermore, it is recommended to offer incentives in order to augment the accessibility of loans for small-scale companies and food crop cultivation. In addition, it is crucial to offer provisional credit in order to guarantee credit accessibility for emerging sectors and occupations in the non-impoverished sector.

Goyal et al.(2016a) the challenges experienced by bank personnel for Agriculture Priority Sector Advances (mandatory credit)were investigated. Data is gathered using a variety of Secondary and Primary resources. A questionnaire was used to obtain primary data from 112 bank personnel. Exploratory Factor Analysis was implemented to analyze the data obtained from bank personnel. According to the findings of the study, bank officials face a variety of issues in the Agriculture Priority Sector Advances field, including: difficult recovery in the Agriculture Priority Sector Advances, a greater workload burden for bank officials, a lot of social, political, and target pressure on bank officials, and little incentive for officials at banks to expand their lending to these sectors. They also addressed various solutions to these issues.

Ibrahim (2016) conducted a study on Regional Rural Banks of India. The intent of this article was to scrutinize and analyze the rural finance and the significance of RRB in priority and non-priority sector landings. This research attempted to assess the rural lending pattern and the purpose of Regional Rural Banks in the growth of rustic economies. Various statistical methods, including Descriptive Statistics, 't'-test, Correlation, and Anova, were used to analyse the data and draw conclusions using EXCEL and SPSS Software. There had been remarkable progress in distributing loans in both the non-priority and priority sectors. The study discovered and concluded that the Regional Rural Banks had considerably boosted the rural economy in India.

Ranjan Mohapatra & Gaur (2019) attempted to compare non-performing assets (NPAs) in the priority and non-priority sectors within India's commercial and public sector banks. In order to obtain the necessary results, statistical techniques such as Compound Annual Growth Rate (CAGR), Regression, and One-way Analysis of Variance (ANOVA) were employed. Based on the calculated Compound Annual Growth Rate (CAGR), non-performing assets (NPAs) in the priority sector increased at a higher pace in private sector banks compared to public sector banks. In addition, there has been a significant disparity in the expansion of loans between the priority sector and the non-priority sector (comprising private and state banks). It signifies that a higher proportion of loans extended by private sector banks to priority sectors are failing to be repaid compared to loans extended by public sector banks. Based on the data, the non-performing assets (NPAs) in the Priority Sector Lending (PSL) are actually higher than the average NPAs in both the PSL and non-PSL combined. The proportion of non-performing assets (NPA) provided by directed lending is equivalent to that of non-directed lending.

Nagarajan et al.(2013) examined the patterns in Gross Non-Performing Assets (NPA) and net NPA of Public Sector Banks (PSBs) for analysis if Priority Sector advances had a major influence on Total Non-Performing Assets of PSB and to determine the effect of Recovery on PSB's NPAs throughout the research period (2002-2003 to 2011-2012). Advanced statistical methods such as ratios, means, and ratio were used to make the study more useful. The findings indicated that there was a decrease in the ratio of gross and net Non- performing Assets of PSB's until 2008-09 and an increase in the subsequent years over the study period, and that there was a decreasing pattern in the ratio of gross and net Non- performing assets of PSBs until 2006-07 and an increase in the subsequent years. Furthermore, the results demonstrated a considerable influence of Recovery of NPAs on overall Non Performing Assets of PSB.

Selvarajan & Vadivalagan(2013) had conducted a research to assess the sectors of Agriculture, SSI, Weaker Section Advances, and other directed lending. Data pertaining to PSL was gathered for Indian Bank and the PSBs collectively over a span of 10 years (2001-2011). A study revealed that Indian Bank's lending expansion towards the directed sector surpasses that of the banks with more than 50% shareholding by government in its whole. Additionally, Indian Bank has higher proficiency in managing Non-Performing Assets (NPAs) compared to Public Sector Banks. Capital owners do not receive a guaranteed minimum profit on their investment, and depositors do not receive a guaranteed minimum return on their deposits. Non-performing loans represent poor investment choices, and they have the potential to negatively impact the banking system and reduce the amount of money available in circulation, which might potentially lead to economic contraction.

Kadiwala, K. A. (2017) done a research to explain the commercial bank's performance in lending to priority sectors. The study's main conclusion was that during the study period (2014–15 to 2018–19), PSL by sample banks fell short of the objective set by the RBI. Additionally, it was discovered that the norms for priority Sector lending to Total lending are not similar across all of the selected banks in India's private sector. The main cons of this research are the narrowly chosen two sectors, the five-year time frame, and the six banks.

Singagerda et al.(2020) employed both regression analysis and descriptive statistics methods to examine long-term financing patterns towards the housing, educational, and renewable energy sectors. Throughout the study phase on the nationalized banks of India, affirmative trend had been seen in the case of overall Directed lending and its several groups, such as housing, education, and renewable energy.

Kundu & Banerjee(2022) compared the performance of public and private banks in India using two efficiency metrics: operational and policy. Data gathered for 19 Public and 16 Private Banks throughout 10 years (2010–19) are analyzed in three stages. To determine the banks' efficiency scores for the two efficiency paradigms, non-radial DEA with slack-based measure (SBM) was employed. It is discovered that PVBs are more operationally effective than PSBs. Instead, PSBs are discovered to be more effective in implementing policy. Older and larger banks of Public sector Banks performed a great job in relations to policy efficiency and operating efficiency. According to the analysis, the suggested merger of Public Sector Banks to create larger banks may be effective.

Gaur & Mohapatra(2021) research had been done to look at the link between Priority sector advances and GDP. The study, which analyzed data from 45 scheduled commercial banks, covered 14 years (2004–2018). The Dumitrescu-Hurlin test had been used to assess the Granger causality between Priority sector advances and GDP. PSL and other parameters' impact on NPA has been analyzed using both static and dynamic panel regression. The dynamic panel has utilized the system generalized methods of moments (S-GMM) methodology. It was discovered that PSL and GDP had a positive connection and a bidirectional causal link. Priority sector advances was discovered to have little impact on the NPA ratio. The results of this study can be used as a guide for bank management and policymakers to lessen their exposure to the problem of loan non repayment.

Desai(2021) conducted a study to categorize the entire PSL into four sub-segments: agricultural, industry, services, and individual lending. Utilized a regression model with panel least squares, incorporating both fixed and random effects, according to this research’s findings, credit to the agriculture sector significantly lowers bank profitability, but lending to the service sector increases the profitability of banks. Profitability was shown to be unaffected by industrial and individual credit. Future study may be done taking market-based performance indicators like Tobin's Q ratio & market size into consideration as it is based on accounting measurements of profitability.

Sharma et al.(2020) found in his study that, as compared to New Private Banks, Public Sector Banks had a much greater level of NPAs. Although the disparity is not statistically important, the annual average of PSB NPAs for the time following the crisis's start is greater than it was for the time before it. However, the post-crisis period's much larger coefficient of variation value suggests an upward tendency throughout this time. The non-priority sector's emergence as the primary reason of the growth in Non performing assets of the Public sector banks throughout the post-crisis era was the study's second important result.

Khati & Mukherjee(2020) Utilized data envelopment analysis, the study assessed the technical efficiency (TE) of India's domestic commercial banks within the timeframe spanning the global financial crisis to the merger of the State Bank of India and its affiliates. The resulting metrics, termed Pareto-Koopmans (PK) measures, were derived from a sample comprising 26 public sector banks (PSBs) and 19 private banks (PVBs) over the period 2010–2011 to 2016–2017. Employing a three-input-three-output technology assumption for both groups, the average PK efficiencies for PSBs and PVBs during the research period were found to be 0.86 and 0.72, respectively. This suggests significant potential for improving the productive performance of PVBs. A breakdown of PK efficiencies into input- and output-specific components revealed that inefficiencies in Public Sector Banks were primarily linked to physical assets, whereas for Private Banks, the main contributing factor was other earnings. In a subsequent second-stage regression study, a non-linear relationship between PK-TE and bank size was identified. Priority Sector Lending (PSL) was found to positively impact PK efficiency, while the deposit to liabilities ratio and management caliber were associated with negative effects.

Kapadia & Madhav(2019) examined the patterns of NPA and the causes of the rise in NPAs in the banking industry. In addition, the requirement for provisions and the high costs of borrowing have resulted in an increase in non-performing assets, which has contributed to a decrease in the profitability of the bank. Poor recycling of funds as a result of inadequate credit deployment is one of NPA's knock-on effects that might pose a risk to the equilibrium of the financial system of the credit system. There are a few steps that must be taken, including the creation of a monitoring department and the reformulation of banks' credit evaluation processes.

Gulati & Kumar(2017) presented a paper on a comprehensive method for evaluating bank efficiency overall and breaking it down into intermediation and operational efficiencies. In order to determine intermediation and operational efficiencies as well as total bank efficiency, the researcher employed two-stage network data envelopment analysis (NDEA). According to the findings, the primary cause of total bank inefficiency in the Indian banking industry is operating inefficiency. An additional noteworthy finding suggests that although public sector banks exhibit greater efficiency during the intermediation phase of the manufacturing process, private sector banks are more effective during the operational phase. The results obtained from the bootstrapped truncated regression analysis suggest that profitability and income diversification have an impact on interbank variations in operating efficiency. Conversely, fluctuations in intermediation efficiency may be accounted for by variables including the scale of the bank, its level of liquidity, directed lending practices, and the expense of intermediation.

Swamy (2019) examined the macroeconomic implications of transaction costs in supporting microfinance by conducting an analysis. The research utilized panel data encompassing various categories of Indian banks, such as public sector banks, commercial banks, and foreign banks, spanning from March 1993 to

March 2009. The methodology involved estimating a panel Vector Autoregressive (VAR) model to identify factors influencing the transaction cost model in financial intermediation. Additionally, the study employed panel Granger causality analysis to evaluate the causal relationship between banks' operational expenditures and their financial intermediation processes. The analysis discloses a significant correlation between operational expenditures and bank lending to priority industries. The results suggest that financial institutions engaged in microfinance intermediation encounter challenges posed by transaction costs. Nonetheless, banks exhibit the ability to address these challenges by raising overall deposit mobilization and expanding their lending activities beyond microfinance. The report makes the recommendation that microfinance intermediaries' operational efficiency be increased.

Martínez-Campillo et al.(2020) assessed the efficacy of Indian Public Sector Banks (PSBs) in extending credit to both priority and non-priority sectors through the application of a novel Network Slack-Based DEA model. This study thoroughly examined the key variables influencing bank efficiency. The results suggest commendable performance by Indian public banks in both priority and non-priority sectors, with a slight edge in social efficiency compared to financial efficiency. Importantly, the commitment to lending in priority sectors has not compromised the profit-oriented objectives of traditional banking services. Factors such as regional prosperity, bank size, branch networks, and rural location exhibit contrasting impacts on the determinants of social and financial efficiency.

3. Reasons of Increasing NPA

- Government interventions
- Diversification of loans
- global crisis
- Necessity of provisions
- High funding costs
- Types and patterns of lending

4. Conclusion

Indian Bank continues to have challenges in effectively managing non-performing assets (NPAs). Hence, it is imperative for the Indian Bank's management to prioritize the management of NPAs and implement effective measures to prevent the accumulation of new NPAs, while also focusing on recovering current NPAs. In order to ensure the bank's future prosperity, prompt action is essential.

According to existing literature, it was found that the proportion of Foreign banks' Directed lending significantly contributes to the nation's economic growth. As earlier, the percentage of PSL by foreign banks was 32% and has now increased to 40%, showing a decent shift of 8%. But the research study in this domain, considering the importance of foreign banks was very limited, which highlights the scope of future research.

Frequently, government intervention in the loan system causes several problems, resulting in the transfer of funds to the wealthy rather than those in need.

Comparing the PSL ratio between PSBs and private sector banks, it was observed that the PSBs lends less according to PSL because it creates high NPAs for them, which they later found difficult to recover. Therefore, they focus more on serving their real purpose and on the formulation and implementation of efficient policies. On the other hand, private banks prefer to spend more on PSL by giving loans randomly and then categorizing them according to PSL sectors.

The issues of non-performing assets (NPA) and recovery can be resolved by the use of rigorous monitoring and supervisory mechanisms. Bank authorities must ensure that there is no misappropriation of loans for purposes other than their intended use.
By revising PSL objectives for banks according to their fundamental business models, they would be able to achieve their targets with more efficiency.
Research on PSL showed that in recent years, more lending by commercial banks was in the agriculture sector, but the profitability rate of banks was hampered due to the lack of recovery in this sector. Few studies focusing on the service sector highlight greater profitability as the rate of recovery is high in this sector. Therefore, to enhance profitability and reduce the NPA ratio, it is better for banks to focus more on the service sector for PSL lending.

Acknowledgements
Each of two authors have contributed to the conceptualization and designing of the study. Preparation of draft manuscript was done by Shanu Tyagi and significant revisions on the manuscript was done Dr. Neha Goyal. All the authors read and approved the final manuscript.

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