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## Empowerment of weaker sections through priority sector lending: A literature review with special reference private sector banks in India

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### Abstract

Priority Sector Lending (PSL) is one of the policy tools developed by the Reserve Bank of India in order to achieve inclusive growth by securing sufficient credit supply to lagging sectors of the economy like agriculture, micro and small and medium enterprises, and weaker members of society. Although the major contribution to the implementation of PSL has always been made by the public sector banks, the banks in the private sector have started playing a major role in the post-liberalization period, using technology and novel methods of delivering their services, and using alternative methods of credit evaluation. This paper will critically examine the available literature on the role of the private sector banks in Priority Sector Lending in particular its contribution to the empowerment of the weaker sections in India. The approach to research taken in the paper is conceptual and descriptive, which is founded solely on secondary research, which includes scholarly journals, reports of the Reserve Bank of India, policy documents, bank publications. The review summarizes important results concerning sectoral allocation, the outreach approach, and the regulatory compliance, and the problems that private banks encounter when meeting PSL requirements. Through the analysis, it is possible to see that the performance in the case of the PSL in the private sector has been enhanced due to digital lending, partnerships, and Priority Sector Lending Certificate, but the issues of genuine outreach, risk-aversion, and dependence on indirect lending mechanisms remain. The paper identifies the necessity of more powerful policy incentives, greater financial literacy programs, and impact-driven models of PSL. The results provide useful information to the policy-makers, banking practitioners and research practitioners who require to enhance the efficiency of PSL in sustainable financial inclusion.

**Keywords:** Priority sector lending, financial inclusion, weaker sections, private sector banks, empowerment

### Introduction

Priority Sector Lending (PSL) is a significant regulatory intervention in the Indian banking system, and is planned to prioritize the institutions credit to the sector that has high value on inclusive economic development but is under-served by the market-based lending mechanisms. The PSL program was introduced by the Reserve Bank of India requiring the scheduled commercial banks to ensure a given ratio of their loans by lending go to priority sectors such as agriculture, micro and small enterprises, education, housing and weaker segments of the society. PSL has over the years been adjusted to the shift in economic priorities, regulatory changes and the growth of financial technology, keeping alive its suitability in the development-oriented banking policy of India. As a business and management concern, PSL is also a complex area of interest because it has a direct effect on the lending policies of banks, their risk management policy, their operational effectiveness and regulatory affairs. This is a strategic challenge especially when there is a need to pursue financial viability and social responsibility in a competitive banking environment. Therefore, PSL has become a significant topic within the literature of banking and financial management, researchers exploring its role in credit provisions, assets quality, and performance of institutions.

Growing involvement of banks in the PSL by the privately held banks is an important issue that should be examined in academic circles. People who use different approaches to meet PSL requirements in regards to the features of a particular bank include the private banks which are profit oriented, technologically advanced, and centrally located in urban areas.

The increasing dependence on digital lending models, collaborations, and market-based instruments has changed the manner the PSL has been implemented and the question is on how far and of what quality the financial inclusion has been attained. Weak area and financial inclusion is the focal point of PSL requirement. As a disadvantaged population, the economically disadvantaged are still affected by access, affordability, and financial literacy barriers, even with policy assistance. To define the effectiveness of PSL as a tool of development it is necessary to examine how the role of the contribution of the private sector banks to coping with these problems was solved.

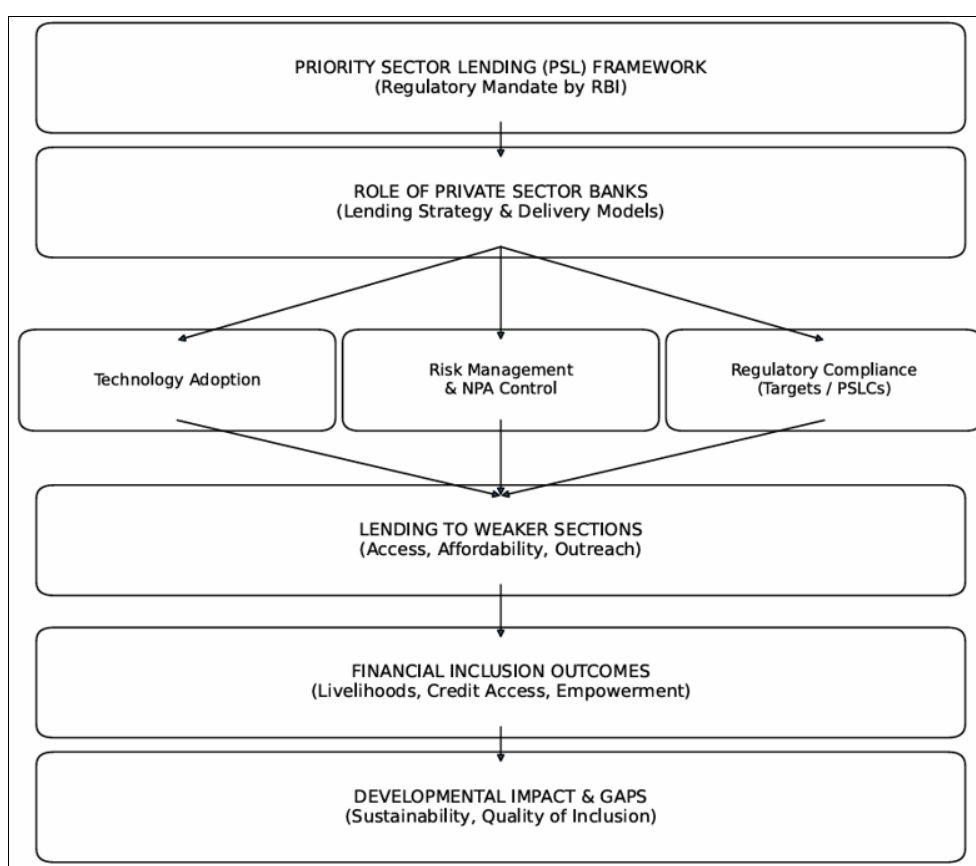
This literature review aims at critically synthesising literature on Priority Sector Lending with specific focus on the contribution of the private sector banks, in empowering the weaker parts of the India nation. The conceptual development of PSL, its connection with financial inclusion, role of the private sector banks, possible challenges in implementation, and new trends are presented in the review, which ends in the recognition of the gaps in the research and direction of further research.

### Conceptual Framework

As a measure to ensure that the institutional credit is

distributed evenly to areas of the economy, which are impacted greatly in socio-economic development yet are generally underserved by formal financial institutions, Priority Sector Lending (PSL) in India was implemented. The Reserve Bank of India (RBI) requires commercial banks to have periodic commercial banks to set aside a specific percentage of their Adjusted Net Bank Credit to various priority groups like agriculture, micro and small and medium enterprises (MSMEs), education, housing and weaker sections (Reserve Bank of India [RBI], 2020). The theory of directed credit and social banking is the conceptual basis of PSL that lays stress on the role of the state in rectifying market failures in distributing credit (Burgess and Pande, 2005) <sup>[1]</sup>.

The literature perceives PSL as a tool of indicating inclusive growth by enabling the enjoyment of cheap credit and enabling income-creating actions among marginalised groups (RBI, 2019). The changing nature of the financial system in India and changing developmental priorities can be also anticipated by periodic revision of PSL guidelines. According to the scholars, this flexibility has served to keep PSL as one of the key foundations of the financial inclusion strategy of India, also casting doubt on its implementation efficiency and regulatory effectiveness (World Bank, 2018).



**Fig 1: Conceptual Framework**

### Role of Private Sector Banks in Priority Sector Lending

With the liberalisation of financial sector, the role played by banks in the Indian banking system, including the execution of PSL mandates, has gradually become important by the banks in the private sector. Available literature suggests that with the growth of digital platforms, data analytics, and other tools to evaluate creditworthiness, the behavior of the existing private banks becomes more technology-driven and efficiency-oriented when it comes to increasing the number

of firms to whom they offer loans at a PSL level (RBI, 2021). By doing this, the strategies have helped the private banks deliver credit in a better manner, especially in the MSME and retail-based focus areas.

The literature, however, also shows that there were structural limitations influencing lending by the private sector banks to the weaker parts and agriculture. Higher risk aversion, reduced networks of rural branches, and the issue associated with the quality of assets are often constraining

the direct interest in vulnerable borrower groups (Sarma and Pais, 2011) <sup>[12]</sup>. Consequently, some research studies note that it brings a dependency on the mechanisms of indirect lending and market-based instruments which can satisfy the regulatory needs and restrain the depth of developmental prospects of PSL outreach (RBI, 2022). This is the conflict between regulation and social responsibility, the theme of which is repeated in the scholarly discussions of the topic of involvement of the private sector in PSL.

### Impact of Priority Sector Lending on Weaker Sections

There exists a large volume of empirical and policy-driven literature that discusses the effects of PSL on lesser members of the society. The studies have shown that PSL has resulted in the improved access to formal credit to marginal farmers, women entrepreneurs and low-income households, causing aggression of formal sources of finance (Burgess and Pande, 2005; RBI, 2018) <sup>[1]</sup>. Growth in access to institutional credit has been linked to an increase in agricultural productivity, small enterprises and stability of household income.

However, the uneven results within the regions and banking institutions are also highlighted in the literature. Regional infrastructure, institutional capacity, and awareness of borrowers are the factors that play a major role in determining the success of PSL interventions (World Bank, 2018). The studies on private sector banks suggest that lending by weaker section banks tends to be clustered in urban and semi-urban regions, which restricts their coverage to rural and informal populations where there is an extreme need of exclusion, specifically financial (Sarma & Pais, 2011) <sup>[12]</sup>. Such an uneven distribution highlights the necessity to put into consideration the performance of PSL beyond aggregate lending objectives.

### Challenges and Gaps

In spite of the intensive research on the topic of PSL, there are still a number of challenges in the literature, which have not been sufficiently covered. The increase in Non-Performing Assets (NPAs) relating to lending to weaker sections has become an acute issue, which is shaping the perception of risks by banks and its lending behaviour (RBI, 2021). The post credit support, low financial literacy by the beneficiary, and weak monitoring mechanisms further limit the effectiveness of the PSL programs in the long-term.

The gap in the literature is pronounced as far as research is concerned. Most of the current studies are on policy assessment and target performance with little incorporation

of bank strategy, risk management, and developmental contribution. Specifically, research has not concentrated on the way in which the private sector banks reconcile the PSL requirements and the management of asset quality. Additionally, there are limited researches that critically evaluate the implication of the increased use of indirect compliance systems in the real financial inclusion. These gaps have to be filled in order to contribute to the academic knowledge and evidence-based policymaking.

### Methodology

The research will use systematic literature review as a methodology towards synthesising already existing scholarly and policy-driven literature on Priority Sector Lending (PSL) in reference to the role of Indian banks in the private sector. The systematic approach was selected to guarantee the transparency, replicability, and coverage of all the relevant literature, as best practices dictate when undertaking review-based research is in management and commerce.

The secondary data exclusively used in the review will include peer-reviewed journal articles, official publications of Reserve Bank of India (RBI), Government of India policy documents, and reports by international development institutions. The sources used in the review were published in the last five years, 2010-2024, which is when the regulatory frameworks in PSL were drastically changed, as well as the growth of the trading in the banking sector by the government, and the prioritization of financial inclusion. Authenticated academic databases like Google Scholar, JSTOR, and publishing sites were called upon to find relevant peer-reviewed studies on the search terms including Priority Sector Lending, private sector banks, financial inclusion, weaker sections, and Non-Performing Assets. Regulatory and institutional impressions of the banking industry were procured by reviewing RBI master directions, annual reports, and reports on Trend and Progress of Banking in India. The use of literature was based on its relevance to the research area, relevance of the source, and its contribution to the domain of PSL implementation, participation of the private sector by the bank, and the outcomes to the weaker parts. To achieve a good synthesis equilibrium, descriptive, empirical, and conceptual studies were also included. The chosen literature was interpreted using the thematic approach, and the results were derived based on the conceptual grounds, strategies of implementation, effects, challenges, and gaps in research.

**Table 1:** Summary of Selected Literature on Priority Sector Lending and Private Sector Banks

Author(s) & Year	Title / Focus	Context & Methodology	Key Insights Relevant to PSL
Burgess & Pande (2005) <sup>[1]</sup>	Social banking and rural credit	Empirical study using Indian district-level data	Directed credit policies improve access to banking services in rural and underserved regions
Sarma & Pais (2011) <sup>[12]</sup>	Financial inclusion and development	Construction of a Financial Inclusion Index	Financial inclusion outcomes depend on institutional outreach and policy effectiveness
Chakrabarty (2011) <sup>[2]</sup>	PSL and inclusive growth	Policy-based analysis (RBI perspective)	PSL is essential for inclusive growth but requires monitoring and institutional commitment
RBI (2015)	PSL framework review	Regulatory review	Emphasised sub-targets for weaker sections and agriculture
Ghosh (2016) <sup>[2]</sup>	PSL and bank performance	Empirical analysis of Indian banks	PSL impacts profitability differently across public and private sector banks
RBI (2018)	Trend and Progress of Banking in India	Descriptive and analytical report	Highlights sector-wise PSL performance and regional disparities
Mohan (2019) <sup>[5]</sup>	Financial inclusion and banking reforms	Conceptual policy review	Institutional credit is critical for inclusive development

RBI (2020)	Master Directions on PSL	Regulatory document	Revised PSL norms, expanded categories, and compliance flexibility
Goyal & Joshi (2021) <sup>[14]</sup>	PSL and NPAs in Indian banks	Empirical study	Higher PSL exposure linked to asset quality concerns in some banks
RBI (2021)	Banking performance and NPAs	Analytical report	NPAs influence lending behaviour, especially towards weaker sections
World Bank (2018)	Financial inclusion in India	Policy evaluation	Institutional reforms needed to sustain inclusion initiatives
Sharma & Kukreja (2022) <sup>[14]</sup>	Financial inclusion initiatives in India	Review-based study	Digital banking improves inclusion but gaps persist in rural areas
RBI (2022)	Review of PSL framework	Policy analysis	Increased use of indirect PSL instruments noted
Sengupta & Vardhan (2023) <sup>[13]</sup>	Private banks and inclusive finance	Empirical analysis	Private banks show efficiency but limited rural penetration
Recent studies (2020-2024)	PSL, digital lending, and inclusion	Mixed methods	Technology enhances outreach, but qualitative inclusion remains uneven

Source: Compiled by the author based on reviewed literature

## Literature (Thematic Synthesis) Discussion

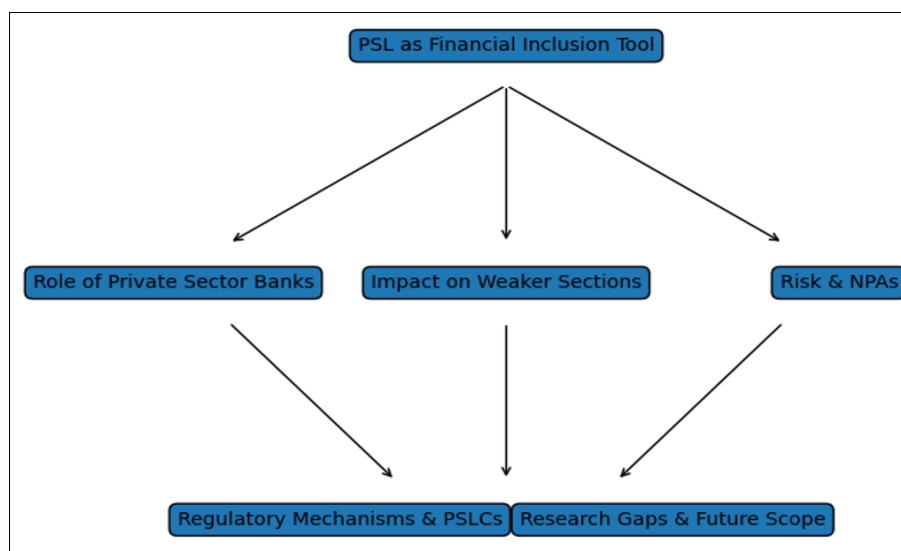


Fig 2: Thematic Synthesis

Figure 1: Presents the thematic synthesis derived from the reviewed literature.

A review of literature on the topic of Priority Sector Lending (PSL) in India demonstrates that there is a overlap of themes in the context of inclusive finance, regulatory intervention, banking strategy, and developmental outcomes. In both policy documents and scholarly research, PSL is unanimously agreed as one of the crucial tools in dealing with structural inequities in institutional credit access. Nevertheless, thematic synthesis of literature shows that the usefulness of PSL is dependent not solely on the enforceability decrees but also on the institutional ability, methods of implementation and contextual processes that impact the behaviour of the borrowers.

### PSL as a Financial Inclusion Effective Device

One of the most prevalent themes in the literature concerns the ability of PSL as a means of promoting the financial inclusion. Empirical work based on social banking and directed credit models underline that the idea of making forms lent to the priority sectors has enhanced formal financial inclusion of the marginalised populations, especially in the rural and semi-urban regions. It is indicated in the literature that PSL has helped to minimize reliance on informal sources of credit and help engage in income-generating activities. A number of studies however warn

against greater access leading to meaningful inclusion and support the importance of credit adequacy, affordability, and post-disbursement support.

### The strategic orientation of the Banks of the private sector

The other theme comes out as touching on the clear strategic orientation that the private sector banks needed in the implementation of PSL. According to the literature, the tactic of private banks is to emphasise efficiency-based and technology facilitated solutions, the emphasis on standardised products, internet-delivery channels, and information-driven credit evaluation. Although such strategies have promoted the efficiency of operations carried out as well as the ability to achieve the required regulatory targets, there has also been selective engagement of priority sectors. The studies indicate that banks in the private sector are more sensitive to risk especially when they are lending to the agricultural and weaker areas and this reflects on the levels of inclusion and its sustainability.

### Disproportionate Effect of weaker sections

The influence of PSL on the weaker segments comes out as a complicated and geographically diversified topic in the literature. Although the empirical and policy-driven literature does indicate that there is an improvement in



access to credit and livelihood opportunities, it also reports a high level of disparities in regard to geographical factors, type of borrowers and the financial institutions. According to the literature, banks in the private sector are more likely to focus the lending to weaker sections in urban and semi-urban regions, usually in formalised forms that lending products which do not necessarily cover the needs of highly vulnerable groups. This unequal influence brings questions about how many PSL policy goals have been achieved as per development results.

### **Risk Management and Quality of Assets**

Risk management and quality of assets are major themes which are essential especially concerning the weaker section lending. Some of the studies refer to Non-Performing Assets (NPAs) as one of the major constraints that will affect the willingness of the banks to increase the direct exposure to the PSL. According to the literature, credit risk is raised by volatile incomes, exogenous shocks, and poor financial literacy of borrowers, which has led the private sector bank to engage in jingling lending. Although such a risk-averse behaviour makes perfect banking sense, it tends to lead to decreased outreach, or more extensive use of indirect compliance means, and thus worsen the actual social impact of PSL.

### **Regulatory flexibility and indirect mechanisms of compliance**

The development of flexible mechanisms of compliance, including Priority Sector Lending Certificates, has also become a significant theme in the new literature. Although these instruments are innovative tools that make the market more efficient and less regulatory-compliant, a number of studies are concerned about its implications on the idea of genuine financial inclusion. The literature reveals a conflict of opinion on the issue of indirect mechanisms encouraging efficiency at the expense of the developmental intent especially when banks focus on accomplishing the targets rather than engaging in direct interaction with the weak portion.

### **Research Gaps and Future Research Directions**

Critical review of the available literature on the topic of Priority Sector Lending (PSL) shows that, although the topic has received much policy focus and scholarly interest, there are still a number of conceptual, empirical, and methodological gaps. These gaps need to be filled in to enhance the performance of PSL especially when it comes to the operation of weaker section lending by the banks in the private sector.

### **Identified Research Gaps**

To begin with, there is great disparity between quantitative target accomplishment and qualitative impact measurement. Most of the current literature considers the performance of PSL in aggregate credit disbursement and targeted compliance, but few studies focus on the achievement of the individual borrowers, including income stabilization, enterprise survival, and empowerment by financial means in the long term (Burgess & Pande, 2005; World Bank, 2018) <sup>[1]</sup>. This small perspective inhibits the knowledge on whether PSL can translate into any meaningful long-lasting financial inclusion.

Bank specific and strategy-oriented analysis is not adequate, especially in relation to banks that are in the private sector. Although the role of increasingly active involvement of private banks in PSL is also recognized by several studies, very little research is conducted to investigate the effect of their business models, risk management frameworks, and technological adoption on the weaker section lending results (Reserve Bank of India [RBI], 2021). The compromise between profitability and compliance to regulations is also an area that has not been well addressed in the literature.

Non-Performing Assets (NPAs) are often mentioned as a limitation when it comes to lending by weaker sections, but the empirical research that connects explicitly PSL exposure, asset quality and lending behaviour of banks of private sector are relatively few (RBI, 2022). Lack of combined analyses constrains the understanding of how the considerations of credit risk influence the PSL strategies and the decisions on outreach.

There has been paucity of critical analysis on the growing use of the indirect compliance mechanisms like the Priority Sector Lending Certificates (PSLCs). Although policy documents emphasize on improving efficiency and flexibility, a small number of studies evaluate their implications to embody actual financial inclusion and direct credit provision to high-income earners (RBI, 2020). Lastly, the literature recognizes regional and institutional differences in the results of PSL, but there is less comparative research across regions, types of banks, and types of borrowers. This minimizes the construction of context policy interventions (World Bank, 2018).

### **Future Research Directions**

Future studies should not rely on the aggregate measures but follow borrower-oriented and impact-focused methods to evaluate the measures of PSL efficiency. Longitudinal research on livelihoods consequences, credit sustainability and financial resilience of the weaker sections would give further information on quality of inclusion. Bank level and strategy oriented research on how banks in the private sector create PSL portfolios as well as how credit risk is managed, technology harnessed and social obligations instead of merely addressing them is also needed. The institutional dissimilarities in public and private sector banks can also be clarified with the help of comparing their applicability to the PSL.

The empirical results are to be investigated further through additional empirical research to determine the association between PSL lending and NPAs, in the weaker section segments, in particular. Combining measures of asset quality and PSL performance would allow providing a better insight into whether the organizational risks are structural or managerial. Also, the long-term outcomes of using PSLCs and other indirect mechanisms as an approach to assessing the developmental goals of PSL should be critically evaluated in the future studies. To reform the policy, it is important to evaluate how these tools will either complement or dilute financial inclusion goals.

Lastly, banking, development economics, and public policy issues can be used to increase insights into PSL as a dynamic regulatory tool by interdisciplinary research. Such practices would add to evidence-based policymaking and make banking more inclusive, as well as sustainable.

## Conclusion

The literature review assessed critically the conceptual basis, program dynamic and results of Priority Sector Lending (PSL) in India, paying particular attention to the role played by the private sector banks and the consequences of the program to the weaker sections of the society. In the analysed literature, there is a consistent acknowledgment of PSL as a foundation of an inclusive banking system that is focused on structural credit market failures and enhancing equal access to institutional finance. Policy innovations and regulatory refinements have made PSL remain relevant over the years in the face of the changing financial system. The synthesis of the existing works suggests that the banks operating in the private sector are becoming significant players in PSL by taking advantage of the technological progress, efficiency in the operations, and new delivery templates. Nevertheless, their involvement is typified with a risk-averse and careful attitude especially when lending to weaker sections. Although the aggregate PSL targets are being met more often, the literature remains deeply worried about the depth, quality, and sustainability of financial inclusion by using the medium of banking by a private sector.

The review also highlights the perspective that the effects of PSL on weaker sections is not evenly spread across regions and categories of borrowers. Inadequate rural outreach and non-quality aspects of assets, as well as increased dependence on indirect means of compliance limits, limit the developmental efficacy of PSL. In addition, the literature indicates that the intent of the policy and its practical implications are not connected, which may imply that being a law-abiding citizen may not ensure significant empowerment of the underprivileged groups.

The research paper makes a contribution to the literature on management and commerce by combining policy, banking strategy, and developmental approaches and pinpointing the key gaps that are of interest to academic and policy-making endeavours.

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