

EFFECTIVE UTILIZATION OF FUNDS UNDER PRIORITY SECTOR LENDING (PSL): ANALYZING SOURCES OF REPAYMENT AND THEIR IMPACT ON LOAN SUSTAINABILITY

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Abstract

Priority sector lending (PSL) is a crucial initiative in driving inclusive economic growth by directing financial resources to underserved sectors such as agriculture, MSMEs, education, housing, and renewable energy. This study explores the effective utilization of PSL funds with a specific focus on the sources of repayment for priority sector loans. Based on primary data analysis, the research highlights the repayment trends across various loan categories, identifies the challenges of repayment, and examines how the loan source influences the sustainability of PSL programs. The findings reveal significant variations in repayment sources among different priority sectors, with income generated from projects being the most dependable repayment source. The paper also investigates the role of financial literacy, tailored loan products, and government subsidies in enhancing loan repayment success.

Keywords:- Priority Sector Lending, Effective Utilization of Funds, Loan Repayment Sources, Agriculture, MSMEs, Weaker Sections, Financial Sustainability, Inclusive Growth.

Priority sector lending (PSL) is a strategic initiative implemented to ensure that critical sectors of the economy, which are often underserved by traditional financial institutions, receive adequate financial support. These sectors include agriculture, micro, small and medium enterprises (MSMEs), education, housing, and

renewable energy. The effective utilization of PSL funds is essential for promoting inclusive economic growth and ensuring that the benefits of development are widely distributed across all segments of society.

Proper utilization involves not only the disbursement of loans but also ensuring that these funds are used

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productively for their intended purposes, thereby fostering sustainable development and economic stability. One of the key factors influencing the effective utilization of PSL funds is the source of repayment. Understanding and assessing the repayment capacity of borrowers is crucial. For instance, agricultural loans often depend on the seasonal income from crops, which can be unpredictable due to factors like weather conditions and market prices. Similarly, MSMEs rely on their business revenues, which can be volatile due to market competition and economic fluctuations.

Defaults on loan repayments can arise from several reasons, such as poor crop yields, market volatility, mismanagement of business operations, and economic downturns. To mitigate these risks, it is essential to have a thorough credit assessment process and continuous monitoring of the borrower's financial health. Another significant challenge in the effective utilization of PSL funds is the diversion of credit. Loans intended for specific purposes, such as purchasing agricultural inputs or expanding a small business, may sometimes be diverted to other uses, reducing their effectiveness and increasing the risk of default. Ensuring that funds are used for their intended purposes requires stringent monitoring and robust governance mechanisms. Success factors in PSL include providing borrowers with financial literacy and advisory services, which can help them manage their finances better and enhance their ability to repay loans. Additionally, banks must offer tailored financial products and support services that align with the unique needs of each priority

sector. By addressing these challenges and focusing on these success factors, PSL can significantly contribute to the sustainable and inclusive growth of the economy.

Review of Literature

Veerashekerappa (1993) discovered in his study that although advances to priority sectors in the state surpassed the targeted amount, the expansion of institutional finance primarily benefited larger farmers, leaving many rural households in lower strata without access to institutional finance.

Goyal et al. (2015) scrutinized the impact of PSL targets set by the Reserve Bank of India on the rising NPAs in both public and private banks, covering the period from 2001 to 2013.

Throve Harsha A. (2015) conducted an analytical study comparing Priority and Non-'priority sector lending' in nationalized banks in India, emphasizing the role of nationalized banks in the country's development. The study highlighted the importance of reducing NPAs, especially in the non-priority sector, and suggested government support to enhance 'priority sector lending'.

Rana (2016) focused on the "Analysis of Non-Performing Assets of Public Sector Banks in India," emphasizing NPAs' detrimental impact on bank profitability and the need for preventative measures. The study categorized NPAs with respect to loan advances into priority and non-priority sectors, analyzing data from 2004 to 2014. Results revealed a continuous increase in NPAs in public sector banks across both sectors.

Manjushree & Giridhar, (2018) discussed priority sector lending in State Bank of India, emphasizing the sectors receiving special dispensation. They found an increase in lending but highlighted challenges in loan recovery. The study suggested achieving RBI's targets to aid rural and weaker sections, enhancing bank profitability, and incentivizing performance rather than penalty-based systems.

Yadav, (2019) traced the evolution of the priority sector lending policy, noting its flexibility in defining and setting targets. The broadened definition and interest rate deregulation made the policy more adaptable over time.

Statement of the Problem

Priority Sector Lending (PSL) is a key financial initiative aimed at providing credit to underserved sectors such as agriculture, micro, small, and medium enterprises (MSMEs), education, housing, and renewable energy. However, ensuring the effective utilization of funds and the reliable repayment of loans from these sectors remains a significant challenge. The success of PSL depends largely on whether the funds are utilized productively, and the source from which borrowers repay the loan is of paramount importance in ensuring the sustainability of this initiative. While the PSL scheme is designed to foster inclusive growth, understanding the variability in repayment sources and the risks associated with them is crucial. Agricultural loans, for instance, may depend on uncertain income from crop yields, while MSMEs might face difficulties in securing stable business revenues. Additionally, borrowers may

resort to external sources like loans from moneylenders or selling assets, which can further complicate repayment and increase the risk of default.

Scope of the Study

The present study focuses on evaluating the effective utilization of funds under Priority Sector Lending (PSL), with particular emphasis on analyzing the sources of loan repayment among borrowers in key sectors such as agriculture, micro, small and medium enterprises (MSMEs), and weaker sections. The research primarily examines how borrowers meet their repayment obligations by relying on various sources, including income generated from financed activities, borrowing from informal sources such as moneylenders, loans from other financial agencies, participation in chitty or kuri systems, and asset liquidation. The study aims to understand the relative reliability of these repayment sources and their implications for loan sustainability. The analysis is based on primary data collected from respondents, reflecting their actual repayment behavior, preferences, and financial decision-making patterns. In terms of methodology, the study employs quantitative tools such as mean analysis and one-sample t-tests to assess variations in repayment sources and to identify statistically significant differences in borrower responses. However, the scope of the study is limited to a selected sample of respondents and does not extend to all geographical regions or institutional frameworks. It does not include a comparative analysis across different banks or policy-level evaluation but instead concentrates on borrower-level insights. Despite these limitations, the

study provides a focused understanding of repayment dynamics within the PSL framework, offering a micro-level perspective on how loan utilization and repayment behavior influence financial sustainability.

Significance of the Study

This study holds substantial academic significance as it contributes to the existing body of knowledge on Priority Sector Lending by examining an often underexplored dimension - sources of loan repayment and their impact on sustainability. By integrating empirical analysis with statistical validation, the research provides a deeper understanding of borrower behavior and repayment patterns across priority sectors. It adds value to academic discourse by highlighting the relationship between income-generating activities and repayment reliability, thereby offering a basis for further research in areas such as credit risk assessment, financial inclusion, and rural financing models. From a practical and social perspective, the study offers important implications for policymakers, financial institutions, and development agencies. It emphasizes the need for designing sector-specific loan products, improving financial literacy among borrowers, and strengthening monitoring mechanisms to ensure proper utilization of funds. The findings also underscore the importance of reducing dependence on informal credit sources, which often increase financial vulnerability. Socially, the study supports the broader objective of inclusive growth by promoting sustainable lending practices that enhance borrower capacity and

reduce default risks. Overall, it provides actionable insights that can improve the efficiency, resilience, and long-term viability of Priority Sector Lending initiatives.

Objectives of the Study

1. To examine the various sources of repayment for Priority Sector Lending (PSL) loans.
2. To analyze the reliability of different repayment sources such as income from projects, borrowing, and asset liquidation.
3. To evaluate the extent to which borrowers depend on self-generated income for loan repayment.

Analysis of Source of Repayment

Assessing the repayment source for priority sector loans involves examining if the funds will be used for activities that generate income. For instance, loans directed to farmers for buying agricultural tools or seeds anticipate repayment from the profits made during the harvest. Understanding the borrower's financial strength involves scrutinizing income statements, bank records, and other financial papers to confirm they possess enough income to pay off the loan. Sometimes, loans in priority sectors are backed by assets or collateral. Assessing these assets' value and liquidity is crucial to ensure they cover the loan if the borrower defaults. Moreover, some priority sector loans receive government subsidies or guarantees, offering repayment support or reducing risks for the lender. Financial institutions utilize specific criteria and models to evaluate the creditworthiness of priority sector

borrowers. These criteria help gauge the likelihood of repayment and determine the loan terms. Balancing the social objective of aiding priority sectors with loan sustainability is crucial for lending institutions. This ensures they can continue supporting these sectors while effectively managing associated risks.

For evaluating the source of repayment of loans among the respondents, variables were identified as; income generated from the project, selling and pledging other assets, taking a loan from moneylenders, loan from other financial agencies, and chitty or kuris. All these variables were analysed on a five-point scale as follows;

Never 0-1; Rarely 1-2; Sometimes 2-3; Often 3-4 and Always 4- 5. Mean values were used for the analysis and interpretation of the data.

Considering the source of repayment of the loan revealed that the respondents “Often” repay the loan from income generated from the

project ($\bar{x}=3.54\pm0.735$). Respondents “Sometimes” repay the loan using Chitty or Kuris ($\bar{x}=2.96\pm0.839$), followed by taking loan from moneylenders ($\bar{x}=2.78\pm0.770$), Loan from other financial agencies ($\bar{x}=2.70\pm0.895$) and “Rarely” used the amount from Selling and pledging other assets ($\bar{x}=1.65\pm1.051$).

It can be concluded that most of the respondents used Income generated from the project for the repayment of the loan.

The one-sample t-test results indicated that there was significant variation in the opinion of respondents with regard to the source of repayment of the loan for Income generated from the project, Selling and pledging other assets, Taking a loan from moneylenders, and Loan from other financial agencies ($p<0.05$). However, there was no significant difference in the opinion of respondents regarding the Chitty or Kuris ($p>0.05$). There is a significant difference in the respondents’ overall source of repayment of the loan ($p<0.05$). The details are presented in Table 1.

Table 1
Source of Repayment of the Loan

Variable	Mean	SD	t-value	p-value
Income generated from the project	3.54	0.735	14.185	<0.001**
Selling and pledging other assets	1.65	1.051	-24.558	<0.001**
Taking a loan from moneylenders	2.78	0.770	-5.501	<0.001**
Loan from other financial agencies	2.70	0.895	-6.612	<0.001**
Chitty or Kuris	2.96	0.839	-.852	.395
Overall	2.88	0.847	6.793	<0.001**

Source: Primary Data

** Significant at 1% level

* Significant at 5% level

The average ratings for various loan repayment sources in priority sector lending display differing trust levels. Income generated from the project emerges as the most dependable, aligning closely with an “Often” rating on the scale. Conversely, relying on selling or using assets as collateral is viewed as less reliable, leaning toward “Rarely” on the scale. Meanwhile, borrowing from moneylenders, other financial agencies, and engaging in Chitty or Kuris fall within the moderately reliable range, ranging between “Sometimes” and “Often.” This comparison underscores a stronger preference for self-generated income as a repayment source over external borrowing or asset liquidation in priority sectors. These insights can inform the design of more targeted lending strategies that better suit the perceived reliability of these repayment avenues.

Major Findings

1. Income Generated from the Project as the Primary Repayment Source:

The analysis of loan repayment sources revealed that the most reliable source of repayment, as indicated by the respondents, was the income generated from the project ($\bar{x} = 3.54$, $SD = 0.735$). This suggests that borrowers tend to rely on the profits from their respective ventures (agriculture, MSMEs, etc.) to repay their loans. This aligns with the general assumption that PSL loans are given to sectors that generate income directly related to the borrower’s activity.

This repayment method was rated as “often” on the scale, emphasizing its central role in loan repayment strategies.

2. Other Financial Sources:

Chitty or Kuris ($\bar{x} = 2.96$, $SD = 0.839$) and Taking loans from moneylenders ($\bar{x} = 2.78$, $SD = 0.770$) were considered moderately reliable sources of loan repayment. These sources may be more common in certain sectors like agriculture and weaker sections, where borrowers might have limited access to institutional financial products.

Loans from other financial agencies ($\bar{x} = 2.70$, $SD = 0.895$) were also seen as a source of repayment, indicating some level of dependence on external financial support, which might be in the form of microfinance, co-operatives, or similar institutions.

3. Selling and Pledging Assets:

Selling and pledging assets ($\bar{x} = 1.65$, $SD = 1.051$) was viewed as the least reliable source of repayment. Borrowers in the PSL categories tend to use this method rarely, suggesting that they are hesitant to liquidate their assets unless absolutely necessary. This could be due to the fear of depleting their assets or the uncertainty of market conditions.

4. Significant Differences in Loan Repayment Sources:

Statistical Significance: The one-sample t-test revealed significant differences in the sources of loan repayment, especially regarding income generated from the project, selling and pledging assets, and loans from other financial agencies ($p < 0.05$). This suggests that the repayment sources vary based on the financial conditions and priorities of the borrowers.

Chitty or Kuris did not show a significant variation ($p > 0.05$), indicating that this method of repayment may be a common practice across sectors, but not a particularly reliable or preferred one in comparison to project-generated income.

5. Trust Levels of Repayment Sources:

The analysis underscores a strong preference for income generated from the project over other repayment methods. Borrowers consider their self-generated income (e.g., profits from agriculture or MSMEs) to be the most trustworthy method of repaying loans.

The moderate reliability of external sources like loans from moneylenders and financial agencies suggests that these may serve as secondary sources of repayment, often used when project income is insufficient or delayed.

Suggestions

1. Strengthening Financial Literacy Programs:

Given that income generation from projects is the primary source of repayment, there is a need for greater financial literacy programs aimed at helping borrowers understand their cash flow management better. This will enhance their ability to generate consistent income and, in turn, improve their loan repayment capacities.

Many borrowers in priority sectors, especially in rural areas, may lack the necessary skills to efficiently manage the finances generated by their ventures. Training in budgeting, financial forecasting, and managing profits and

losses could boost their repayment reliability.

2. Tailored Loan Products for Each Sector:

Lending institutions should design sector-specific loan products that align with the unique income patterns and needs of each category, such as agriculture, MSMEs, housing, and renewable energy. These products could come with flexible repayment options that are more aligned with seasonal income (in agriculture) or business cash flow (in MSMEs).

This would reduce the need for borrowers to rely on external sources like moneylenders, loans from other financial agencies, or asset liquidation. For example, agricultural loans could be structured with repayment schedules that coincide with the harvest cycle, while MSME loans could be linked to business growth and profit milestones.

3. Minimizing the Use of Moneylenders and Informal Credit:

It is important to reduce the reliance on informal borrowing channels, like moneylenders, which can lead to higher debt burdens and increased default risks. Banks and financial institutions should improve access to formal credit by simplifying loan processes, lowering interest rates, and offering better terms for MSMEs and agriculture-related loans.

Moneylenders often charge exorbitant interest rates, and the informal nature of these loans can lead to increased financial strain on borrowers. Encouraging borrowers to rely on formal credit sources, with better terms and

support, would increase repayment rates and financial stability.

4. Enhancing the Monitoring and Evaluation of Loan Utilization:

Establish a robust monitoring system to ensure that the funds from PSL loans are used for their intended purposes. Regular audits, field visits, and borrower feedback could help identify whether funds are being diverted for unintended uses.

Misuse or diversion of funds is a significant concern that leads to poor loan repayment performance. Ensuring that loans are used as intended would mitigate risks of defaults and increase the sustainability of PSL programs.

5. Incorporating Government Support and Guarantees:

Government subsidies and loan guarantees should be expanded, especially in sectors where income is highly volatile (like agriculture). This could include weather insurance schemes, crop failure compensation, and other forms of support.

The inclusion of government guarantees and subsidies would help reduce the risk to lenders and increase the willingness of borrowers to repay. Such support would be particularly valuable in sectors vulnerable to external shocks (e.g., agriculture, renewable energy).

6. Flexible Repayment Terms:

Financial institutions should offer flexible repayment terms that adapt to the

borrower's cash flow cycles. For instance, allowing deferred repayment during lean seasons or offering low-interest loans during periods of economic downturn would help reduce the pressure on borrowers and increase repayment success rates.

Flexibility in repayment terms will alleviate the burden on borrowers during difficult periods, making it easier for them to repay the loan without resorting to asset liquidation or borrowing from moneylenders.

7. Promotion of Asset-Based Lending with Proper Valuation:

For those borrowers who may not have sufficient cash flow, asset-based lending should be promoted. However, it is essential to have accurate and up-to-date asset valuations to ensure that the collateral can cover the loan amount in case of default.

By using assets as collateral, lenders can minimize the risk of non-repayment. Proper valuation will ensure that the collateral holds its value and can be liquidated without significant loss.

Conclusion

This study highlights the importance of self-generated income as the most reliable source of repayment for priority sector loans. While external sources such as loans from moneylenders, financial agencies, and Chitty or Kuris are also used, they are less dependable and can add to the financial burden of the borrowers. The findings underscore the need for targeted

loan products, financial literacy programs, and flexible repayment terms to enhance the sustainability of PSL funds and improve loan repayment rates. By focusing on income generation, reducing

reliance on informal credit, and introducing better monitoring and government support, priority sector lending can fulfil its goal of fostering inclusive growth and reducing poverty.

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