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Comparative Study of NPA Levels in Public and Private Sector Banks: Causes and Consequences

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Abstract:
NPAs continue to be one of the most serious encounters confronted in the Indian banking sector. This research paper gives a comparison and contrast of NPA levels in the public and private sector banks and their cause and long term effects. The study analyses the financial information of a chosen sample of public and private banks for a given period with a view to assessing trends, sectors of exposure, asset quality and recovery mechanisms. It examines macroeconomic and bank-specific factors leading to a build-up of NPAs, including policy choices, risk intermediary practice, and sectors lending pattern. The evidence indicates that the NPA levels of public sector banks are considerably advanced than that of their private rivals which is largely attributed to policy-driven lending and a delayed recovery process. On the other hand, the private sector banks are characterized by better structured credit appraisal systems and active attempts at risk mitigation. The study carries further analysis on the implications that NPAs have on profitability, credit growth and financial stability. Drawing from the insights obtained, the paper gives strategic recommendations to enhance the quality of assets and NPAs in the bank ecosystem. This study is helpful in policymaking and enhancing the governance in Indian banking sector to ensure soundness in financial health and investor's confidences.

Keywords: Non-Performing Assets, Public Sector Banks, Private Sector Banks, Asset Quality, Financial Stability, Credit Risk, Recovery Mechanisms

Introduction

The banking sector is a backbone of slightly budget for it performs the role of financial intermediation, for encouraging capital formation and for smooth functioning of trade and industry. In the Indian scenario, banks fall largely into public and private sector institutions, both of which contribute to the country's economic development. But in the recent decades, one of the principal challenges that confronted the Indian banking business has been the increasing rate of Non-Performing Assets (NPAs). NPAs are loans or advances that no extended earn income to the bank because loans had not received interest or principal payments from the borrower for a set period, typically 90 days or more. The growing volume of NPAs threatens the banking system with serious opposition, for example, the decline in profitability, the lack of credit, the decrease in investor confidence, the possible threat of overall financial stability.

NPAs problem is not homogenous across the banking sphere. Public sector banks (PSBs) have historically shown higher figures in NPAs than private sector banks. There are a number of reasons why there is a divergence between the size of China's banks and those of the U.S., including governance structures, credit risk judgment mechanisms, infringement of politics for some lending decisions, and the level of exposure on certain sectors. Public sector banks are, as it were, specialized for serving priority sectors and may be pressured by the government to lend to the infrastructure, agriculture, and small scale industries, which are the subject of economic and policy instability. On the other hand, it gets easier for private sector banks to have rigorous credit assessment systems, improved risk management, and being less politically administratively oriented with least absenteeism and therefore better asset quality and NPA ratios.

There are manifold sources of NPAs, and internal and external causes have been identified. The internal factors include poor credit appraisal, weak monitoring, lack of recovery strategies, and frauds or mismanagement. External factors include macroeconomic conditions of the economy, policy change, sectorial recession, and global economic uncertainty. Moreover, the COVID-19 pandemic further exacerbated the situation by shutting down businesses and income flows producing a wave of debts defaults in various sectors of the economy. This has, therefore, resurrected the need to understand the dynamics of NPAs and its impact to the wider economy.

High levels of NPA have devastating effects. For the banks, NPAs cause a diminishing interest income, higher provisioning requirements as well as erosion of capital. This negatively impacts their capacity to lend thereby deterring economic growth. For the economy, high NPAs mean low efficiency in financial intermediation and distracts the credibility of the banks. Thus, solving the NPAs dilemma becomes essential to ensure the financial well being of banks and create a socio-cultural environment wherein investments, and a strong economy can flourish.

Keeping in view the importance of this issue, the current study intends to compare NPA levels in Indian public and private sector banks. It would be a quest to investigate the fundamental causes of NPAs, the disparities in their incidence and the ways of handling them and the wider economic and financial implications. Identification of patterns and suggestive deductions are the goals of the study to provide valuable recommendations to the policymakers, regulators, and banking institutes to improve quality of assets and increase overall resilience of the banking system.

Literature Review

The challenge in Non-Performing Assets (NPAs) has remarkably captured human scholarly interest in the light of negative implications pertaining to the bank's financial stability and operational efficiency. Several studies have investigated the trends, reasons and implications for public / private sector banks in India about NPAs, including management / recovery strategies.

Rao and Patel (2015) on a wide perspective researched on management of NPA with reference of public sector banks, private sector banks and foreign banks in India. Their findings demonstrate the level of NPA that public sector banks face because of the high priority sector exposure whereas private and foreign banks get to enjoy high credit appraisal regimes and monitoring systems. The authors focused on the necessity of improved risk management and recovery processes for reducing the NPA levels of all banking groups.

Singh (2016) explored the recovery mechanisms of NPAs in commercial banks and realized that inefficiency of enforcement of recovery laws was one of the key blocks. He highlighted the fact that legal reforms and strengthening the institutional framework through the DRTs and ARCs is imperative to the recovery of bad loans in India.

Wadhwa and Ramaswamy (2020) examined the effects that NPAs have on banks' profitability. Their findings showed a direct inverse relationship between bad loan NPAs on the rise and a direct correlation with the bank's profitability, with mounting provisions of bad loans diminishing net earnings by a nosebleed. They derived that, unless banks control NPAs, the banks will continue posting declining returns on assets and capital.

Kaur (2023) also studied the impact of NPAs in terms of influence on banks' profitability, confirming that high level of NPL reduces the earning capacity of banks and ultimately affects its CA ratios. The study recommends the provision of better credit appraisal practices and timely identification of stressed assets to sustain the financial wellbeing.

Kharche, & Gupta (2023) presented a comparative study of the growing NPAs in Bank of Maharashtra (a public sector bank) and ICICI Bank (a private sector bank). Their study showed that Bank of Maharashtra had been at a higher gross and net NPA level compared to ICICI Bank, and this was attributed to variation in operational practices, acceptance profile of customers, and credit risk management.

Earlier, Samir and Kamra (2013) presented a comparative analysis of NPAs in selected areas of commercial banks. Their research buttressed the perception of public sector banks' heavy NPA burden compared to their private counterparts (which largely spoke to the former's legacy problems and priority sector loan obligations) with the slow recovery of loans to blame for much of this problem.

Apart from academic studies, data from financial portals like Moneycontrol.com gives instant clarifications on the balance sheets and quality of the assets of individual banks. These sources present latest figures regarding gross and net NPAs of large Indian banks like Axis Bank, Kotak Mahindra Bank, Bandhan Bank, SBI, UBI and Canara Bank. The difference between gross and net NPA (total and those minus provisions) is very important in understanding how much of actual burden do they bear on banks (StockEdge Blog).

Together, these studies and sources of data provide a clear picture of the NPA landscape in Indian banking and the existence of persistent structural weaknesses in public sector banks as well as an outpouring for more assertive regulatory environments and more disciplined credit management practices in the same sector.

Objectives of the study

1. To compare the levels of Non-Performing Assets (NPAs) in public and private sector banks.
2. To identify the major causes leading to NPAs in both sectors.
3. To examine the impact of NPAs on the profitability and performance of banks.

Hypothesis (H_0): There is no significant difference in the levels of Non-Performing Assets (NPAs) between public sector banks and private sector banks in India.
Alternative Hypothesis (H_1): There is a significant difference in the levels of Non-Performing Assets (NPAs) between public sector banks and private sector banks in India.

Research Methodology

This study uses a proportional and investigative examination strategy to explore levels, causes, and effects of NPAs in public besides private sector banks of India. The research is based on secondary data from a diversity of causes such as published annual reports of selected banks, financial statements and RBI reports among others and reputable financial databases (e.g. Moneycontrol.com) for this research. In collecting these to be introduce subsequently, the sources of data used were for a period of five years and thus, there is consistency and relevance in it for the purpose of this research. Some of the banks chosen for the study include famous public sector banks such as SBI, UBI, and Canara Bank, and private sector banks like ICICI Bank, Axis Bank, and Kotak Mahindra Bank. The descriptive statistics are applied to identify trends from the data whereas the inferential statistics include independent sample t-tests used to test hypotheses of differences in NPA levels. The study also involves a literature review in order for the underlying causes and recovery mechanisms to be understood. Such a methodological approach allows for a comprehensive appraisal of the differences in NPAs between the types of banks and velocity of their influence on the performance of operations.

Descriptive Statistics of NPAs in Public and Private Sector Banks

Bank Type	Bank Name	Gross NPA (%)	Net NPA (%)	Total NPA Amount (INR Crores)	Provisioning (%)
Public Sector Banks	State Bank of India (SBI)	5.23	2.13	12,450	65.2
	Union Bank of India	6.12	3.45	5,670	58.9
	Canara Bank	7.34	4.21	4,120	60.1
Private Sector Banks	ICICI Bank	2.35	1.1	2,890	75.8
	Axis Bank	1.98	0.92	3,220	72.5
	Kotak Mahindra Bank	1.62	0.77	1,210	79.6

Analysis of Descriptive Statistics

The descriptive statistics contain a significant disparity in the simultaneously measured Non-Performing Assets (NPAs) for public and private banks. Banks in the public sector, like SBI, UBI, besides Canara Bank, have higher gross as well as net NPA ratios in terms of its value, as between 5.23% and 7.34% of gross NPAs and 2.13% and 4.21% of net NPAs. On the other hand private sector banks (ICICI Bank, Axis Bank, Kotak Mahindra Bank) reflect significantly lower NPA levels representing gross NPA between 1.62% and 2.35% and the net NPA between 0.77% and 1.10%. The results indicate that private sector banks hold a superior level of quality in their assets as compared to their public sector counterparts, which may possibly be attributed to tougher credit appraisal processes, rapid detection of stressed assets and aggressive recovery schemes.

The aggregate NPA amounts of public sector banks also look bigger, both due to greater NPA ratios and since the asset bases of these banks are larger. For example, the total NPA value of SBI is INR 12,450 crores which is much higher than the respective values of NPA in private sector banks such as ICICI Bank (INR 2,890 crores recorded) and Axis (INR 3,220 crores recorded). Such a difference in NPA figure suggests that despite NPA levels being higher in public sector banks, the latter have inefficient mechanisms for reducing the accumulation of non-performing assets as associated to private banks.

Furthermore, there is also a difference between the two sectors in regard to the provisioning coverage ratio – percentage of provisions reserved for NPAs. Public-Sector banks such as SBI and Union Bank have provisioning ratios ranging between 58.9 to 65.2 percent, which is a conservative assessment under the circumstances as it manages exposure to potential bad debts. Alternatively, there are private sector banks such as Kotak Mahindra Bank besides ICICI Bank that have better provisioning coverage ratios of between 72.5% and 79.6%, and this implies that they are in a better position to cushion themselves against any possible losses that can be a result of NPAs, perhaps this is due to the better financial health of such banks and positive asset management practices that an organization can adopt.

Such results highlight the importance of asset quality management in public as compared to the private sector banks in India. Low levels of NPAs and high provisioning ratios in private sector banks and high NPA ratios in public banks are indicative of better risk management by the former and persistent challenges to credit quality and recovery by the latter.

Independent Sample t-test

Group	N	Mean	Std. Deviation	Std. Error Mean
Public Sector Banks	10	6.25	1.47	0.46
Private Sector Banks	10	2.05	0.78	0.25

Levene's Test for Equality of Variances	F	Sig.
Equal variances assumed	2.56	0.123

Independent Samples t-Test	t	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	95% Confidence Interval of the Difference
Equal variances assumed	10.78	18	0	4.2	0.39	(3.42, 4.98)

Analysis of Hypothesis Testing:

For the study comparing the levels of Non-Performing Assets (NPAs) between public and private sector banks in India while doing hypothesis testing a method to be used is an Independent Sample t-test. Regardless of the difference in NPA of the two sectors, the null hypothesis (H_0) postulated that NPA in the two sectors do not have a significant difference while the alternative hypothesis (H_1) posited otherwise. The level of significance (α) was at 0.05.

After running the t-test, Levene' s Test for Equality of Variances yielded a p-value of 0.123 which is > 0.05 and hence the assumption of equal variances between the public and private sector banks was maintained. This enabled us to go ahead with the assumption for equal variances in the t-test.

The t-statistic which is a result of the independent samples t-test has a t-value of 10.78 and a p-value of 0.000 and less than the 0.05 value of significance. This implies that we reject the Null hypothesis (H_0) in favor of the alternative hypothesis (H_1). We therefore conclude that there is a statistically significant difference in the level of NPAs at private banks and public sector banks.

The difference in NPA in the two categories averagely stands at 4.20, this goes to show that on average the public banks have highly higher NPAs than the private banks. The mean difference has a 95% confidence interval from 3.42 to 4.98, which also tells that there is a meaningful difference.

In general, the hypothesis testing offers strong evidence of the fact that the levels of NPA of public sector banks are much higher than the ones in the private sector banks, thus confirming the statement about the public sector banks having the higher difficulties in dealing with their non-performing assets. This finding has far-reaching consequences for the banking industry by making it necessary to design specific strategies for addressing and eliminating NPAs, especially in public-sector banks.

Overall Conclusion:

To this effect, this study attempted to compare levels of NPAs in the public versus private sector banks of India; comparing the causes and consequences of NPAs both in public and private sector banks. According to the results of analyzing and hypothesis testing, it was the difference between the two groups. The Independent Sample t-test showed that public sector banks are significantly higher in NPAs than private sector banks wherein mean difference is 4.20. The statistical significance of the results was demonstrated by having a value of 0.000, less than the 0.05 significance limit.

The above findings reveal that the public sector banks are experiencing greater difficulties of meeting the NPAs and such a situation had potential to be deteriorating their profitability, liquidity, as well as overall financial viability of these banks. On the other hand, private sector banks seem to have greater effective mechanisms that constrain NPAs, which is indeed a good sign of the money being in good order and the overall efficiency level of such an institution.

The increased levels of NPAs in public sector banks may have been caused by reasons including the intervention by the government, poor credit appraisal procedures, and socio-political pressure that may affect loan allocation decisions. On the other hand, the private sector banks are a bit more commercially driven and have stricter lending criteria, in addition to having a more robust framework in place to both manage it.

In conclusion, the study highlights the need of improving the management of NPAs of PSB in order to improve their financial performance and partake in stabilizing the banking system as a whole. Policymakers and the management of a bank should think about referring to leading practices that are used in the private sector banks such as more strict credit evaluation practices, fast recovery measures, good risk management strategies that would help in slowing down the growth of NPAs and maintaining financial well-being in the long run.

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