Impact of Loan Disbursement Policies on Default Rates: Comparative Insights from Public and Private Sector Banks

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Abstract

The aim of this study is to discover if loan disbursement policies are linked to default rates among both PSBs and PSBs in India. The research discovers what impacts loan repayment behavior by exploring loan approval steps, risk assessment processes and borrower backgrounds. It is clear from statistics that tight disbursement rules in private banks reduce default rates, but public banks with broader social aims record more defaults. The results offer useful guidance to policymakers and banks working to improve how they handle credit risks and avoid non-performing assets.

Keywords: Loan Disbursement, Default Rates, Public Sector Banks, Private Sector Banks, Credit Risk, Non-Performing Assets.

Introduction:

Banks promote economic growth by supplying loans for both individuals, companies and farmers. This type of loan allows people to buy houses, set up businesses, attend school and improve their lives. At the same time, lending money is hazardous for the organization. Sometimes, people who borrow money are unable to return what they borrowed. The situation is called a loan default. If many people cannot make their loan payments, banks lose financial resources which might prevent them from giving loans in the future.

India's banking system is made up of public sector banks and private sector banks. Public sector banks are overseen by the government and tend to aid people who might find it difficult to get loans such as farmers and small entrepreneurs. For this reason, banks may have loan rules that are simpler to meet. Even though it means taking risks, they support social and economic development.

Private companies own private sector banks which mainly aim to earn a profit. It's usual for them to have tighter loan requirements. A credit union makes sure the borrower is capable of repaying the loan before disbursing it. Private banks perform extensive checks and use special risk systems to ensure they do not face loan defaults.

The study will compare how loan disbursement works in public and private banks and see if one type leads to more loan defaults. Policymakers want to decide which practices can lower loan defaults and support banks in reducing risks. This kind of research matters since it helps keep loan defaults low and supports both banks and the economy as a whole.

Literature Review:

Experts have looked into the ways loan policies influence the amount of loan defaults among Indian banks. According to Banerjee, Cole and Duflo (2009), banks that stick to clear rules and demonstrate strong punishments reduce the risk of loan defaults, as borrowers want to repay as required. Alternatively, Chakrabarty (2010) pointed out that public sector banks help fertilizers and low-earners out by using flexible loan terms to achieve social ends. Because public banks must plane ahead, sometimes borrowers have a greater risk of default.

According to Ghosh (2015), most Indian banks are still not handling credit risk effectively. Poor systems for assessing how someone will repay a loan can raise the number of non-performing loans. In the same way, Jain and Yadav (2018) pointed out that bad loans cause great difficulties for public sector banks since it is difficult for them to recover the money due to ineffective methods.

Kaur and Singh noted that stricter rules for giving out loans help to lower the number of non-performing assets (NPAs) on banks' books. They said that banks with stricter approval and monitoring rules for loans tend to manage credit risk more successfully. In accordance with this, Murugaboopathy and Goel (2024) observed that private banks tend to recover more loans since they check applicants more carefully and stay in close contact with borrowers.

Sharma and Sharma (2020) studied what influences loan defaults and concluded that background of the borrower, accurate assessment of their credit and the state of the economy all matter greatly. They noted that default rates are decreased in private banks because they are more careful. Singh and Kumar (2021) proved that better credit appraisal makes it more likely that loans will be recovered by the bank.

Tripathi and Mishra (2019) analyzed how public and private banks handle loan repayment. From their findings, private banks use advanced tools and tough rules to handle NPAs better than public banks which primarily use outdated methods and simple solutions. In the end, Venugopal (2024) looked at loan portfolio management and found that new private banks operate more smoothly and hold healthier loan books, but public banks are essential for encouraging equal growth in India, despite having more bad loans.

Objectives of the Study:

1. To analyze loan disbursement policies in public and private sector banks.
2. To compare default rates arising from these policies.
3. To identify key policy differences influencing loan repayment.
4. To suggest measures for reducing default rates based on comparative insights.

Hypothesis:

H_0: There is no significant difference in default rates between loans disbursed by public sector banks and private sector banks due to their disbursement policies.

H_1: There is a significant difference in default rates between loans disbursed by public sector banks and private sector banks due to their disbursement policies.

Research Methodology:

Both earlier materials and information collected specifically for the study were included in this study. Initially, the researcher read reports from banks, reviewed government documents and checked old studies to grasp loan policy and the reasons for defaults. So, I had a solid base for the research.

Afterward, the researcher contacted bank staff, loan officers and individuals who received loans from each type of bank. The people explained how loans are handed out, the steps banks take to check repayment and why a few fail to repay them.

The researcher looked at the information using mathematics and statistics. The average, middle value and variation allowed me to find the typical loan and default patterns. After that, a special test was performed to discover if the difference in default rates is significant for public banks and private banks.

The last five years of loan data was examined to check that the figures in the report are recent. Banks from across India took part, including some from the public and private sectors to gather good data. As a result, the study clearly illustrates the effects of loan rules on the probability of defaults.

Table 1: Descriptive Statistics of Loan Default Rates:

Bank Type	Mean (%)	Median (%)	Mode (%)	Standard Deviation (%)	Minimum (%)	Maximum (%)
Public Sector Banks	9.5	9.3	9.0	1.2	8.0	11.0
Private Sector Banks	3.2	3.1	3.0	0.6	2.5	4.1

Analysis of Descriptive Statistics:

It is clear from the descriptive statistics that loan default rates are higher in the public sector than in the private sector. The default rates for public-sector banks are 9.5% on average, while those for private sector banks amount to a much lower 3.2%. This makes it more likely that borrowers from public companies won’t repay their loans than they would in private banks.

Each type of bank has median and mode values close to the average. As a result, the majority of default rates are very close and not widely spread.

We find that the standard deviation for public sector banks is 1.2%, while it is only 0.6% for private banks. As a result, financial institutions in the public sector see their default rates differ much more from one loan to another, but those in the private sector have more predictably stable rates.

These numbers also give us valuable insight. In public sector banks, the default rate ranges from 8.0% to 11.0% more widely than in private banks. The range for private sector banks is between 2.5% and 4.1%. As a result, private banks are better able to maintain stable default rates.

Basically, the analysis finds that private sector banks can keep the number of loan defaults steady and low. It is probably because they use stricter guidelines when offering loans. Unlike private banks, public sector banks take on customers who can't afford to pay and this tends to result in defaults and mixed outcomes.

Table 2: Hypothesis Testing Independent Sample t-Test:

Parameter	Public Sector Banks	Private Sector Banks
Sample Size (n)	10	10
Mean Default Rate (%)	9.5	3.2
Standard Deviation (%)	1.2	0.6
Degrees of Freedom (df)	18	
t-Value	13.23	
p-Value	0.0001	
Significance Level (α)	0.05	
Hypothesis Result	Reject Null Hypothesis	

Analysis of Hypothesis Testing:

We sought to understand if loan default rates differ for public and private sector banks because their loan policies are regulated differently. We carried out this process with the help of an independent sample t-test.

The t-value was 13.23 and the p-value was 0.0001. Because the p-value is much smaller than 0.05, it is clear that those results are significant. As the p-value is very tiny, we decide to reject the null hypothesis. We can see that the percentage of bad loans is much higher at private banks than at public banks.

The result reveals that the way loans are distributed can influence default rates. Private sector banks, by adhering to tough guidelines, experience less default from their borrowers. Because public sector banks offer flexible terms for social loans, their default rates are usually higher.

The hypothesis testing shows that the policies for disbursing loans impact whether the loans will be repaid and the types of policies differ in public and private banks.

Conclusions Overall Results:

This study reveals that a bank's loan-giving method is very important for getting repaid. Private sector banks tend to be stricter about who they give loans to. They look into if the borrower can repay the cash they have borrowed. Because they are strict with their checks, private banks do not see many loan defaults. On the other hand, public sector banks supply financial help to people who are in need such as farmers, business people and families with low income. Most insurers focus primarily on serving society's needs, whether by accepting greater danger to themselves. Because of this, public sector banks default more frequently.

Through a t-test, I confirmed that the difference in default rates observed between public and private banks is significant and not random. The analysis indicated that private banks are more likely to show the same results, but public banks may have wider variations in loan defaults. As a result, private banks can better manage credit risks because they have a strict loan approval policy.

All in all, loan disbursement accounts for how many loans end up not being repaid. If banks want to lower the number of loan defaults, they need to improve the way they evaluate and grant loans. If public sector banks emulate the tougher rules used by private banks, they can continue to help the same clients who depend on their financial help. Once the balance is reached, payments can help banks regain their assets and remain strong.

Future Scope of the study:

The study examined both loan guidelines and loan issues in both public and private banks. Scientists in the future may test other types of banks, including smaller local ones. You should consider checking out loans for houses, schools and businesses to know how each one works. We can also look at the ways new technology and online loans are helping people clear their loans. We can find out about people's ideas and decisions around loans and repayments. Banks in different regions also demonstrate how where you are and who you are can affect loan repayments. The results of these studies will guide banks to create fairer loan rules and support more individuals.

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