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Comparative Study of NPAs in Mudra Loans: Public Sector v/s Private Sector Banks

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Abstract

This research paper investigates the issue of Non-Performing Assets (NPAs) in loans sanctioned under the Pradhan Mantri Mudra Yojana (PMMY), comparing the performance of public sector banks (PSBs) and private sector banks (PvSBs). The study utilizes secondary data from RBI reports, government publications, and annual bank reports to analyze trends, causes, and management strategies of NPAs. The analysis reveals that PSBs face higher NPA ratios in Mudra loans compared to PvSBs due to differences in credit appraisal, monitoring mechanisms, and borrower profiles. The paper concludes with recommendations to strengthen the Mudra loan framework and reduce NPAs across the banking sector.

Keywords: Pradhan Mantri Mudra Yojana (PMMY),Non-Performing Assets (NPAs),Public Sector Banks (PSBs),Private Sector Banks (PvSBs), Comparative Banking Study, Banking Sector Reforms.

Introduction

The Pradhan Mantri Mudra Yojana (PMMY), launched in 2015, aims to support micro and small enterprises by providing collateral-free loans up to Rs. 10 lakhs through various financial institutions. These loans, categorized into Shishu, Kishore, and Tarun, have played a key role in promoting financial inclusion. However, the growing incidence of Non-Performing Assets (NPAs), especially in public sector banks, has raised concerns about the scheme's sustainability. This study focuses on comparing the NPA levels and management practices in public and private sector banks under Mudra loans to identify underlying causes and suggest improvements.

Objectives of the Study

- To analyze the trends of NPAs in Mudra loans among PSBs and PvSBs.
- To compare the causes of NPAs in both banking sectors.
- To evaluate the effectiveness of recovery and risk management mechanisms.
- To suggest policy recommendations for improving asset quality.

Review of Literature

The issue of Non-Performing Assets (NPAs) in Mudra loans has attracted considerable attention from researchers and policymakers. Multiple studies have explored the factors influencing NPAs and the performance of different types of banks under the Pradhan Mantri Mudra Yojana (PMMY).

- **RBI Reports (2019–2023)** consistently indicate that Public Sector Banks (PSBs) have a higher share of Mudra loan disbursements but also report significantly higher NPA levels than Private Sector Banks (PvSBs). The reports highlight challenges in credit appraisal and recovery mechanisms in PSBs.

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- **Sharma & Gupta (2020)** examined the role of credit appraisal and borrower screening in controlling NPAs. Their study found that private banks, owing to better use of technology and stricter lending norms, tend to have fewer defaults under Mudra loans.
- **ICRA (2022)** emphasized the importance of risk-based lending. The study noted that PvSBs have better asset quality due to cautious lending practices, limited exposure to high-risk borrowers, and use of credit scoring models.
- **Economic Survey (2021–22)** acknowledged that while PMMY has been instrumental in promoting financial inclusion, rising NPAs pose a threat to the scheme's effectiveness. It called for improved financial literacy, especially among micro-entrepreneurs.
- **Mohan & Reddy (2021)** studied the socio-economic background of Mudra loan defaulters and concluded that lack of business training and inconsistent income streams were major reasons for default in PSB-disbursed loans.

Research Methodology

The study is based on secondary data collected from the Reserve Bank of India (RBI), Ministry of Finance, annual reports of major public and private sector banks, and relevant research articles. The data covers the period from 2016 to 2023. A comparative analysis was done using statistical tools such as ratio analysis and trend analysis.

Trends in NPAs (2016–2023)

- From 2016 to 2018, NPA levels remained moderate across both sectors. However, PSBs saw a steady increase beginning in 2018, coinciding with aggressive disbursement targets.
- In 2020–21, the COVID-19 pandemic exacerbated default rates, with PSBs witnessing a sharper rise in NPAs due to their larger exposure to vulnerable borrower groups.
- PvSBs showed resilience through tighter credit screening and digital tracking, maintaining comparatively stable NPA levels.
- The post-2021 period reflects attempts at stabilization, with PSBs initiating recovery drives, though still lagging behind PvSBs in controlling asset quality.

Causes of NPAs: Comparative Analysis

- **Public Sector Banks (PSBs):**
  - Lenient Loan Appraisal: PSBs often follow broader government mandates to promote inclusive lending, sometimes at the expense of thorough credit evaluation.
  - Political and Social Pressure: Mandated lending to priority sectors may compromise risk assessments.
  - Limited Technological Integration: Manual processes and outdated systems hinder efficient borrower evaluation.
  - Ineffective Monitoring: Delayed follow-ups and weak loan tracking mechanisms.
  - Higher Exposure to Informal Sector: Increased vulnerability due to limited credit history of borrowers.

- **Private Sector Banks (PvSBs):**
  - Strict Credit Checks: Emphasis on creditworthiness and use of credit scoring tools.
  - Digital Risk Analytics: Advanced tools for risk profiling and borrower monitoring reduce defaults.
  - Selective Lending: Preference for less risky and more profitable customer segments.

- Better Recovery Processes: Streamlined legal and technological systems aid faster resolution of defaults.
- Higher Operational Efficiency: Leaner operations lead to better loan portfolio management.

Risk Management and Recovery Mechanisms: Effectiveness Evaluation

- **Public Sector Banks (PSBs):**
  - Recovery efforts are often delayed due to procedural bureaucracy, limited staff training, and inefficient follow-up.
  - Asset Recovery branches are understaffed and sometimes lack adequate legal support to expedite recovery.
  - PSBs largely rely on manual processes, which slow down response times and weaken borrower communication.
  - Government interventions, such as loan waivers and moratoriums, reduce the incentive for borrowers to repay on time.
  - Risk management frameworks in PSBs are generally outdated, with limited use of predictive analytics or early warning systems.

- **Private Sector Banks (PvSBs):**
  - PvSBs utilize AI and analytics-based early warning systems to detect potential defaults well in advance.
  - Dedicated recovery teams and third-party agencies enhance follow-up and legal proceedings, improving loan recovery.
  - Use of centralized digital dashboards allows real-time monitoring of NPAs.
  - PvSBs often incentivize recovery agents and implement flexible restructuring options to manage delinquent accounts effectively.
  - Their dynamic risk management practices, including frequent portfolio reviews, ensure quick risk mitigation actions.

Overall, private sector banks have demonstrated superior effectiveness in both recovery and risk management practices compared to public sector banks. Their technological advantage, faster decision-making, and customer-focused strategies contribute significantly to their lower NPA levels under the Mudra scheme.

Analysis and Findings

Disbursement Trends:

- PSBs account for over 60% of total Mudra loan disbursements.
- Private banks contribute around 20-25%, with the rest covered by RRBs and MFIs.

NPA Ratios:

- As of 2023, PSBs reported an average NPA ratio of 8-10% in Mudra loans.
- PvSBs maintained a relatively lower NPA ratio of around 3-5%.

Discussion

The trend analysis clearly indicates that while both bank categories faced rising NPAs in the aftermath of the pandemic, PSBs consistently show a higher burden. Structural inefficiencies, lax due diligence, and wider outreach contribute to this divergence. In contrast, private banks limit their exposure to high-risk borrowers and deploy better technology for monitoring, resulting in lower NPAs. Thus, the data trend from 2016 to 2023 reinforces the need for differentiated policy approaches for each sector.

Recommendations

- Strengthen credit appraisal and due diligence in PSBs.
- Implement borrower education and financial literacy programs.
- Encourage use of technology and AI in loan tracking and risk assessment.
- Promote accountability and periodic performance audits.
- Provide dedicated training for recovery agents and legal support teams in PSBs.
- Establish a centralized digital monitoring system across PSBs to track Mudra loan accounts.

Conclusion

This comparative study underscores significant differences in the management of NPAs under the Mudra scheme by public and private sector banks. Public sector banks, while instrumental in financial inclusion, face higher NPAs due to systemic inefficiencies and wider exposure to at-risk borrowers. In contrast, private sector banks benefit from superior credit assessment, technological integration, and targeted risk strategies, resulting in more stable asset quality. Addressing the root causes of NPAs through robust credit mechanisms, technology-driven monitoring, and sector-specific reforms is crucial for the long-term sustainability of the Mudra initiative. By learning from private sector practices and enhancing institutional capacity, PSBs can improve their performance and reduce the NPA burden, thereby strengthening the overall impact of the PMMY scheme.

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