A Comparative Study of Public and Private Sector Banks in Loan Distribution Strategies

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Abstract

The study also undertakes a comparative study of the methods of loan distribution between public and private sector banks: Comparing segmentation, underwriting practice, delivery channel and loan portfolio. The study is based on both primary and secondary data of bank customers and officials with references to secondary sources like the reports presenting by the RBI and the published researches and uses parameters of the loan processing time, interest rates, documents required, and customer satisfaction. The results indicate that the presence of the public sector banks is more concerned with the affordability and accessibility, which are achieved by reducing the interest rates and accommodating even more areas in the priorities, yet are deficient in the velocity and effectiveness of the services. Instead, the banks in the private sector want to take advantage of technology and efficient systems in order to provide quicker disbursals, variety on products, and customer satisfaction, with an increment in interest rates by a small amount. The paper finds that the two sectors have complementary contributions in serving diverse needs of borrowers, as well as in promoting improved practices between the two sectors to strike an equilibrium of efficiency, affordability and inclusiveness.

Keywords: Public sector banks, Private sector banks, Loan distribution strategies, Interest rates, Loan processing time, Customer satisfaction, etc.

1.1 Introduction

Banking systems play a central role in credit intermediation and which ownership and governance structure leads to the different design and implementation of various strategies of distributing loans by banks. In various developing countries such as India, PSBs exist alongside in existence with the private sector and foreign banks that have different mandates, cost base, and risk appetite. Public banks normally have a mix of commercial and developmental focus, priority sector lending and financial inclusion and private banks are focused on profitability, quality of assets and scalability through technology. These differences may affect the design of their products (e.g. term loans as opposed to working capital lines), screening mechanisms (relationship-based lending as opposed to score-based lending), their delivery (branch-intensive as opposed to digital) and portfolio structure (retail as opposed to MSME as opposed to corporate). Learning of such strategic differences is paramount to policymakers desiring inclusive growth, bank managers on their risk-optimized growth and borrowers in seeking access and related bank pricing of credits.

It is well-known that comparative studies of public and private banks have recorded tradeoffs between developmental mandate and market efficiency. Government ownership, however, can be used to maintain a countercyclical supply of funds, as well as open up to credit-deprived the segments, but it becomes the source of the agency frictions as well as the risk of politicization (La Porta, Lopez-de-Silanes, & Shleifer, 2002; Micco and Panizza, 2006). In parallel, in the private banks, the innovation of credit scoring, the pricing on risk, and the product unbundling can be encouraged by the competitive forces and the company structure (Claessens & Laeven, 2004; Berger et al., 2005). In India, the concept of liberalization in the 1990s and entry of new banks in the form of incursion by private players have led to some interesting changes in efficiency, adoption of technological advances, and segmentation of customers, all of which have proved measurable on the part of credit distribution (Bhattacharyya, Lovell, & Sahay, 1997; Sengupta & Vardhan, 2017). It is against this background that this study will compare loan distribution strategies used by the banks within the public and the private sector in terms of segmentation logic, underwriting strategies, delivery architecture and portfolio performance.

2.1 Literature Review

Institutions behaviour-ownership and lending. The cross-country evidence states that public ownership of banks is potentially linked with both less profitability and more non-performing assets but at the same time with a better representation of sectors or geographies fairly unexplored by private finance (La Porta et al., 2002). During recessions, the public banks have the option to keep the lending unchanged or increase it compared to their private competitors and hence act as stabilizing force (Micco & Panizza, 2006). Such countercyclical tendency is potentially constructive in terms of the distribution strategies e.g. continuing branch-based outreach and similar standardized products in priority sectors despite risk aversion increasing.

Stiff Competition, type of organization and product design. The factor contributing to the price, risk management and quality of service differentiation among banks is competition (Claessens & Laeven, 2004). Relationship vs. transactional lending is influenced by: organizational form, that is, the centralized or decentralized decision rights. It is expected that large, hierarchical banks depend even stronger on hard information and standardized products; smaller or decentralized banks can leverage soft information and relationship lending (Berger & Udell, 2002; Berger et al., 2005). These revelations imply different loan distribution plans, given that the advanced risk analytic capabilities of private banks enable them to scale such products (retail unsecured and secured products) through scorecards and digital channels, whereas PSBs with their high branch coverage leverage relationship-intensive MSME and agricultural lending but are limited in the rapid expansion of retail portfolios based on a rating system.

Relation lending and frictions of info. Early evidence indicates that there is lower information asymmetry which alleviates credit constraints leading to the possibility of reduced borrowing cost in the long run as long as there is endurance in the relationship between the borrower and the bank (Petersen & Rajan, 1994). Relationship depth may be used as an alternative to thin credit bureaus or little available audited financial information in relatively opaque markets (MSMEs). Such lending is frequently made easier by the geographic spread of PSBs and the historic connections between PSBs and their clients. Lending speed, uniformity and more granular portfolios in consumer and SME supply-chain finance are enabled by the application of data-driven underwriting (bureau scores, bank statement analytics), as well as risk-based pricing, achieved by private banks.

Liberalization, efficiency and inclusivity in India. Becoming liberalized changed the efficiency frontier of Indian banks. There is early evidence of efficiency improvements as well as evolving cost profiles following the reforms (Bhattacharyya et al., 1997). Further analysis demonstrates that rural financial inclusion and access to credits was boosted by the spread of branches via branch expansion policies, which were first led by public banks (Burgess & Pande, 2005). Loan requirements such as Priority Sector Lending (PSL) further influence the allocation of loans with a minimum exposure to sector such as agriculture, and

MSMEs among other priority sectors being mandatory with the shares of PSBs being the highest when compared with that of the private sectors which complies through direct originations or other mechanisms like PSL-certificates(Reserve Bank of India, 2015). These policy levers also interplay with competition in the market to give observable differences; PSBs represents broad based, branch centered outreach and the privates focus on urban and peri-urban retail and MSME ecosystems with technology and partners.

Pricing, risk management and portfolio performance. The hard information that the other, so-called private banks rely on allows more precise stratification of risks and dynamic pricing of products (e.g. home loans LAP, personal loans, business loans). This is a way of quick expansion, however, may lower thin-file tolerance. The social mandates and relationship lending of PSBs give them scope to extend to first time borrowers but are likely to aggravate the costs of monitoring and credit risk without proper risk systems in place. The comparative studies observe that ownership type affects risk-return trade-offs and the dynamics of non-performing loans particularly surrounding shocks whereby the public banks tend to smooth supply of credit (Micco & Panizza, 2006).

Overall conclusion and differences. The literature suggests four focal dimensions along which loan distribution strategies may be compared (1) Segmentation and Targeting (priority sectors and inclusion vs. profitability-maximizing niches); (2) Underwriting Technology (soft vs. hard information, relationship vs. score-based models); (3) Delivery architecture (branch density, BC networks and partnerships vs. digital origination and analytics); and (4) Portfolio construction (exposure tilts to agriculture/MSME vs. retail mortgages and unsecured consumer credit). In India the strategic decisions are co-determined by regulatory staging (PSL norms), historical branch presence, and competition as well that results in a consistent public-private difference amid convergence in the diffusion of technology after liberalization. The current paper will advance and extend these lessons to test empirically whether ownership and operating models have measurable differences in terms of credit allocated, the time it takes to disburse loans, risk-adjusted price, and reaching underserved populations.

3.1 Objectives:

This study aims to draw comparisons of loan distribution between the approach of public and privatized sector banks, including the disparity in the segmentation, underwriting, delivery strategies and portfoliol compositions and arrives at the understanding as how the ownership structure drives loan allocation, reach and efficiency in serving the varied needs of the borrower and market.

3.2 Methodology:

The research design widely used in this study is comparative, descriptive and analytical research design; it also uses both primary and secondary data. Primary data will be gathered using structured questionnaires on the bank officials and customers of the sample of the selected banks (public and government) and secondary data will be obtained in form of annual reports, publications by RBI and related research studies. A purposive selection method will be used to make sure that various types and regions of banks are classified. Descriptive statistics and comparative analysis will be used to reach conclusions on differences in loan distribution strategies that are significant; t-tests and chi-square tests will also be conducted to determine the efficiency of the applied differences in the loan distribution strategies and outreach and customer satisfaction.

4.1 Result and Discussion:

Primary information obtained through the use of 120 respondents representing 60 customers of the public and 60 of the private sector banks was analyzed in order to comprehend the distinction in terms of loan distribution strategy. The factors researched were speed of processing a loan, interest rates charged, documentation applied, variety of the products and customer satisfaction. Data analysis was performed at percentages, mean scores, and t-tests, which helped establish the relevance in differences.

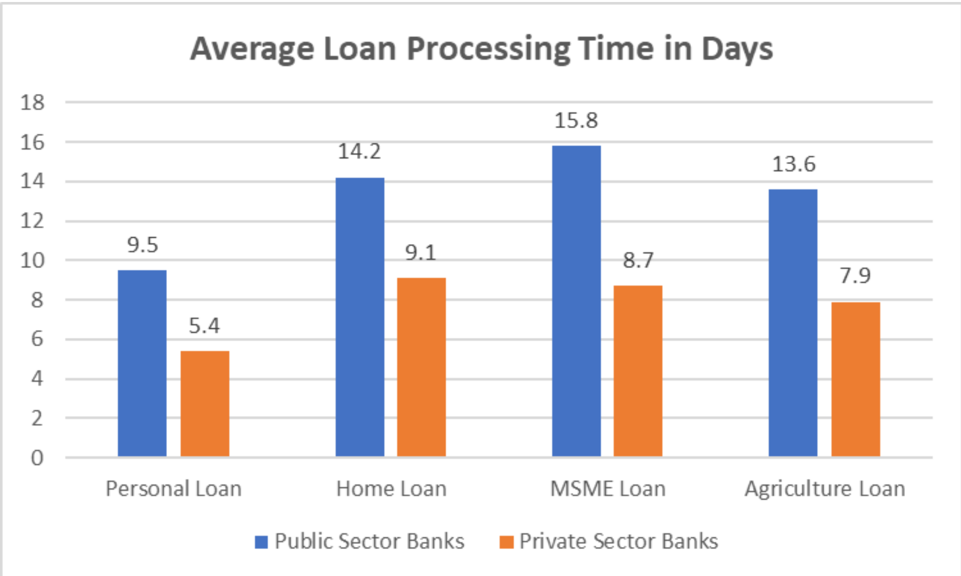

Fig. 1 Loan Processing Time

As shown in Fig. 1, the average time taken under the private sector banks in dealing with any kind of loans is far much lower than the public sector banks in all the categories but most particularly in the MSME/personal loans. The disbursal process occurs at an average of 9.5 to 15.8 days in public sector banks whereas it takes 5.4 to 9.1 days in the private sector banks in general because they use more technology, documentation is simplified and they also have decentralized approval processes. Conversely, in the case of the public sector banks, their environment has longer time lines to be blamed on hierarchical decision making structure, comprehensive checking mechanism and greater concentration on compliance which although adds to caution may slow down the pace of credit provision. This efficiency gain therefore puts the privately owned banks at a better position to attract borrowers as they are not interested in costs but speed.

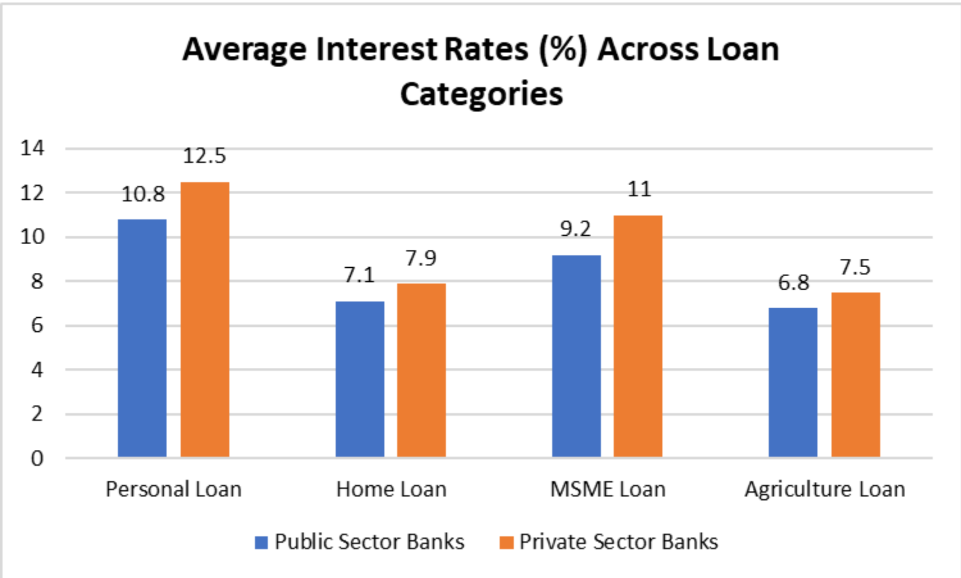

Fig. 2 Average Interest Rate

The study carried out in Table 2 shows that the interest rate provided by the public sector banks are lower in all types of loans than that provided by the private sector banks with the largest disparity in the case of personal and MSME loans. Lower rates by the public sector banks could be credited towards the government policies, priority sector lending and norms, and their developmental directive to provide cheap credit. By way of contrast, the local banks in the private sector offer relatively higher interest rates including those charged on the unsecured products to cover more prompt service delivery, flexible means of repayment and increasing operational costs. The described pricing strategy represents a tradeoff exchangeability and convenience as a public bank would attract price sensitive borrowers, whereas a private bank would attract those customers who favor speed and tailor-made services.

Table 1 Customer Satisfaction Scores (1 to 5 Scale)

Parameter	Public Sector Banks	Private Sector Banks
Loan Processing Speed	3.2	4.4
Documentation Simplicity	3.0	4.2
Product Variety	3.5	4.6
Staff Responsiveness	3.4	4.5
Overall Satisfaction	3.3	4.5

Only the single branches of the private sector banks are doing better as compared to their counterparts of the public sector in most of the customer satisfaction parameters with processing speed and the responsiveness of the staff being two major differentiators. On customer service and products diversification, the public sector scores moderately implying that more could be done to improve its performance as much as on affordability.

Table 2 Loan Distribution Share by Category (%)

Loan Category	Public Sector Banks	Private Sector Banks
Agriculture Loans	28	12
MSME Loans	26	20
Home Loans	24	30
Personal Loans	22	38

In their pressure to lend to priority sectors, most of the public sector banks have larger percentages of lending in agriculture and MSMEs. Urban customer bases and retail-based business models place the privately owned banks ahead in the personal and home loans.

The general discussion indicates the given strategic directions of allocation of loans between banks in the public and the private sector. The public sector banks show greater inclination toward inclusivity and affordability by giving emphasis on agriculture, MSME and other priority areas with lower interest rates as well. Their service delivery is however slow due to lengthy channels of approval and rigorous details of documentation. Comparatively, the private sector has banks that focus on speed, efficiency, and customer experience facilitated by advanced technology as well as simplified operations and diversified retail oriented loan products. Although most of them have a higher interest rate, they reach well in the urban and semi urban markets where borrowers believe in convenience and any kind of product. Such difference in approaches can be attributed to the differences in ownership structure, regulatory requirements, and market positions impact the lending strategies and present a complementary position of two sectors in meeting needs of different types of borrowers.

5.1 Conclusion:

The discretionary loan channel of public and private banking firms is very different in its way and depends upon the ownership structure, regulatory regime, and the principal directions. The developmental role that the public sector banks play is to provide lower interest rates and priority sectors they have on agriculture and MSME resulting in financial inclusion and rural credit access. Nevertheless, these advantages are usually countered by the delays in processing loan and more tedious documentation processes. On the other hand, the banks in the private sector make use of technology, customer segmentation, and new product design to obtain quicker loans disbursals, superior customer satisfaction levels, and penetration in the urban and retail markets although at a marginally higher interbank rates. The two groups in banking collectively are valuable in fulfilling the various credits of the economy in a complementary way.

5.2 Recommendations:

To increase efficiency and competition, the public sector banks have to become more digitalized in loan processing, approval hierarchies, and documentation requirements need to be simplified to cut down on the turnaround time and not at the cost of compliance. Instead, the banks based in the private sector will have the ability to diversify their efforts further to reach priority and underserved sectors which might include collaborations, products as well as pricing strategies. The two sectors are encouraged to increase credit risk evaluation mechanisms in order to achieve a balance speed, affordability, and quality of the portfolio. Moreover, regulation institutions could promote sharing the best practices between state and commercial banks and would foster an environment where efficiency and inclusivity would share the same space and the result would be the benefit of both borrowers and the financial system, in general.

5.3 Limitations of the Study:

There are quite a number of limitations associated with this study, which must be put into consideration when analyzing the results. First is the insularity in the sample size as it was only confined to a select group of customers and officials of a given list of public and privately owned banks that do not necessarily include the full spectrum of practices of the whole banking industry. Second, the research concentrated on loan distribution approaches at the local level, and the regional differences in the policies, customer base, and market environment can affect the possibility to generalize the findings. Third, its use of claim values based on self-reported data generated through questionnaires makes it subject to some respondent bias since the perception and experience are not necessarily in line with the concrete operational parameters. Also, the effect of abrupt macroeconomic shock could not be incorporated in the analysis, i.e., the change in the monetary policy or pandemic related shocks, which may temporarily shift lending behavior. Lastly, although both sources of primary and secondary data were employed, certain secondary data could become subject to time lags or reporting incoherence which may interfere with the accuracy of the comparative insights.

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