Estimating Adverse Selection in Indian Banks: An In-Depth Study of Non-Performing Assets of All Public Sector and Private Sector Banks in India

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Abstract
Adverse Selection is a problem facing lenders across the world. Evidence of instances of Adverse Selection by lenders is available in literature from different parts of the worlds, however, there appears to be no method of measuring the same through a metric which may be used across economies. This paper attempts to provide a metric for estimating Adverse Selection using data from Indian banks from an ex-post perspective using mathematical techniques. It performs computation using data relating to 46 Scheduled Commercial Banks in India (26 Public Sector Banks and 20 Private Sector Banks) as published by selected banks, for the 11 year period 2004-2014. The results point towards presence of Adverse Selection, which we attempt to measure and highlight steps to improve the measurement and to take urgent steps to curtail the problem of Adverse Selection with a view to improving the health of Indian banks.

Key Words: Indian PSU Banks, Adverse Selection, NPA Estimation, Index of Adverse Selection