Estimating Moral Hazard in Indian Banks: An In-Depth Study of Non-Performing Assets of Public Sector and Private Sector Banks in India

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Abstract
Moral Hazard is a problem facing lenders across the world. The problem originated in economic literature a few decades ago and there is ample geographical evidence of instances of Moral Hazard however, there appears to be no method of measuring the same at the level of lenders or economies. This paper attempts to provide a metric for estimating Moral Hazard in Indian banks using analytical techniques. It presents a small step as an attempt at ‘quantifying’ Moral Hazard in Indian banks and taking a look at the problem at the macro / system level. It is open for discussion and debate as also for further inputs by contemporary researchers. This paper performs computation on key information provided by banks for the 14 year period 2002-2015 and also tracks evidence from the field about Moral Hazard. It goes on to compute the index of Moral Hazard based on existing actual ex-post data. The results point towards presence of Moral Hazard, which we attempt to measure and highlight steps to be taken by lenders to curtail the problem of Moral Hazard. There is an urgent need to take steps to curtail the problem of NPA with a view to enhancing the health of Indian banks.

Key Words: Economics of Information, Indian Banks, Moral Hazard, Index of Moral Hazard