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CREDIT RISK MANAGEMENT OF COMMERCIAL BANKS IN INDIA: A COMPARATIVE STUDY OF SELECTED PUBLIC AND PRIVATE SECTOR BANKS

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ABSTRACT

Every country has to undergo from the continuous process of development. Banks play a vital role in this process. The Indian banking system has progressed as a powerful mechanism of planning for economic growth. Banks channelize savings to investments and consumption. Through that, the investment requirements of savers are reconciled with the credit needs of investors and consumers. NPAs reflect the performance of banks. A high level of NPAs suggests high probability of a large number of credit defaults that affect the profitability and net- worth of banks. NPAs affect the liquidity and profitability. The problem of NPAs is not only affecting the banks but also the Indian economy. In fact high level of NPAs in Indian banks is nothing but a reflection of the state of health of the industry and trade. It is necessary to trim down NPAs to improve the financial health in the banking system. For the study data has been collected from secondary sources. An attempt is made in this paper to understand NPA, the status and trend of NPAs in public and private sector banks of India. The factors contributing to NPAs, are the reasons for high impact of NPAs on banks in India and recovery of NPAs through various channels.

KEYWORDS: *Credit Risk Management, Non-Performing Assets, Know Your Customer (KYC).*

Introduction

Worldwide recession and its impact on Global economy have highlighted the need for banks to incorporate the concept of Credit Risk Management particularly in Indian economy into their regular policies. In current scenario credit risk in Indian banks has increased due to market competition, social and economical condition, dynamics of market, and foreign exchange business and Global Business. Today, most of the banks in India are facing the default risk with respect to the business and Agriculture loans and advances. In recent years most of the Indian banks have started to expand their branches and diversify to other business such as insurance mutual funds etc. However, these expansions also bring risk for these banks. At the times of high volatility and fluctuations in the market, banks need to prove their sustainability in terms of growth as well as have a share value. Hence, an important factor for credit risk management framework would be to steam line all the risks and maximize profit from the products and service offered by the bank. There is a need that the banks have to discriminate avoidable and unavoidable risks and are required to decide on what extent such risks can be taken by banks. Risk plays a major part in the profit making of a bank, the high risk pays high returns, and hence it is essential to maintain priority between risk and return.

Credit Risk

Commercial banks continue to remain in the forefront of Indian financial system. Banks provide necessary finance for planned development. if a borrower is failed to repay the debt amount which may raise default on a debt and this condition is known as a credit risk. Risk means that there is a possibility of loss or damage which, may or may not happen. In the simplest words, risk may be defined as possibility of loss. It may be financial loss or loss to the reputation/ image.

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Type of Risks

The major risks in banking Sector as commonly referred, are listed below:

- Liquidity Risk
- Interest Rate
- Market Risk
- Credit or Default Risk
- Operational Risk
- Other Risk

Literature Review

- **Rekha Arunkumar and Koteshwar (2017),** feel that the Credit Risk is the oldest and biggest risk that Banks, by virtue of their very nature of business inherit. The pre-dominance of credit risk is the main component in the capital allocation. As per their estimate credit risk takes the major part of the Risk Management apparatus accounting for over 70 per cent of all Risks. As per them the Market Risk and Operational Risk are important, but more attention needs to be paid to the Credit Risk Management in Banks.
- **Vivek Rajbahadur Singh (2016),** in their study an attempt is made to understand the status and trend of NPAs in Indian Scheduled commercial banks, The factors contributing to NPAs, reasons for high impact of PAs on Scheduled commercial banks in India and recovery of NPAs through various channels. This study shows that extent of NPA is comparatively very high in public sectors banks. The NPAs level of our banks is still high as compared to the foreign banks.
- **Nayan & Kumaraswamy (2014)**, in their study find that the profit in PSBs was declining trend due to competition, lack of diversity of banking services and stringent rules of RBI before economic reforms. The profit was declining initial period due to operation was not linked with profit and lack of diversity in the banking services.

The Credit Evaluation Process

The credit evaluation process of applicant involves three steps:

- Gathering Credit information
- Credit Analysis (credit worthiness of applicants)
- Credit Decision

Non-performing Assets

An asset, including a leased asset, becomes nonperforming when it ceases to generate income for the bank. A non – performing asset (NPA) is a loan or an advance where:

- Interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan.
- The account remains “out of order” in respect of an Overdraft/Cash Credit (OD/CC).
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.
- The installment of principal or interest there on remains overdue for two crop seasons for short duration crops,
- The installment of principal or interest there on remains overdue for one crop season for long duration crops.

Statement of Problem

Post liberalization, credit Risk Management has got much importance in the Indian Economy. The main challenges faced by the banking sector today are the challenge of identifying the risk and managing it. The risk is imbibed nature of the banking business. The main role of bank is of intermediate for those having surplus and those requiring resources. For risk management various risks like credit risk, market risk or operational risk have to be converted into one composite measure. Therefore, it is necessary that banking sector credit risk management is being most important task of all.

Objectives of the Study

- To understand the concept and nature of Credit Risk Management of Commercial Banks (public and private sector) in India.
- To know the different types of credit risks and the techniques to manage risk in Indian banks.
- To analyze the trends in Non-Performing Assets of Public and Private sector banks in India.
- To analysis lending trend of Commercial banks for borrowers.
- To analyze NPAs position of Public and Private Sector Banks and their risk management
- To suggest the measures for improving credit risk management practices of public and Private sector banks of India.

Research Methodology

This study includes secondary data and The secondary data have been collected were studied and data available on internet and other sources have also been used like Annual Reports, RBI Publications etc.

Research Type

This research is descriptive in nature which is relevant to an inquisitive study as it requires some analysis on the efficient management of bank's credit risk relating to NPAs.

Types of Data

The secondary source of data have been collected from annual report of RBI publications including Trend and Progress of Banking in India (from the year 2012-2017), Statistical Tables relating to Banks in India, Articles, books, website and Papers published in different journal and magazines concentrated on Commercial Banks only information.

Data Analysis Tools

After collecting the relevant data, the relevant data is converting into tabular form. The statistical tools which are considered for the study are trend, Ratio Analysis.

Data Analysis and Interpretation

Analysis of Gross Advances and Gross NPAs .Firstly the study examined the trend of gross advances, total assets, gross NPAs, ratio of gross NPAs to Gross Advances, and gross NPAs to total assets. It is revealed from the table that gross advances of the banks have shown a rising trend during the study period 2012 to 2017. The gross NPAs in absolute terms have increased by 2012 to 2017. The study observed that the gross NPAs of private sector banks have less than Public Sector Banks.

Summarized Statement of NPAs

For determining the trend and magnitude of NPA, summarized statement is prepared using rank, combined rank and ultimate rank which shows actual positions of banks in terms of NPA.

Table 1: Summarized Statement of NPAs on Bank Wise Mean Value

Banks	GNPA to Gross Advance	Rank	GNPA to Total Assets	Rank	NNPA to Net Advance	Rank	NNPA to Total Assets	Rank	Combined Rank	Ultimate Rank
SBI	5.30	2	3.61	2	2.69	2	1.69	2	8	5
BOB	5.17	3	3.12	3	2.50	3	1.44	3	12	4
PNB	7.41	1	4.75	1	4.53	1	2.79	1	4	6
AXIS	1.88	5	1.29	5	0.70	5	0.48	5	20	2
HDFC	0.98	6	0.61	6	0.25	6	0.16	6	24	1
ICICI	4.46	4	2.84	4	1.94	4	1.25	4	16	3

Source: DATA Collected and compiled from 2012-17

Table shows the ranking of selected public and private sector banks under the study period 2012-2017 on the basis of its average like rank, combined rank and ultimate rank. Rank has been given to each bank on the basis of their Gross NPA to Gross Advances, Net NPA to net advances, Gross NPA to total assets and Net NPA to total assets and highest rank has been given to the lowest NPA ratio. The combined rank of each bank has been calculated by total rank of four categories of NPAs ratio. Then ultimate rank is calculated on combined rank values. The findings specify that none of the banks indicate efficient performance in terms of controlling NPAs. The above table shows that HDFC bank (1^{st} rank) performance is satisfactory followed by AXIS, ICICI, BOB, SBI and PNB. NPAs are arising due to non recovery of the principal amount on loan asset and its interest, by analysis this, it can be said that the recovery performance of the bank is not sound. There are so many reasons behind it like more advances to priority sectors, tough competitions, and willful defaults like so on. Some steps can be taken by RBI to trim down NPA like legal steps, (asset reconstruction companies) ARC etc. But, it is true that no single policy can control the NPAs because all these banks perform their functions in every part of the country. For minimizing the NPA banks have to develop strategies keeping in mind all these factors.

Findings of the Study

- Credit risk in banks has been increasing for the last decade as per the data analysis by the researcher and Public and private sector banks have identified that credit to Industry and Agriculture sector has more lending risk is comparatively to other sector, because major of the loans are issued against some type mortgage property and Government Policies, secured for repayment of loans. The study finds that Indian Public and private sector banks have find a perfect combination of traditional, modern and international services in the global banking system. RBI has made Indian banks to move towards global banking.
- Credit risk management performance of commercial banks in India is not satisfactory. The present study revealed the credit management practices in Indian public and private sector banks and management of loans and advances. The private sector banks today are offering all most all services that are offered by public or international bank. The Commercial banks have linkage with mutual funds, capital market, insurance etc.
- The study found out that the profit in Public and private sector banks was increasing trend due to competitive advantage, diversity of banking services provided by the banks and rules of RBI after economic reforms. The banks are facing the problem of liquidity due to credit like house loan whose repayment period is between 25 – 30 years long. The banks were not segmenting
- The customers as per their requirement it is revealed from last six years data that the housing finance is having almost half of the total share in personal loans as it fulfill one of the basic needs of human being. The Top leading Commercial banks are satisfying the needs of customers by providing housing loan at an affordable interest rate Finally it can be concluded that the banks should manage its credit risk more consciously, anticipates adverse changes and hedges accordingly, so that it can be used as a competitive advantage.

Suggestions

- To reduce the NPAs credit the Public and Private sector banks must follow the guidelines of the RBI. Banks
- Should have Loan Review Policy and it should be reviewed annually by the Board. The main objectives of Loan Reviews are to provide feedback on effectiveness of credit sanction and to identify deterioration in quality of portfolio.
- Private sector Banks have to maintain an effective management information system through which the banks can know the history of borrowers which help them to decrease the no. of defaulters and which automatically decrease the NPAs. The effectiveness of risk management depends on efficient information system, computerization and networking of the branch activities.
- In today’s competitive environment, both public and private sector banks may train their employees as per demand of the global market.
- The private sector banks should decrease the rate of interest on personal credit. Banks will, therefore, have to sharpen their credit assessment skills by providing better t raining to enhance their conceptual understanding of credit risk and improving their skills in handling it which lay more emphasis in providing finance to the wide range of activities in the services sector.
- Private sectors bank can strengthen banking services by reduce service chargers on debit transactions. Banks should adopt a credit grading system which comprises the facilities of assigning a risk grade & the borrower’s risk grades should be clearly stated on credit application.
- The Basel Committee set up by BIS has been urging banks to set up internal systems to measure and manage credit risk. It is important that Indian banks use credit ratings available from agencies in conjunction with their internal models to measure credit risk.

- The employees of both Public and Private sector banks should carefully check the customers KYC form, and take enough collateral before providing them loan. KYC concept needs to be strengthened.

Conclusion

Credit Risk Management is the proactive strategy to plan, organize, lead, and control the variety of risks that are associated with the organization's daily and long-term functioning. Credit risk analysis has emerged as a big challenge for the banks in India. It is imperative to mention that default clients have been a major problem for the banks and too for long and the banks have been trying to reduce the default problem all along. The Non-Performing Assets have always created a big problem for the banks in India. It is just not only problem for the banks but for the economy too. The bank management must speed up the recovery process. The problem of recovery is not with small borrowers but with large borrowers and a strict policy should be followed for solving this problem. There is an adverse effect on liquidity of the bank. The RBI has been striving to assist the Indian Banks to get out of the default risk problem by formulating policies. As a continuance to this, RBI has been providing directives when a where it seems to be necessary. Indian economy and banks has already prove their strength to the world at the time recession, now the Indian banks have just follow the RBI guidelines to reduces their NPAs.

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