International Journal for Multidisciplinary Research (IJFMR)

E-ISSN: 2582-2160 ● Website: www.ijfmr.com ● Email: editor@ijfmr.com

Managing Credit Risk in Indian Commercial Banks

Mr. Nikhil Sharma

Research Scholar, Commerce

Abstract

Credit risk management has emerged as a critical focus area for financial institutions, particularly due to the inherent uncertainties in the financial services sector. The volatility of the financial industry underscores the necessity of robust risk management strategies. This study explores the topic of "Credit Risk Management and Its Influence on Performance in Indian Commercial Banks." The research aims to deepen the understanding of credit risk management practices and their effect on performance, specifically measured by return on assets (ROA).

Credit risk has long been a significant concern for both bankers and business professionals, as the failure of a trading partner to meet their obligations on time can disrupt the operations of the other party. The core objective of this study is to provide a comprehensive insight into how banks address credit risk. The initial section of the study outlines the research background, followed by a detailed literature review that examines banking practices, credit risk management tools, and assessment frameworks.

A quantitative research approach was adopted, utilizing a cross-sectional survey method to collect data. The analysis involved descriptive statistical techniques and hypothesis testing through a regression model. The findings reveal that banks with effective credit risk management strategies tend to experience lower loan default rates and achieve higher returns on assets, emphasizing the importance of sound credit risk policies in enhancing financial performance.

Keywords: Commercial Banks, credit risk, return on assets, statistical techniques, regression model

Introduction

A Study of Credit Risk Management in the Indian Banking Sector

Credit risk is the most traditional form of risk encountered by bankers worldwide. It refers to the risk of borrowers defaulting on their loans. Due to its inherent nature, credit risk represents the most significant threat that banks face. If we define credit as “the expectation of receiving a sum of money within a specified timeframe,” then credit risk indicates the likelihood that this expectation will not be met. Credit risk has existed as long as lending itself. In recent years, the prevalence of credit risk has increased. Corporations secure loans to make acquisitions and expand, small businesses borrow to enhance their operational capacity, and individuals rely on credit for various reasons. The simplest definition of credit risk is the likelihood that a bank borrower or counterparty will fail to fulfill their obligations as per the terms agreed upon. The primary objective of credit risk management is to increase a bank’s risk-adjusted return by ensuring that credit risk exposure remains within acceptable limits. Banks must manage not only the credit risk associated with their entire portfolio but also the risks involved in individual credits or transactions. Additionally, banks should evaluate the interplay between credit risk and other types of risk. Effectively managing credit risk is crucial to a comprehensive risk management strategy and is vital for the long-term success of any banking institution. Given that credit risk remains the predominant source of difficulties for banks globally, both banks and their regulators should learn valuable lessons from historical practices. Financial institutions must now be acutely aware of the importance of identifying, measuring, monitoring, and controlling credit risk, as well as ensuring they maintain sufficient capital to cover these risks and that they are adequately rewarded for the risk they accept.

Credit risk

Credit risk refers to the situation when a lender provides funds to a borrower who might be unable to repay. Loans are granted to individuals or businesses based on their capacity to meet upcoming payment responsibilities (including principal and interest). Lenders invest significant effort in evaluating a borrower's financial status to gauge the risk of the borrower potentially defaulting in the future.

LIST OF MAJOR COMMERCIAL BANKS IN INDIA:

1. State Bank of India
2. ICICI Bank
3. HDFC Bank
4. AXIS Bank
5. Kotak Mahindra Bank
6. IndusInd Bank
7. Bank of Baroda
8. Punjab National Bank (PNB)
9. Yes Bank
10. Industrial Development Bank of India (IDBI)

Credit risk management framework

The processes for managing credit risk can be categorized into four main components.

- Identification of Credit Risk
- Measurement of Credit Risk
- Monitoring and Control of Credit Risk
- Mitigation of Credit Risk

II. Review of literature

- Treacy and Carey (2000) discovered that qualitative factors played a more significant role in determining the credit ratings assigned to loans for small and medium-sized enterprises, with loan officers primarily responsible for these ratings, unlike large firms, where credit staff mainly utilized quantitative methods to set ratings.
- Adem Anbar (2006) reviewed the credit risk management practices in the Turkish banking sector and concluded that banks should expedite their studies and preparations related to borrower and loan data utilized in credit risk measurement.
- Bagchi (2003) investigated credit risk management in banks, focusing on aspects such as risk identification, measurement, monitoring, control, and audit as fundamental elements of credit risk

management. He concluded that a robust architecture, well-defined policies and frameworks, an effective credit rating system, along with monitoring and control processes, are crucial for successful credit risk management.

- In the study by Bodla & Verma (2007), the focus was on the application of the Credit Risk Management Framework by Commercial Banks in India. A primary survey was conducted to meet the study's objectives. Findings indicated that 94.4% of public sector banks and 62.5% of private sector banks delegate credit risk approval authority to their Boards of Directors. Most banks engage in various activities for Credit Risk Management, including industry analyses, routine credit assessments, plant visits, management information systems (MIS) development, risk scoring, and annual account reviews.
- Radhakrishana & Bhatia (2009) examined the implications of adopting Basel II Norms for Indian banks, emphasizing the necessity of these norms for the sector. Their study found that while embracing Basel II Norms presents challenges, it also provides opportunities for Indian banking institutions.
- Banerjee (2011) outlined the introduction to commercial banking in India, highlighting potential risk management areas in the sector. The paper detailed the growing involvement of Cost and Management Accountants (CMAs) in Indian commercial banks, contributing to enhanced risk management and efficiency.
- Barros et al. (2012) conducted research on the impact of risk on performance and sought to integrate risk measurement into performance evaluations. Their work underscored the necessity of harmonizing these methodologies by incorporating risk factors into performance assessment analyses.
- -Singh (2013), this research highlights that the issues concerning Credit Risk are addressed in various bank policies, including Loan Policy, Credit Monitoring Policy, Real Estate Policy, Credit Risk Management Policy, Collateral Risk Management Policy, Recovery Policy, and Treasury Policy.
- Murthy and Pathi (2013) argue that effective risk management depends on the ability to assess risks and implement suitable strategies. Their analysis examines the position of Non-Performing Assets (NPAs) in both Public and Private Sector Banks in India, while also focusing on the risk management practices post-Basel II implementation from 2007 to 2012. Therefore, a robust risk management system is essential.
- -In her 2013 study, Ms. Asha Singh explored credit risk management in Indian commercial banks, pointing out that the bank's credit risk management policy outlines its credit risk strategy. Enhanced risk management practices will empower the bank, thereby providing it with a competitive edge in the marketplace.
- P. Bhaskar's 2014 research on credit risk management in Indian banks indicated that business growth largely depends on taking risks. Higher risks generally yield higher profits; therefore, business entities must find a balance between the two.
- Shukla and Malusare (2014) assessed the alterations in capital structure and solvency of banks by employing various risk indicators to illuminate the risk profile of Indian banking institutions. Their paper closely analyzed the risk profiles of the top ten public sector banks and the top ten private sector banks.

- Rajeswari (2014) identified different types of credit risks within scheduled banks and the methodologies employed by these banks to mitigate risks, thereby enhancing the understanding of credit risks in the banking sector. Banks with effective risk management processes are more likely to thrive in the long-term market.
- Kurne (2014) emphasized that effective credit risk management is a vital element of a well-rounded risk management strategy and is crucial for the sustained success of any banking institution. Banks must consider credit risk within their entire portfolio as well as in individual credits or transactions.
- Singh (2015) explored the impact of credit risk management on both private and public sector banks in India. Credit risk arises when customers default or fail to meet their debt obligations, leading to potential total or partial loss. Inadequate credit risk management is the main contributor to credit risk. Improved risk management allows banks to enhance their returns.
- Suksham, Kapoor, and Pahuja (2015) conducted an empirical study to evaluate the extent to which Indian banks have succeeded in minimizing the adverse impacts of risks on their financial performance and capital. There is a pressing need for an efficient risk management system that includes risk identification, measurement, and control. They aimed to assess the financial health of commercial banks in India by analyzing their risk levels and insolvency probabilities.

iii. Problem statement

A research analysis on Credit Risk Management Practices and their effect on the performance of the Commercial Banking Sector in India.

Iv. Study objectives

1. To analyze the current credit risk management measures implemented by banks when extending credit to consumers.
2. To pinpoint areas that can be improved upon and provide recommendations.
3. Existing training programs for bank managers in assessing customer credibility.
4. Develop a comprehensive framework to categorize different types of loans and advances, and evaluate their implications on credit quality and risk.
5. To investigate bankers' perceptions regarding credit risk management in public sector banks.
6. To assess the influence of credit risk management on the profitability of public sector banks.
7. To study the effect of credit risk management on the liquidity position of public sector banks.

V. Research methodology

The available evidence on credit risk assessment within Indian banks and financial institutions following Basel guidelines is limited. The comprehensive study of the relationship between credit risk management and the ownership structure of Indian banks is lacking. This research aims to enhance the understanding of credit risk management in Indian banks and its correlation with ownership.

VI. Research design

The research approach for this study is both exploratory and descriptive. This study is descriptive as it seeks to analyze the bankers' perceptions of credit risk management policies. Simultaneously, it is exploratory as it aims to uncover new ideas and insights. The current research also investigates how credit risk management affects the profitability and liquidity of Indian public sector banks.

Sources for Data Gathering

Data will be obtained from a variety of sources including Books, Magazines, Newspapers, Journals, the Reserve Bank of India, the Bank for International Settlements (BIS), Annual Reports from banks, and other government platforms such as the Indian Banking Association (IBA) along with published research papers and relevant websites.

Data Collection Approach

The data will be amassed through secondary data collection methods since this study involves various commercial banks where data are accessible via different websites and numerous published materials.

Sampling Framework

The study will utilize data and documents from the Reserve Bank of India and the Bank for International Settlements (BIS) database.

Sampling Unit

The focus will be on a sample of 8-10 Commercial Indian Banks.

Data Analysis Tools

The research will employ descriptive statistical methods for data analysis.

- Graphical representations to visually summarize the data or enable comparisons.
- Tabular data representations that present numerical summaries.
- Summary statistics (single numerical figures) to encapsulate the data.

BANK NAME	Analysis of Capital Adequacy Ratio
SBI	13.83%
KOTAK MAHINDRA BANK	21.0% 18.33%
ICICI	15.55%
AXIS BANK	18.01%
INDUSIND	3.03%
BOB	14.74%
PNB	17.05%
YES BANK	20.14%
IDBI	

IX. REFERENCE

1. https://shodhganga.inflibnet.ac.in/
2. https://www.inspirajournals.com/issue/downloadfile/2/Volumne-Pages/QEkeaPOn35j5wyjd5rbD
3. https://m.rbi.org.in/scripts/bs_viewcontent.aspx?Id=3657
4. https://www.sas.com/en_in/insights/risk-management/credit-risk-management.html
5. https://www.ceicdata.com/en/india/commercial-banks-statistics