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A Study on Credit Risk Management Practices in Indian Banks

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Abstract: *Risk is a crucial element of any form of business. Earnings and default risk move in an opposite direction. A business has to confront risk to earn revenue for the survival in competitive business environment. Credit risk is the risk of loss arises from the borrower who failed to pay the loan amount on due date. A proper management of credit risk leads to achieve financial standards as well as ensures success in the long run. The present study encompasses on the credit risk administration strategies of the Indian banks to overcome the default risk. As this research is descriptive in nature, based on the previous study, relevant conclusions have been drawn. Also the study includes providing recommendation to senior managers on the approaches followed in managing the credit risk in the national banks.*

Keywords: *Financial standards, Credit Risk Management, National Banks, Long term.*

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I. Introduction

The Indian Banking Industry has vastly changed for the liberalization and deregulation process stated in the year of 1991. The financial system is the lifeline of the economy of any country. The changes in the economy get reflected in the performance of the banking industry. Credit risk is all about loans and their defaults, and loan transactions account for more than 50% of all banking activities. Credit risk management is a well-structured approach to manage uncertainties by risk assessment. Credit risk management defines identification, measurement, monitoring and control of the credit risk exposures. The effective management of credit risk is a crucial component of comprehensive risk management and important for the long term performance of a banking organization.

Risk management is a constant challenge to all financial institutions. Specially, banks need to regularly frame and improve their operational and technical practices. In the present business environment, credit risk management assumes an important place; banks are increasingly moving towards quantitative risk evaluation of their loan portfolios.

Objectives of the Study

- To study the present credit risk management steps undertaken by banks in issuing credits to consumers.
- To identify the areas where there is a scope for improvement and offer suggestions.
- Existing training to bank managers in identifying customer’s credibility.

Categories of Risk

The word ‘risk’ is derived from an Italian word ‘resicare’ which means ‘to dare’. Basically risk is more a ‘choice’ than a ‘fate’. An extension of this analogy reveals risk is a possibility of loss or injury perils and the degree of uncertainty in return. Banks in the process of financial intermediation are facing with one or more of the following risk categories:

• Credit Risk

Credit risk has been defined as the potentiality that a bank borrower will fail to meet its obstacles in addition to agreed terms. The objective of credit risk management is to maximize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks should need to manage the credit risk in the total portfolio and the risk in individual credit or transaction. Banks must consider the relationships between credit risk and other risks. The effective management of credit risk is an important factor of a contingency approach to the risk management and essential to the long term success of any bank.

• Market Risk

Market risk has been defined as the possibility of an investor experiencing losses due to factors that to overall performance of the financial markets in which he or she is involved. Market risk is also called as "Systematic risk" cannot be eliminated through diversification.

• Operational Risk

Operational risk defines the risk a company undertakes when it attempts to operate within a given field or industry. Operational risk is the risk not inherent in financial, market wide risk. It is that kind of risk which remaining after determining financing and systematic risk as well as includes risks resulting from breakdowns in internal procedures and systems.

II. Review Of Literature

(Bodla &Verma, 2007) in this study the implementation of the Credit Risk Management Framework by Commercial Banks in India. To achieve the objective a primary survey was conducted. The results showed that the authority for approval of Credit Risk vests with 'Board of Directors' in case of 94.4 percent and 62.5 percent of the public sector and private sector banks respectively. For Credit Risk Management, most of the banks are found performing several activities like industry study, periodic credit calls, periodic plant visits, developing MIS, risk scoring and annual review of accounts.

(Radhakrishana & Bhatia, 2009) studied on the implication on adoption of Basel II Norms for Indian banks. The author described the need of Basel II Norms for Indian banks. The study concluded that accepting of Basel II Norms will pose challenges for and also offered opportunities to Indian banking sector.

(Banerjee., 2011) sketched the introduction to the commercial banking in Indian scenario and tried to locate risk management areas in banking sector. The paper outlined the increasing role of Cost and Management Accountants (CMAs) in commercial banks in India to contribute towards risk management functions to increase its efficiency and growth.

(Barros et al., 2012) made a study on the impact of risk on performance and attempted to introduce measurement of risk in performance assessments. Thus, there remained a need to unify these approaches by using risk factors as an integrating part of performance analyses. This implied that risk has endogenous components. Therefore, it was necessary to develop monitoring tools to thoroughly examine the relations between risk and performance.

(**Singh., 2013)** in this study it has been found that the issues related to Credit Risk are addressed in the policies stated in the Bank's policy namely – Loan Policy, Credit monitoring Policy, Real Estate Policy, Credit Risk Management Policy, Collateral Risk Management Policy, Recovery Policy, Treasury Policy.

(Murthy & Pathi, 2013) in this study the effective risk management lies with the ability to gauge the risks and to take appropriate measures. In the light of this, an analysis was carried out to highlight the NPAs position of Public and Private Sector Banks in India. The study also focuses on the risk management practices of Public and Private Sector Banks after the implementation of Basel II with the help of capital adequacy ratio for a period of 2007 to 2012. Hence an efficient risk management system is needed.

(Shukla & Malusare, 2014) this study evaluated the changes in the capital structure and solvency position of banks by using various risk indicators for highlighting risk profile of Indian Banking entities. The Paper evaluated in detail the risk profile of top ten public sector banks and top ten private sector banks.

(Kurne., 2014) the researcher gone through a study of the effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization. Banks need to look after the credit risk in the total portfolio as well as the risk in individual credit or transaction.

(Rajeswari., 2014) the study identified various credit risks in scheduled banks and methodologies followed by banks to reduce risks, these by creating a better understanding of credit risks in Banking Sector. Only those banks that have effective risk management procedure will survive in the long run market.

(Singh., 2015) this paper examines the effect of credit risk management on private and public sector banks in India. Credit risk comes when customers default or failed to comply with their obstacles to service debt, pushing a total or partial loss. The primary cause of credit risk is poor credit risk management. When banks manage their risk better, they will get advantage to increase their return.

(Singh., 2015) this study shows that there was a significant relationship between bank performance (in terms of return on asset) and credit risk management. Thus, it was of crucial importance that banks practiced prudent credit risk management and safeguarding the assets of the banks and protected the investors' interests. The study also revealed banks with higher profit potentials could better absorb credit losses whenever they cropped up and therefore recorded better performances.

(Suksham, Kapoor & Pahuja, 2015) the purpose of this empirical study is to make an assessment as to how far Indian banks have been successful in achieving their objectives of minimizing the negative effects that risks can put on the financial results and capital of a bank. The need of the hour is an efficient risk management system comprising risk identification, measurement and control. An effort has been made to assess the financial health of the commercial banks in India by analyzing their riskiness and the probability of being insolvent.

(Oino., 2016) this research study assesses the impact of credit risk management on Indian public and private banks during the 2009-2012 periods. The results show that private banks are more capitalized and more profitable than public banks. The study extracted the essence of capital and the importance of risk management in ensuring stability in the financial industry.

III. Findings

- Risk in public sector banks is higher than that of private sector banks as the large private sector banks need to further build up their capital base to face any eventuality of solvency risk.
- The study revealed that the strategic risk came on the top, followed by the operations and empowerment risks being disclosed by the banks.
- Banks should initiate efforts on adopting the new technologies in order to improve their customer service levels and provide new delivery platforms to them.
- Banks should provide training for the employee to enhance their capacity and reviewing the adequacy of credit training across.

IV. Recommendations

- There should be safeguards and limits in respect of policy and process.
- Collateral, termination clauses, cash settlement should be used to mitigate the credit risk.
- Financial Institutions should setup an institute that supervises overall risk management at the bank. Such a setup could be in form of a risk manager, committee or department depending on the size of the bank,
- Develop risk assessment and measurement systems.

V. Conclusion

The aim of credit risk management is to reduce the probability of loss from a credit transaction and implement the practices of risk management in a good manner. In this way it is needed to meet the goals and objectives of banks. After the study of the literature reviews it has been concluded that the researcher found few problems regarding to credit risk management practices in India. These policies list out the target markets, risk acceptance levels or risk tolerance limits. The risk management practices in the Bank will result in Bank emerging stronger, which in turn would confer competitive advantage in the market.

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