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Retail credit risk management of commercial banks in India with special reference to private sector bank

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Abstract

There seems to be no unanimity in the proper policies to be followed in resolving this problem. 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 and also erodes the value of the asset. NPAs affect the liquidity and profitability, in addition to posing threat on quality of asset and survival of banks. 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 private sector banks of India. The factors contributing to NPAs, reasons for high impact of NPAs on private sector banks in India and recovery of NPAs through various channels.

Keywords: risk management, Indian banks, credit risk, non-performing assets, private sector banks

1. 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 retail loans and advances. As the increasing global competition by foreign banks, introduction of innovative products, and have forced the Indian banks to be prepared for the credit risk management specially retail customers. 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., at a rapid rate and have reached great advancements in technology and quality of service. 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. Banks are exposed to tough market competition and hence are compelled to take various types of financial and non-financial risks. 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. In banks and other financial institutions, risk plays a major part in the profit making of a bank. The high risk, high returns, hence, it is essential to maintain parity between risk and return.

2. Credit Risk

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 may mean 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 (Sharma, 2003).

Type of Risks

The major risks in banking business or 'banking risks', as commonly referred, are listed below:

1. **Liquidity Risk**
   a) Funding Risk
   b) Time Risk
   c) Call Risk
2. **Interest Rate Risk**
   a) Gap Risk
   b) Yield Curve Risk
   c) Basis Risk
   d) Embedded Risk
   e) Reinvested Risk
   f) Net Interest Position Risk
3. **Market Risk**
   a) Forex Risk
   b) Market Liquidity Risk
4. **Credit or Default Risk**
   a) Counter party Risk
   b) Country Risk
5. **Operational Risk**
   a) Transaction Risk
   b) Compliance Risk
6. **Other Risk**
   a) Strategic Risk
   b) Reputation Risk

3. Literature Review

Tamimi and Mazrooei (2007) [1] in their study find that the credit risk in public sector banks bear the credit risk attached to forward contracts and advances from bank. Credit risk means the risk of defaults or protracted arrears on outstanding loan.

Dash & Kabra (2010) [5], revealed that large banks are not necessarily more effective in screening loan customers when compared to their smaller counterparts as there is no significant relationship between the size of a banking institution and the level of NPAs it reports.

Mallikarjun (2012) [9] stressed upon the various risks that Indian banks are facing; systematic risks, operational risks, liquidity risks and credit risks. He had suggested different plans and decisions should be taken by the banks to reduce these risks.

B.Selvarajan & Dr. G. Vadivalagan (2013) [13], stresses that the problem of NPA is not limited to only Indian public sector banks, but it prevails in the entire banking industry. Major portion of bad debts in Indian Banks arose out of lending to the priority sector at the dictates of politicians and bureaucrats. The top management of the banks was forced by politicians and bureaucrats to throw good money after bad in the case of unscrupulous borrowers. Agriculture advances have registered a 7 fold net increase, SSI advances have set a record net increase of 8.5 times and the advances to other priority sector have made a net increase of 4.5 times, that of their respective figures in 2001–02.

Nayan & Kumaraswamy (2014) [10] 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.

Lalon (2015) [8], it is imperative to mention that default clients have been a major problem for the banking financial institutions for long and the financial institutions have been trying to minimize the default problem all along. The Bangladesh Bank has been striving to assist the financial institutions to get out of the default risk problem and formulating policies for that purpose. As a continuance to this, Bangladesh Bank has been providing directives when and where it seems to be necessary.

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.

4. 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 measurement of credit risk should be in tandem with other measurements of operation and market risk so that the requisite composite estimate can be worked out. So, in banking sector credit risk management is being most important task of all.

5. Objectives of the Study

1. To understand the concept and nature of Retail Credit Risk Management of Commercial Banks (Private sector) in India.
2. To know the different types of credit risks and the techniques to manage risk in Indian Private sector banks.
3. To analyze the pattern in Non-Performing Assets of Private sector banks in India.
4. To analysis lending trend of Private sector banks for retail borrowers.
5. To analyze NPAs position of Private Sector Banks and their risk management
6. To suggest the measures for improving credit risk management practices of Indian Private sector banks.

6. Research Methodology

This study includes both primary and secondary data and. The secondary data have been collected were studied and data available on internet and other sources have also been used.

6.1 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.

6.2 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 2005-2015), Statistical Tables relating to Banks in India, Articles, books, website and Papers published in different journal and magazines concentrated on Commercial Banks only information.

6.3 Data Analysis Tools

After collecting the relevant data, the relevant data is converting into tabular form. The statistical tools that considered for the study is Trend, Ratio Analysis /Percent Analysis

7. Data Analysis and Interpretation:

7.1 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 ratio of gross NPAs to total assets. It is revealed from the table - 1 that gross advances of the banks have shown a rising trend since 2004-2005 to 2015-2016. Gross advances of the private sector banks in absolute term have increased from Rs 2213032.969 million in 2005 to Rs 19393394.255 crore in 2015-2016. There is sharp increase of 541.98 percent in gross advances of the private sector banks during the study period. The gross NPAs in absolute terms have increased by 539.77 percent in the year 2004-2005-2011 over 2015-2016. An in-depth analysis into gross NPAs shows that the gross NPAs of the private sector banks have declined in the year 2005-2006, and then increased every year but drastically increased in the last two years of study i.e. 2014-2015 and 2015-16. The study observed that the gross NPAs of private sector banks have depicted an increased trend over the period of study. It is found on the basis of analysis of data that the asset quality of private sector banks mixed improved in the past few years as reflected in the decline in the ratios i.e. gross NPAs as percentage of gross advances, and but opposite effect on gross NPAs as percentage of total assets.

Table 1: Gross Non-Performing Assets (NPAs) of Private Sector Banks (Amount in Million)

Year	Gross Advances	Gross Total Assets	NPA		
			Amount	% to advances	% to total assets
2004-05	2213033	4278917	87822	3.97	2.05
2005-06	3129618	5716312	78108	2.5	1.37
2006-07	4147513	7454038	92553	2.23	1.24
2007-08	5184024	9401438	129974	2.51	1.38
2008-09	5753276	10277559	169266	2.94	1.65
2009-10	6324409	11507362	176400	2.79	1.53
2010-11	7975440	13982168	182406	2.29	1.3
2011-12	9664030	16930915	187678	1.94	1.11
2012-13	11432486	19897971	210705	1.84	1.06
2013-14	13429346	22588101	245424	1.83	1.09
2014-15	15843119	26032618	341062	2.15	1.31
2015-16	19393394	30832404.8	561857	2.9	1.82

***Source*:** Statistical Tables No.2 RBI Relating to Assets and Liabilities of Scheduled Commercial Banks and Table No.7 Movement of Non Performing Assets Scheduled Commercial Banks.

7.2 Retail Portfolio of Private Sector Banks in India

During 2015-16, banks' retail loan portfolio witnessed expansion at a higher rate as compared with the previous year, mainly led by growth in credit card, consumer durables and other personal loans. Housing loans continued to constitute almost half of total retail portfolio of bank. Housing loans shows approximately same growth rate in year 2014-15 and 2015-16.

Table 2: Retail Portfolio of Private Sector Banks in India (Amount in million)

S.No	Portfolio	Amount of Outstanding Loan			Percentage Chan	Percentage C
		2013-14	2014-15	2015-16	2014-15	2015-16
1	Housing	1368440	1644545	1979269	20.18	20.35
2	Consumer Durables	42796	46435	58636	8.5	26.28
3	Vehicles	376562	395183	508108	4.95	28.58
4	Education	21762	23844	27715	9.57	16.24
5	Personal Credit Cards	183145	237027	321543	29.42	35.66
6	Other Personal Loans	942472	781508	1073160	-17.08	37.32
	Total Retail Loan	2935176.65	3128541.79	3968432.17	6.59	26.85

***Source*:** Outstanding Credit of Scheduled Commercial Banks According To Occupation from RBI Publications)

The above chart indicates the market share of each retail products of Indian banking sector. Housing finance alone occupies the maximum share in the total personal loans (50%), Personal Credit Cards is having 8% of its share in total personal loans.

Table 3: Quaterly Status of Outstanding Housing Loan (Rs. in Millions)

	Personal Loan	Housing Loan	% of Housing Loans in Personal Loans
Mar 2014	2935177	1368440	46.62
Dec 2014	2985249	1535942	51.45
Mar 2015	3128542	1644545	52.57
June 2015	3268503	1730992	52.96
Sep 2015	3428470	1779493	51.9
Dec 2015	3678624	1851512	50.33
Mar 2016	3968432	1979269	49.88
June 2016	4176942	2033174	48.68
Sep 2016	4391278	2072911	47.21

***Source*:** Outstanding Credit of Scheduled Commercial Banks According To Occupation from RBI Publications

From the above Table No. 3 it is revealed from quarterly data that the housing finance is decreasing. The private sector banks are satisfying the needs of customers by providing housing loan at an affordable interest rates.

8. Findings of the Study

Retail credit in private sector banks has been increasing for the last decade as per the data analysis by the researcher and private sector banks have identified that credit to this sector has less lending risk is comparatively to other sector, because major of the loans are issued against some type mortgage property etc. and secured for repayment of loans. The study finds that Indian 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. The study shows that the

Gross NPAs level of Private Sector Banks did registered a clear decreasing trend during the 2004-05 to 2006-07. The NPA level was 2.94 percent during the year 2007-08, which again went on reducing till 2013-14.

In the year 2014-15 NPAs level registered at 2.15%. The Gross NPAs level of Private Sector Banks shows an increasing trend during the year 2014 to 2016.The Gross NPAs of private sector banks in during the year 2004-05 is 2.05 % as a percentage of total assets, where as the lowest NPA was 1.06% during the year 2012-13. This show that the performances of private sector banks in Retail Credit Risk Management was not satisfactory. During the year 2015-16, retail Loan Portfolio witnessed the higher expansion mainly because of the growth in credit card (8%) and other personal loans. Housing loans alone occupies the 50% share in total retail portfolio of bank.

During the post-liberalization period NPAs level of private sector banks did register a clear decreasing trend.. The decrease in NPAs level is caused by reduction in concentration risk. Credit risk management performance of commercial banks in India is not satisfactory. The present study revealed the retail credit management practices in Indian 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 in retail. The private sector banks have linkage with mutual funds, capital market, insurance etc.

The study found out that the profit in private sector banks was increasing trend due to competitive advantage, diversity of banking services provided by the private sector banks and rules of RBI after economic reforms. The private sector banks are facing the problem of liquidity due to the period of retail 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 five 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 private sector 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 retail credit risk more consciously, anticipates adverse changes and hedges accordingly, so that it can be used as a competitive advantage.

9. Suggestions

1. To reduce the NPAs in retail credit the 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.
2. 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.
3. In today's competitive environment, private sector banks may train their employees as per demand of the global retail market.
4. The private sector banks should decrease the rate of interest on personal credit.
5. 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.
6. Private sector banks can strengthen retail banking services by reduce service chargers on debit transactions. Banks should adopt a credit grading system which comprises the facilities of e assigning a risk grade & the borrowers risk grades should be clearly stated on retail credit application.
7. 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.
8. The employees of Private sector banks should carefully check the customers KYC form, and take enough collateral before providing them loan. KYC concept needs to be strengthened.
9. Before finalizing the proposal of retail loan the public sector banks should ensure that there is an adequate mortgage is provided by the borrowers.
10. Private sector banks should keep provision against the loans.

10. Conclusion

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 private sectors banks and others banks 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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