



Credit Risk Management in Indian Banking Industry- Evaluation of Crisis in Co-operative Banking Sector

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Abstract

Banking sector has witnessed dynamic changes in institutional development and innovation. There are some risks which create hindrance on the development of banking sector Risk is an integral part of banking business as it handle with loans and advances for different sections of economy. The banks face the problem of significant rise in Nonperforming Assets. This problem creates serious impact relevant with regard to survival of Indian banking sector. Credit risk arise when the bank is not able to control the loss due to non recovery of its credit. Reserve bank of India issues some guidelines and to manage the alarming situation of NPA tactically. The banks are expected to follow uniform procedure for managing the stressed assets. In India the cooperative banking sector play an important role in enhancing the credit facilities to the rural mass. The co-operative banking sector tries to manage the problem of NPA through the implementation of rules and regulations of the financial authorities concerned. At the same time they adopt some strategies of their own to control the quantum of stressed assets. There are some problems with regard to NPA management in cooperative banking sector. A realistic approach towards proper management of Nonperforming Assets facilitates prompt recovery of amount due from the borrowers. This paper tries to study the problems persists in the area of NPA management in cooperative banking sector and the measures adopted to control the present situation.

Keywords: nonperforming assets, credit standard, credit norms

1. Introduction

Since 1912 the co-operative credit institutions have been playing an important role in the financial system of the economy. The co-operative banking system serves the banking needs of small and medium income groups. Generally it is not adequately considered by the public and private sector banks. It acts as supplement to the activities of the commercial banks in mobilizing savings and meeting the credit needs of the local population. Cooperatives banks have played an important role in the socio –economic development of rural masses. After independence the emergence of Co-operative movement have remarkable role in poverty eradication and economic development of the Nation. At present, there are more than five lakh co-operative societies which have spread over the rural economy. Co-operative credit societies are mainly constituted to encourage thrift, self help and co-operation among the members. The problem of NPA has become a crucial one in the operation of Indian banking system. When an account becomes NPA it will affect the profitability, liquidity and general performance of the banks. If it is not controlled properly, the situation of capital erosion may happen in the future. The RBI and statutory auditors consider the status of NPA as a criteria for giving grade to the banks. The asset classification and provisioning is to done correctly according to the norms and guide lines of RBI. The loan account should be creative in the sense to ensure minimum expected return from the distributed amount among the borrowers. It is the main source of revenue to the banking institutions. When loan asset is not

able to generate expected return in the form of interest, it will become Nonperforming asset. This situation creates adverse impact on the long term survival of banking business. The development of banking system is entirely based on effectiveness of debt recovery. Recently there is tendency to demand for the cancellation of debt due to the Co-operative Societies by the farmers Union. Co-operative banks are under Political pleasure to write off loan given to different purpose. In India various Committee recommendations in this regard suggested several measures to reduce the quantum of NPA. The norms and procedure of Reserve Bank of India for controlling the situation of NPA shows positive direction for the recovery of debt dues.

2. Review of literature

Kaveri (2001) ^[3], in this study, “Loan Default and Profitability of Banks” it is concluded that Prevention of NPAs required an immediate attention because fresh accrual of NPAs had created more recovery efforts. Credit monitoring in banks should be strengthened by creating a database. Potential NPAs should be identified well in advance through a system of monitoring of advances on a regular basis and concerned parties should be contacted immediately.

Shekhar (2003) ^[4], conducted a study on “Reduction of NPAs-Key to Banking Reforms” pointed that in a proposal to help banks and financial institutions recover funds, the government enacted the SARFAESI Act, 2002 with hope that the problem would be resolved amicably for the benefit of both the banks and the industry, paving the way for easy

availability of cheaper credit.

NABARD (2005) [5], conducted a study to evaluate the financial performance of some urban cooperative banks and rural cooperative credit institutions. The study reveals that the amount of NPA in sub-standardized assets reduced significantly in the rural sector. Whereas the amount of NPA in doubtful assets have increased. But the doubtful assets, the amount of NPA have increased resulting fall in the asset quality. It also revealed that the NPA proportion of Central Cooperative banks vary in different States of the Country

Pevekar and Ashvine (2006) [6], emphasized the role of public relations personnel in reducing NPAs. They concluded that public relations people should be sensitized to realize that they were the key persons in improving relations between banks and customers. It would make the banks more customers focused and further help in reducing NPAs

3. Significance of the study

The banks give main importance to attract more customers and retain them as a part of banking business. Tough competition is present economic scenario of business every business in the world. The long term survival for the banking business is possible if it maintain adequate profit and over all effective performance. Loans and advances of a banking institution should be active in the sense that which is in a position to earn desirable return in the form of interest income. The default in repayment of loan amount badly affects the earning capacity of the banks. As the cooperative societies serve for the credit requirement of ordinary people of the society, it is essential to nurture a good credit culture in the economy. The present study aims to examine the credit risk management crisis in Indian banking sector with special attention to the cooperative banks.

4. Statement of problem

The existence of well functioning cooperative banking sector is an important element in the development of economy concentrating activities on the backward areas. In this sector there are some problem relating to the debt recovery. The co-operative credit institutions have the crisis of credit risk because of improper NPA management. Many of the credit cooperative societies are unable to collect dues from the borrowers. If the NPA continue without effective control, it will create survival crisis and unable to maintain required return and functional efficiency. The better performance of a bank is the outcome of effective NPA management activities of the institution. A study on NPA crisis in cooperative banks helps to reveal the problem

prevailing in this sector.

5. Objectives

- 1) To identify the loan portfolio and credit standard of co-operative banks.
- 2) To study the impact of credit Risk in the functional areas of co-operative banks.
- 3) To make suggestions and recommendations based on study.

6. Research methodology

Based on the objective the researcher collected both primary and secondary data for statistical analysis. The primary data have been collected from the bank officials through pre-structured questionnaire. The secondary data for the study purpose are collected from reports of various committees, published financial statements, financial journal and news paper.

Credit Portfolio and Credit Standard

The credit standard and loan portfolio are studied by collecting primary data on this behalf. Credit standard is analyzed by considering the five Cs; Capital, Capacity, Collateral and Conditions. The credit portfolio of the banks includes loan to agriculture sector, business, personal and housing projects.

Table 1: Loan portfolio of the Cooperative Banks

Credit Portfolio	Number	Percentage
Agriculture	25	50
Business/trade	7	14
Housing	8	16
Personal loan	10	20
Total	50	100

(Source: primary Data)

The table shows that credit portfolio of the banks. It can be noted that there are 50% of bank give more emphasis on agricultural related activities of the farmers, the number of respondents are 25. It shows the bank gives more importance to agriculture credit distribution.

The five C's of Credit Standard among different categories of Co-operative bank.

The credit standard determination of loan sanctioning among different Co-Operative Banks is analyzed by applying Chi Square test

Ho: There is no significant difference in the determination of credit standard among different categories of Co-operative Banks

Table 2: Categories of Co-operative Banks and Credit standard (Chi square test)

Type of Bank	Credit standard					Total	P value#
	Character	Capacity	Capital	Collateral	Condition		
Primary Agricultural Credit Societies	0	0	5	20	0	25	<.001
Rural Co-operative Societies	0	0	3	2	0	5	
Urban Co-operative Bank	1	0	3	1	0	5	
Employees Credit Co-operative Bank	2	2	8	3	0	15	
Total	3	2	19	26	0	50	

(Source: Compiled from Survey Data)

Chi square test

Since the P value is less than .01 the null hypotheses is

rejected at 1% level of significance. There exist difference in credit standard determination based on the five C's.

Table 3: Opinion about effects of NPA on the bank

SL.No	Factors	Total	Mean score
1	Capital adequacy norms are not maintained	233	4.66
2	The profitability of the bank come down	242	4.84
3	Affects the liquidity position of the bank	193	3.86
4	Affects the credit expansion scheme of the bank	248	4.96
5	Bank force to maintain higher rate of interest to meet the administration and collection cost	155	3.1
6	Adverse effect on reputation of bank among general public	127	2.54
7	Pressure of shareholders for more dividend	132	2.64

(Source: primary Data)

Likert's five point rating scale was used to analyze the opinion of the respondent with regard to effects of NPA in different functional area of the bank. Here the highest mean scores are 4.96 and 4.84. It means the accumulated NPA affects the credit expansion schemes and profitability of the bank. The least effect of NPA is adverse effect on the reputation of bank among general public.

Findings of the Study

- The Cooperative societies mainly provide to loan to the agriculture sector. It means this type financial institution catering the credit needs of rural people especially farmers.
- The credit standard of the cooperative banks is based on financial ability and the security provided. The character, capacity and condition are least considered while sanctioning loan to the borrowers.
- The problems in the agriculture sector reduce the earnings from agricultural activities to the farmers and they are not able to pay the due in stipulated period. It is main reason for NPA to the banks.
- The uncontrollable NPA adversely affect the loan expansion capacity and profitability of the banks

Suggestions

- At present the bank give more importance to capital and collateral of the customers while sanctioning the loans. The other C's may also consider for setting the credit standard.
- The trained employees may be appointed to collect information of the customers, credit appraisal, interact with customers and motivate them for repayment of loan.
- Diversify the credit portfolio with other loan facilities to the general public according to their requirements.

Conclusion

The element of NPA result some adverse impact on the functional area of the banking institutions. The loan portfolio and credit standard should be systematically determined to facilitate NPA management effectively. The credit portfolio of the bank may be rearranged according to credit needs and changing economic environment. With the help of credit rating agencies, the bank can understand the credit worthiness of the borrowers. The study reveals that NPA in cooperative banking sector badly affects the credit expansion capacity and profitability of the bank. The survival of the cooperative banking institutions is not possible without proper control of accumulated NPA. The authorities concerned should adopt suitable measures for

solving these situations and protect the interest of all parties associated with the banking Industry.

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