ABSTRACT

Banks play a crucial role in growth and sustainability of any economy as prime intermediaries in mobilizing resources and channeling resources to various sectors of the economy. Therefore health of banks has a direct bearing on the health of economy. Prior to 1990 health of Indian banks was generally measured by growth of the bank and profits earned. Growth was computed in terms of assets (loans and advances made), liabilities (deposits mobilized from public) and geographic coverage (number of branches) with out any reference to the impaired assets and capital. The Mexican crisis of 1994, the financial crisis in Thailand during 1997-98, the debacle and cost of restructuring of the financial system in Indonesia, Russian banking debt burden and Brazilian crisis of 1998-99, the Argentinean banking crisis and the melt down of US and European banking systems had a telling effect on their economies and established that the real barometer of economic health is the soundness of the banking system. Banks started adopting best international practices in accounting, disclosure and measuring health of the banks in terms of capital adequacy, unimpaired tier one capital, level of provisions to total advances, share of non performing assets to total advances and the quality of advances etc. due to the efforts of Bank of International Settlement, (BIS) in ushering an era of prudential banking by Capital Adequacy Accord 1988 and subsequent improvements in the areas of risk measurement, management and supervision. A weak bank may not be able to withstand competition and a spill over effect of such weakness could cause serious consequences for the health of banking system as a whole. Therefore the urgency to strengthen the system assumed serious proportions.

The high levels of NPAs and fresh generation of NPAs are a natural result of poor and slow decision making regarding fresh sanction of advances and acceptance of compromise proposals. They also result in loss of fund-based advances and fee income. Poor risk management and weak internal control and housekeeping aggravate the problem of poor credit quality. Absence of cost control results in non-competitive pricing. Low level of skill in credit, risk management, foreign exchange, treasury management and other specialized areas and in-adequate training facilities to meet the
requirements contribute to poor efficiency in key areas like credit and risk management, which in turn contributes to poor quality of credit and fresh NPAs. The vicious cycle of one factor leading to another clearly shows that many of the weaknesses of a bank are to a large extent, a direct result of poor credit and risk management practices.

Indian banks have been following systematically many risk management measures. This should have, in normal course resulted in very low total non performing assets and also minimum addition of fresh NPAs. Banks keep updating their systems and introducing new risk management measures and mechanisms. Still the problem of poor quality of credit persists, bad loans recur and recovery is slow and delayed. Both aspects of credit risk management namely credit granting and loan recovery suffer from inefficiencies. Therefore it becomes necessary to analyze whether banks have robust risk management practices installed in their systems and if so, to find out the reasons why the credit risk management practices are not helpful in reducing the NPAs and preventing further generation of NPAs.

The study attempts to find out the exiting practices of risk management in Indian banks to avoid, mitigate and control credit risk, recurring common risk incidents and the causes for the same, constraints in implementing effective credit risk management system and the importance of human factor in building credit risk management systems. The scope of this study is restricted only to financial risks, particularly credit risk also known as default risk of the counter party or borrower. The entire study covers only Indian banks in the context of Indian banking and regulatory environment. Though the study covers pan India banks, its geographical coverage is limited Chennai only.

Ten leading banks were chosen for the study. Apart from review of the systems and procedures in the chosen banks, a survey using a structured questionnaire was conducted covering officers who work in credit and risk related areas. A sample size of 350 was chosen using random sampling with replacement. A pilot study was conducted and reliability of the findings was established.

The collected data was statistically treated as appropriate and required for the study like determination of relationship between variables, effect of components on the overall value, to test the independence of attributes, to compare performances, identification of
moist sensitive variables, etc.,. The researcher used following statistical tools in the analysis:

1. Simple percentage analysis
2. Ranking analysis
3. T test
4. Cluster analysis
5. Non parametric Chi – Square
6. Analysis of variance
7. Multiple regression analysis

The study found that younger officers who are mostly graduates and serving in the middle management cadre of the bank are predominantly employed work in risk management areas.

Bank officers are well aware of the role of credit risk management and that the most important role of the risk department is to maintain quality.

Officers working in risk related areas opine that non compliance with terms of sanction (like obtaining securities, insurance, ensuring end use of funds etc.) is the major cause of risk assets along with poor credit appraisal and poor monitoring are the second and third important causes.

It emerges from the study that corporate sector loans contribute most to delinquency resulting in non performing assets. Small and Medium Enterprises loans and Agricultural loan are ranked as second and third most contributors to delinquency.

The research reveals that Risk Management training is more in the nature of credit appraisal and the tools for risk analysis like track record verification, pre sanction audit, system for early detection of delinquency, information exchange between banks are weak or not effectively used. However it was found that computerization has helped in better credit risk monitoring.
There is agreement among bank officers, that there are recurring lapses in credit appraisal, credit disbursement and credit monitoring and ignorance about the procedure and logic for the procedure as the most important cause for recurring lapses.

HR policies on promotion/ placement affect efficient credit risk management and present training given for Credit Risk Management is adequate are notions not validated by the research.

The research established that adoption of credit risk management system in banks as per Basel committee recommendations and RBI guidelines has resulted in better credit management. The result has helped to conclude that credit risk management system of banks in India is mostly influenced by risk policies and procedures, recurring common mistake and human factor.