ORIGINAL RESEARCH PAPER

Commerce

CREDIT RISK MANAGEMENT IN INDIAN COMMERCIAL BANKS

KEYWORD:

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ABSTRACT

This study analysed credit risk management of commercial banks and also attempted to establish if there exists any relationship between the credit risk management determinants by use of CAMEL indicators and financial performance of commercial banks in India. The study found out that there is a strong impact between the CAMEL components on the financial performance of commercial banks. This study concludes that CAMEL model can be used as a tool to measure credit risk management used by banking industry.

INTRODUCTION

Credit Risk is the principal challenge faced by the banks and such risk is inherent to any business of lending of funds may be to an individual, trade, industry, transport, agriculture etc. The granting of loans and advances is the main source of income of the financial institutions but this is also the source of credit risk. RBI has approved this framework for measuring the performance of Indian Commercial banks. CAMEL is, basically, a ratio-based model for evaluating the performance of banks.

OBJECTIVES

- To measure the performance using CAMEL model.
- To analyze the relationship between risks and performance of the selected banks.

METHODOLOGY

A period of five years from (2013-2014) to (2017-2018) have been taken for the study. Five private sector banks and five public sector banks in India have been considered for the study based on ranking by money control.com. The data required for the study has been collected only from secondary sources. Secondary data have been collected from various journals, websites, annual reports, text books, etc. the tools used in the study are Mean, Ranking, Correlation and Ratio analysis are used in the study.

LITERATURE REVIEW

OgiloFredrick(2012), in his study "The impact of credit risk management on financial performance of commercial banks in kenya" to analyse the relationship of credit risk management and performance. the objective of the study is to analyse impact of credit risk management and to know relationship between credit risk management determinants and performance of banks in kenya. it adopted regression, multicollinearity test to analyse the data. The CAMEL model is adopted in the study. The study concludes that CAML variables are having weak relationship and earnings has strong relationship with financial performance of banks.

Somanadevi et.al (2011) in their study "Credit risk determinants of public and private sector banks in India" to predict the determinants using an econometric model. The objective of the study to quantify the contribution of various bank specific and macro-economic determinants of credit risk in public and private sector banks by using econometric model. The model used in the study is high R square. The results showed that lagged non-performing assets had a strong and statistically significant positive influence on current non-performing assets. The study reveals that both factors play crucial role in determining credit risk of the commercial banking sector.

RESULTS AND DISCUSSION

The CAMEL model components are Capital adequacy, Asset quality, Management efficiency, Earning Quality, Liquidity.

- Capital adequacy is analysed using Capital adequacy ratio, Debt equity, Advances to total assets, Government securities to total Investment and total assets.
- Asset quality is analysed using Net NPA to Net Advances, Total investment to total assets, Gross NPA to total advances, Advance yield ratio, Net NPA to total assets.
- Management Efficiency is analysed using Total advances to total deposits, Profit per employee, Business per employee, total expenses to total income, asset turnover ratio, diversification ratio.
- Earnings quality using Spread to total assets, growth in net profit, Dividend pay-out ratio, interest income to total income, net interest margin, return on equity, net profit margin.
- Liquidity is analysed using liquid assets to total assets, Liquid assets to total deposits, government securities to total assets, total investments to total deposits, interest expended to interest earned.

All the ratio calculated are ranked according to the level of performance and grouped under the components. The group rank table is presented below.

COMPOSITE RANKING (OVERALL PERFORMANCE)

BANK	C	A	M	E	L	AVERAGE	RANK
HDFC	7.50	2	3.00	2	5	3.90	4
ICICI	3.00	5	4.00	3	2	3.40	2
AXIS	10.00	4	2.00	4	3	4.60	5
KOTAK MAHINDRA BANK	2.00	1	5.00	1	1	2.00	1
YES	5.50	3	1.00	5	3	3.50	3
BANK OF BARODA	5.50	8	9.00	6	10	7.70	8
PUNJAB NATIONAL BANK	9.00	9	7.00	10	8	8.60	10
CENTRAL BANK OF INDIA	4.00	6	10.00	6	6	6.40	6
CANARA BANK	1.00	7	8.00	9	7	6.40	6
BANK OF INDIA	7.50	10	6.00	6	9	7.70	8

Source: Annual Reports

In order to assess the overall performance of commercial Banks in India, the composite rating has been calculated from the group ranking of the private and public sector banks in India for the period of 2013-2018 and results are presented in the above table. On the basis of CAMEL model analysis, Kotak Mahindra Bank stood at first position followed by ICICI Bank and Yes Bank while Punjab National Bank secured the least position.

CORRELATION

As a key assumption of correlation model, the study sought to establish whether there was correlation between independent and dependent variables. The average values of the datasets were used for the five-year period (2013 – 2018). The results are presented on table.

CORRELATION

Correlations							
		ROE	C	A	M	E	L
ROE	Pearson Correlation	1	.851**	-.876**	-.038	.855**	.423
	Sig. (2-tailed)		.002	.001	.917	.002	.223
C	Pearson Correlation	.851**	1	-.618	-.343	.815**	.206
	Sig. (2-tailed)	.002		.057	.331	.004	.568
A	Pearson Correlation	-.876**	-.618	1	-.343	-.675*	-.508
	Sig. (2-tailed)	.001	.057		.332	.032	.134
M	Pearson Correlation	-.038	-.343	-.343	1	-.209	.334
	Sig. (2-tailed)	.917	.331	.332		.563	.346
E	Pearson Correlation	.855**	.815**	-.675*	-.209	1	.311
	Sig. (2-tailed)	.002	.004	.032	.563		.381
L	Pearson Correlation	.423	.206	-.508	.334	.311	1
	Sig. (2-tailed)	.223	.568	.134	.346	.381	
	N	10	10	10	10	10	10
**. Correlation is significant at the 0.01 level (2-tailed).							
*. Correlation is significant at the 0.05 level (2-tailed).							

Source: Annual Reports

Pearson correlation was used to analyse the correlations between the variables and financial performance. Table reveals the correlation coefficients between the variables and financial performance. Table shows that capital adequacy has a correlation coefficient of r=0.851 at p=0.002 with Return on Equity. The asset quality and Return on Equity is negatively correlated with value of r=- 0.876 at p=0.001. Management quality also has Negatively correlated with Return on Equity with value r = -0.038 at p=0.917. A correlation was also established between earnings quality and ROE with value of r=0.855 at p=0.002. A correlation was also observed between liquidity and financial performance of r=0.423 at p=0.223.

CONCLUSION

The performance of private banks is better than the public banks may due to the management policies as public banks work for welfare of public and private banks to earn profit. The correlation coefficients between the variables and financial performance. It shows that Capital Adequacy, Earnings Quality, Liquidity has a positive correlation with Return on Equity. The Asset Quality and Management Efficiency had negative correlation with Return on Equity. So, the CAMEL components has high impact on performance of banks.

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