Bankers Primarily Deal with Various Forms of Risk - An Empirical Study

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ABSTRACT:

In this paper author presents Bankers primarily deals with various form of risk Bankers primarily deal with various forms of risk. These include credit risk, liquidity risk, market risk, interest rate risk, earnings risk and solvency risk. In addition, Country risk, currency risk, and cross-border risk can result in an international lending incase. Of all the various types of risks credit risk field is of significant concern to the banking sector as they raise the possibility of unsustainable assets. Poorly controlled credit risks result in banks failing financially. It is therefore critical that banks employ a proper framework for managing credit risk. Moreover, the Bank's functions are no longer restricted to territorial limits. Banks must ensure the safety, liquidity and profitability of the funds invested by the general public to raise the trust of the customers. Risk management as a human operation incorporates risk identification , risk evaluation, the development of management techniques and risk reduction using administrative tools while credit risk is the possibility of failure due to non-payment by a debtor of a loan or other line of credit (either the principal or the interest or both) .Thus the current research aims to examine the effect of credit risk management on the financial performance of a bank with reference to selected banks of the public sector in India.

KEYWORDS: Return on Assets, Capital Adequacy ratios, Credit Deposit Ratios, Profitability, Credit Risk

INTRODUCTION

It is the potential possibility of loss arising from a failure by the borrower to repay the loan or satisfy contractual obligations. In this analysis, the credit risk regarding the CAR and CDR is calculated. The Capital Adequacy Ratio (CAR) is the central indicator of the financial ability of a bank from the perspective of a regulator.

The capital adequacy ratio is made up of the forms of financial capital deemed to be the most stable and liquid, mainly the equity of the shareholder. Bank with high Capital Adequacy Ratio has good return. With good needed money, Commercial banks will take out badly gone loans. Cash Deposit Ratio: The loans are split into deposits. It is a proportion of the loan that banks generate from the deposits that it collects. This represents the Bank's ability to lend money. The effect of this ratio reflects the Bank's ability to make full use of the capital available.

Banks are the engine for economic growth, as they play a major role in organizing public funds. Indian banking systems have become more proactive and competitive, through their systematized and structured structure. There are three types of banks, namely commercial banks, regional rural banks and banks in the cooperative sector. Commercial banks are profit-making entities that serve as intermediaries between borrowers and lenders assists the banks in producing profits It is therefore very necessary for banks to perform these functions with utmost care and due diligence. The loans given and publicly made deposits form major bank assets and liabilities. All loans are still risk related. Default in the payment of these loans could lead to a crisis for banks

LITERATURE REVIEW

Samuel and Muoni (2017) looked at approaches to credit risk management and their impact on the performance of commercial banks in Kenya. The study was inspired by the theory of credit liquidity, the theory of portfolios, credit risk theory and the theory of credit tax. The study was based upon a succinct definition explaining the current state of affairs. The data were collected via questionnaires and interviews, and analyzed through SPSS. The study focused on selected Tier III commercial banks in Kenya regarding the Department of Loans, namely Consolidated Bank, African Banking Company, and Credit Bank. The study sample consisted of 62 staff members from the loans department of Consolidated Bank, African Banking Company, and Credit Bank. We find that approaches to credit risk management such as credit risk rating risks, credit acceptance risks, portfolio management risks and a chance of security perfection have a positive effect on the performance of commercial banks in Kenya.

Nwude and Okeke (2018) looked at the impact credit risk management has on bank performance using five banks to deposit money into Nigeria. Methodology for ex-post facto analysis was applied using data obtained from the annual reports and financial statements of the selected deposit money banks for the period 2000 to 2014. They found that credit risk management had a positive and substantial impact on the lending of total loans and the lending of deposit money banks, the return on assets and return on equity. The study indicated bank managers need to make more effort to handle the NPL by critically measuring lenders' ability to pay back. The regulator should be enhancing his monitoring ability in this respect. studied how Credit Risk affects bank profitability. Credit risk (CAR), Non-performing Asset Ratio (NPA), Loans to Deposits Ratio (LDR), Costs per Loan Ratio (CLR), Insurance Coverage Ratio (PCR), Debt Ratio (LR), Substandard Asset Ratio (SAR), Questioned Asset Ratio (DAR), Loss Asset Ratio (LAR). Return on Capital (ROC) used as metric for efficiency. The secondary data was collected from annual reports of the State Bank of India during twenty years (1996-1997 to 2015-2016). The data was analyzed using multiple regression. The results of the study showed that PAR and LR have major, negative effects on ROC, and other variables have no significant impact on ROC. Yet the overall credit risk has an important influence on the profitability of state banks. Indian state bank faced credit risk because of insufficient credit risk management.

Singh and Sharma (2018) analyzed the impact of credit risk on the profitability of public-sector banks. Secondary data were collected from journals, blogs, Reserve Bank of India Reports for a period of six years, i.e. from 2011 to 2016. We find the ROA-CAR relationship, LPNPL, to be significant and positive, while the negative ROA-NPLR relationship is. Credit risk forecasts 55.7 percent of the return on assets, meaning that CAR, NPLR and LPNPL have a significant influence on ROA. NPLR is the single most powerful predictor of the bank's profitability among credit risk indicators, while CAR and LPNPL are not the main predictors of its profitability

RESEARCH PROBLEM AND OBJECTIVES

A systematic analysis of earlier research studies on the profitability of banks made us aware of the lack of conclusion to the credit risk management and profitability relationship between Indian Public Sector banks. Some of the experiments were performed outside India, and different results were reported. However, no systematic effort has been made to study the relationship between credit risk management and financial performance of Indian banks. This research, entitled “IMPACT OF CREDIT RISK MANAGEMENT ON PROFITABILITY OF SELECT PUBLIC SECTOR BANKS IN INDIA," is therefore undertaken to fill the gap in the existing literature.

The Objectives of the study are:

- To identify the relationship between credit risk management and the profitability of public sector banks in India.
- To analyze the impact of credit risk management on the Profitability of public sectors banks in India.

RESEARCH HYPOTHESIS

- There exists a statistically significant relationship between credit risk management and the profitability of Public sector banks in India. (Correlation analysis is used)
- There exists a statistically significant impact of credit risk management on the Profitability of public sectors banks in India.(Regression analysis is used)

RESEARCH METHODOLOGY

This research aims to address the following key question (Has an impact on the financial results of the selected Indian Public Sector Banks. This analysis is focused on the secondary knowledge. The data needed for this study were gathered from various sources, such as monthly RBI bulletins, published by RBI, Govt. Of India, RBI annual reports, publications and updates of various banks. Banks are considered to be the financial foundations of the country as they play a very significant role in the nation's economic growth. Banks are known as the basic responsibility to accept deposits and to lend credit to the society. In this phase, banks need to face different types of risk which affect their financial results. Credit risk is the banks' most critical form of risk

that occurs because of non-payment of loans. This paper aims to analyse and compare the effect credit risk management has on the banks ' financial performance. In terms of Capital Adequacy Ratio (CAR) and Credit Deposit Ratio (CDR) the credit risks are calculated. Return on Asset (ROA) is seen as a metric for the bank's financial efficiency. The top five public sector banks each are listed based on the rate of market capitalization. The panel data from the 2014-15 to 2018-19 period is collected and analysed using the SPSS 21.0 kit. The study shows that CAR and ROA are strongly correlated but CDR and ROA have been found to be toughly positively correlated with the effect of CDR only when both sector banks are combined. The study advises that banks should pay due attention to both of these factors to reduce potential credit risks.

The population of the banks in India is Public Sector Banks (PSBs). Sector banks have been named to top 5 Public sector banks based on market capitalization.

- Bank of Baroda
- Punjab National bank
- Bank of India
- Canara Bank
- Allahabad Bank

The dependent variable reflects the Return on Assets assessed financial output. Independent variables reflect the metrics of credit risk management, which include CAR and CDR.

The selected banks used five-year period from 2014-15 to 2018-19 to examine the relationship between credit risk management and its effect on the financial performance of public sector banks in India.

A descriptive research design is used to study the effect of credit risk management and financial performance as well as its relation. Data analysis performed using SPSS 25.0 Statistical Tools.

OPERATIONAL DEFINITIONS

- **Financial Performance**

  Financial performance refers to the extent to which the financial targets are or have been achieved. Typically it is used to measure the overall financial performance of the company over a given period of time. Financial output in the present study is calculated using only one variable namely Asset Return (ROA). It refers to the divided net profit by the Total Assets.

Asset return (ROA) is a measure of how profitable a business is relative to its total assets. ROA provides an idea to a boss, investor or analyst as to how effectively an organization tries to use its assets to produce income. The return on the assets is shown as a percentage.

- **Credit Risk**

ANALSYIS AND INTERPRETATION

For study, we apply specific data obtained by taking average financial performance indicator figures of five years, namely Return on Assets (ROA) and measures of credit risk management viz. Ratio Capital Adequacy (CAR), Cash Deposit Ratio (CDR). Secondary analysis is achieved by splitting into two sections, viz. Descriptive analysis, and study of inferences.

Descriptive Statistics

In this section we provide details of mean descriptive parameters and standard deviation of data scores for each of the above mentioned variable, taking into account three classes viz. banking the Public Sector. Information is as follows:

From the table above it is shown that

1. Public sector banks' profitability is negative and poor, with high variances
2. Credit risk to public sector banks in terms of CAR is lower with low variance
3. Credit risk for public sector banks in terms of CDR is lower with low variance

Thus, the above review shows that banks in the public sector have less credit risks but their profitability is negative.

Inferential Analysis

Frequently, inferential statistics are used to address questions about cause and effect, and to make forecasts. This analysis was used by the present study researcher for hypothesis testing. There are two research theories.

Hypothesis 1:

Alternate Hypothesis - There exists a statistically significant relationship between credit risk management and the profitability of Public sector banks in India.

1. In all instances, CAR & ROA are considerably positively associated. In the case of public sector banks, CDR & ROA are insignificantly positive correlated

2. In the case of public sector banks, CAR & CDR are substantially positively linked in an insignificantly positive way. This shows that collinearity is at problem. Therefore we established pair wise regression models in the next hypothesis test.

Alternate Hypothesis of there exists a statistically significant relationship between credit risk management and the profitability of Public sector banks in India is accepted

Hypothesis 2

There exists a statistically significant impact of credit risk management on the Profitability of public sectors banks in India.

Two different models are tested with Public sector banks having dependent variable as ROA for all models and independent variables as CAR and CDR. Details are given below. Initially we provide model summary.

Determination coefficient (R Square) measures the potential of the independent variables to explain the variance within the dependent variable.

1. With CAR as an independent variable, 52.1 per cent of the variation in the dependent variable (ROA) was explained by the independent variable (CAR).

2. With CDR as an independent variable, the independent variable (CAR) clarified the variance in the dependent variable (ROA) at 3.4 per cent (very low).

In any case the modified R Sqr is similar to R Sqr. The Durbin – Watson statistic (expected to be between 1 and 3) tells us whether the presumption of independent errors is justifiable. Here values are between 1 and 2. Therefore, it is justifiable to assume independent errors.

In the next table we give details of ANOVA

Table 4 of ANOVA reveals the importance of the regression analysis. It indicates whether or not dependent variable depends substantially on separate variable.

With CAR as a separate vector, all p values are below 0.05. This indicates pronounced regression. Therefore ROA relies heavily on CAR.

With CDR as an independent variable, there is negligible regression in the case of banks in the public sector ($p > 0.05$).

Table 5 –Regression Co-efficient

	Unstandardised Co-efficients		**Standardised Co-efficients**		
	B	Std.Error	B	t	Significance(p)
(Constant)	-81.23	22.541		-2.981	0.013
CAR	7.145	1.782	0.811	2.799	0.021
(Constant)	-15.71	27.987		-0.549	0.544
CDR	0.175	0.436	0.105	0.365	0.572

The details of the regression coefficients are given in Table 5.

For the effect of independent variables against the dependent variable, the Unstandardized Coefficients B value shows. From table 5, with CAR as an independent variable, all unstandardized coefficients are important ($P<0.05$), with CDR as an independent variable being negligible unstandardized coefficients ($p>0.05$).

It is evident from the above table 6 of the regression model that ROA is strongly dependent on CAR and that ROA is insignificantly dependent on CDR. Both negative constant values suggest possibly an inverse relationship.

Alternate Hypothesis of there exists a statistically significant impact of credit risk management on the Profitability of public sectors banks in India is accepted.

CONCLUSION

1. Banks in the public sector bear low credit risk and negative profitability

2. In the case of public sector banks CAR & ROA are strongly positively associated. A high CAR bank has a good return on profitability. This is obvious from the fact that for the public sector CAR mean (11.63)

3. Public sector banks CDR have a favorable effect on ROA but a statistically insignificant association. CDR's negative effect on results indicates that banks charge the depositors less than what the bank paid as interest cost.

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