Implementations of Need based Approach to Credit Portfolio Management of Scheduled Commercial Banks in India

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Abstract

After the 2007-2008 global financial crises, the credit portfolio management function has become the most important function of banks and financial institutions. The third stage of the Basel Agreement, Basel III, was formulated after the crisis. It aims to strengthen banks' capital requirements by increasing bank liquidity and reducing bank leverage, and encourage banks to measure the credit risk of bank investment portfolios. The Basel Committee also raised the issue of applying the risk weights used in the capital adequacy framework to determine risky asset exposure to determine credit risk. (Morris,2001). The main purpose of this article is to analyze the credit implementation of the commercial banking sector and the implementation of demand-based credit management methods. This research analyzes the concentration of loans and the total amount of bad debts by sector and product, and studies the concentration of banks in credit portfolio management. This research also aims to provide some suggestions for overcoming the problems associated with credit portfolios.

Keywords: Basel, credit portfolio, credit risk management, Gross non-performing loans.

Introduction

Credit Portfolio Management (CPM) has become a discipline as financial institutions have continued to measure credit risk more accurately and manage credit risk more effectively across their businesses over the past decade. Credit Portfolio Management (CPM) is an important function of banks (and other financial institutions such as insurance companies or institutional investors). They have large and diversified loan portfolios, which typically include low-liquidity loans. Credit Portfolio Management (CPM) refers to a set of principles, tools and processes that support the management of a credit portfolio (collection of credit assets). A distinct feature of credit portfolio management activities is that the assessment and management of credit risk is not done in isolation, but in a mixed portfolio environment (BPI 2009). The financial crisis of 2007 has changed the way these institutions operate, and CPM is no exception. The historical role of CPM still exists. However, new regulatory requirements, especially those related to increased capital and liquidity, increased cost and profit pressure, and changing market conditions, have made CPMs play a broader role in finance, accounting and risk. It needs to be closely coordinated with other areas such as data. This study understands the basic requirements of credit portfolio management and describes the basic tools that allow banks to effectively manage their portfolios.

Objectives of the study

The study has been conducted with the following objectives defined:

1. To understand the basic objective of credit portfolio management.
2. To analyse the Sectoral Deployment of Bank Credit of commercial banks.
3. To analyse the gross non-performing loans scenario in Indian banking sector.

Literature review

Ivaskeviciute, Macerinskiene, and Laura (2008) suggested dividing the loan portfolio into sub-categories: large projects, private clients, and companies based on the bank's business unit to obtain more comprehensive results and prepare for the portfolio review.

Afroz (2013) found that Bangladesh Krish Bank focuses its loans on the main agricultural sectors to serve the poor in rural areas. Later, it diversified its activities towards secondary agriculture. After diversification, the bank's financial situation has become more transparent and better results are expected soon.

Tabak, Fazio and Cajueiro (2010) studied 96 Brazilian banks and found that the loan portfolio of Brazilian banks was medium and moderately concentrated. He concluded that the centralization of loan portfolios may improve the performance of Brazilian banks in terms of profitability and default risk. The concentration index is positively correlated with profitability and negatively correlated with risk.

Though there are researches conducted on credit portfolio management in international scenario, very few literatures have reflected on the need based credit portfolio management for commercial banks in India. Moreover the sectoral deployment of loans and the gross non-performing loans have not been discussed in terms of credit portfolio management.

Method of the study

The study has been conducted using secondary data for authentic sources such as articles, published bulletins of Reserve bank of India, statista etc. The facts and figures are very recent and have been taken for a period from 2008 to 2021.

Portfolio Management-objectives

Credit Portfolio Management (CPM) refers to the process of building various investments based on credit relationships and managing the risks associated with those investments. The structure of your credit portfolio will likely depend on the nature and distribution of the loan, and may depend on your bank's credit structure. They can break their total credit balance into portfolios by purpose, by sector, by type of loan, and even by product or security. However, it is advantageous to classify large loans into industry categories such as priority sectors, energy sector, agriculture sector, infrastructure sector, manufacturing sector, commercial and real estate sector, etc. Mortgage Portfolio, Auto Loan Portfolio, Personal Loan Portfolio, Education Loan Portfolio, Credit Card Portfolio, Gold Loan Portfolio, etc. (Buddhism Kumar Malla 2017).

There are three main portfolio management goals that a smart bank follows: liquidity, security, and earnings. To achieve on the bank will have to sacrifice other goals. For example, if banks are looking for high yields, they may have to sacrifice some security and liquidity. If it is looking for more security and liquidity, they may have to forgo some income.

Sectoral Deployment of Bank Credit

Data on the deployment of bank lending by sector was collected from 33 scheduled commercial banks, representing around 90% of the total non-food lending that is expected to be developed by all commercial banks, announced in April 2021. Bank lending on non-food increased by 5.7% in April 2021 against 6.7% in April 2020.

Growth in credit to agriculture and related activities increased to 11.3% in April 2021 against 4.7% in April 2020. 0.4% in April 2021 against 1.7% in April 2020. However, credit to medium-sized industries recorded strong growth of 43.8% in April 2021 against a drop of 6.4% there a year. Credit growth for micro and small industries accelerated to 3.8% in April 2021, down from a 2.2% decline a year ago, while credit to large industries down 1.0.9% from an increase of 2.7% a year ago. . In industry, credit in agribusiness, textiles, gems and jewellery, paper and paper products, glass and glassware, infrastructure, leather and leather and wood products and products wood growth in April 2021 compared to the corresponding month of the previous year. However, credit growth for mines and quarries, beverages and tobacco, petroleum products and nuclear fuels, rubber, plastics and their products, vehicles, vehicle parts and transportation equipment, base metals & metal products, cement & cement products, all engineering, chemical & chemical and reducers/contracted construction.

Credit growth to the service sector slowed to 1.2% in April 2021 from 10.6% in April 2020, mainly due to credit growth to NBFCs and narrowing margins in the credit activities of the operator. However, the commercial credit segment continued to perform well, recording 10.5% growth in April 2021 from 8.7% a year ago.

Personal loans grew rapidly by 12.6% in April 2021 from 12.3% a year ago, mainly due to rapid growth in auto loans, gold jewellery loans and card balances (RBI, Bulletin, 2021)

Non-performing loans

India recorded a total toxic asset (GNPA) ratio of more than 8% in FY2020 and 7.5% in September 2020. This is lower than the previous year, but India is expected to experience bad debt for: Impact of Coronavirus Disease (COVID19) Infectious Disease Based on the value of September 2020, the Central Bank of India anticipates three scenarios from fiscal year 2022 to September 2021. In the baseline scenario, the GNPA rate reaches 13.5%, a new high. Under moderate or severe stress, the GNPA rates are 14.1% and 14.8%, respectively (Statista Research Laboratory, 2021).

Research Article

Fig1: Gross non-performing loan ratio across India from financial year 2008 to 2021, with estimates until September 2021
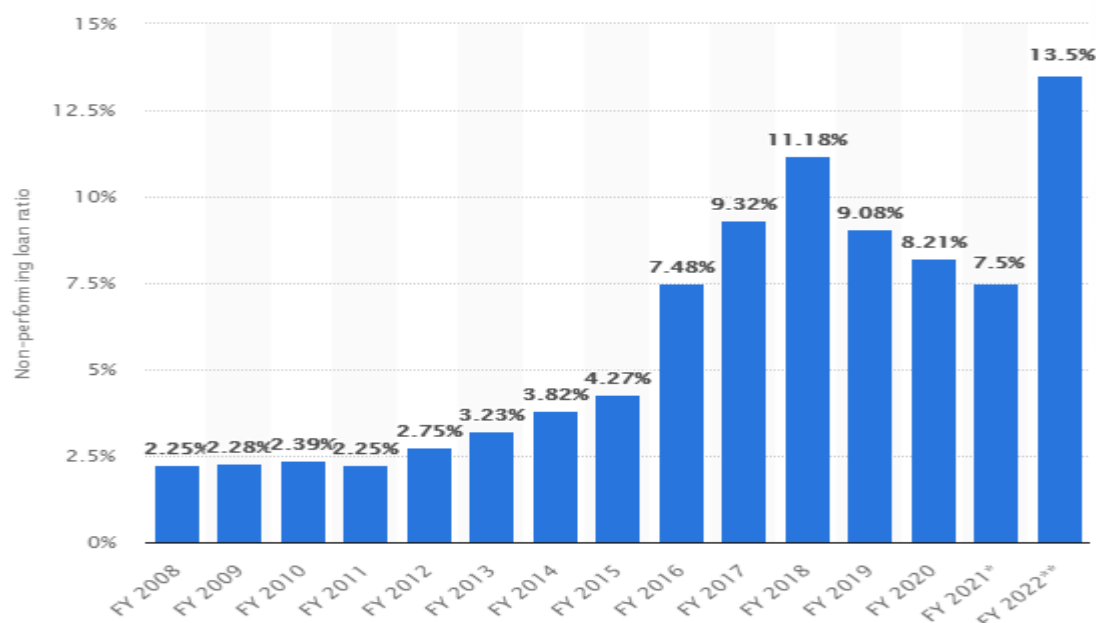
Source: Statista 2021

In recent reports, the M2 money supply in India grew 15.5% year-on-year in March 2021. India's foreign exchange reserves were valued at $ 536.7 billion in March 2021. The reserves of India were valued at $ 536.7 billion in March 2021. Currencies were equivalent to 13.4 months of imports in February 2021. Credit reached $ 2,458.1 billion in February 2021, up 9.3% year on year. Indian household debt reached $ 335.6 billion in March 2020, which represents 12.4% of the country's nominal GDP (ICCS data, 2021).

Loan Review Mechanism (LRM)

Appropriate risk assessment / pricing can help better portfolio management Banks need to identify borrower migration patterns based on the variability of their credit quality. The data will provide banks with the information they need to determine the quality of their loan portfolios and take corrective action if necessary. In addition, banks can also: Create a credit limit based on a borrower's rating to limit credit risk.

- Understand the distribution of ratings of borrowers in different industries.
- Restrict exposure to market segments based on pros and cons and current financial conditions. If the industry goes through a period of stress, banks can raise the quality standards required to apply for loans.
- Design and execute stress tests to identify weaknesses in your credit management, policies and tools to improve your credit risk management process.

LRM is a great tool to understand the quality of the loan book and achieve an improvement in the quality of credit related decisions. LRM helps identify loans of great value that can develop credit weaknesses and create a positive approach to credit risk management. In addition, LRMS is also very useful.

- Loan policy, validity of the procedure and identification of compliance.
- Confirm compliance with government law.
- Support the existing credit risk management infrastructure.

Conclusion

Effective credit risk management begins with assessing a borrower's profile and continues through collection and beyond. Banks need to create flexible lending processes equipped with relevant scoring systems to determine creditworthiness and charge appropriate interest rates. This will help them settle any potential debt that may arise in the future. Banks also need to allocate enough capital to cover large and persistent loan losses. Such practices are necessary to reduce the likelihood of higher defaults and improve the soundness of loan portfolios.

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