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A Study on Impact of Lending Procedure on Credit Risk Analysis in Selected Private Sector Banks

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Abstract

This thesis studies company loan credit risk control and seeks to define various methods to efficiently control the risk. The thesis involves credit risk management theories. A sample of 265 persons who were customers of banks and availed loans was chosen to collect opinions through a structured questionnaire in Bangalore. The factors under study were Credit Risk, Credit Score, Interest Rates, Insurance Charges, Default Loan, and Documentation. Using Descriptive and correlation analysis, the findings were found. Results showed that a connection exists between towards Insurance charges, credit score, interest rates and default loan while availing a business loan. Qualitative research is conducted through email interviews with customers of the target bank. Besides the primary data of the interviews. The study recommended that these private sector banks management should understand how they can edge themselves against the eminent dangers of over exposure to credit risk whose importance cannot be understated as can be realized from the findings that can impact negatively on their profitability. The results of the thesis highlight some issues that restrict the case bank's credit risk management as well as suggestions on the case bank further study is also given with the results.

Keywords: Credit risk • Lending procedure • Interest rates • Credit score

Introduction

Credit is the lifeline of trade, industry and commerce. Infusion of credit to the economic sector is as important as that of understanding the needs of the factors and dispensation of the credit in required quantum and in appropriate time. The research gaps identified by reviewing some of the research papers. The above literature gives us the clear information about the lending procedures in the private sector banks. Most of the research was confined to a specific geographical region and time period. This is done to reduce the credit risk while availing the business loans. A banker must be practical as well as prudent while enabling credit to the needs of the people. The concept of credit management is undergoing unimaginable changes. From the days, when bankers were shy of expanding credit, because of interference of political parties and modem government rules and regulations, they have reached a stage where they would like to find new avenues of credit. Credit innovations are emerging in the present context. Business banks function as catalysts in a country's economic development. This is achieved by mobilizing almost one third of the Gross National Product through their various deposit schemes. Thus, deposit mobilizing, and lending credit dispensation Are the business banks ' two most significant functions. Banks are the trustees of the public funds and savings.

In India credit management has assumed much significance in the post reform period. Introduction of potential accounting norms such as income recognition norms, the development of advanced loan management instruments led in asset classification standards and provisioning standards. Banks have become a component of our lives today. There was a moment when the city's residents could enjoy their services alone. The banks give access to even a common person and their operations extend to fields that have been previously untouched. They have come out to fulfil domestic duties in addition to their traditional business-oriented tasks. Banks meet the requirements of farmers, manufacturers, traders and all other segments of society. They thus accelerate a country's economic growth and drive the wheels of the economy towards its self-righteous aims. Accepting deposits and lending money are the core functions of a bank [1].

Literature Review

This study enhances some of the current studies by investigating the sub-total and overall impact of credit risk management and its indicators on banks ' economic results using specific credit risk management indices. Credit risk is by far the most significant risk faced by banks, and their company's accomplishment is greater than

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any other danger based on accurate measurement and efficient risk management. In our nation, the economic industry is still evolving and many banks have not been able to set up a strong risk management structure, especially credit risk management, to avoid unfavourable events The primary source of credit risk involves restricted institutional ability, improper credit policies, unstable interest rates, bad governance, low levels of assets and liquidity, d Managing credit risk for banks is not an easy task because it requires extensive factors and procedures to identify, measure In her research, "Banking Sector Reforms: PSBs Experience" analysed PSBs ' performance as a consequence of reforms in the banking sector. Two sections of the research are split. A short review of banking reforms was produced in the first portion. The significant reforms are deregulation of entry deregulation lending / deposit rates, revamping of licensing policies for branches, measures to enhance economic health, measures to enhance operating efficiency and pre-emption reserves. Evaluated Public Sector Banks (PSBs) performance since deregulation in both absolute and relative terms and highlighted the fundamental reason for enhanced PSB performance. The author stated that there was neither a collapse of the banking system nor a banking crisis. Comparing the economic performance of private sector banks since 1994-95, he clarified that a fresh banking experience has been provided by private sector banks. The author has attempted to gain an understanding into these institutions 'economic operations in this paper. For financial analysis, a sample of 5 banks was drawn. All these banks' economic track record has been assessed and their economic performance has been contrasted [2]. In this paper, "Comparing Performance of Public and Private Sector Banks: A Revenue Maximization Efficiency Approach," a performance comparison was created between three classifications of banks government, private and foreign banks using physical input and output amounts and comparing banks ' income maximization effectiveness in 1992-00. In her thesis entitled Credit Management and NPA Issue in Public Sector Banks, she proposed that for efficient handling of NPAs, there is an urgent need to raise awareness of the adverse effects of NPAs on profitability among bank employees, especially in the sector. The above literature analysed through chosen determinants in their research the impact of the Czech Republic's financial position on the results and profitability of the banking sector. They focused on evaluating the banking sector's efficiency and profitability using the "Multiple linear regression model" technique. In her research paper entitled a study on non-performing assets of selected public and private sector banks in India, D. JAYAKKODI aimed to examine and compare selected public and private sector banks ' Gross NPAs and Net NPAs. Vaibhavi Shah and Sunil Sharma attempted to explore the non-performing assets of ICICI and HDFC banks in their research paper titles as a Comparative study of NPA in ICICI bank and HDFC bank

The research gaps identified by reviewing some of the research papers. The above literature gives us the clear information about the lending procedures in the private sector banks. Most of the research was confined to the geographic region and time period. This is done to reduce the credit risk while availing the business loans [3]. The thesis seeks to provide an extensive overview of the techniques that banks can use to enhance their management of credit risk. To accomplish this, we will concentrate on answering the study questions.

- How can loan risk control be efficiently implemented in banks in the private sector?
- How does the financing structure of the bank influence its behaviour in lending?
- Is the quality of bank capital of both banking schemes important for their lending behaviour respectively?
- What techniques can banks apply before issuing a loan to minimize credit risk?
- How can banks manage credit risk throughout the loan life cycle?

The study is aimed at studying the lending procedure for Better Credit risk Prediction. For this research a total of 265 people who are the bank customers and availed the loan from the banks been surveyed and the data has been collected through questionnaire survey. Primary data: Questionnaire survey was done to collect opinions of customers who had availed Loans from the banks. We regarded the lending procedure in Scheduled Commercial Banks for this research, which involves banks of the private sector mentioned in the Second Schedule of the Reserve Bank of India Act, 1934. The research is based on information of primary importance. The article describes the loan lending conceptual framework and highlights the trends, status and effect of the lending process on scheduled commercial banks. The scientists used several reputable research journals including research paper and articles. In addition, during the research, RBI Report on Trend and Progress of Banking in India has been referenced for several years, websites and a book on banking. Population: The banking sector is considered:

- To study the lending procedure of private sector banks
- To identify credit risk screening through lending procedure
- To analyse the impact of lending procedure on credit risk
- To provide suggestions for the better credit risk prediction

Discussions

Methodology starts with the original assessment of the information gathered using the basic statistical tool called SPSS. An initial assessment of mean and standard deviation of the data collected is done to check the reliability between the variables. The following tests are conducted to check the impact between dependent and independent variable.

- Credit score
- Documentation
- Interest rates
- Credit risk
- Insurance charges
- Bank charges
- Loan default

Variables

- Documentation: Credit-related documents, including credit contracts, economic statements, company plans, lender's safety interest records and other records used by the lender to assess the lender's creditworthiness.
- Credit scores: A credit score is a numerical term based on a level evaluation of an individual's credit documents, representing an individual's creditworthiness. ... Lenders use credit scores to

determine who qualifies for a loan, at what interest rate, and what credit boundaries.

- Economic status: In finance, a loan is one or more individuals ' loan of cash, organizations, or other entities to other individuals, organizations etc. The recipient (i.e. the borrower) incurs a debt and is usually liable to pay interest on that debt until it is repaid, and to repay the principal amount borrowed.
- Terms of loan: A term loan is a monetary loan repaid in regular payments over a defined period. Term loans generally last from one to ten years, but in some instances may last up to 30 years. Usually a term loan includes an unfixed rate of interest which will add extra balance to be repaid.
- Interest rates: The proportion of the loan paid to the borrower as interest, typically expressed as an annual percentage of the outstanding loan.
- Bank charges: It is a non-refundable extra fee that must be paid when applying for a personal loan. Processing charges are generally 1%-2% of the loan's main quantity.
- Insurance charges: The insurance premium is described in the easiest terms as the quantity of cash that the insurance company will pay you for the insurance policy you buy.
- Registration: A loan register is an internal maturity dates database of a servant's loans. The credit register indicates when the loans are due and lists them by maturity date in chronological order.
- Processing charges: In addition to the interest payable on the principal amount charge, there is a non-refundable amount when applying for a personal loan. The lender pays processing fees to take care of any documentation that requires to be processed as part of the application process, generally 1-2 percent of the lending principal.

Reliability Test Results

Cronbach Alpha is one of the most important indicators in scale development process. It describes the reliability of items with higher value of alpha indicating the high internal consistency. This means that all the items used in scale development is measuring the construct of interest. Alpha is an indication of the percentage of variance attributable to the real score in the scale results. Internal consistency of items is tested with Cronbach alpha coefficient. A survey was conducted from June 1st to July2 and to analyse the reliability and confirm the internal consistency of the questionnaire, the questionnaire was subjected to reliability test using Cronbach's Alpha scale (Table 1) [4].

Variables	Cronbach's Alpha	Cronbach's Alpha on Standardized Items	No of Items
Credit Score	0.831	0.0831	30
Credit Risk	0.781	0.0781	30
Insurance Charges	0.654	0.0654	30
Default Loan	0.781	0.0781	30
Interest Rates	0.579	0.0579	30
Bank Charges	0.981	0.0981	30
Processing Charges	0.692	0.0692	30

Table 1. Table showing the reliability of the variables.

Interpretation

The α of Cronbach was used to evaluate the consistency of the questionnaire. The general coefficient of 0.831 was discovered to exceed the minimum suggestions, i.e. 0.80. Therefore, the viability and validity of the instrument is deemed to be enough.

Descriptive statistics

Descriptive statistics are brief descriptive coefficients that summarize a collection of data that can either be a representation of the entire population or a population sample. Descriptive statistics are split into important measurements of trend and measurements of variation (spread). Core tendency measurements include mean, mean, and mode, while measurements of variation include standard deviation, variance, minimum and maximum variables, and kurtosis and skewedness.

Correlation test between the variables

Correlation is a bi-variate analysis that measures the association power between two variables and the relationship direction. The value of the correlation coefficient differs between+ 1 and-1 in relation to the intensity of the connection. A value of ± 1 refers to an ideal degree of connection between the two variables. The connection between the two factors will be weaker as the correlation coefficient value goes up to 0. The sign of the coefficient shows the direction of the relationship; a + sign shows a favourable connection and a -sign indicates a negative connection. We usually evaluate four kinds of correlations in statistics: Pearson correlation

Correlation of Credit Score and Interest rates

The correlation results reveal that there is a strong positive relation between credit score and interest rates. As we can see that the correlation coefficient is 0.749, of 0.01 level of Significance of interest rates and credit score. From the results, it is seen that the significant (2-tailed) test is 0.000 which is less than 0.05. This means that credit score is statistically significantly correlated to interest rates. In Other words, increase or decrease in credit scores will significantly change the interest rates.

Correlation of loan default and credit risk

The correlation findings show that the loan default on credit risk has a mild beneficial relationship. As we can see that the correlation coefficient is .673at 0.01 level of significance of loan default and credit risk. From the results, it is seen that the significant (2-tailed) test is 0.002 for loan default which is more than 0.05. This means that loan default is statistically insignificantly correlated to credit risk. In other words, increase or decrease in loan default will have a moderate change in credit risk.

Correlation of insurance charges for business and Availability of credit. The correlation results reveal that there is a moderate positive relation between of insurance charges for business and Availability of credit. As we can see that the correlation coefficient is .255**and .094at 0.01 level of significance of interest rates on Risk for business and Availability of credit. From the results, it is seen that the significant (2-tailed) test is 0.002 which is less than 0.05. This means that insurance charges are statistically significantly correlated to Risk for business and availability of credit. In other words, increase or decrease in bank charges will have a moderate significant change towards risk for business and availability of credit [5].

The study analysed the descriptive statistical measures of the data to determine the lending procedures of private sector banks (selected banks i.e. Axis and HDFC Banks). Results indicated that banks had average Mean as 3&4. Further analysis showed that mean volume of deposits is 27%. Additionally, mean interest rate is 10.71%. At last will talk about standard deviation which is very much lower than small CV. Accordingly to Correlation analysis, it is observed that volume of deposits, and interest rate and credit risk influence lending rates of these two banks. In addition to this ANOVA is fit to identify the quantity of loan match with variables (interest rates, loan default, credit score, credit risk, insurance policy).

Conclusions

The study outcome has discovered that, therefore the amount of deposit to have high quality and have an impact on business bank loan and to alternate it to produce the first-rate compromise in bank lending. Bigger banks are in position to draw extra investments in the form of deposits and enhances their ability to increase the credit rating. Higher banks have the position to draw more investments in the type of deposits and complements their ability to expand the credit score ranking. The study which have established is the most liquid banks make better residencies more credit rating.

This section, after having gone through the knowledge base and conclusions, will now return to the four investigative issues described in chapter 1. Subchapter 5.1 responds to the IQ1, 2 and 3. Next, we will talk about the reliability and validity of the information gathered and the results of the research. The outline of Chapter 5 will be accompanied by the response to IQ4, which relates to suggestions for the case firm and the Vietnam State Bank. Finally, the writer provides his own learning self-assessment. There has been a tendency in the sector to take advantage of banks ' short-term credit for inventory-based manufacturing development. Diversion was usually due to sluggish capital market circumstances since 1962, and restricted assessment of short-term loans relative to medium and long-term loans. In general, banks connect their loan boundaries to the safety provided by their customers through cashflow analysis, mostly without assessing the borrower's general economic situation.

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