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Analysing Credit Risk Assessment in Commercial Bank Lending in Indian Context

Dr. Renu Arora

Abstract

This study analyses the various judgmental and analytical credit risk assessment systems prevalent in banks to measure the credit risk and track the transitions during the life span of a commercial loan. The input for this analysis is the review of literature, and unstructured personal interviews with 38 credit and risk managers of twelve Indian public sector banks. Various economic and environmental factors expose business and industry to varied risks and uncertainties, which are transferred to banks while granting commercial loans coupled with the tendency of commercial borrower to willfully default and siphon off banks money for unauthorized purposes. Therefore, the banks must develop comprehensive credit risk assessment framework for efficient risk measurement and risk-based pricing of business loans to minimize the credit losses. The study has concluded that the combined use of quantitative and judgmental approaches provides the optimum credit risk assessment of business borrowers. Experiential factors based on credit analysts' job experience and his tacit knowledge improves the business loan appraisals in Indian public sector banks.

Key words: Credit scoring, Bad debts, Expected loss, 6 Cs, Campari & Ice, Debt to equity ratio, Subjective assessments, Peak debt/equity ratio.

1. INTRODUCTION

Banking prudence and efficiency to manage their risks in different business cycle and environment would help to alleviate crises and losses (RBI, 2018). A dynamic business environment, global and domestic pressures have necessitated for Indian banks to improve and integrate their credit risk management systems to maintain asset quality and improve profitability. Credit risk refers to the possible losses of banks coming from borrower failing to repay (Han, 2015). Credit risk mainly exists in three common forms: principal loss risk; interest loss risk and profit loss risk (Han, 2015). The position of Indian public sector banks (PSBs) on asset quality is quite alarming as these are registering highest gross NPAs, stressed and restructured assets than their counterparts in the banking industry, private and foreign banks. Reserve Bank of India (RBI) in its annual report