Credit Risk Analysis- A Case Study of Canara Bank

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ABSTRACT

All the people who need loan may turn to their local banks, credit unions or peer to peer lenders. Every lending institution has its own advantages and drawbacks. In this scenario credit risk management becomes increasingly important element as the same is concerned with managing the financial debts and safeguarding the interest of the banks. The purpose of credits given by banks is to earn interest and make profits. The important function of credit management is to decide how much credit should be given to the borrower and ensuring compliances with the credit terms of repayment and avoid Non-Performing Assets (NPA) to the banks. Credit risk is the biggest risk the bank faces by the virtue of nature of business, inherits. The ability of commercial banks to formulate and adhere to policies and procedures that promote credit quality and curtail non-performing loans is the means to survive in the stiff competition. Inability to create and build up quality loans and credit worthy customers leads to default risk and bankruptcy as well as hamper the economic growth of the country.

Keywords: Credit Risk, Non-Performing Loans, Credit Worthiness, Bankruptcy, Systematic Risk

1. INTRODUCTION:

Credit risk is the oldest form of risk that is faced by the bankers across the globe. It is the risk of default on loans. Credit risk is the biggest risk the bank face by the virtue of nature of business, inherits. If credit can be defined as “nothing but the expectation of a sum of money within some limited time” then credit risk is the possibility that this expectation will not be fulfilled. Credit risk is old as lending. Banks are financial institutions which play a role of financial intermediation between people in excess of funds and those in need of finances. This role is essentially performed by accepting different types of deposits, e.g. money at call, fixed deposits, saving, etc. for further lending to the numerous customers by way of loan and advances.
In recent decades credit risk has become pervasive. Companies borrow to make acquisitions and to grow, small business borrow to expand their capacity and individuals use credit for other purpose. It is only after determining the risk represented by each individual borrower and by each individual credit service that one can begin to manage the loan portfolio as a whole.

Since exposure to credit risk continues to be the leading source of problems in banks world-wide, banks and their supervisors should be able to draw useful lessons from past experiences. The aim of credit risk management is to minimize bank’s risk adjusted rate of return by maintaining credit risk exposure within acceptable boundary. Banks need to manage the credit risk inherent in the entire loan portfolio as well as the risk in individual credit or transaction. Credit management means the total process of lending starting from inquiring potential borrowers up to recovering the amount granted. In the sense of banking sector, credit management is concerned with activities such as accepting application, loan appraisal, loan approval, monitoring, recovery of non-performing loans, etc. Credit

Management is implementing and maintaining a set of policies and procedures to minimize the amount of capital tied up in debtors and to minimize the exposure of the business to bad debts.

Credit Management from debtor's point of view is managing finances especially debts so as not to have a tail of creditors lurking behind your back. Credit Management is responsibility that both the debtors and the creditors should seriously take when it functions efficiently; credit management serves as an excellent instrument for the business to remain financially stable.

Credit management is the process of granting credit, setting the terms on which it is granted, recovering this credit when it is due and ensuring compliance with company credit policy, among other credit related functions. The goal within a bank or company in controlling credit is to improve revenues and profit by facilitating sales and reducing financial risks.

2. LITERATURE REVIEW:

Hoff and Stiglitz (1990) denoted, in the past decades there have been major advances in theoretical understanding of the workings of credit markets. These advances have evolved from a paradigm that emphasis the problems of imperfect information and imperfect enforcement. They pointed out that borrowers and lenders may have differential access to information concerning a business risk, they may form different appraisal of the risk. What is clearly observed in credit market is asymmetric information where the borrower knows the expected return and risk of his/her business, whereas the lender such as bank knows only the expected return and risk of the average business in the economy.

Theodore N.Beckman and Ronald S Foster (1924) states that Banks in today world have many functions. Lending is the most important one. Credit or loans covers the large portion of banks total asset and a backbone of every bank structure. In formulating policies and procedures for the credit granting process several basic steps must be taken by credit management.

Bert et al. (2003) defines credit management as a process of granting credit, the terms it's granted on and recovering this credit when it's due. This is the function within a bank or company to control credit policies that will improve revenues and reduce financial risks.

Fernando and Nimal (2013) examined the impact of overall risk management on Sri Lankan banks' performance. The main objective of this study was to identify the impact of risk management on bank efficiency in Sri Lankan Banks. The study found that the risk management programs have improved the efficiency of the Licensed Commercial Banks in Sri Lanka.

Yurdakul (2014) stated that the credit risk is of categorised into two types i.e., systematic and unsystematic. Systematic risk arises out of fluctuations in economic, social and political circumstances and affects all financial (capital and monetary) markets and securities (financial assets) that are traded in markets. Unsystematic credit risk is subject to the characteristics of the industry in which the firm operates. It is composed of elements such as poor management, new innovations, technological developments, and changes in consumer preferences.

Bekhet and Eletter (2014) stated that it is very important to scrutinise the financial history and background of the customer before making any credit decision as it helps in minimising the credit risk.

2.1. Research Gap:

The present paper analyses not only management of credit risk in bank but also analyses the variations in Non- Performing Asset (NPA) levels.

3. OBJECTIVES OF THE STUDY:

- To study the Credit Risk Management in Canara Bank.

- To evaluate Credit Risk Model of Canara Bank.
- To ascertain Credit Risk Management Policy with Bloom's Taxonomy.
- To analyze the variations in Non-Performing Asset(NPA) levels in 5 years.

4. RESEARCH METHODOLOGY:

The information has been collected to prepare this case analysis from different sources. It can be classified as primary and secondary source.

4.1. Primary Source:

The Primary source of the data for the present case study is collected by having discussion, interview with the branch Managers and the staff of the bank and ideas received from them. The primary source of the data includes the information obtained through direct personal interview with the manager and the banks staffs. It also includes observation and discussion.

4.2. Secondary Source:

The secondary source was collected through annual reports, manuals, magazines, internal records, previous records and Balance Sheets. Some of the information was also been explored from the books and from the several websites of the bank. The secondary source of data include, Bank Annual Reports, Manuals and through websites of the bank and other relevant websites.

5. PERIOD OF STUDY:

The study of Credit risk management of the bank is undertaken for the last 5 years i.e., from 2016 to 2020 considering the advances and deposits, interest earned and expended by the bank and the variation in the Non-Performing Assets (NPA) levels for 5 years.

6. OVERVIEW OF CANARA BANK:

Canara Bank was founded by Sri Ammembal Subbarao Pai, a great visionary and philanthropist, in July 1906, at Mangalore, then a small port town in Karnataka. The Bank has gone through the various phases of its growth trajectory over hundred years of its existence. Growth of Canara Bank was phenomenal, especially after nationalization in the year 1969, attaining the status of a national level player in terms of geographical reach and clientele segments. Eighties was characterized by business diversification for the Bank. In June 2006, the bank completed a century of operation in the Indian Banking Industry. The eventful journey of the bank has been characterized by several memorable milestones. Today Canara Bank occupies a premier position in the comity of Indian banks. With an unbroken record of profits since its inception, Canara Bank has several firsts to its credit. These include:

- Launching of Intercity ATM Network
- Obtaining ISO Certification for a Branch
- Articulation of "Good Banking"- Banks Citizen Charter
- Commissioning of Exclusive Mahila Banking Branch
- Launching of Exclusive Subsidiary for IT Consultancy
- Issuing Credit Card for Farmers
- Providing Agricultural Consultancy Services

Over the years, the Bank has been scaling up its market position to emerge as a major 'Financial Conglomerate' with as many as nine subsidiaries/sponsored institutions/joint ventures in India and abroad. As at March 2015, the bank has further expanded its domestic presence, with 5682 branches spread across all geographical segments. Keeping customer convenience at the forefront, the Bank provides a wide array of alternative delivery channels that include 8533 ATMs, covering 4021 centers. Several IT initiatives were undertaken during the year. The bank set up 132 hi-tech Elounges in selected branches with facilities like ATM, Cash Deposit Kiosk with voice guided system, Cheque Deposit Kiosk, Self-Printing Passbook Kiosk, Internet Banking Terminal, Online Trading Terminal and Corporate Website Access. Canara e-Info book – an electronic passbook and banking related information facility was introduced on mobile platforms- Android, Windows and IOS. The Bank also launched Canara Bank Rupay Debit Card, Canara Club Card- Debit, Canara Secured Credit Card, Canara Elite Debit Card, Canara Bank Platinum Rupay Card and EMV Chip Cards under debit and credit cards. Online savings Bank and PPF account opening were introduced during the year.

Founding principles:

- To remove superstition and ignorance
- To spread education among all to sub-serve the first principle.
- To inculcate the habit thrift and savings
- To transform the financial institution not only as the financial heart of the community but the social heart as well.
- To assist the needy
- To work with sense of service and dedication
- To develop a concern for fellow human being and sensitivity to the surroundings with a view to make changes/ remove hardships and sufferings.

Vision and Mission of Canara Bank:

***Vision statement*:**

"To emerge as a Best Practices Bank' by pursuing global benchmarks in profitability, operational efficiency, asset quality, risk management and expanding the global reach."

Mission statement:

"To provide quality banking services with enhanced customer orientation, higher value creation for stakeholder and to continue as a responsive corporate social citizen by effectively blending commercial pursuits with social banking."

Types of deposits and loans:

Deposits:

The Banks offer various deposit schemes which yield attractive rate of interest.

- Current Deposit
- Saving bank Deposit
- Fixed Deposit
- Recurring Deposit

Loans:

The following loans are available in Canara bank

- Personal loan
- Educational loan
- Vehicle loan
- Housing loan
- Home improvement loan
- Canara Jeevan – Reverse Mortgage loan

7. ANALYSIS AND INTERPRETATION:

7.1. Methodology of Data Interpretation:

The data is extracted from the balance sheet and income statement of the banks for the period of 5 years and the percentage is being calculated to find out the advances provided and the deposits received, interest earned and the interest expended and the variations in the Non- Performing Assets (NPA) levels.

Table 1: Advances provided by Bank for the previous 5 years.

Year	Amount (Rs. In Cr)
2016	324714.82
2017	342008.76
2018	381702.99
2019	427727.27
2020	432175.20

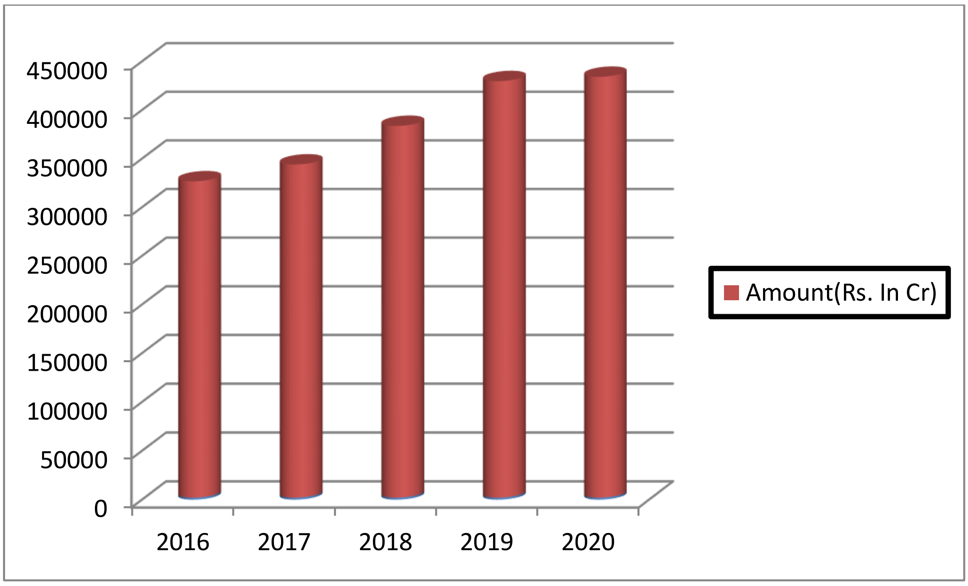

Figure 1: **Advances provided by Bank for the previous 5 years.**

Interpretation:

From the above chart it is evident that the advances provided by the bank are increasing over the years which clearly indicate that the bank is meeting its demand from the customers with regard to the various credit facilities required by its customers and contributing to the economic development of the society. Further the increase in advances contributes to the increase in income earning capacity of the bank.

Table 2: Deposits received by Bank for the previous 5 years.

Year	Amount (Rs. In Cr)
2016	479791.56
2017	495275.24
2018	524771.86
2019	599033.27
2020	625351.17

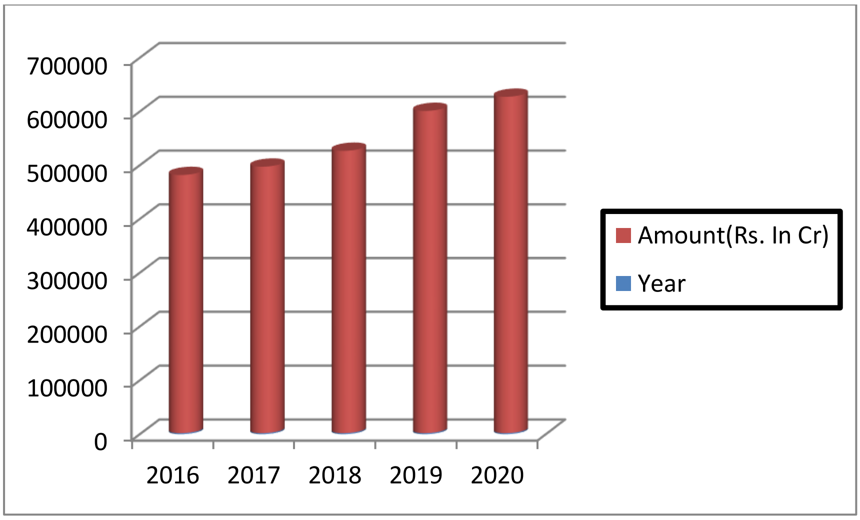

Figure 2: Deposits received by Bank for the previous 5 years.

Interpretation:

From the above chart it is evident that the deposits received by the bank have been increasing over the years, which in turn has been creating the cash flow for providing advances to meet the financial requirements of its customers.

Table 3: Interest earned on advances by Bank for previous 5 years.

Year	Amount (Rs. In Cr)
2016	31377.25
2017	29585.67
2018	29096.44
2019	34319.28
2020	36075.88

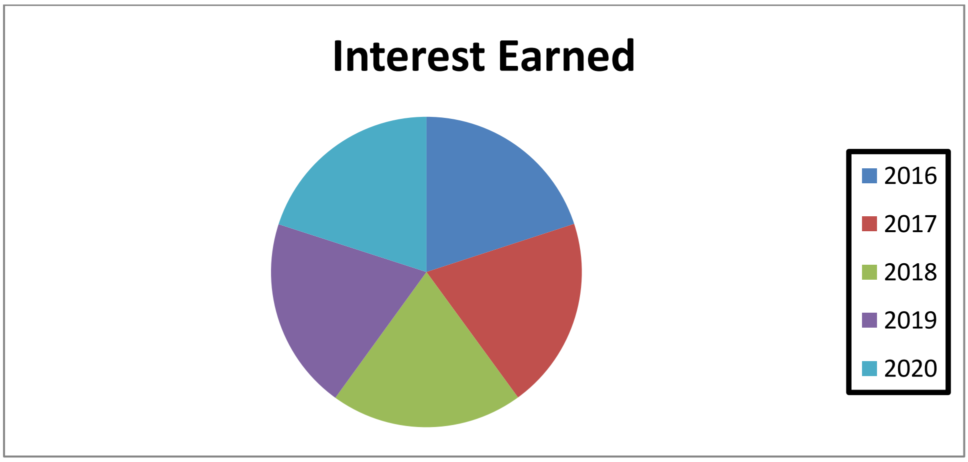

Figure 3: Interest earned on advances by Bank for previous 5 years.

Interpretation:

From the above table it is observed that the interest earned by the bank has been increasing in proportion to the increase in advances over the years, which in turn increases the profit earning capacity of the bank.

Table 4: Interest expended by bank during 5 previous years.

Year	Amount (Rs. In Cr)
2016	32350.02
2017	29560.08
2018	27136.16
2019	30098.46
2020	33520.94

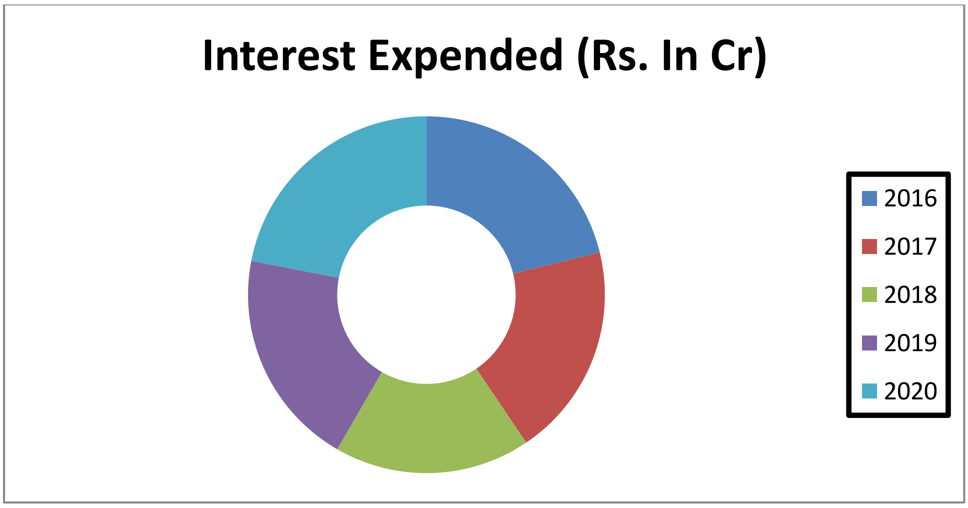

Figure 4: Interest expended by bank during 5 previous years.

Interpretation:

From the above table it is observed that the interest expended by the bank has been increasing in proportion to the increase deposits over the years.

Table 5: Profitability statement of Canara Bank for previous 5 years.

Year	Amount (Rs. In Cr)
2016	-2812.82
2017	1121.92
2018	-4222.24
2019	347.01
2020	-2235.72

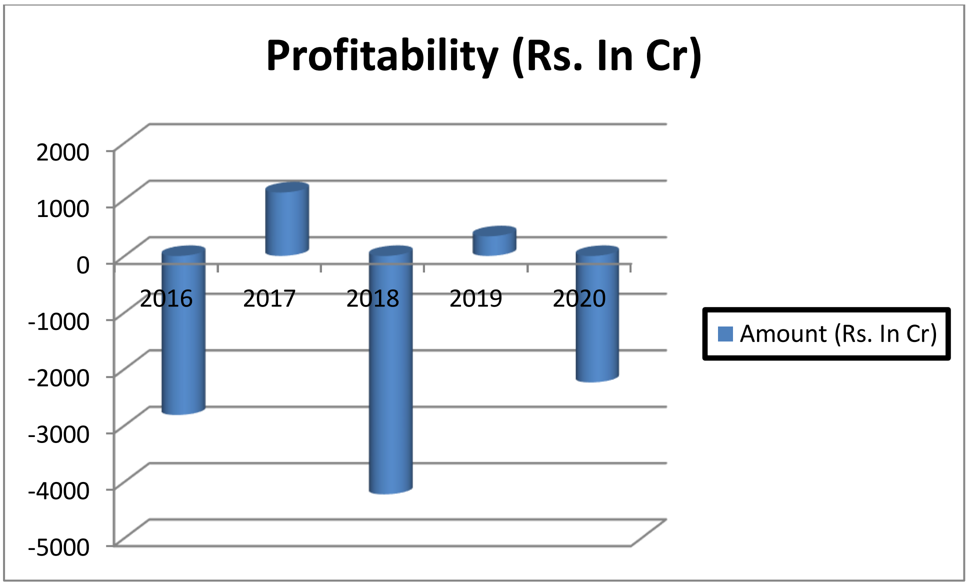

Figure 5: Profitability statement of Canara Bank for previous 5 years.

Interpretation:

From the above table it has been observed that the bank has incurred losses during various years, the major reason being the deposit of the bank being more than the advances given wherein the interest paid/expended by the bank would be more than the interest earned on advances.

Table 6: Non-Performing Assets (NPA) of the Bank for previous 5 years

Year	Amount (Rs. in Cr)	Total advances	% of Total Advance
2016	31637.83	324714.82	9.74%
2017	34202.04	342008.76	10.00%
2018	47468.47	381702.99	12.44%
2019	39224.12	427727.27	9.17%
2020	37041.15	432175.20	8.57%

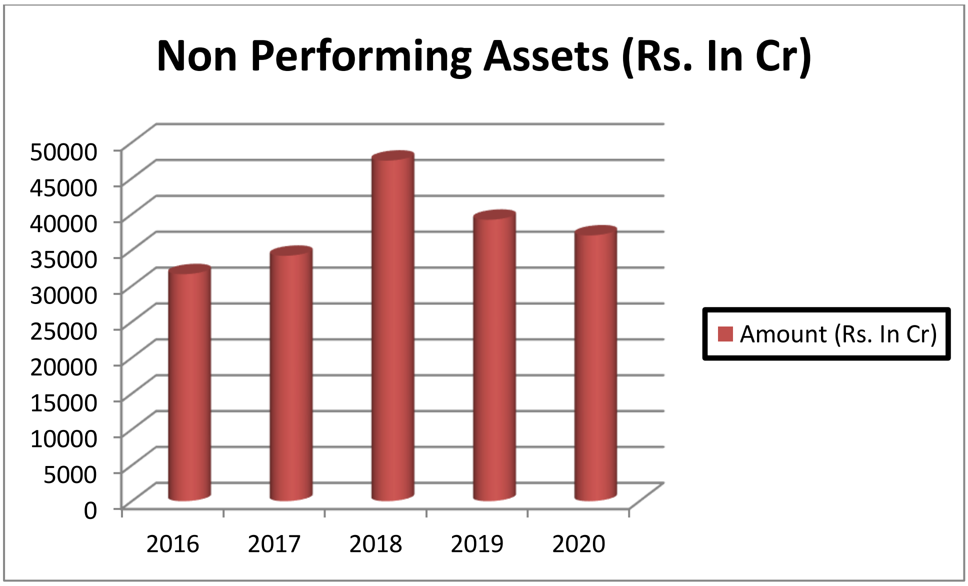

Figure 6: Non-Performing Assets (NPA) of the Bank for previous 5 years

Interpretation:

The above table indicates that the NPA percentage of the bank to its total advances which clearly indicates that the said percentage has reached a peak of 12.44% for the financial year ended 31.03.2018. Since then the same has been showing a decreasing trend and the said percentage for the year ended 31.03.2020 has remained at 8.57% which shows a good recovery percentage by the bank. Further the reduction in the NPA percentage or the total NPA of the banks shows the good credit risk management of the bank which clearly shows that the bank has been considering the major credit risk factors during the time of sanction of the credit facilities to its customers.

LIMITATIONS OF THE STUDY:

1. In depth analysis of the data required some confidential information which was not disclosed by the bank.
2. All the staffs of the bank were having a very busy schedule; more information could not be collected through interviews with the staff.

FINDINGS:

- Deposits received by the bank have been increasing over the years.
- Advances provided by the bank are increasing over the years.
- NPA of the banks shows the good credit risk management of the bank which clearly shows that the bank has been considering the major credit risk factors during the time of sanction of the credit facilities to its customers.

CONCLUSION:

Indian banks have gone a long way in adopting credit risk management policy and procedures as stated by the BASEL. The study confirms banks implementation of credit risk management policy. The need for the banks is to implement a strong credit risk models in banks to avoid loan defaulters. If banks will implement better credit risk models to identify the status of the borrowers they will be far from the actual credit risk. Therefore credit risk management is an essential tool for banks so that they can reduce the losses and increase their profitability and in turn leads to economic development of the country.

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