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CONTENTS

Sr. No.	TITLE & NAME OF THE AUTHOR (S)	Page No.
1.	A STUDY OF DINING OUT OPTIONS OF MIDDLE CLASS FAMILIES IN MUMBAI *DR. JEHANGIR BHARUCHA*	1
2.	COMPARATIVE ANALYSIS OF MANDATORY DISCLOSURES AND NON MANDATORY DISCLOSURES OF INDIAN COMPANIES *DR. RAMAJIT KAUR*	5
3.	LEVERAGING EMPLOYEE ENGAGEMENT IN THE HOSPITALITY INDUSTRY: A COMPARATIVE STUDY OF INDIAN HOTELS COMPANY LIMITED V/S ITC-HOTELS DIVISION *BHARTI TYAGI & PRATIK GHOSH*	10
4.	MICRO CREDIT A POVERTY ALLEVIATION MANTRA *DR. PRAMILA CHOUDHARY*	21
5.	THE MEDIATING ROLE OF JOB SATISFACTION BETWEEN LEADER-MEMBER EXCHANGE, ORGANIZATIONAL CULTURE AND ORGANIZATIONAL COMMITMENT: STUDIES ON CIVIL SERVANTS IN THE LOCAL GOVERNMENT TARAKAN, INDONESIA *CATUR HENDRATMO, TULUS HARYONO & ASRI LAKSMI RIANI*	26
6.	THE IMPACT OF MAHATMA GANDHI NREGS IN THE ECONOMIC CONDITION OF RURAL POPULATION *V.AMBILIKUMAR, M. S. RAJU & MATHEW SEBASTIAN*	35
7.	PRE PURCHASE BEHAVIOR OF CONSUMERS OF LIFE INSURANCE PRODUCTS: AN EMPIRICAL STUDY *KARABI GOSWAMI & SUJIT SIKIDAR*	40
8.	A STUDY ON CREDIT RISK MANAGEMENT OF NON-PERFORMING ASSETS IN NATIONALISED, PRIVATE AND FOREIGN BANKS *VIDYASHREE D V & DR. PRALHAD RATHOD*	44
9.	RURAL DEVELOPMENT AND NON-FARM SECTOR: A REVIEW *ARNAB GHOSH*	47
10.	THE STUDY OF CLASSICAL ECONOMISTS' HYPOTHESIS ON THE RELATIONSHIP BETWEEN THE RENT AND THE PRODUCT PRICE *SAYYED MAHDI MOSTAFAVI*	53
11.	ROLE OF FOREIGN BANKS IN CONSUMER SATISFACTION: A STUDY *DILIP KUMAR JHA*	57
12.	AN ANALYTICAL STUDY ABOUT FDI IN INDIAN RAILWAYS *ANUPAMA. K & KOSHY C.J*	60
13.	REGIONAL DISPARITIES IN HARYANA *VIKAS THAKRAN & SURENDER KUMAR*	63
14.	TALENT MANAGEMENT PROGRAM AND ITS IMPACT ON THE EMPLOYEE RETAINMENT AND PERFORMANCE IN INDIAN BANKING SECTOR *NEHA GUPTA*	66
15.	A RESEARCH PAPER ON FDI IN INSURANCE SECTOR IN INDIA *MEENAKSHI*	71
16.	A STUDY OF THE PROBLEMS FACED BY B. Ed. TEACHERS TEACHING IN A CLASSROOM OF ENGLISH AND MARATHI MEDIUM STUDENTS OF MUMBAI *SARBANI SANKAR PANIGRAHI*	74
17.	RISING TRENDS IN PRODUCTION AND PRODUCTIVITY OF VEGETABLES IN INDIA: A STUDY FROM 2001-02 TO 2012-13 *KAMINI CHOUDHARY & RAHUL KUNDAL*	78
18.	POSITION AND ROLE OF 'ODL' INSTITUTES: A STUDY OF MARGINALIZED SECTIONS OF SOCIETY *SANA PERWEEN & ARIF ANWAR*	81
19.	INDIA'S REVEALED COMPARATIVE ADVANTAGE IN EXPORT OF RICE (HS CODE 1006) *DIKSHA PANWAR*	84
20.	A COMPARATIVE STUDY OF DIFFERENT BANKING SECTOR ON THE BASIS OF NPAS *NEETU GUPTA*	89
	REQUEST FOR FEEDBACK & DISCLAIMER	93

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FINDINGS
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- Bowersox, Donald J., Closs, David J., (1996), "Logistical Management." Tata McGraw, Hill, New Delhi.
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A STUDY ON CREDIT RISK MANAGEMENT OF NON-PERFORMING ASSETS IN NATIONALISED, PRIVATE AND FOREIGN BANKS

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ABSTRACT

In the course of their operations, banks are invariably faced with different types of risks that may have a potentially negative effect on their business. Risk management in bank operations includes risk identification, measurement and assessment, and its objective is to minimize negative effects risks can have on the financial result and capital of a bank. Banks are therefore required to form a special organizational unit in charge of risk management. Also, they are required to prescribe procedures for risk identification, measurement and assessment, as well as procedures for risk management. During the year ended March 2015, banking business slowed down with a decline in both deposit and credit growth. The ratio of gross non-performing advances (GNPAs) of scheduled commercial banks (SCBs) marginally increased between September 2014 and March 2015. The present paper focuses on detail study of credit risk faced by all the sectors of banks particularly in 2014-2015 and the measures taken by banks to recover NPA's.

KEYWORDS

Credit Risk Management, Non-performing Assets, Public Sector Banks, Private Sector Banks, Foreign Banks.

INTRODUCTION

The banking industry in the world over has undergone a profound transformation since the early 1990s. The changed operating environment for the banking sector, underpinned by liberalization, privatization and globalization, coupled with the reforms of information technology, has resulted in intense competitive pressures. Banks have responded to this challenge by diversifying through organic growth of existing businesses as well as through creative marketing of its services but the risk factor of banks are increasing.

Risk is inherent in any walk of life in general and in financial sectors in particular. Till recently, due to regulate environment, banks could not afford to take risks. But of late, banks are exposed to same competition and hence are compelled to encounter various types of financial and non-financial risks. Risks and uncertainties form an integral part of banking which by nature entails taking risks. There are three main categories of risks; Credit Risk, Market Risk & Operational Risk. Credit risk is intrinsic to banking and it is as old as banking itself. Credit risk is defined as the possibility of losses associated with diminution in the credit quality of borrowers or counterparties. In a bank's portfolio, losses stem from outright default due to inability or unwillingness of a customer or counterparty to meet commitments in relation to lending, trading, settlement and other financial transactions. Alternatively, losses result from reduction in portfolio value arising from actual or perceived deterioration in credit quality. Credit risk emanates from a bank's dealings with an individual, corporate, bank, financial institution or a sovereign**.**

OBJECTIVES

1. To understand the concept of credit risk management
2. To analyze NPAs position and their risk management in public sector, private sector and foreign banks
3. To focus on the macro stress factors relating to credit risk impacting on Public, Private and Foreign banks.
4. To study the techniques to overcome credit risk.
5. To estimate the success rate in recovering the NPA's.

RESEARCH METHODOLOGY

The present study is based on descriptive study where the methodology used to collect the data is based on secondary data like books, report of RBI publications including Trend and Progress of Banking in India, Statistical Tables relating to Banks in India, Articles and Papers relating to NPAs published in different journal and magazines were studied and data available on internet and other sources have also been used.

TYPES OF RISKS

The money lent to a customer may not be repaid due to the failure of a business. Also, money may not be repaid because the market value of bonds or equities may decline due to an adverse change in interest rates. Another reason for no repayment is that a derivative contract to purchase foreign currency may be defaulted by a counter party on the due date. These types of risks are inherent in the banking business.

CREDIT RISK

The Basel Committee on Banking Supervision (or BCBS) defines credit risk as the potential that a bank borrower, or counter party, will fail to meet its payment obligations regarding the terms agreed with the bank. It includes both uncertainty involved in repayment of the bank's dues and repayment of dues on time.

The default usually occurs because of inadequate income or business failure. But often it may be willful because the borrower is unwilling to meet its obligations despite having adequate income.

MARKET RISK

The Basel Committee on Banking Supervision defines market risk as the risk of losses in on- or off-balance sheet positions that arise from movement in market prices. Market risk is the most prominent for banks present in investment banking.

MAJOR COMPONENTS OF MARKET RISKS

The major components of market risk include:

- Interest rate risk

- Equity risk
- Foreign exchange risk
- Commodity risk

INTEREST RATE RISK

It's the potential loss due to movements in interest rates. This risk arises because a bank's assets usually have a significantly longer maturity than its liabilities. In banking language, management of interest rate risk is also called asset-liability management (or ALM).

EQUITY RISK

It's the potential loss due to an adverse change in the stock price. Banks can accept equity as collateral for loans and purchase ownership stakes in other companies as investments from their free or investible cash. Any negative change in stock price either leads to a loss or diminution in investments' value.

FOREIGN EXCHANGE RISK

It's the potential loss due to change in value of the bank's assets or liabilities resulting from exchange rate fluctuations. Banks transact in foreign exchange for their customers or for the banks' own accounts. Any adverse movement can diminish the value of the foreign currency and cause a loss to the bank.

COMMODITY RISK

It's the potential loss due to an adverse change in commodity prices. These commodities include agricultural commodities (like wheat, livestock, and corn), industrial commodities (like iron, copper, and zinc), and energy commodities (like crude oil, shale gas, and natural gas). The commodities' values fluctuate a great deal due to changes in demand and supply. Any bank holding them as part of an investment is exposed to commodity risk.

OPERATIONAL RISK

The Basel Committee on Banking Supervision defines operational risk "as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputation risk."

LIQUIDITY RISK

Liquidity by definition means a bank has the ability to meet payment obligations primarily from its depositors and has enough money to give loans. So liquidity risk is the risk of a bank not being able to have enough cash to carry out its day-to-day operations.

Provision for adequate liquidity in a bank is crucial because a liquidity shortfall in meeting commitments to other banks and financial institutions can have serious repercussions on the bank's reputation and the bank's bond prices in the money market.

REPUTATIONAL RISK

Reputational risk is the risk of damage to a bank's image and public standing that occurs due to some dubious actions taken by the bank. Sometimes reputational risk can be due to perception or negative publicity against the bank and without any solid evidence of wrongdoing. Reputational risk leads to the public's loss of confidence in a bank.

RBI GUIDELINES ON MANAGEMENT OF CREDIT RISK

The central bank, Reserve Bank of India (RBI) was established in April 1935 with a share capital of Rs 5 crore on the basis of the recommendations of Hilton Young Commission. One of the important functions of the RBI is controller of credit, i.e., it has the power to influence the volume of credit created by banks in India. It can do so through changing the Bank rate or through open market operations.

RBI suggests that each bank should have an effective Credit Management Framework which comprises; Credit Risk Policy, Organization Structure and Operation/System. The board of directors of each bank shall be responsible for approving and periodically reviving credit risk strategy and significant credit risk policies. The policy should include risk identification, risk measurement, risk grading/ aggregation techniques, reporting and risk control/ mitigation techniques, documentation, legal issues and management of problem loans. These policies shall further be communicated to branches and controlling offices. A sound organization structure is outcome for successful implementation of an effective credit risk management system. Each bank should constitute a high level Credit Risk Management Committee (CRMC). Concurrently, each bank should also set up Credit Risk Management Department (CRMD), independent of the Credit Administration Department.

ANALYSIS & INTERPRETATION

TABLE 1: SHOWING GROSS AND NET NPA'S OF PUBLIC, PRIVATE & FOREIGN BANKS AS ON MARCH 31ST 2015 (Amount in ₹ Million)

Bank	Gross NPAs					Net NPAs	
	As on March 31 (previous year)	Addition during the Year	Reduction during the Year	Write-off during the Year	As on March 31(current year)	As on March 31(previous year)	As on March 31(current year)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
STATE BANK OF INDIA & ITS ASSOCIATES	627785	592558	289358	132820	798165	281000	418151
PRIVATE SECTOR BANKS	210705	192187	101836	55632	245424	59944	88611
NATIONALISED BANKS	1022272	1046558	577129	9126	1482576	619362	888086
FOREIGN BANKS	79971	67775	28082	3874	115790	26796	31724

TABLE 2: GROSS NON-PERFORMING ASSETS OF CO-OPERATIVE BANKS (Per cent of gross advances)

Year (end-March)	**Urban Co-operative Banks (UCBs)**	**Rural Co-operative Banks**				
		Short-Term Structure			**Long-Term Structure**	
		StCBs	**DCCBs**	**PACS**	**SCARDBs**	**PCARDBs**
1	**2**	**3**	**4**	**5**	**6**	**7**
2006-07	18.3	14.2	18.5	29.1	30.3	35.4
2007-08	15.5	12.8	20.5	35.7	34.5	53.7
2008-09	13.0	12.0	18.0	44.8	30.1	39.0
2009-10	10.1	8.8	13.0	41.4	45.1	51.9
2010-11	8.4	8.5	11.2	25.2	32.3	40.6
2011-12	7.0	6.8	9.7	26.8	33.1	38.6

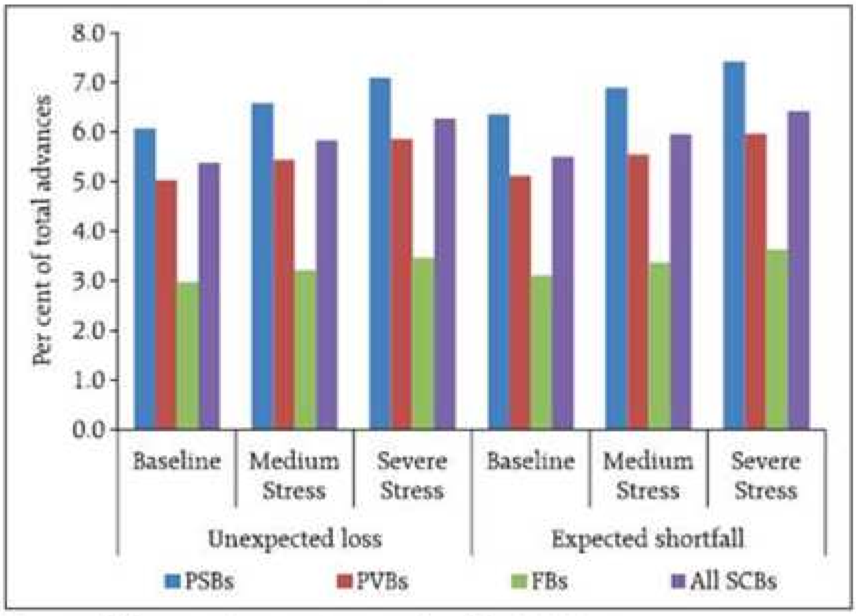
StCBs : State Co-operative Banks
DCCBs : District Central Co-operative Banks
PACS : Primary Agricultural Credit Societies
SCARDBs : State Co-operative Agriculture and Rural Development Banks
PCARDBs : Primary Co-operative Agriculture and Rural Development Banks
Source : Reserve Bank for UCBs and NABARD for Rural Co-operative Banks (excluding PACS for which the source is NAFSCOB).

TABLE 3: NPAS OF SCBS RECOVERED (Amount in ₹ million)

Year	No.	Recovery Channel	Lok Adalats	DRTs	SARFAESI Act	Total
2012-13	1	No. of cases referred	840,691	13,408	190,537	1,044,636
	2	Amount involved	66	310	681	1,058
	3	Amount recovered*	4	44	185	232
	4	3 as per cent of 2	6.1	14.1	27.1	21.9
2013-14	1	No. of cases referred	1,636,957	28,258	194,707	1,859,922
	2	Amount involved	232	553	946	1,731
	3	Amount recovered*	14	53	244	311
	4	3 as per cent of 2	6.2	9.5	25.8	18

Notes:
1. *: Refers to amount recovered during the given year, which could be with reference to cases referred during the given year as well as during the earlier years.
2. DRTs: Debt Recovery Tribunals.

CHART 1: UNEXPECTED LOSS AND EXPECTED SHORTFALL (Bank-groupwise March 2015)



Source: RBI supervisory returns and staff calculations.

The resilience of the Indian banking system against macroeconomic shocks was tested through a series of macro stress tests for credit risk at the system, bank-group and sectoral levels. These tests encompass assumed risk scenarios incorporating a baseline and two adverse macroeconomic scenarios representing medium and severe risks. The adverse scenarios were derived based on up to one standard deviation (SD) for medium risk and up to two SD for severe risk as per RBI.

The macro stress test of credit risk suggests that under the baseline scenario, the GNPA ratio may increase to 4.8 per cent by September 2015 (same as recorded in December 2014) from 4.6 per cent as of March 2015, which could subsequently improve to 4.7 per cent by March 2016. However, if the macroeconomic conditions deteriorate, the GNPA ratio may increase further and it could rise to around 5.9 per cent by March 2016 under a severe stress scenario.

FINDINGS

1. The ratio of gross non-performing advances (GNPAs) of scheduled commercial banks (SCBs) marginally increased between 2014 to March 2015.
2. Comparatively Public sector banks have more non-performing assets and have fallen in maintaining credit risk management.
3. The RBI has played a major role in establishing the credit risk management framework guidelines for all the sectors of banks.
4. The Scheduled banks have been successful in recovering 3% of bad debts.
5. The foreign banks are having less non-performing assets and are managing the credit risk. Expected shortfall is also minimal.

SUGGESTIONS

1. The bank employees have to take up still more initiatives to follow the credit policies during lending process.
2. The public sector banks have to minimize the NPA's ratio by following credit risk controlling techniques in a much better way.
3. The RBI has laid down the policy but it has to make all the banks especially for Public Sector Banks to implement in a systematic manner.
4. Stress tests reveal resilience; the system could become vulnerable if the macroeconomic conditions deteriorate sharply. Henceforth, immediate action has to be taken to lessen the risk.

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4. www.rbi.org.in
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