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CREDIT RISK MANAGEMENT OF UNION BANK OF INDIA GORAKHPUR

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ABSTRACT

"A Credit risk is the risk of default that arise when borrower failing to make required payment." A credit risk is a result of the business loan from the banks by the people or company. Banks are a kind of enterprise; their ultimate goal is maximize profits. Credit business is the core business of all commercial banks. By the RBI guidelines, the banks have to provide loan to the customers so that increase flow of cash in the market. The purpose of credit risk management is maximizing the returns by maintaining the rules and regulation of the banks and RBI.

PROCESS OF CREDIT RISK MANAGEMENT-

IDENTIFICATION:-*The process starts with an identification of all possible risks. It is the process of analysis all resources and keeps deep knowledge of financial products that will disclose the source of potential risk.*

MEASUREMENT:-*Once the risk is identified then next step is measurement. To find the actual probability of default, sensitivity changes in underlying factor movements. Statistical analysis of historical events and data are important for measuring risk and when they are not adequate and limited, banks utilize theoretical models and human expert skills to measure risks.*

TREATMENT:-*It is important for banks to avoid risks that are harmful for return. these actions, i.e. avoidance, reduction, transformation and acceptance of risk are treatment part of risk management.*

IMPLEMENTATION AND EVALUATION:-*the implementation and evaluation is carried out by the senior management, staff by using IT infrastructure and statistical models on both existing and new investment transactions.*

Keywords:-*Business loan, Credit risk, Credit risk management*

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INTRODUCTION

CREDIT RISK MANAGEMENT TECHNIQUES-There is eight steps in this technique.

1. **KNOW YOUR CUSTOMER:-**Knowing your customers are the foundation of the credit process, so that you must operate on pertinent accurate and timely information. Establish good relationship so that long term process for the banks. Set up an effective interactive session with customers.

2. ANALYZE NON FINANCIAL RISKS:-Understand your customer's business by analyzing non financial risks. The concept of risk management can apply to a single loan (micro level) or to an entire loan portfolio (macro level) both is a risk.

PROCESS OF ANALYZE NON FINANCIAL RISK-

(a)IDENTIFY RISK:-Your credit risk management department will identify risk factors and query to the whole loan portfolio so that to judge whether the particular risk is relevant to the customer.

(b)**EVALUATION:-**Evaluating industry, business and management risks enables you to ask questions of customers and in order to identify, quantify and mitigate risks.

(c)**CRITICAL THINKING:-**Evaluation develops your critical thinking skills so that you can integrate economic, political and market issues into the whole underwriting process.

(d)**RISK ANALYSIS:-**Proper analysis of risks gives you information to help structure the loan in a way that will ensure the highest probability of repayment.

3. **UNDERSTAND THE NUMBERS:-"**Before beginning any financial analysis it is important to understand why companies and individuals borrow money." As a lender, you should know how the loan funds are going to be used and how they are thinking to be repayment.

PROCESS OF UNDERSTAND THE NUMBER-

(a) Focus on the financial capacity of the company as data provided by the companies.

(b)Check the accuracy of the data.

(c)Check the quality and sustainability of financial performance.

4. **STRUCTURE THE DEAL:-**Identify the features that affect a company's success.

AREA TO STUDY-

(a) Nature of the business

(b)Nature of the industry

(c)Impact of economic conditions

(d)Business strategy

(e)Competencies and deficiencies of management

Loan structure depends on the nature of your customer's business and how your bank intends to provide financial services to the company. Loan structure is important because your customer have to clearly understand the boundaries and services of the bank. The structure of the deal means how the bank performs during the term of the relationship.

5. **PRICE THE DEAL:-**Your bank and lending department will set the loan pricing and service fee strategies. Price the deal ensures that your bank will be adequately compensated for the risk of the deal.

6. **PRESENT THE DEAL:-**

(a) Summaries and recommendation

(b)Economic and Competitive environment

(c)Management Assessment

(d)Financial Analysis and Projections

(e)Sources of repayment

7. **CLOSE THE DEAL:-**

(a)Prepare a closing memorandum or detailed loan documentation checklist

(b)Provide adequate time for the borrower and other parties to collect documents

(c)Provide guidelines on how to complete your standard document

(d)Prepare drafts of loan documents and send them borrower

8. **MONITOR THE RELATIONSHIP:-**Provide reviews, rating, and audits can ensure that the customer will create long term profitability for your bank. Failure, to notify your customers, so that make relationship long term

CREDIT RISK MANAGEMENT MODEL

Altman's Z score model-

Altman Z- score variables developed to measure the financial strength of a firm

Z score = a1.V1 + a2.V2 + a3.V3 + a4.V4 + a5.V5

Where,

V1=Working capital / Total assets

V2=Retained earnings / Total assets

V3=Earning before interest and taxes / Total assets

V4=Market value of Equity / Book value of total liabilities

And a1 to a5 are the model constraints identified through statistical analysis

If value of Z>2.6-Excellent

2.6<Z>1.1- Safe

Z<1.1- Bankrupt case

CREDIT RATING AGENCIES

1. CRISIL (Credit Rating Information Services of India Limited)
2. CARE (Cooperative for Assistance and Relief Everywhere)
3. FITCH INDIA
4. ICRA (Formely Known Investment Information and Credit Rating Agency)

OBJECTIVES OF THE STUDY

Objectives are Goals or Aims which are meant to achieved through the directed and controlled efforts of the researcher.

The objective of this study is Meta centric in nature and aims at finding the answers to Following aspects of CREDIT RISK MANAGEMENT with special reference to UNION BANK OF INDIA, GORAKHPUR

1. To know about the TECHNIQUES adopted by UNION BANK OF INDIA GORAKHPUR for CREDIT RISK MANAGEMENT.
2. To analyze the trends of Credit risk management in past FIVE YEARS of UNION BANK OF INDIA, GORAKHPUR

RESEARCH METHODOLOGY

Research Methodology is basically based, described as the structured process adopted in ones project to conduct research. this Research Project work is based on secondary data .

RESEARCH DESIGN:-The Research Design used in this research work is descriptive in nature.

RESEARCH TECHNIQUES:-The research techniques used to complete this study is secondary data and Quantitative Technique.

LITERATURE REVIEW

1-**Swaranjeet Arora** (2013) :- made an attempt to identify the factors that contribute to credit risk analysis in Indian banks and to compare credit risk analysis practices followed by public and private sector banks , the empirical study has been conducted and views of employees of various banks have been tested using statistical tools. Present study explored the phenomenon from different perspectives and revealed that credit worthiness analysis and collateral requirements are the two important factors for analyzing credit risk. From the descriptive and analytical results, it concluded that Indian bank efficiently manage credit risk . The results also indicate that there is a significant difference between the Indian public and private sectors banks in analyzing credit risk.

2-**T.Veerabhadra Rao** (2011):- in this study assessed the risk management, regulation and supervision of financial sector in general and the banking sector in particular is of paramount for the orderly growth of the economy. The present study is undertaken to assess the impact of such risk management and risk based supervision measures introduced by RBI in post reform period. The main objective of the study is to evaluate the benefits of these measures on the overall working of scheduled commercial banks belonging to three sectors, public sector, private sector and foreign sectors banks. The study also made inter sector cross comparisons to see if the impact is uniform among these sectors and if not, to find out which sector has performed better due to these changes. It found that the impact of the changes was favorable in the case of the SCBs in general. It observed that public sector banks shown outstanding performance indicating significant difference in their

working on results of the ANOVA and post hoc test have also confirmed that the difference is significant in the case of public sector bank to private sector bank.

3-**Dr Krishn A. Goyal (**2010):- made an attempt to discuss in depth, the importance of risk management process and throws light on challenges and opportunities regarding implementation of Basel-II in Indian banking industry. The banking industry is exposed to different risks such as forex volatility, variable interest rate risk, market play risk, operational risk, market play risk etc. which can directly affect its profitability and financial health. Credit risk management has thus emerged as a new and challenging area in banking. Basel–II intended to improve safety and soundness of the financial system by placing increased emphasis on bank own internal control and risk management process and models. The supervisory review and market discipline .indeed to enable the calculation of capital requirements under the new accord requires a bank to implement a comprehensive risk management framework. Over a period of time, the risk management improvements. However these changes will also have wide ranging effects on a bank information technology systems, process, people and business, beyond and regulatory compliance, risk management and finance function.

4-**Bodla, B. S. ,Verma, Richa** (2009) :- designed a paper to study the implementation of the credit risk management framework by commercial banks in India. The results show that the authority for approval of credit risk vests with board of directors in case of in case of 94.4% and 62.5 % of the people sector and private sectors banks respectively. This authority in the remaining banks however is with the policy committee. For credit risk management most of the banks are found performing several activities like industry, periodic credit calls, periodic plant visits, developing MIS, risk scoring and annual review of accounts. However the bank in abstaining from the use of derivatives products as a risk hedging tool. The survey has brought out that irrespective of sector and size of bank, credit risk management framework in India is on the right track and it is fully based on RBI s guidelines issued in this regard.

5-**Rekha Arun kumar and G. Koteshwar** (2006):- in their study felt that credit risk is the oldest and biggest risk that banks faced; by virtue of their very nature of business inherit. The pre dominance of credit risk is the main component in the capital allocation. As per their estimate credit risk takes the major part of the risk management apparatus accounting for over 70 % of all risks. As per them the market risk and operational risk are important, but more attention needs to be paid to the credit risk management in banks.

Concentration risk is a very significant component of overall credit risk profile of a banking institution. A prudent credit risk management is based on the principle of diversified portfolio to avoid concentrations in any one or couple of occupations or industry. It concludes that public sector banks risk profile is low while in private sector risk is moderate.

Finally, the results concluded that that the declining trends in NPAs in public sector bank during the post liberalization period is an outcome mainly caused by the improved credit portfolio diversification. The concentration risk profile of credit portfolio of private sector banks is higher than that of public sector banks impacting adversely the NPAs level of private sector bank vis-à-vis public sector banks.

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FINDINGS

1. Better credit risk management improves overall performance and secure competitive advantage.
2. Reduces financial risk and generate revenues.
3. Better profitability.
4. Chief goal of risk management adopt universal and best practices followed worldwide.
5. The use of external reports is an invaluable tool for the credit management department of a bank.
6. The report from a rating agency would indicate the degree of risk which the bank faces towards its clientele from a macro economic analysis viewpoint
7. Likewise, reports from specialist analysts would indicate the latest evaluation of a borrower's performance

CONCLUSION

At present, Credit Risk Management in deregulated market is a big challenge. Increased market volatility has brought with it, the need for skill analysis and specialized applications in managing credit risk. A systematic policy framework is needed to help the operating staff recognize the risk event, assign a probability to everyone, quantify the likely loss, check the acceptability of the exposure, price the risk and control where they are paid off. To prevent blindsided, banks must develop a competitive Early Warning System (EWS) which combines strategic planning, competitive intelligence and management action. EWS disclose how to change strategy to cope up new realities, avoid common practices like benchmarking and tell executives what they need to know-not what they want to hear.

The goodwill of a bank is very significant for corporate clients. A corporation seeks to develop relationship with a reputable banking entity with a proven better quality service and good practices. Therefore, it is important to adopt the advanced Basel-II methodology for credit risk. The Basel committee had acknowledged that the Basel-I are not sensitive. Basel-II is a risk based approach, that is important for the commercial banks, to prepare themselves to be competitive among the India' banks.

A very crucial aspect of credit risk management is the credit rating. Union bank has implemented their own Internal Rating system of all borrowers enjoying/seeking credit limits above Rs 2 lacs. The rating grades range from CR1 to CR8. Credit rating is up to CR5 are investment grade. CR6 to CR8 are not investment grade as per the loan policy of the bank. Migration in credit rating especially downward migration should be discussed in detail and road map to improve the credit rating has to be implemented. Credit rating gives a very clean and clear picture of the borrowers creditworthiness.

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