Credit Risk Analysis of Canara Bank – A Case Study

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ABSTRACT

Purpose: *Credit risk has become a serious issue in the present scenario. No banking transactions are free from credit risk. Banks can survive in the modern world only if they can manage the risk efficiently. The study is been undertaken to find out the different types of loans provided by Canara Bank and the rate of default resulting in NPA over 5 years. The author mainly considered the study on loans provided by Canara Bank and the credit risk encountered by the bank due to non-payment of loans and the interest amount on the due date.*
Methodology: *Qualitative research is grounded on secondary data. Information is gathered through annual reports, manuals, previous bank records and balance sheets. For depth information, Focus group interactions with the manager and the staff are carried out.*
Findings: *Better credit risk policy of the bank reduces the NPA percentage which in turn increases the profitability of the bank.*
Originality: *The study highlights the effect of profitability due to credit risk arising out of NPAs.*
Paper type: *Case study*
Keywords: Credit risk, Canara bank, Default, Loans, Non-Performing Asset (NPA), SWOT analysis

1. INTRODUCTION :

The health of the banking industry depends on how well the banks manage their credit risks. Credit risk is the possibility of loss when there is a failure on the part of borrowers to repay the debts. It has been a challenge for financial institutions to manage their credit risk by minimizing losses. Over decades, Indian banks' interest incomes are diminishing which has led to problems in economic growth, non-performing assets, etc. [1]. This is possible only when banks understand the adequacy of capital and loan loss reserves at a given point of time. Credit risk management has become a very important aspect of the banking sector as the banks face financial crisis globally.
The regulators started demanding more transparency and they put stringent rules to know whether banks have a thorough knowledge of the customers and their associated risks. To survive in the banking industry, banks should follow various techniques for managing credit risk. The main function of credit risk management is to decide what amount of credit to be given to the borrower with the agreement to repay the amount at a specific term. Banks can survive in the stiff competition if they can formulate policies and procedures that reduce credit risk and curb the non - performing assets. When the company faces huge default due to the failure of the borrowers to repay the amount, it affects the economic development of the country. The loans are usually provided to agriculturists, industrialists and self- help groups after assessing their financial position and the ability to repay the borrowed amount [2]. Banks provide loans to individuals, industrialists and businessmen, after assessing their financial status and verifying and collecting various documents from the borrower. To know the position or risk level of the borrowers, the providers usually collect a huge amount of information from them [3]. Even after following all the procedures and providing loans, they may have to face the risk due to the non-payment of the borrowed amount. Risk is basically of the lender which includes loss of interest and principal amount, interruption of cash flows and high collection costs [4]. The future is uncertain, so banks have to face huge credit risks and can survive only if they

can manage the credit risk effectively. Banks can be stable and strong by reducing the non-performing loans [5].
Credit risks that the bank faces have a direct effect on the performance because even if a few large customers fail to repay the loans, it would cause huge problems for banks [6]. Banks will not indicate what will be the percentage of default loans; their earnings will vary which will lead to fluctuations in profits. Whenever banks provide loans to businesses and consumers they will experience a risk of loan losses when borrowers fail to repay the loans provided to them [7].

2. REVIEW OF LITERATURE :

Credit risk is a measure of a borrower's creditworthiness. Lenders calculate credit risk by estimating the likelihood that they will recover all of their principal and interest when making a loan. Borrowers with low credit risk are charged lower interest rates. Few scholars have contributed their views on the credit risk is exhibited below in Table 1.

Table 1: Exhibits the contribution of different authors in Credit Risk.
Keywords: Non-Performing Assets, Liquidated banks, Risk Assessment, Loans, Credit risk, Non-Performing loans, problem loans, insolvent, borrowers, losses, Credit Risk Management. The review of literature is carried out for 1990, 1996-1999, 2002, 2004, 2006-2015, 2018-2022.

S. No.	Field of Research	Focus	Outcome	Reference
1.	Public and Private sector banks	The researchers discovered a link between past and current non-performing assets	The GDP and credit risk of both public and private organizations are directly correlated.	Thiagarajan, S., et al. (2011). [8]
2.	Operating banks	The study highlighted that most of the banks were liquidated due to the failure in collection of loans and advances provided to the borrowers.	The non-performing loans ratio increased when 60 out of 115 operating banks suffered due to failure in collection of loans and advances provided to the borrowers.	Adekunle, A. O., Ishola, R. A., & Felix, A. A. (2011).[9]
3.	Credit market	Improvements in the theoretical understanding of working of credit markets may lead to a variance in access to information relating to business risks to the borrowers and the lenders which leads to a different assessment of risk among them	Uneven information between the lender and borrower	Hoff, K., & Stiglitz, J. E. (1990). [10]
4.	Banks	Providing loans is the most important function.	The major part of the asset of the bank is due to loans and it helps in the growth of the banks	Arif, A., & Anees, A. N. (2012). [11]
5.	Banking environment	Systematic and Unsystematic risk.	Systematic risk occurs due to alterations in the economic, social and political environment. Unsystematic risk occurs due to inefficiency in management, new	Yurdakul, F. (2014). [12]

			inventions and advancements in technology.	
6	Bank loans	financial background and history of the customers	It is very essential to find out the financial background and history of the customers before taking decisions on granting loans as it helps in reducing the credit risk.	Bekhet, H. A., & Eletter, S. F. K. (2014). [13]
7	Financial institution	The study highlighted that credit risk decisions are an important factor for a financial institution to be successful	If the decisions on credit risk are wrongly taken, then it will suffer huge losses	Lahsasna, A., Ainon, R. N., & Teh, Y. W. (2010). [14]
8	Banking decisions	Assessing the credit risk	It is very important to assess the credit risk as it assists in taking decisions before granting loans to the customers	Wu, C., Guo, Y., Zhang, X., & Xia, H. (2010). [15]
9	Credit assessment techniques	Advancements in credit assessment techniques	The study pointed out that though there are advancements in credit assessment techniques and portfolio diversification, credit risk remains to be a major threat to successful lending of loans.	Angelini, E., Di Tollo, G., & Roli, A. (2008). [16]
10	Banks operations	Banks operations, solvency and regional concentration	The way the banks carry out operations, solvency and regional concentration will result in the variation of NPAs across Indian banks.	Rajaraman, I., Bhaumik, S., & Bhatia, N. (1999).[17]
11	Macro-economic factors	The non -performing loans are influenced by a large number of macro- economic factors	The non -performing loans are influenced by a large number of macro- economic factors such as Gross Domestic Product, quick expansion of credit, Size of the bank and the capital adequacy ratio.	Salas, V., & Saurina, J. (2002). [18]
12	Larger banks and smaller banks	Larger banks are better able to manage risk than smaller ones.	The size of a bank is directly related to its non-performing loan portfolio	HU, J. L., Li, Y., & CHIU, Y. H. (2004). [19]
13	Problem loans	The amount that could be lent out depended on a variety of parameters, including operating	The study discovered that a small number of macroeconomic and	Das, A., & Ghosh, S. (2007). [20]

		costs, the size of the country, and its GDP.	banking-level variables affected problem loans	
14	Effective credit risk management	Credit risk management will reduce the loan losses	The study highlighted that effective credit risk management will reduce the credit risk which in turn reduces the level of loan losses.	Menkhoff, L., et al. (2015). [22]
15	Failure of Banking system	Credit risk leading to banking system failure.	Credit risk is the main reason for the failure of the banking system of a country.	Accornero, M., et al. (2018).[23]
16	Banking system	Absence of proper credit risk management	There will be financial crisis and confusion in the banking system when proper credit risk management is absent.	Berger, A. N., & DeYoung, R. (1997). [24]
17	non-payment of loan	Inability or unwillingness by the borrower on the pre committed time.	Credit risk arises due to the non-payment of loan due to inability or unwillingness by the borrower on the pre committed time.	Santomero, A. M. (1997). [25]
18	Failure to pay money	Small number of important borrowers	If a small number of important borrowers fail to repay the money, the bank will face huge losses and it may become insolvent	Flannery, M. J. (1996). [26]
19	Failed banks	Failed banks are due to non-performing loans.	The feature of failed banks is not operating inefficiency but a large amount of non-performing loans	DeYoung, R., & Whalen, G. (1998). [27]

3. RESEARCH GAP :

Various studies have looked at the credit risk of banks for different reasons. The purpose of this study is to find out how much of a credit risk banks face when borrowers don't pay back their loans. So, the main focus of this research is to find out if the bank's non-performing assets have gone up or down, leading to gains or losses for the bank.

4. RESEARCH AGENDA :

(1) What is the credit risk involved at Canara Bank due to the failure in repayment of advances?
(2) What are the factors that lead to an increase or decrease in the NPA percentage of Canara Bank?
(3) What is the influence of NPAs on the profitability of the Bank?
(4) Which are the different types of loans provided by Canara Bank?
(5) How to analyse the company's Strengths, Weaknesses, Opportunities and Threats?

5. OBJECTIVES OF THE STUDY :

(1) To study the credit risk involved at Canara Bank arising from failure in repayment of advances.
(2) To find the factors that lead to an increase or decrease in the NPA percentage of Canara Bank.
(3) To understand the influence of NPAs on the profitability of the Bank.
(4) To identify the different types of loans provided by Canara Bank.
(5) To analyse the company by SWOT Analysis.

6. SCOPE OF THE STUDY :

The study mainly concentrated on the loans and advances provided to the public and the increase or decrease in NPAs resulting in the increase or decrease in profits of the bank. The study is limited to the risk faced by Canara bank due to the failure in the recovery of loans provided to the borrowers.

7. RESEARCH METHODOLOGY :

The information has been collected to prepare this case analysis from different sources. The data for the present case study is collected by having focus group interactions with the branch Managers and the staff of the bank and ideas received from them. The data was also collected through Bank annual reports, manuals, magazines, internal records, previous records, websites and Balance Sheets. Articles were also referred to through Google scholar.

8. COMPANY PROFILE OF CANARA BANK :

Canara Bank is a commercial bank in India that is well-known and acknowledged throughout the country. It was established in 1906 by Mr. Ammembal Subba Rao Pai, a well-known figure in the city of Mangalore in the state of Karnataka. The name of the institution, which was formerly known as the Canara Bank Hindu Permanent Fund but is now known as Canara Bank Limited, was altered at some point in time. Mr. Ammembal Subba Rao Pai wanted to achieve his goal of providing financial services while simultaneously serving social concerns such as removing misunderstandings and ignorance, encouraging people to save money, assisting those who are in need, and cultivating humanity [28][30]. Not only does Canara bank have a long list of notable achievements, but it was also the first financial institution in India to launch an intercity ATM network. In addition, it was the first bank in India to provide credit cards for farmers and the first bank to offer agricultural consulting services. All of these firsts occurred during Canara bank's time in India [29].
By implementing its motto of "Together We May," the bank has worked hard to maximize its potential through information technology to meet customer expectations. Credit cards, business banking, and personal banking are all offered by Canara Bank. Banks provide a wide range of retail products, including savings accounts, time deposits, vehicle and house loans, personal loans, gold loans, education loans, debit and credit cards, mutual funds, and bank assurance. Corporate banking services include syndication, business counselling, project evaluations, legal services, and cash management [30] [31]. The bank's primary goal is to provide excellent client service. They take into account the preferences of each consumer while putting together a service package to match their requirements. Banks lend money to individuals, enterprises, industries, farms, and self-help groups after carefully examining their financial situation and validating a substantial quantity of paperwork [32].

9. ADVANCES, PERCENTAGE OF NPA AND PROFITABILITY OF CANARA BANK :

Profitability of the bank is affected when the advances provided to the customers are not collected promptly. NPAs reduce bank profitability by increasing operating costs and decreasing interest margins. This table shows the effect of advances and NPA on the profitability of Canara Bank.

Table 2: This table shows the Advances, NPA and Profits of Canara Bank for the previous 5 years.

Year	Advances (Rs. in Cr)	NPA (Rs. in Cr)	Profits (Rs. in Cr)
2016	324714.82	31637.83	-2812.82
2017	342008.76	34202.04	1121.92
2018	381702.99	47468.47	-4222.24
2019	427727.27	39224.12	347.01
2020	432175.20	37041.15	-2235.72

Source: Annual Reports [33]

When a borrower is unable to pay the loan obligation in full or in more than ninety days past the due date of the loan repayment, the credit risk manifests itself in the form of the borrower account becoming an NPA. This occurs when either the borrower is unable to pay the loan obligation in full or is more than ninety days past the due date of the loan repayment. Credit risk can affect the financial transaction that is taking place, which is the provision of a loan to the borrower. It is possible that a more widespread economic shift is to blame for the borrower not paying back their debt or falling behind on their payments. Alterations in the borrower's economic conditions, such as an increase in competition or a recession, can affect the borrower's capacity to make payments on the loan's principal as well as the interest. This could be another reason why the borrower is unable to make the payments.

A high percentage of non-performing assets (NPAs) indicates a significant likelihood of many loan defaults, which can have an impact on a bank's profitability and net worth as well as the asset's value. In addition to endangering the quality of assets and the viability of banks, NPAs have an impact on liquidity and profitability. The NPA level for 5 years are shown in table 3.

Table 3: This table shows the Non-Performing Assets (NPA) of the Bank for the previous 5 years.

Year	NPA (Rs. in Cr)	% Increase or Decrease	Total advances	% of Total Advance
2016	31637.83	-	324714.82	9.74%
2017	34202.04	8.10%	342008.76	10.00%
2018	47468.47	38.78%	381702.99	12.44%
2019	39224.12	-17.37%	427727.27	9.17%
2020	37041.15	-5.57%	432175.20	8.57%

Source: Annual Reports [33]

The advances provided by the bank are increasing over the years which indicate that the bank is meeting its demand from the customers concerning 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. 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. Further, the increase in NPA percentage in the financial years 2017 and 2018 has added to the increase in the losses incurred by the bank. This shows a poor credit recovery policy of the bank adding to credit risk faced by the bank. Subsequently, the reduction in NPA percentage has reduced the losses and the banks have incurred profits which is evident from the financial year 2019 onwards.

NPA percentage of the bank to its total advances which 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.

10. LOANS OFFERED BY CANARA BANK :

A loan is a sum of money borrowed from a bank or other financial institution by one or more individuals or businesses to finance planned or unplanned events. In doing so, the borrower incurs a debt, which he must repay with interest and within a specified time frame. The interest rates on the loans change on a regular basis, and each individual loan has its own unique rate of interest. The different types of loans with their rate of interest provided by Canara Bank are shown in Table 4.

Table 4: This table shows the loans provided by Canara Bank and their Rate of Interest.

Loans Offered	Rate of Interest (%)
Housing loan	7.10 - 9.30
Home improvement loan	9.80 - 11.85
Site loan	8.35 - 9.40
Teacher loan	11.30 - 13.35
Vehicle loan	7.75 - 10.30
Mortgage loan	10.35 - 12.40
Gold loan	7.65
Deposit loan	7.25

Consumer loan	12.80 - 14.30
Term loan	7.85-9.90
Overdraft facility	13.85
Personal loan	12.80 - 14.30
Education loan	7.30 - 9.30

Source: [34]

11. SWOC ANALYSIS OF CANARA BANK :

SWOC analysis is a strategic planning method used to study the external and internal elements which affect company growth and success. Investors, shareholders, and the corporation as a whole are all impacted [35]. To better match the company's resources to the needs of the environment, it is critical to examine the SWOC to discover the policies and practices that will assist establish a model for the company [36]. SWOC analysis is a tool used by businesses to identify their firm's assets, liabilities, strengths, weaknesses, opportunities, and threats.

11.1 Strengths:

Strengths are the constructive activities, and processes that are undertaken by the company. It also focuses on its behaviour. The success of the company depends on its strengths. So it is the Strengths of a company that helps them to achieve its goals and be successful in the long run [37].

(1) Contribution to the enhancement of rural living standards by helping the farmers by providing them low- interest loans.
(2) Positive banking experience for consumers.
(3) Stronger goodwill in the minds of customers.
(4) Huge employment opportunities.
(5) Partnership with UNEP to start a successful solar loan program.

11.2 Weaknesses:

The weakness of a company refers to the area where it needs to work upon so that it can face tough competition and survive in the market. It can sustain itself in the competitive world only when it analyses its weakness and tries to overcome them.

(1) Poor marketing.
(2) Poor Customer Service.
(3) Client Base is very poor.
(4) Inadequate Publicity.
(5) Low International presence.

11.3 Opportunities:

This helps in finding out different ways in which a firm can excel using its existing skills and resources. It helps in finding out the areas where a firm can expand and diversify its revenue and market share.

(1) Concentrate on Rural Banking.
(2) Increase in use of Social Banking.
(3) Agriculture based consultancy.

11.4 Challenges:

When companies introduce new and innovative schemes it is very difficult for the existing company to survive in the market. The company will face stiff competition and it will find it difficult to survive in the market.

(1) Private Sector Banks are increasing their competition by introducing novel investment packages.
(2) Economic Crisis.
(3) Banks operations get affected when there are changes brought up by RBI.

12. FINDINGS :

(1) Increase in advances over the years of Canara Bank indicates that people are willing to borrow funds to meet their financial requirements.
(2) Increase/ decrease in NPA percentage indicates the credit recovery policy of the bank which in turn increases or decreases the credit risk management of the bank.
(3) Increase or decrease in NPA impacts the provisioning requirements of the RBI and results in increase or decrease in profits earned by the bank.
(4) To forecast a bank's financial success, credit risk must be managed. If the outstanding loans are not collected, banks won't be able to perform profitable activities.
(5) Banks that avoid credit risk management will undergo several challenges which include even survival in the current highly competitive financial environment.
(6) Provision of financial help to customers and efficient credit risk management by the bank can be profitable for a bank.

13. RECOMMENDATIONS :

(1) Regularly review and monitor the borrower accounts.
(2) Have a regular update of customer reports and their key financial data.
(3) Close monitoring of commercial loans through visual dashboards.
(4) Consider tracking loans that go into arrears regularly.
(5) Obtain collateral securities and guarantees to help mitigate the risks.

14. CONCLUSION :

The study is based on the credit risk faced by Canara bank and its effect on the profitability of the bank as a whole. Even though the bank is managing to achieve a reduction in NPA percentage over the years, certain areas may be looked into to efficiently reduce the credit risk due to advances turning into non-performing assets. The reduction in credit risk due to the reduction in NPAs will in turn increase the profitability of the bank.

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