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DETERMINANTS OF COMMERCIAL BANKS LENDING: EVIDENCE FROM INDIAN COMMERCIAL BANKS

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***ABSTRACT*: -** This study investigated the determinants of commercial banks' lending behaviour in the Indian context. The study aimed to test and confirm the effectiveness of the monetary policy along with common determinants of commercial banks' lending and how it affects the lending decision of commercial banks in India. An understanding of commercial banks' loan pricing decisions can be useful for policy purposes in various ways. First, the price discovery in the loan market characterized with loan interest rates and their spreads over deposit interest rate and risk free yield on government securities, can reflect upon the competitiveness and efficiency of banks in financial intermediation through mobilisation of deposits from saving households and allocation of funds to investors for productive activities. Thus, loan interest rates can be associated with economic growth and macroeconomic stability. Second, for successful conduct of monetary policy through the interest rate channel by the authorities, it is required that commercial banks should adjust loan interest rates in tandem with policy actions.

The Indian financial market dynamics have changed after reforms initiated in 1991. Banks are allowed to articulate their credit and investment policy within limits specified by its regulators. Banks are allowed to devise their credit policy after maintaining priority sector lending norms. Banks have to mandate to invest some portion of deposits in SLR securities and are free to invest in non SLR securities. The present research work highlights factor affecting investment portfolio in Indian scheduled commercial banks during last 13 years. In scheduled banks SBI group, nationalized banks, old private, new private and foreign banks are considered. Size of firm, non-interest income, Cash Deposit ratio, spread, and cost of production, cash and profitability are considered as determinants of investment portfolio. This study found mix results in all bank groups, but CD ratio and cash is found significantly and negatively related with investment in all bank groups. The study found that new private sector banks are less experienced than its peer banks, so their investment strategy may be changing as bank specific and economic specific factor changes. Foreign banks function with its branches in India so their investment strategy are devised by their home country bank and evidence also support so that they are more inclined to lending than investment. Commercial Banks are distinguished from other financial institutions primarily by their acceptance of demand deposits. Deposits provide them with funds but their responsibility for the liquidity and safety of the deposits limits the use of these funds. The privilege of receiving deposits is accompanied by an elaborate framework of legal and supervisory controls designed to protect depositors and govern the monetary effects of demand deposits.

KEYWORDS: Common determinants of commercial banks, financial market**.**

INTRODUCTION

The Indian financial system comprises a vast network of different banks. The banking sector is the core segment in deciding the progress of the entire economy of the country. The banking sectors become an important segment of Indian economy for money market dynamics. Financial sector controlled and managed by banking industry works as a source for generating money supply. The commercial banks play a dominant role in the economic development of the country. It is well known that the rapid growth in the various sectors of the economy can be brought through efficient, effective, disciplined banking system (RBI report (2010)). The banking sector in India has played a pivotal role in the Indian economy. Financial institutions in India can broadly be classified into banking and non-banking institutions. Banking institutions are of three types: Commercial Banks, Industrial or Investment Banks and Rural Banks. The commercial banking structure in India consists of Scheduled Commercial Banks and Non-Scheduled Commercial Banks. Scheduled Commercial Banks constitute those banks which have been included in the second schedule of the Reserve Bank of India (RBI) Act, 1934. The Reserve Bank continued its focus on ensuring the availability of banking services throughout the country and instituting an efficient and comprehensive credit delivery mechanism catering to the productive sectors of the economy. This study intended to analyze the working and operation of commercial banks. The indicators selected to study are Aggregate Deposits mobilized by Scheduled Commercial Banks, credits and investments made by the schedule commercial banks, Credit-Deposits Ratios, Investment-

Deposits Ratios, and the Share of Scheduled Commercial Banks in the Priority Sector Lending.
The various methods employed by the RBI to control credit creation power of the commercial banks can be classified into two groups, viz., quantitative controls and qualitative controls.
The commercial banking sector plays an important role in mobilization of deposits and disbursement of credit to various sectors of the economy. The banking industry in India is undergoing transformation since the beginning of liberalization. Banks in India are venturing into non-traditional areas and generating income through diversified activities other than the core banking activities. There have been new banks, new instruments, new windows, new opportunities and, along with all this, new challenges.

This paper intended to analyze the lending and deposit of commercial banks. The indicators selected to study are Aggregate Deposits mobilized by Scheduled Commercial Banks, credits and investments made by the schedule commercial banks, Credit-Deposits Ratios, Investment- Deposits Ratios, and the Share of Scheduled Commercial Banks in the Priority Sector Lending. This paper also covers the main objective of this study to understand as how a bank is able to use the available resources to increase the profitability and performance of banks and banks in India are performed well or not.

OBJECTIVES OF THE STUDY

- To grant advances and the loans and investing the amount which is deposited by the customers?
- Your treatise is based on the following objectives To present an overview on priority sector lending in India
- To review the present policy framework of priority sector lending.
- To study BASEL III NORMS, Capital adequacy and NPA
- To know the various problems and provide some suggestions to strengthen this system of lending and future.

HYPOTHESIS OF THE STUDY

To achieve study's objective the researcher developed the following research hypotheses i.e. the main arguments of the study were fashioned in to two alternative hypotheses.
H1: There is significant relationship between commercial banks' lending and internal factors- bank size, credit risk, deposit, liquidity ratio, capital and investment in security.

H2: There is significant relationship between commercial banks' lending and external factors- GDP, cash required reserve and interest rate.

METHODOLOGY

The nature of our study is perspective and analytical .The present study is based on Primary Data as well as Secondary Data. Primary Data have been collected with the help of personal interview, questionnaire and detailed discussions with the branch managers of Bank of Baroda. RBI Report on Trend and Progress of Banking in India for various years, websites and a book on banking has been referred during the study. The Secondary data have been obtained from the following sources:-

- Published annual reports, different policies of Various published deposit schemes and loan schemes and service provided by Bank of Baroda to customers,
- Published and unpublished research studies of various research scholars,
- Journals, magazines and newspapers published by different organizations and institutions literature published by the Reserve Bank of India, various magazines, Journals, Books dealing with the current banking scenario and research papers.

Primary Data has been collected by this Questionnaire. They are as follows:

Q1) What is the relationship between bank capitalisation and credit risk? Are low-capitalised banks more or less risk-averse?
ANSWER- The main proposition of our analysis is that banks with differential levels of credit risk and capital will be associated with firms with differential risk and performance. Specifically, risky and less profitable firms can have a difficult time obtaining credit from banks with relatively low levels of credit risk in their portfolios (risk-averse banks). In turn, banks with higher levels of credit risk are usually inclined to lend to more risky and less profitable firms.
To control inflation and the growth, RBI uses certain tools like CASH RESERVE RATIO, STATUTORY LIQUIDITY RATIO, REPO RATE, and REVERSE REPO RATE

As per this diagram, if deposit is Rs.1000 and CRR is 6% that is Rs.60 which is deposited with RBI and therefore lending balance by Commercial bank will be Rs.940 . If RBI cuts **CRR** in its next monetary policy review then it will mean banks will be left with more money to lend or to invest. So, more money can be released into the economy which may promote economic growth.

What is Statutory Liquidity Ratio (SLR)?

Besides CRR, Banks have to invest certain percentage of their deposits in specified financial securities like Central Government or State Government securities. This percentage is known as **SLR**.

Example **-** Individual deposits say Rs 1000 in bank. Then Bank receives Rs 1000 and has to keep some percentage of it with RBI as SLR. If the prevailing SLR is 20% then they will have to invest Rs 200 in Government Securities.

Q2) Do banks with more diversified activities exhibit better loan quality?

Answer- The evidence we present suggests that, in contrast to the recommendations of traditional portfolio and banking theories, diversification of bank assets is not guaranteed to produce superior return performance and/or greater safety for banks.

LITERATURE REVIEW

Literature sets for the divergent views regarding the determinants of bank lending. According to one view it is the demand side elements that determine the bank lending whereas the other view professes the dominance of supply side factors. Thus, the response of demand for loans to such economic variables as interest rates and economic activity would also determine bank behaviour regarding the above mentioned balance sheet accounts. For example, a rise in the demand for loans from banks (supply of this form of earning asset) would be met, subject to the deposit constraint, by reductions in investments and excess reserves and an increase in borrowings from the banking sector. The profit maximization principle implies that commercial banks' responses to market forces determine their portfolio behavior the commercial bank's decision of allocating its portfolio of assets between the two earning assets, i.e., loans and investment are generally determined by the existing legal reserve requirements against commercial banks' demand and time deposits. Given the de jure and de facto status of the most of banks' liabilities, and given that an individual bank cannot predict with certainty future deposit flows, loan demands, interest rates, and actions by the monetary authorities, commercial banks desire to have a portion of their asset portfolio that represents a stock of liquidity to act as a buffer against changes in the aforesaid factors.

An alternative view is that fluctuations in bank lending reflect supply side developments such as changes in banks' capacity and willingness to lend. To the extent that some firms face a high external premium in accessing the capital market, or such markets are not well developed, they are heavily dependent on bank lending. Others have argued that bank credit is, indeed, special because it could trigger innovation, particularly in industries that did not have access to external financing. Thus, any shock that relaxes banks' lending capacity **-** a rise in capital inflows or an easier monetary policy **-** could lead to increased credit supply in the economy. Moreover, such shocks could affect asset prices and balance sheets, exerting an indirect influence on banks' capacity to lend

Bank lending is determined by both supply side and demand side factors. On the supply side, banks' portfolio behaviour determines their lending. Commercial banks hold a portfolio of assets based on risk return perceptions and distribution of the liabilities so as to yield the greatest return. Loans and investments are the two most important earning assets in the asset portfolio of banks and their composition is determined by the banks' portfolio behaviour which, in turn, is based on either accommodation principle where lending is the key determinant of banks' portfolio or profit maximisation principle. A rise in capital inflows or an easier monetary policy could also lead to increased credit supply in the economy. Banks' willingness to lend could also be affected by the regulatory regime in place, and whether they hold enough capital to support all the new profitable loan proposals.

NON-PERFORMING ASSETS

Today non-performing assets are the subject of major concerns to the banking sector and the other non-banking financial institutions. A loan or lease that does not meet the stated principal amount and the interest amount payments is termed as non-performing assets. NPA can be classified into commercial loans which are overdue for more than 90 days, and consumer loans which are due for more than 180 days. Furthermore, banks can also issue notices under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 for enforcement of security interest without intervention of courts. Further, banks, (excluding securitisation companies/ reconstruction companies) have been permitted to undertake sale/purchase of NPAs.

Classification of Assets: Non-performing assets are further classified into three categories based on the span for which the asset has remained non-performing and the recovery of the dues:

i. Substandard Assets
With effect from March 31, 2005, a substandard asset would be the one, which has remained as a non-performing asset for a period of less than or equal to 12 months. Substandard assets have credit weaknesses and there are also possibility of incurring and sustaining some losses if the deficiencies are not corrected.

ii. Doubtful Assets
With effect from March 31, 2005, an asset is classified as doubtful if it has remained as a sub-standard asset for a period of 12 months. A loan classified under the doubtful category has all the weakness characteristics as defined for the sub-standard assets.

iii. Loss Assets
A loss asset is one where loss has been identified by the bank's internal auditors and RBI's external auditors, but the amount has not been written off fully. These kinds of assets are also considered as uncollectible.

ASSEST LIABILITY MANAGEMENT (ALM)

Asset-liability management basically refers to the process by which an institution manages its balance sheet in order to allow for alternative interest rate and liquidity scenarios.
Banks and other financial institutions provide services which expose them to various kinds of risks like credit risk, interest risk, and liquidity risk. Asset liability management is an approach that provides institutions with protection that makes such risk acceptable. Asset-liability management models enable institutions to measure and monitor risk, and provide suitable strategies for their management. Asset-liability management is a first step in the long-term strategic planning process. Therefore, it can be considered as a planning function for an intermediate term. In a sense, the various aspects of balance sheet management deal with planning as well as direction and control of the levels, changes and mixes of assets, liabilities, and capital.

CAPITAL ADEQUACY RATIO

Capital Adequacy Ratio (CAR) is the ratio of a bank's capital in relation to its risk weighted assets and current liabilities. It is decided by central banks and bank regulators to prevent commercial banks from taking excess leverage and becoming insolvent in the process.
Capital Adequacy Ratio = (Tier I + Tier II + Tier III (Capital funds)) /Risk weighted assets The risk weighted assets take into account credit risk, market risk and operational risk.

The Basel III norms stipulated a capital to risk weighted assets of 8%. However, as per RBI norms, Indian scheduled commercial banks are required to maintain a CAR of 9% while Indian public sector banks are emphasized to maintain a CAR of 12%.
According to new Basel-III norms, which kick in from March 2019, Indian banks need to maintain a minimum capital adequacy ratio (CAR) of nine per cent, in addition to a capital conservation buffer, which would be in the form of common equity at 2.5 per cent of the risk weighted assets. In other words, banks' minimum CAR must be 11.5 per cent, which is higher than the 9.62 per cent banks are required to currently maintain.

PROBLEMS

1. Due to improper communication between the different branches of selected commercial banks, these banks are facing problems in giving better services to their customers.
2. In rural area, banks are providing loans to their customers, but few numbers of customers are not able to return back the amount of loan and the bank has to face the problem of excess bad debts.

FINDINGS AND SUGGESTION

The bank has given increased importance for flow of credit to agriculture and allied activities.

1. Educational loan up to Rs. 7.5 lakh for studies in India and up to Rs. 15 lakh for studies abroad is sanctioned for the eligible students.

2. Commercial banks should develop credit procedures, policies and analytical capabilities. Commercial banks should strategize on how to attract and retain more deposits so as to further improve on their lending performance.

3. There should be closer consultation and cooperation between commercial banks and the regulatory authorities so that the effect of regulatory measure on commercial banks will be taken into account at the stage of policy formulation.

CONCLUSION

To sum up, different theories have evolved from time to time to explain banks' lending behaviour. According to the commercial loan theory, which is the earliest theory on credit, the earning assets of banks will be in the form of short-term and self-liquidating loans. According to the shift ability theory, the main consideration is how quickly the assets can be converted into cash. The anticipated income theory postulates that a bank can maintain its liquidity if loan repayments are scheduled on the basis of the anticipated income of the borrower. According to the liability management theory, it is not necessary for a bank to observe traditional liquidity standards if it can go into the market and bid for funds whenever it is in need of liquidity. Banks' lending operations are determined at the micro level, based on certain considerations as suggested by the theories. However, the overall quantum and target group of lending is determined by the financial system which a country adopts, i.e., market based financial system or bank based financial system.

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