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DEFAULTER BEHAVIOR IN THE INDIAN BANKING SECTOR: A BANKER PROSPECTIVE

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Abstract

The Indian Banking sector is a very prominent and efficient lending sector all over the world. India's bankers have adequately manage their lending sector in order to increase the spread. The entire risk bearing activity as only to earn profit. Indirectly if we say, the association between profit and risk is linear. The primary function of bank is accepting deposits and lending loans. The bank cannot run either of any one activity alone, so that investment is vary essential in order to get more spread.

Again if we see understanding a human psychology is very much difficult and perhaps above eighty five percent bankers has failed to read or understand individual psychology. Again we can suggest as understanding borrower psychology is inversely proportional to loan functions, i.e. if understand the psychology very keenly the chances of loan defaulting is very low and vice versa. India is a combination of different income level individual and their behavior also drastic upon their income level. Sometimes the above said prove falls as in this study has seen the people behavior is constant some time reverse irrespective to the income. I have gathered information about various mind set of people, when they are given loan. Most of the bankers entitled the lenient factor of defaulting is willfulness.

I. INTRODUCTION

Financial institutions play a vital role in supporting the business sector as well as national development. Through financial institution, business deposit. Transfer money and acquire business loan. The process of issuing loan by the financial institution grows hand in hand with risk such as loan repayment risk, liquidity risk, interest rate risk, Forex risk, operating risk, technology risk, fraud risk, regulatory risk, off-balance risk and capital adequacy risk (Santomery, 1997). Additional risk is created for banks when the state intervenes in the regulation of credit activities by banks. The e.g. of lending to small scale industry India is consider below to illustrate this intervention by the state.

Bank lending is a risky activity. Banks undertake risk when they grant a loan- the risk that the borrower may not honor their debt commitment according to the terms and condition of the loan contract. The probability of default on the loan amount to the borrower depends on the

In the observation of this study, we have focused the bankers, and we have seen 57% of managers and 43% are loan officers are directly involve in loan granting activities. The ratio says that, many banks doesnot depend upon loan officer for loan granting.

quality of risk evaluation by the bank. To deal with this risk banks are created methods of risk evaluation. The two main approaches to credit risk evaluation by banks are – the instrumental or quantitative approach and the qualitative approach. The quantitative approach relies on formal rules and variables that help in assessing the client solvency and the probability of default of loan. Borrower characteristics such as age, income, activity, pre4vious record are related to probability of default. The problem with instrumental approach is that the variables used to construct quantitative method are based on the information that could be subjective. The second problem is that the quantitative methods based on accounting date and information in a business situation. The entrepreneur used many other inputs such as past experience training, goodwill and relationship which contribute to business profit.

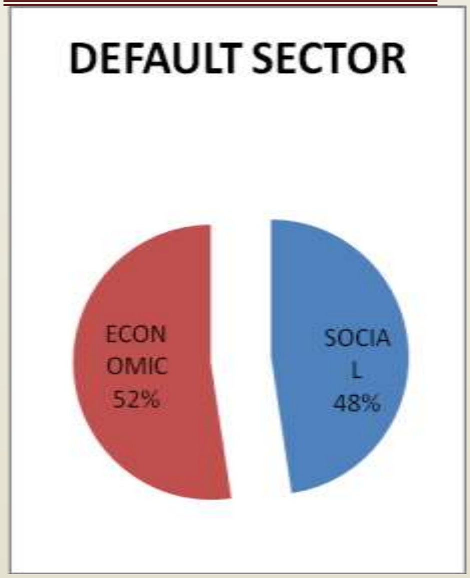
II. OBJECTIVE OF THE STUDY

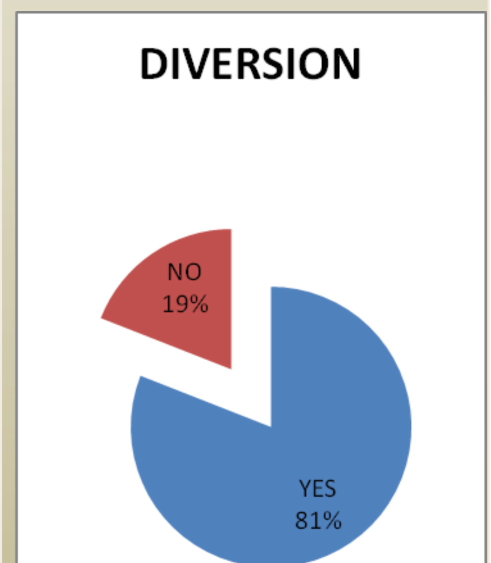
The basic objective of the study is to focus the behavior of the loan defaulter in the bankers prospective.

a. Nature of relationship between branch manager and loan officer:

The hierarchy of the banking sector is very strategic starting from the CEO to clerk level. A branch manager of a bank branch is the leader and chief executive at the local level. They are responsible for the profiatable operation of the branch. The branch manager approve own request within their delegated authority. This approval is done based on the evaluation of loan application by loan officer.

Sometimes a branch manager may delegate the lending authority to a loan officer for a temporary period. When a branch manager delegates this authority to a loan officer, they take a considerable risk. If the loan officer doesn't used the delegated authority in accordance with the banks policy and procedure, the branch manager may be had accountable for any mistake committed by the loan officer. When a loan officer assumes the authority of a branch manager on delegation, may also undertake a risk if the loans are not approved according to the bank policy and procedure. The branch manager may refuse to confirm the action of the loan officer. In such case the loan officer may be held personally accountable for any lapse of judgment. Neither a branch manager will delegate their authority to a loan officer nor the loan officer, will assume the delegated authority of the branch managers unless there is a trust between the branch manager and loan officer (BHATI, 2006). The agency theory (Jensen& Macklin, 1976) has





been used in finance literature to describe economic relationship. The agency theory has a limitation in describing the relationship between a branch manager and a loan officer of a bank branch because this relationship has different dimension from a simple principal- agent relation.

b. Trust in banking:

The literature on lending relationship that includes trust focus on lending relationship between a bank and the borrowing customer. Lehmann et al (2001) provide an empirical analysis of a bank lending to small and medium size farm in Germany. There are study provides evidence that the availability and farm of loan are not fully influence by farm characteristics and credit risk variable but also by social interaction between a loan officer and farm manager. This social interaction may indicate mutual trust as advantageous to both borrower and the bank. Petersen and Rajan 1994 so that a bilateral credit relationship between a bank a customer is considered as enduring when both parties have dealt with each other for some time and expect to continue to do so in future.Leheman et al (2001), Mayer(1988) and Burhhoff (2000) suggested that the continue relationship between the bank and the borrowing customer is beneficial to the bank and the customer alike and the quantitative variable used by bank when their credit evaluation process are not enough in credit risk management. Banks have to look into social interaction between the bank and the borrower in order to reduce the credit risk for the banks.

c. Default sector:

India is a country where agriculture has given foremost priority. The majority of borrower are belongs to industry, retail sector, education and business sector. The bankers are very much optimistic on the loans which will give more return with less risk again if we clearly focus the cause of default very keenly; we observe these above said sectors creating more default than social reason.

The economic reason is nothing but which is caused by business loss, crop loss, business shut down, unemployment etc. the economic cause is partially diversifiable and partially non diversifiable. Such as crop loss, unemployment, which are systematic in nature, so the entire risk associated to this sector is higher than other sector. The bankers who are regularly dealing with this issue are very drastic and hence they all are agree with the common opinion that these are all diversifiable in nature and the borrower intentionally doing this.

When we are talking about social reason it all depends on diversion of the loan amount in different area except the prior cause for which the

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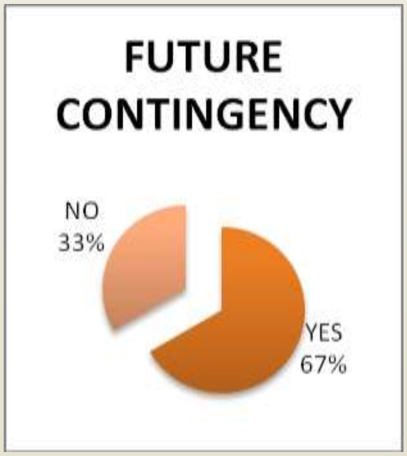

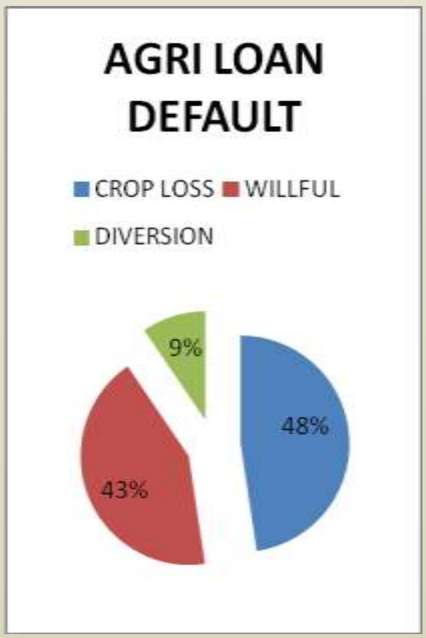

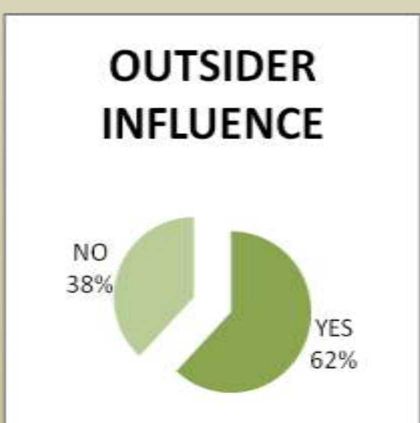

loan is granted. The borrower diversifies of the loan amount in different sector such as family function, funerals, marriage ceremony and most often in chit fund. And the reason where the survey is done is more prone to cheat fund investor whose prior borrowing aim is different from that, so social reason has a bad impact on loan recovery process. The bankers are unable to collect their loan amount as the amount is already invested in some other area where the net return is minimum or zero. According to the bankers review, the diversion has a played a major role and hence cause a huge loss both to the borrower and banks. The main reason is when the loan officer evaluate the project before sanctioning the loan, if more focus on risk and return analysis but when the diversion made by the borrower he may invest the entire amount in a risky project where the net return is minimum or even low.

d. Future Contingency affecting the loan payment:

Future contingency is a term which is depicted by the bankers by understanding the psychology loan defaulter, who are kept the demand money for future happenings. The future happening may be daughter marriage, children education, construction of house, purchasing as vehicle or any family function which is going to be held in future in future date.

The defaulter irrespective to their educational qualification and gender have engaged in such types of activities. Many times the bankers are faced difficulties when they are going for collection and confiscations because at that time of collection there is no such profit or return with the borrower for giving back to banks. According to bankers experience the female ratio is highest in north side of India, where as male ratio is high in eastern side.

e. Crop Failure:

Agriculture sector in India is continuing with underdeveloped zone till independence. It is caused by calamities, improper insurance management or political issue which stands, very ambiguous on the Indian context. How much bankers are trying to resolve agri loan problem in order to prevent farmer suicide and give better life to the farmer in case of providing better financial assistance to improve their crop, is always being neglected by the above said reason.

Our study gives a result about farmer behavior towards loan payment is very smooth according to the bankers who are interacted. And in the same time many of the bankers also agree

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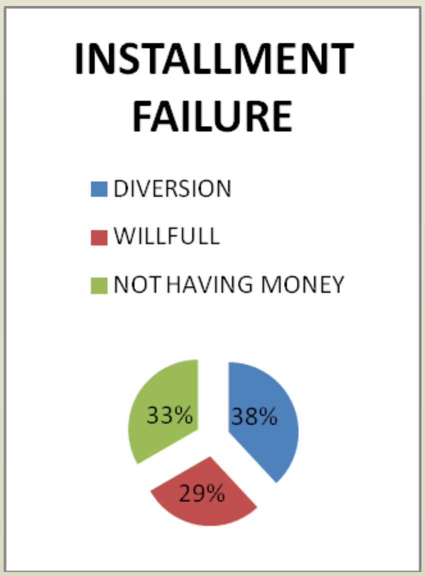

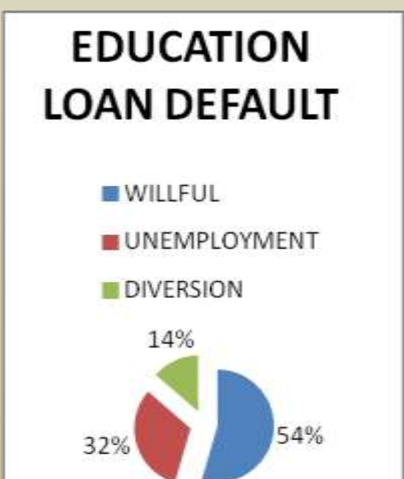

with a point that, they are willful defaulter and committed with loan diversion issue.

f. Negative signals by the outsiders towards non-payment of loan:

Sixty two percent bankers are agreed that, the loan holder's behavior is drastically biased by the outsider. The outsider in our study is explain the person who is being defaulted by many years and even black listed by the banks but is easily access to the product which are offered by the bank in the kind of loan. So it implies that such types of people make themselves a good ideology for the new loan holder their own example.

Such outsiders issue can't be restricted by the bank as this type of comments and influences are born by the individuals. Ninety percent of the people who are educated are committed by the influencer outsiders for nonpayment of bank loan and many times the bankers has observed the person who has already take the glimpse of the product are not interested to take it furthermore, so ultimately he default the installment. So this is also a part of outsiders' influences to the borrower for not paying the loan amount.

g. Poor statutes, bad recovery practices and procedures:

Bad recovery practices by the banks in India has created improper atmosphere in the field of debt recovery management. The bankers (manager and loan officers) must be more adequate and sincere while granting the loans to the individual. Again there are loop holes in the banking regulation act 1949, RBI Act 1934, Debt act 1993 and SARFAESI Act2000 which gives a better alternative for the defaulter to escape in the eyes court of law. When we are addressing bad recovery mechanism in the banking sector we have to understand that if the bank don't have stable securitization policy for collection of debt, it is not wise to accuse the individual.

h. Willful nonpayment of installment:

The consumption goods like refrigerator, motor vehicle, TV, air conditional are purchased through monthly installment basis, which is widely known as EMI but the loan holder was taken the loan with low initial payment and high installment tenure always face an installment default during the period of loan. Many bankers have experience the individuals have enjoy the goods of product and they are tried to escape by paying the installment. Again when the bankers are gone for confiscation, they can easily handle the property to the bank.

Ultimately the bank bears the loss not only providing loan but also in the acquisition part.

i. **Educational loan default:**

Diversion of fund plays a major role when the borrower purchased a good in installment i.e. the borrower face to deploy the monthly installment due to other investment opportunity. Many of the bankers also a common point that, after taking the goods, the borrower unable to support the installment value due low finance surveillance.

The bank like urban co-operative bank, Indian bank, Dena bank etc in that particular region fully stopped the lending activity in terms of educational loan. The above said bank experiences a high loan default in educational loan over the past decades. Other banks, have given different view on educational loan many of them of clearly explain the educational loan holder are defaulting willfully. Another economical cause is that unemployment which placed in second position. Many of the bankers have experience after completing education the loan holder disappear and placed in foreign countries and forget about the loan which he has taken for the education.

III. CONCLUSION

The Indian banking sector is facing new challenges every time, every year. The bankers are trying to counter such risk, some time they get success but most of the case they fails. When we are talking about economic causes of defaulting, the bankers have the reason to mitigate such un systematic risk. But in case of human behavior, most of the cases the bankers are unable to understand the defaulter mind set. Sometimes the behavior is auto correlated that is the reason of current year defaulting is the experience of tackling default loan default from past.

Many of the bankers also addressed the bad recovery management process of the concern bank and RBI they personally feel that their hands are tied of with hand cuff, whenever they are trying to collect the loan amount and confiscate the property. Some bankers are also agreed that there should be a unique identity number of the individual, so that they can easily identify the past record of the individual. In India there are self-identity function e.g. Voter ID Card, Aadhar Card, PAN Card, Ration Card etc. when we are talking about outside influence, it is important to give punishment who are defaulting and make a reward program who are paying the loan amount in their contract period. So that the society will get a positive vibration from the bank point of view.

To improve our economy, it is necessary to continue with lending activities. If such thing is concerned the only possibility to tackle credit risk management is, we would understand defaulter psychology from the beginning it self. So it is the work of RBI to develop training program to the young managers in the area of psychology. The people who are taking educational loan either they not putting much effort on their education or they are escaping from the bank after their education. So the bankers should have to focus priority educational trained in that particular time and also they should have the forecasting ability to understand what will be the future trend of that course.

And mean while they should go and check via their progress in any kinds. The people who are taking loans and diversify for other purpose e.g. marriage, family function; future contingency etc has to be made keenly by the bankers till the end of the contract. So it is necessary rather expansion of new branches of the bank, bank should create sufficient employee so that every segment have eligible and adequate officer who can take care of all the approaches carefully. It is really tough to understand the psychology of the individual we cannot judge them from their education, dress, talking, simplicity, honesty, color and character. As the bankers have experience the people who are better educated fair in color, good in character and perfect in dressing have done maximum default than others.

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