

An Impact of Loan Defaults and Impact on Profitability of Bank

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Abstract - Loan deficiency takes place when a debtor fails to pay back a debt in following an initial arrangement. This means the borrower missed his instalment payment which has to be paid on monthly bases. sometimes lenders and the bank usually allow some grace period before penalizing the borrower after the non-payment of the first instalment the interval between giving the instalment and getting the loan default is known as a delinquency. Bank perform a very important role in the economic process and development. The current study purpose is to recognize the source of loan default on the functioning of the bank and the measure have to take to bring down the cases of loan default. To study the impact of loan deficiency on the profitability of the bank and to direct ways to lessen loan defaults. data collected for the study is primarily based on secondary statistics such as journals, internet, newspaper, magazines & books.

Key Words: - Instalment, Borrower, Default, deficiency.

I. INTRODUCTION

In finance, the defaulter is failing to meet the legal commitments of a loan. This means when a borrower of loan fails to pay its monthly instalment then the borrower become defaulter of the bank sometimes banks allow some grace period before penalizing the borrower. Basically, there are two types of defaulter one is debt service default and another one is technical default. Debt service default arises when a borrower fails to pay its obligation on time and technical default arise when affirmative or a negative content is violated.

The Biggest private default in history is Lehman brothers closed to \$6000 billion in 2008 when it is filed for insolvency. India's Biggest 2,426 planned default owe the banks an astounding Rs. 1047 lakh crore. RBI also releases a list of top 50 loan defaulters worth Rs. 65,607 crores in September 2019 which have been written off in the banking system. Wilful defaulter cases net worth of 25000 cr has been sawed in India before the lockdown was announced in March.

Afterwards 2007 and 2008 financial and banking crises drive to global recession, after that new risk management method came out for banks worldwide. Bank perform a very important role towards economic process and development Defaulting credit will be resulted in substantial and lasting drop on the borrower credit score and will also increase the future interest rates on the loan.

II. OBJECTIVES

- To Recognize the source of loan default on the functioning of the Bank.

- To propose measures to bringing down cases of loan default.
- To study the outcome of loan default on the profitability of the Bank.

III. LITERATURE REVIEW

Mohammad Aslam, Senthil Kumar, (2019) Studies, 'Predicting Likelihood for loan default Among Bank Borrowers and founded that Education level, dependent Revenue, any extra income they are contributing for loan default and age does not appear to be contributing for loan default problem as well lower repayment instalment amount attracts less default.

Rajeev Kumar Upadhyay (2019), 'Predicting Default by Indian firm founded that the defaulting firms, the key ratios relating to liquidity and structure start deteriorating that of the non-defaulting firm.

Evans Oteng (2017), Researched on an assessment of bad loans and its impact on the profitability of a bank in ghana-European concluded that interest on the loan is too high that's the main reason of instability to pay back the loan. Loan processing and disbursement of the loan are not on time. There should be proper supervision on loan recovery. There should be proper rules and procedure for disbursement of the loan.

Cyrus Munyun (2016), 'Factors affecting loan Default in microfinance Institution founded that loan deviation has a lot of challenges with the default finance management practice plays an important part in managing loan default and also leads to increase income. The good firm loan collection procedures are important to get a competitive advantage over the others.

Pro D.S Rathore (2016), 'Non-Performing assets of the Indian banking system and its impact on economy stated that due to the mismanagement in a bank there is a positive relationship between your net profit and NPA which is not good for the bank. The positive relation between NPA and Profit is due to the wrong choice of the clients by the bank which directly effects the liquidity of the firm. Bank are not given the loan to the new customer due to lack of funds

Chepkaroy Dorcas Chepkoech (2016), 'An assessment loan policy and its influence on the financial performance of the commercial bank in Eldoret town founded that commercial bank has to keep a check on borrower before the lending loan. The chief lending officer also has to see the security which is given by the borrower for taking loans. Commercial bank loan policy setup the desired mix of the loan portfolio and also set the limits for the individual loan types.

Alex Addae Korankye, (2014), 'Causes and control of loan default concluded that the source of loan default by the borrower of MFI differ different factor are assigned to the borrower, while loan officer who is on the field also give different factor. Those factors which are assigned by a loan officer is the main reason behind the default of payment. Much thought should be given to that of a loan officer to reduce loan default.

IV. ANALYSIS

The paper has been established by using Secondary data assemble from different journals, newspaper, magazines, internet and books covering the wide collection of information on loan default literature

Sources of loan default on the functioning of the bank: -

Some of the important factors that cause loans default are:

- Absence of willingness to pay back the loan due to diversion of funds by borrowers
- Wilful Carelessness
- Loans officer who is on the field is also responsible for assigning a different factor
- Interest rate ceiling usually imposed by the government
- Huge transportation costs incurred by borrowers in applying for loans
- Endangerment problem
- Business failure
- High loan interest rate
- Lacking Monitoring
- Incorrect time of delivery

Measures for bringing down the cases of loan default

- Management ought to review the loan assessment procedure to stay off from unnecessarily delay of loan disbursement that typically results in customers missing their business opportunities and therefore causing bad loans Appraisal should be completed within 3 working days for payment

- The loan officers have to improve their quality of loans appraisal procedures they need to assemble information concerning loan customers, monitor customers business to avoid the difficulty occur at the time of locating borrowers once loan disbursement.
- Communication ineffectiveness mention to when lenders credit objectives and policies are not clearly communicated to the borrower.
- Loan repayment should be constantly monitored and whenever a client default quick action should be taken by the bank
- There should be proper credit analysis of the potential client to evaluate the credit risk with the borrower and to reach a lending action

The outcome of loan default on the profitability of the bank

The liquidity wasn't statistically notable loan default and cost-income ratio had a negative influence on the profitability whereas revenue and loan recovered had a positive effect. With the increasing ratios of bad loans will likely to reduce the quantum of loanable funds and thus will result in multiple effects on interest income, operating profit and the net profit for the bank. There is a positive relation between Net profit and NPA which is not good for the bank. A positive relation between NPA and profit is due to the wrong choice of the clients by the bank. Which directly affect the liquidity of the bank. Bank are not given a loan to the new customer due to lack of funds

The proper management of loans given to borrowers will yield more profits and also there is a significant relationship between the problem of recovery and overdue of loans on the profitability.

V. CONCLUSION

This study is conducted to examine the loan default and its impact on the profitability of the bank. Loan default has been recognized as one of the major elements that affect the profitability and existence of the bank.

This study says that securities or collaterals must be taken by the bank before an advance is approved to ensure that in the event of default the bank would not have any impediments in realizing the security.

The importance of this study lies in the fact that the performance of the economy on a productive financial service industry is a pre-requisite for the efficient functioning of the economy. A default in the financial system is an indicator of a failure in the economy

The Proper management of loans given to borrowers will yield more profits and we also do the credit analysis of the browser before lending loan proper information has to be collected by loan officer before giving the loans. Repayment should be constantly monitored by banks. Management should also have to review the loan assessment procedure.

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