Indonesian Journal of Business Analytics (IJBA)
Vol.3, No.4, 2023: 1105-1112

Determinant Banking Credit Risk Management

Josua Panatap Soehaditama[1*], Nera Marinda Machdar[2], Adler Haymans Manurung[3]
[1*]Institut Keuangan Perbankan dan Informatika Asia Perbanas, Jakarta
[2,3]Universitas Bhayangkara Jakarta Raya
Corresponding Author: Josua Panatap Soehaditama josua.panatap@perbanas.id

ARTICLEINFO

Keywords: Banking, Credit Risk, Risk Management

Received : 8, June
Revised : 13, July
Accepted: 15, August

ABSTRACT

This article reviews and looks for the relationship between two variables, namely banking and credit risk management from the results of existing research. The research method used is qualitative by looking at the findings or research results from existing literature derived from reputable journals or other sources found to support this study. In this article explains that banking credit risk management, determinants play an important role in identifying, measuring, and managing credit risk. Factors such as debtor characteristics, quality of collateral, economic and industrial conditions, bank policies and procedures, and legal and regulatory factors affect the level of credit risk. A deep understanding of these factors helps banks in taking better decisions and developing effective strategies in managing credit risk.

DOI: https://doi.org/10.55927/ijba.v3i4.5032
ISSN-E: 2808-0718
https://journal.yp3a.org/index.php/ijba

INTRODUCTION

In the banking industry, credit risk management is a crucial aspect in efforts to maintain financial stability and minimize losses (Altman et al., 2013). The aim is to ensure that banks operate safely, fairly, and in accordance with sound financial principles (Soehaditama, 2023). Credit risk refers to the possibility of payment failure by the borrower or debtor. Therefore, banks need to carry out effective credit risk management to ensure the quality of the credit portfolio and avoid unwanted losses. The credit risk management (CRM) policy of commercial banks includes decision-making mechanisms related to decreased exposure to loan loss allowance and credit asset classification (R, 2012).

Referring to (Krishnamurthy &; Vissing-Jorgensen, 2015) the severity of the crisis can be seen specifically from the increase in credit spreads initially. This increase in spreads shows how much fragility was accumulated during the boom in our model, which also estimates how big the next contraction will be. Many studies have highlighted the main reasons why bad credit occurs to stop it from happening again and to guarantee a healthy banking industry. In this regard, academics emphasize the importance of using systematic (macroeconomic determinants) and special (bank-specific determinants) factors to explain NPL variations (Salas &; Saurina, 2002;Us, 2017). The credit crisis in banks is inseparable from the existing banking system, as stated by (Beck & Cull, 2015) the African banking system crisis, it seems that the growth gains from financial deepening can only be realized in a stable macroeconomic environment and with an appropriate safety framework, both in terms of regulation and external supervision as well as internal bank governance. Despite recent adverse experiences in countries with the strongest financial sectors, Africa's banking system can and should play an important role in the Region's economic development.

In general, this banking sector is not immune to problems and does not always provide enough impetus for economic development, which is problematic because the financial sector in most transitional economies is dominated by banks. The final section examines the problems and prospects of banks fulfilling this role in transition countries (Bonin et al., 2012). The relationship between the banking system and the crisis in management can be seen above, especially there are several things that need to be considered in risk management in credit, namely factors such as credit history, job stability, income, age, and educational background of debtors can affect credit risk. Debtors with poor or financially unstable credit track records tend to have higher credit risk (Altman et al., 2005), the collateral provided by debtors to guarantee credit is also an important factor in determining credit risk. The higher the quality of the collateral provided, the lower the credit risk Freixas, X., & Rochet, J. C, 1997).

External factors such as industrial and economic conditions can also affect credit risk. For example, when an industry faces difficulties or an economic recession occurs, credit risk within that sector may increase (Carbó-Valverde et al., 2009), Policies and procedures implemented by banks can also affect credit risk. For example, loose underwriting policies or inadequate credit monitoring procedures can increase credit risk (Cornett et al., 2011). Legal and regulatory factors also have a significant impact on credit risk. Changes in regulations or legal provisions may affect credit quality and associated risks (Allen et al., 2011).

So this article reviews and looks for the relationship between two variables, namely banking and credit risk management from the results of existing research.

THEORETICAL REVIEW

Banking

According to (Mishkin &; Eakins, 2019) Banking is an activity related to raising funds from the public and distributing these funds in the form of credit or investment, as well as providing various other financial services such as payment, storage, and risk management. Banks play an important role in facilitating economic activities by providing liquidity and bringing together those who have excess funds with those who need funds.

In addition, according to (Thakor, 2019) Banking is an activity or industry involved in collecting funds from the public or customers and channeling them through various financial products and services such as loans, deposits, payments, and investments. Banks act as intermediaries between those who have excess funds (surplus) and those who need funds (deficit) in the economy.

Credit Risk Management

Credit Risk Management is the process of managing risks related to providing credit to customers by financial institutions, such as banks or financing institutions. The main objective of credit risk management is to identify, measure, monitor, and control risks associated with potential payment defaults by borrowers or debtors (Bluhm et al., 2016).

According to (Wilson, T. C, 2019) Credit Risk Management is an approach or process used by financial institutions to identify, measure, monitor, and control risks associated with providing credit to customers or debtors. The main objective of credit risk management is to minimize the risk of default and losses associated with lending.

METHODOLOGY

The research method used is qualitative by looking at the findings or research results from existing literature derived from reputable journals or other sources found to support this study.

RESULTS

Determinants in banking credit risk management are factors that affect the level of risk associated with lending. In this discussion, several determinants of credit risk have been identified, including debtor characteristics, collateral quality, economic and industrial conditions, bank policies and procedures, and legal and regulatory factors. In addition, there is literature from scientific articles from several journals that will support this scientific article including studies from subsequent studies of (Bonin et al., 2012) credit growth continues, sometimes too fast, especially for household credit. The global financial crisis tested the banking transition. Fast-developing credit countries are vulnerable to macroeconomic shocks, and there are concerns that foreign owners will reduce the financing of their subsidiaries in transition countries. However, the banking sector is proving resilient, clearly showing rapid progress in institutional development and regulatory capacity in transition countries.

Subsequent studies from (Chava et al., 2013) in the results of the study stated the deregulation nature of the financial sector has a decisive influence on its potential benefits for the real economy.

Subsequent studies of (Gennaioli et al., 2013) research results of foreign investor wealth drive demand for risk-free debt and securitization indirectly, bank assets and leverage move together, banks connect across markets, and banks increase their exposure to systemic risk while reducing preferential risk through diversification. The shadow banking system was stable and welfare improved below reasonable expectations, but it was open to crisis and liquidity dried up if investors ignored the risk tail.

Subsequent studies from (Beck & Cull, 2015) with the results of research on the African banking system are shallow but stable. African banks are well-capitalized and highly liquid, but lend less to the private sector than banks in non-African developing countries, land African businesses and households use financial services less frequently than similar businesses in other developing countries study.

Studies from (Moreira &; Savov, 2017) Shadow Banking research results collapsed, liquidity reserves shrank, liquidity premiums and discount rates rose, asset and investment prices fell. The model produces slow revenue, rescue, and flight quality effects and highlights major acquisitions, Operation Twist, and other interventions.

Studies from (Huang, 2018) with the results of research on the issue of enforcement of implicit guarantees create endogenous leverage limits in shadow banking. Our model explains that shadow banking is procyclical and shadow banking increases endogenous risk. In our model, tightening banking regulation increases borrowing capacity and financial instability of shadow banking. In addition, we show that limited general risk sharing does not improve financial stability when shadow banking prevails.

Subsequent studies of (Naili &; Lahrichi, 2022) research results despite extensive empirical and theoretical work over the past few decades, the subject of credit risk remains an unresolved area of research. A subsequent study from (Sharma &; Choubey, 2022) more than 60% of respondents believe that green banking initiatives play a positive role in restoring customer trust by improving green branding. Given the lack of research on green banking in India, this qualitative study contributes to knowledge and paves the way for future research on green banking for sustainable development.

The study from (Bhatt et al., 2023) the results of market risk analysis research have a significant effect on credit risk management. The results showed that credit risk management mediates the relationship between environmental risk, credit rating measurement, market risk analysis, and commercial bank performance. Therefore, managers should strive to provide risk prevention and control mechanisms to reduce credit risk and achieve good financial results.

DISCUSSION

Determinants in banking credit risk management play an important role in identifying, measuring, and managing the risks associated with lending. This discussion of the determinants of credit risk can help banks in making better decisions and in developing effective strategies in managing credit risk. Debtor characteristics, such as credit history, job stability, income, age, and educational background, have a significant influence on credit risk. Debtors with poor or financially unstable credit track records tend to have higher credit risk. The discussion could focus on how banks can analyze debtor characteristics to more accurately assess credit risk.

The quality of the collateral provided by the debtor is also an important factor in determining credit risk. The discussion may highlight the types of collateral used in credit risk management, such as valuable assets, property, or securities. Factors affecting the quality of collateral and their impact on credit risk can be important topics in discussion.

Theimportance of policies and procedures applied by banks in credit risk management. Factors such as underwriting policies, credit monitoring procedures, and effective risk management measures can be the focus of discussion. How banks develop adequate policies and procedures to reduce credit risk can be an interesting topic to explore.

And there is one article that states the relationship between variables from the study belongs (Bhatt et al., 2023) but is not thoroughly stated. This can all make a picture of the results of this article.

CONCLUSIONS AND RECOMMENDATIONS

In this article explains that banking credit risk management, determinants play an important role in identifying, measuring, and managing credit risk. Factors such as debtor characteristics, quality of collateral, economic and industrial conditions, bank policies and procedures, and legal and regulatory factors affect the level of credit risk. A deep understanding of these factors helps banks in taking better decisions and developing effective strategies in managing credit risk.

All of the above results are based on scientific articles that have been presented according to variables.

FURTHER STUDY

This article can provide a reference for other researchers, the variables of this study have been widely used and these results provide additional color for science in the field of finance.

ACKNOWLEDGMENT

The results of this article are to contribute to the institution and itself for audience use.

REFERENCES

Allen, F., Carletti, E., & Marquez, R. (2011). Credit market competition and capital regulation. *The Review of Financial Studies*, *24*(4), 983–1018.

Altman, E. I., Brady, B., Resti, A., & Sironi, A. (2005). The link between default and recovery rates: Theory, empirical evidence, and implications. *The Journal of Business*, *78*(6), 2203–2228.

Beck, T., & Cull, R. (2015). Banking in Africa. *The Oxford Handbook of Banking, Second Edition*, *October*, 913–937. https://doi.org/10.1093/oxfordhb/9780199688500.013.0037

Bhatt, T. K., Ahmed, N., Iqbal, M. B., & Ullah, M. (2023). Examining the Determinants of Credit Risk Management and Their Relationship with the Performance of Commercial Banks in Nepal. *Journal of Risk and Financial Management*, *16*(4). https://doi.org/10.3390/jrfm16040235

Bluhm, C., Overbeck, L., & Wagner, C. (2016). *Introduction to credit risk modeling*. Crc Press.

Bonin, J. P., Hasan, I., & Wachtel, P. (2012). Banking in Transition Countries. In *The Oxford Handbook of Banking*. https://doi.org/10.1093/oxfordhb/9780199640935.013.0033

Carbó-Valverde, S., Rodriguez-Fernandez, F., & Udell, G. F. (2009). Bank market power and SME financing constraints. *Review of Finance*, *13*(2), 309–340.

Chava, S., Oettl, A., Subramanian, A., & Subramanian, K. V. (2013). Banking deregulation and innovation. *Journal of Financial Economics*, *109*(3), 759–774. https://doi.org/10.1016/j.jfineco.2013.03.015

Cornett, M. M., McNutt, J. J., Strahan, P. E., & Tehranian, H. (2011). Liquidity risk management and credit supply in the financial crisis. *Journal of Financial Economics*, *101*(2), 297–312.

Gennaioli, N., Shleifer, A., & Vishny, R. W. (2013). A Model of shadow banking. *Journal of Finance*, *68*(4), 1331–1363. https://doi.org/10.1111/jofi.12031

Huang, J. (2018). Banking and shadow banking. *Journal of Economic Theory*, *178*(May 2014), 124–152. https://doi.org/10.1016/j.jet.2018.09.003

Krishnamurthy, A., & Vissing-Jorgensen, A. (2015). The impact of Treasury supply on financial sector lending and stability. *Journal of Financial Economics*, *118*(3), 571–600.

Mishkin, F. S., & Eakins, S. G. (2019). *Financial markets*. Pearson Italia.

Moreira, A., & Savov, A. (2017). The Macroeconomics of Shadow Banking. *Journal of Finance*, *72*(6), 2381–2432. https://doi.org/10.1111/jofi.12540

Naili, M., & Lahrichi, Y. (2022). The determinants of banks' credit risk: Review of the literature and future research agenda. *International Journal of Finance and Economics*, *27*(1), 334–360. https://doi.org/10.1002/ijfe.2156

R, O. A. (2012). Analysis of Credit Risk Management Efficiency in Nigeria Commercial Banking Sector,(2004-2009). *Far East Journal of Marketing and Management*, *2*(1).

Salas, V., & Saurina, J. (2002). Credit risk in two institutional regimes: Spanish commercial and savings banks. *Journal of Financial Services Research*, *22*(3), 203–224.

Sharma, M., & Choubey, A. (2022). Green banking initiatives: a qualitative study on Indian banking sector. *Environment, Development and Sustainability*, *24*(1), 293–319. https://doi.org/10.1007/s10668-021-01426-9

Soehaditama, Josua Panatap. (2023). Sustainability in Bank: Deposits, Investment and Interest Rate. *Formosa Journal of Sustainable Research*, *2*(5), 1069–1078. https://doi.org/10.55927/fjsr.v2i5.3912.

Thakor, A. V. (2019). *The Purpose of Banking: Transforming banking for stability and economic growth*. Oxford University Press.

Us, V. (2017). Dynamics of non-performing loans in the Turkish banking sector by an ownership breakdown: The impact of the global crisis. *Finance Research Letters*, *20*, 109–117.