JETIR.ORG ISSN: 2349-5162 | ESTD Year : 2014 | Monthly Issue
JOURNAL OF EMERGING TECHNOLOGIES AND INNOVATIVE RESEARCH (JETIR)
An International Scholarly Open Access, Peer-reviewed, Refereed Journal

Study of Credit Risk Management with Reference to Selected Public and Private Sector Banks in India

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Abstract:

Credit risk is one of the most critical challenges faced by banks, as it directly affects their financial stability and profitability. This study aims to examine and compare credit risk management practices adopted by selected public and private sector banks in India. The research focuses on evaluating key financial indicators such as the Capital Adequacy Ratio (CAR), Return on Assets (ROA), and Return on Net Worth (RoNW) to assess how effectively these banks manage credit risk. Secondary data for the year 2025 has been collected from annual reports and official sources for five public sector banks and five private sector banks. The analysis reveals that while all selected banks meet regulatory capital requirements, private sector banks generally demonstrate stronger capital positions and higher profitability ratios compared to public sector banks. Kotak Mahindra Bank and ICICI Bank lead among private banks, whereas Bank of Maharashtra shows exceptional performance among public Sector banks. The findings highlight the greater efficiency and risk-handling capabilities of private sector banks, underlining the need for public sector banks to adopt more advanced risk management tools and strategies.

Keywords: Credit Risk Management, Capital Adequacy Ratio (CAR), Return on Assets (ROA), and Return on Net Worth (RoNW), Public Sector Banks, Private Sector Banks

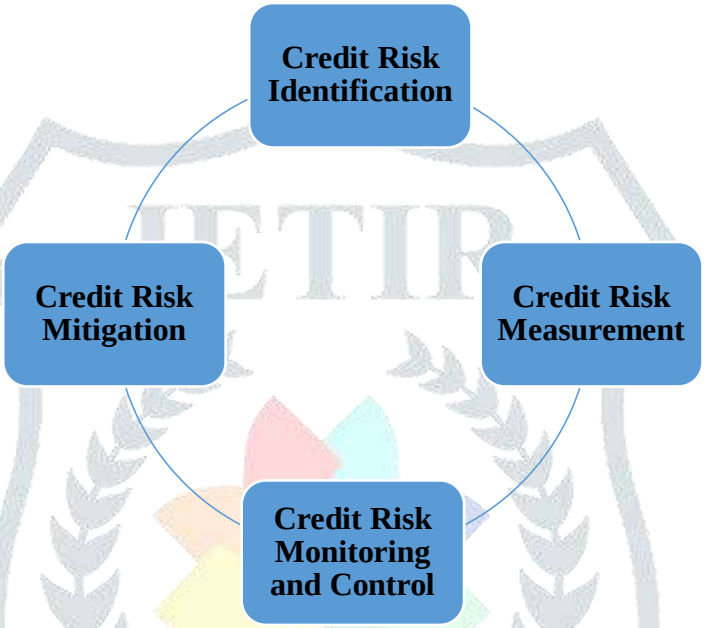
[1] Introduction:

Credit risk is one of the oldest and most significant risks faced by banks worldwide. It refers to the possibility that borrowers may fail to repay their loans, leading to financial losses for banks. Since lending is a core function of banks, managing credit risk is essential. Over the years, credit risk has become widespread, as companies borrow to expand, small businesses seek loans to grow, and individuals use credit for personal needs. Effective credit risk management helps banks maximize their returns while keeping risk levels under control. Banks must monitor credit risk at both individual and portfolio levels while considering its impact on other financial risks. Proper risk management ensures financial stability and long-term success.

Both public and private sector banks must manage credit risk efficiently to remain profitable and protect stakeholders' interests. Public sector banks operate under government ownership and often face regulatory restrictions, while private sector banks have more flexibility and use advanced risk assessment tools. Since credit risk is a leading cause of banking crises worldwide, banks need to identify, measure, monitor, and control this risk while maintaining sufficient capital. This study compares the credit risk management practices of selected public and private sector banks in India. By analysing key financial ratios such as the Capital Adequacy Ratio (CAR), Return on Net Worth (RoNW), and Return on Assets (ROA), the study provides insights into how different banking sectors handle credit risk.

[2] Credit Risk Management Framework;

Credit risk management is an essential process that helps banks identify, measure, monitor, and reduce credit risk. Proper management ensures financial stability and minimizes potential losses. The credit risk management framework is divided into four key parts.



(2.1) Credit Risk Identification

The first step in managing credit risk is to identify potential risks before granting loans. Banks assess borrowers' financial health, repayment capacity, credit history, and past loan performance. They also analyse economic conditions, industry risks, and market trends that may affect a borrower's ability to repay. Identifying risks at an early stage helps banks make informed lending decisions and avoid future losses.

(2.2) Credit Risk Measurement;

After identifying risks, banks measure their potential impact using various financial models and risk assessment tools. They calculate the probability of default (PD), loss given default (LGD), and exposure at default (EAD). These measurements help banks determine the level of risk involved in lending and whether the loan should be approved. Risk measurement ensures that banks lend responsibly and maintain a balanced credit portfolio.

(2.3) Credit Risk Monitoring and Control;

Once a loan is issued, banks continuously monitor the borrower's financial condition and repayment behaviour. Regular tracking of loan accounts helps identify early warning signs of financial distress. Banks use credit scoring systems, periodic financial reviews, and automated monitoring tools to detect potential defaults. If risks increase, banks take corrective actions such as restructuring loans, increasing provisions, or tightening lending policies. Proper monitoring helps prevent defaults and reduces financial losses.

(2.4) Credit Risk Mitigation;

To reduce credit risk, banks implement various risk mitigation strategies. They may require collateral, guarantees, or co-signers to secure loans. Diversification of the loan portfolio across different sectors and industries helps reduce the impact of defaults. Setting credit limits, improving underwriting standards, and using credit derivatives are other common risk mitigation techniques. These measures help banks protect themselves from excessive losses and ensure financial stability.

Banks use financial ratios (like Capital Adequacy Ratio, Return on Assets Ratio, and Return on Net Worth Ratio**)** to measure and monitor credit risk effectively. CAR helps assess whether a bank has enough capital to cover potential losses, while ROA measures how efficiently a bank uses its assets to generate profit, and RONW evaluates profitability in relation to shareholders' equity. Regular monitoring of these ratios helps banks detect financial weaknesses, such as

excessive credit risk or inefficient asset utilization. If CAR declines or ROA and RONW fall, banks can take corrective actions like adjusting credit policies or increasing capital reserves. Including these ratios in credit risk management provides a more detailed assessment, but their use depends on the level of analysis required.

[3] Concept of Capital Adequacy Ratio, Return on Asset Ratio and Return on Networth Ratio:

(3.1) Capital Adequacy Ratio (CAR);

The Capital Adequacy Ratio (CAR) is a measure of a bank's financial strength. It shows how well a bank can handle losses and protect depositors. Banks must keep enough capital to meet their obligations and unexpected risks. CAR is also called the Capital to Risk (Weighted) Assets Ratio (CRAR). It compares a bank's capital with its risk-weighted assets and liabilities. A higher CAR means the bank is in a safer position and less likely to fail. Central banks and regulators set minimum CAR requirements. This helps prevent banks from taking too much risk and facing financial problems. A strong CAR improves trust in the banking system and ensures stability.

Formula

$$\text{CAR} = \frac{(\text{Tier 1 Capital} + \text{Tier 2 Capital})}{\text{Risk Weighted Assets}}$$

Where:

- **Tier 1 Capital**: Core capital, including equity capital and disclosed reserves (most reliable).
- **Tier 2 Capital**: Supplementary capital, including revaluation reserves, hybrid instruments, and subordinated debt.
- **Risk-Weighted Assets (RWA)**: Total assets adjusted for credit, market, and operational risks.

According to Basel III norms, banks are required to maintain a minimum CAR of 8% globally, but in India, the Reserve Bank of India (RBI) mandates a higher minimum of 9% for scheduled commercial banks to ensure financial stability.

(3.2) Return on Asset Ratio:

Return on Asset (ROA) is a financial ratio that shows how efficiently a bank uses its assets to generate profit. It helps in measuring the profitability of a bank in relation to its total assets**.** A higher ROA indicates better asset utilization and profitability, while a lower ROA suggests inefficiencies in asset management.

In India, banks typically have an ROA between 0.5% and 1.5%**,** with 1% or higher considered good for profitability.

Formula

$$Return\ on\ Asset = \frac{Net\ Income}{Total\ Assets}$$

Where,

- **Net Income** is the profit a bank earns after deducting all expenses, including interest, taxes, and operational costs.
- **Total Assets** include all resources owned by the bank, such as cash, loans, and investments.

(3.3) Return on Networth Ratio:

Return on NetWorth (RONW) is a financial ratio that shows how much profit a bank earns compared to its net worth. It helps in measuring how efficiently the bank is using its shareholders' funds to generate profit. A higher RONW means the bank is using its funds effectively and generating good profits for its shareholders. A lower RONW suggests inefficiency in profit generation.

In India, a RONW of 10% or higher is generally considered good for banks, though it varies depending on economic conditions and banking policies.

Formula

$$\text{RONB} = \frac{Net\ Income}{Shareholder's equity}$$

Where,

- **Net Income**: This refers to the profit a bank earns after deducting all expenses, including taxes and operating costs. It represents the actual earnings available for shareholders.
- **Shareholders' Equity**: This is the total amount of money invested by the bank's owners (shareholders) and retained earnings. It reflects the bank's net worth.

[4] Review of Literature:

[4.1] Bayyoud and Sayyad (2015) conducted a study on the banking sector in Palestine to examine how credit risk management influences profitability. They gathered data over a five-year period from 2010 to 2014 and analyzed it using a regression model. In their analysis, Return on Equity (ROE) was used to represent profitability, while the Non-Performing Loan Ratio (NPLR) was used as an indicator of credit risk. The results of the study showed that there was no significant relationship between credit risk and the financial performance of commercial and investment banks in Palestine.

[4.2] Isanzu, J., Akhunjonov, U., & Obrenovic, B. (2017) have studied "The impact of credit risk on the financial performance of Chinese banks". They analyzed data from five commercial banks over the period from 2008 to 2014. Credit risk was measured using indicators such as non-performing loans, loan impairment charges, capital adequacy ratio (CAR), and impairment loan reserves, while profitability was measured by return on assets (ROA). The panel data analysis revealed that non-performing assets (NPA) and CAR significantly influenced the profitability of the banks. The study highlighted that effective credit risk management is essential for enhancing the financial performance of banks.

[4.3] Mei, C. L., Nsiah, T. K., Barfi & Bonsu, M. O.. (2019) conducted a study of **"**Credit risk and bank profitability of commercial banks in Ghana Stock Exchange (GSE)."They used secondary data collected over an eight-year period, from 2010 to 2018. To represent credit risk, they considered indicators such as the non-performing loan ratio, cost per loan asset, capital reserve ratio, and asset growth ratio. These same indicators were also used to measure profitability. The data was analyzed using the Classical Linear Regression Model (CLRM). The study found a negative relationship between credit risk and profitability, indicating that implementing effective credit risk management strategies is essential for improving bank performance.

[4.4] Munangi, E., & Bongani, A. (2020) studied "An empirical analysis of the impact of credit risk on the financial performance of South African banks". "The study covers 18 banks in South Africa over the period from 2008 to 2018." A panel data regression technique was deployed to analyse the data by considering non-performing loans (NPLs) as an indicator of credit risk and return on equity (ROE) and return on assets (ROA) as variables for the financial measurement of the banks under study. The findings revealed that whereas credit risk had a negative influence on financial performance, growth had a favorable impact on bank financial performance

[4.5] Noman, Pervin, Chowdhury, and Banna (2015) studied "The impact of credit risk on the financial performance of eighteen private commercial banks in Bangladesh". They used unbalanced panel data covering the period from 2003 to 2013. The credit risk indicators in the study included the loan loss reserve to gross loan ratio (LLRGL), loan loss reserve to non-performing loan ratio (LLRNPL), capital adequacy ratio (CAR), and non-performing loan to gross loan ratio (NPLGL). Profitability was measured using Return on Average Assets (ROAA), Return on Average Equity (ROAE), and Net Interest Margin (NIM). To analyse the data, the researchers applied the OLS random effect model, Generalized Least Squares (GLS), and the system GMM method. Their findings showed that both NPLGL and LLRGL had a strong negative effect on all three profitability indicators, and CAR had a significantly negative impact specifically on ROAE.

[4.6] Poudel, R. P. S. (2012) studied how credit risk management affects the financial performance of commercial banks in Nepal. The study looked into different parts of credit risk management and how they influence bank profits. It used secondary data collected over 11 years (from 2001 to 2011) from the financial reports of 31 banks in Nepal. The data was analysed using descriptive statistics, correlation, and regression methods. Key measures included the capital adequacy ratio, cost per loan asset, and default rate. The findings showed that all these factors had a negative effect on

bank performance. Among them, default risk was found to have the strongest impact on bank profitability. The study suggested that banks should create strategies to reduce credit risk in order to improve their financial performance.

[4.7] Said, A. (2013) explored the relationship between different types of risks—credit risk, operating risk, and liquidity risk—and the efficiency of Islamic banks in the MENA (Middle East and North Africa) region. The study was conducted in three stages using data from 2006 to 2009. In the first stage, a nonparametric method called Data Envelopment Analysis (DEA) was applied. The second stage involved analyzing financial ratios, and the third stage assessed the correlation between the identified risks and bank efficiency using Pearson Correlation. The results revealed that both operating risk and credit risk were negatively related to bank efficiency, while liquidity risk showed little to no connection with the banks' performance.

[4.8] Sheeba, J. (2017) conducted "A study on the impact of credit risk on the profitability of State Bank of India (SBI)". The research used secondary data collected from the annual reports of the State Bank of India over a 20-year span, from 1996 to 2016. The data was analyzed using multiple regression techniques. The study found that credit risk has a significant negative impact on the bank's profitability. It also recommended that the bank strengthen its credit risk management practices by effectively reducing non-performing assets and managing its leverage more efficiently.

[4.9] Shetty, C., & Yadav, A. S. (2019) studied the "Impact of financial risks on the profitability of commercial banks in India". The study used Return on Assets (ROA) and Return on Equity (ROE) as measures of profitability, while financial risks were represented by interest rate risk (IRR) and foreign exchange risk (FER). The researchers applied panel data regression models with both fixed and random effects to evaluate the data. The results revealed that ROE had a weak correlation with IRR, whereas ROA was significantly affected by IRR. In addition, both ROA and ROE were found to be strongly influenced by FER.

[5] Objectives of the Study

1. To compare the credit risk management practices between selected public and private sector banks in India.
2. To evaluate the financial performance of selected public sector and private sector banks using Capital Adequacy Ratio, Return on Net Worth Ratio, and Return on Asset Ratio.
3. To identify trends and differences in risk management between public and private sector banks.
4. To suggest the measures for improving credit risk management practices of public and Private sector banks of India.

[6] Research Methodology:

[6.1] Sources of Data: This study is based on secondary data. The data has been collected from various sources, including the annual reports of selected public and private sector banks for the year 2024. Other sources include literature books, financial magazines, research journals, and the official websites of the selected banks. Additionally, information has been gathered from the website of the Reserve Bank of India (RBI) to ensure accuracy and authenticity.

[6.2] Sampling Technique: The banks selected for this study were chosen using the sampling method**.** This method was used to select public and private sector banks based on data availability and relevance to the research objectives. The study focuses on five public sector banks and five private sector banks to ensure a balanced comparison of credit risk management practices.

[6.3] Sample Size:
The study includes a total of 10 banks**,** with five from the public sector and five from the private sector**.**

- **Public Sector Banks:** State Bank of India (SBI), Bank of Baroda (BOB), Punjab National Bank (PNB), Bank of Maharashtra (BOM), and Central Bank of India (CBI).
- **Private Sector Banks:** Kotak Mahindra Bank, ICICI Bank, Axis Bank, IndusInd Bank, and HDFC Bank.

[6.4] Statistical Tools:

To analyse the financial performance and credit risk management of the selected banks, various statistical tools have been used. These tools include:

- **Financial Ratios:** The study uses financial ratios like Capital Adequacy Ratio (CAR), Return on Assets (ROA), and Return on Net Worth (RONW) to assess the financial stability and profitability of the banks.
- **Descriptive Analysis:** Basic statistical methods such as percentage analysis and comparison are used to interpret the data.
- **Trend Analysis:** The study examines trends in credit risk management by comparing data across selected banks.
- **Graphical Representation:** Data has been presented using tables, charts, and graphs to ensure clarity and better understanding.

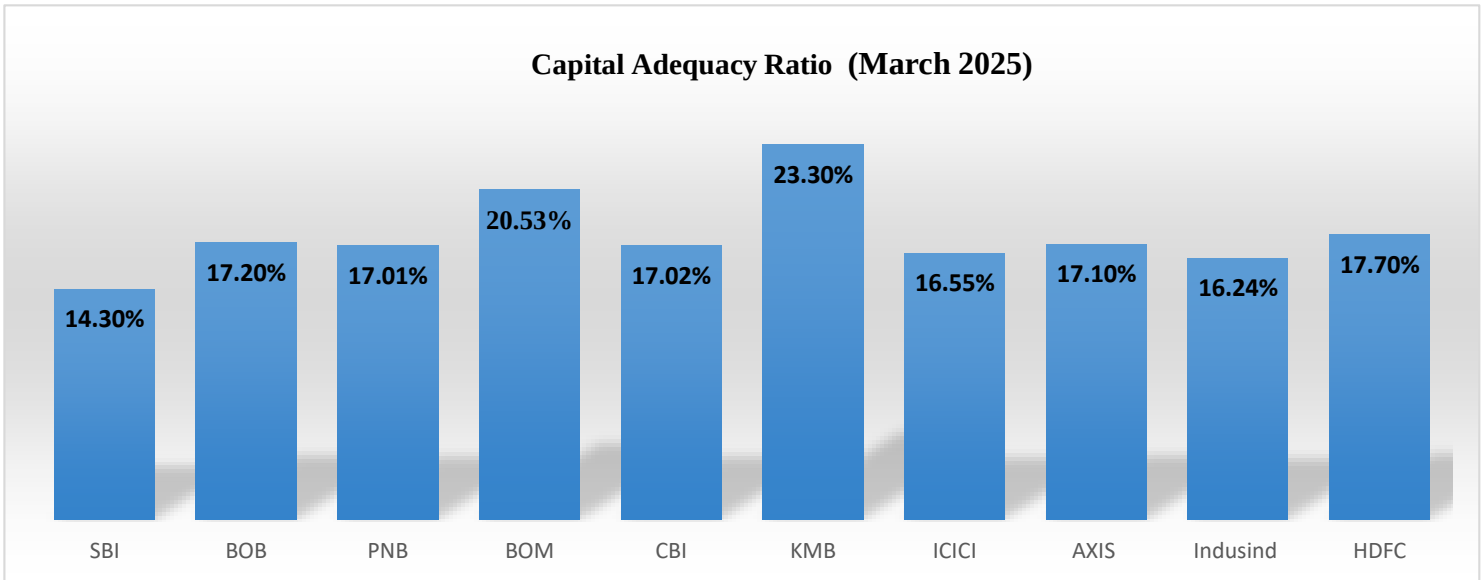
[7] Need for the Study:

Credit risk is a major challenge for banks as it directly affects their financial stability and profitability. Public and private sector banks in India use different methods to manage credit risk, and understanding these differences is important for improving banking practices. After liberalization, credit risk management has become more important in the Indian economy. Banks face challenges in identifying and managing risks, as risk is a natural part of banking operations. Since banks act as intermediaries between those with surplus funds and those in need of resources, managing credit risk is crucial. This study analyses how banks handle credit risk by examining financial ratios like Capital Adequacy Ratio (CAR), Return on Net Worth (RoNW), and Return on Assets (ROA). Effective risk management helps banks maintain financial security and stability. The findings will be useful for banks, policymakers, investors, and researchers to improve decision-making and strengthen risk management practices in the banking sector.

[8] Analysis of Capital Adequacy Ratio, Return on Asset Ratio and Return on Networth Ratio:

(8.1) Analysis of Capital Adequacy Ratio (CAR);

Banks	CAR (March 2025)
SBI	14.3%
BOB	17.2%
PNB	17.01%
BOM	20.53%
CBI	17.02%%
KMB	23.3%
ICICI	16.55%
AXIS Bank	17.1%
Indusind	16.24%
HDFC	17.7%



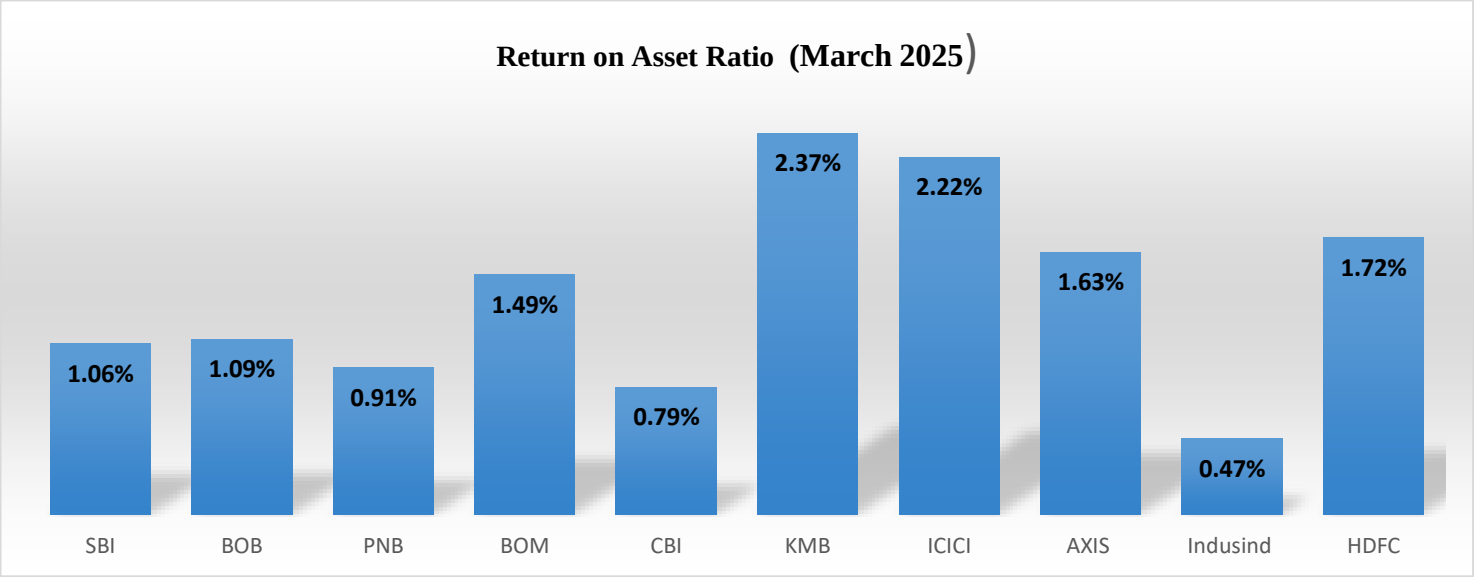
Among the public sector banks, the Bank of Maharashtra (BOM) has the highest CAR at 20.53% as of March 2025. This means BOM is in a very strong financial position. It has a solid capital base to deal with risks and support its operations. Next, BOB has a CAR of 17.2%, followed closely by CBI at 17.02%, and PNB at 17.01%. These banks show good financial health and meet regulatory capital requirements. However, SBI has the lowest CAR among public banks at 14.3%. Although this is still safe and above the minimum requirement, it shows less of a buffer compared to others.

In the case of private sector banks, KMB stands out with the highest CAR at 23.3% (2024 data). This indicates excellent capital strength and a very low risk of default. HDFC Bank also has a healthy CAR of 17.7%, showing good financial stability. AXIS Bank has a CAR of 17.1%, similar to some public sector banks like PNB and BOB. ICICI Bank follows with 16.55%, and IndusInd Bank has the lowest CAR among private banks at 16.24%, which is still safe and above the required level.

Overall, all banks listed are financially stable and meet the regulatory CAR standards. However, private sector banks generally have higher CARs than public sector banks, showing stronger capital positions on average. KMD and BOM are the strongest in their respective sectors. A higher CAR helps banks lend more and face unexpected losses better, making it a key measure of their safety and reliability.

(8.2) Analysis of Return on Asset Ratio (ROA);

Banks	ROA (March 2025)
SBI	1.06%
BOB	1..09%
PNB	0.91%
BOM	1.49%
CBI	0.79%
KMB	2.37%
ICICI	2.22%
AXIS Bank	1.63%
Indusind	0.47%
HDFC	1.72%



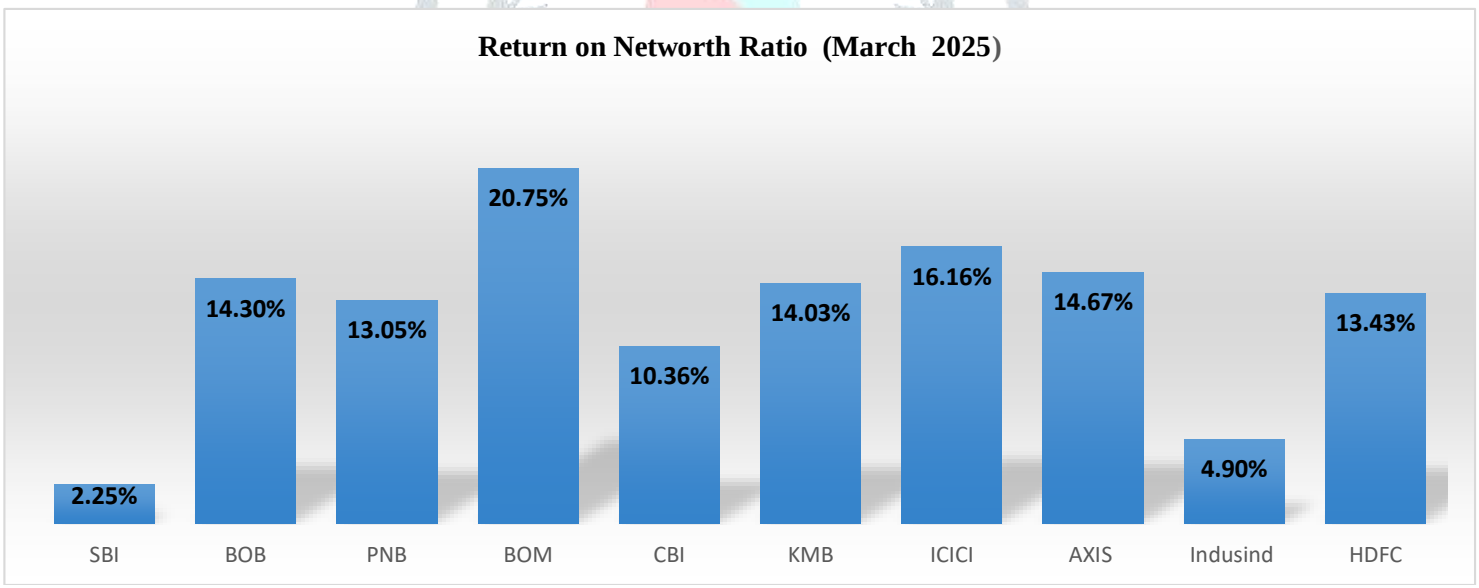
Looking at the public sector banks as of March 2025, the Bank of Maharashtra (BOM) has the highest ROA at 1.49%. This indicates that BOM is using its assets very efficiently to earn profits. Bank of Baroda (BOB) follows with an ROA of 1.09%, and State Bank of India (SBI) is close behind at 1.06%. These values show fairly good profitability for large public banks. Punjab National Bank (PNB) has a slightly lower ROA of 0.91%, while Central Bank of India (CBI) has the lowest ROA among public banks at 0.79%. This means CBI is earning the least profit compared to its asset base.

In the private sector banks, Kotak Mahindra Bank leads with the highest ROA of 2.37% in 2025. This shows very strong profitability and excellent use of its assets. ICICI Bank also performs well with an ROA of 2.22%, followed by HDFC Bank with 1.72%. These banks are clearly more efficient in earning profits compared to public banks. AXIS

Bank has a moderate ROA of 1.63%, still better than most public banks. However, IndusInd Bank has the lowest ROA among all the private banks at 0.47%, which shows poor profitability and inefficient asset use.

(8.3) Analysis of Return on Networth Ratio (RONW);

Banks	RoNW (March 2025)
SBI	2.25%
BOB	14.30%
PNB	13.05%
BOM	20.75%
CBI	10.36%
KMB	14.03%
ICICI	16.16%
AXIS Bank	14.67%
Indusind	4.9%
HDFC	13.43%



Looking at the public sector banks as of March 2025, Bank of Maharashtra (BOM) has the highest RoNW at 20.75%. This means BOM is very efficient in generating high returns on its shareholders' funds. Bank of Baroda (BOB) is next with a strong RoNW of 14.30%, followed by Punjab National Bank (PNB) at 13.05%. These banks show good profitability. Central Bank of India (CBI) has a lower RoNW of 10.36%, and SBI has the lowest RoNW among public banks at just 2.25%, which indicates low returns for its shareholders.

Among the private sector banks, ICICI Bank has the highest RoNW at 16.16%, showing strong performance and high returns to its investors. AXIS Bank also performs well with a RoNW of 14.67%, and Kotak Mahindra Bank is close behind at 14.03%. These banks are clearly efficient in using their equity to earn profits. IndusInd Bank has a lower RoNW of 4.9%, which suggests weaker performance compared to its peers. HDFC Bank reports a RoNW of 13.43%, which is healthy and indicates good profitability.

[9] Findings of the Study:

1. All selected banks meet the minimum regulatory Capital Adequacy Ratio requirements, indicating financial stability across both public and private sector banks.
2. Private sector banks generally maintain a higher CAR than public sector banks, reflecting stronger capital positions and better preparedness to absorb financial shocks.
3. Kotak Mahindra Bank (23.3%) and Bank of Maharashtra (20.53%) recorded the highest CARs in the private and public sector respectively, showing robust financial strength and risk-handling capacity.
4. BOM also achieved the highest Return on Assets (ROA) among public sector banks at 1.49%, indicating efficient use of assets for profitability.

5. Among private sector banks, Kotak Mahindra Bank (2.37%) and ICICI Bank (2.22%) reported the highest ROA**,** reflecting excellent operational efficiency and asset utilization.
6. In terms of Return on Net Worth (RoNW), BOM (20.75%) and ICICI Bank (16.16%) emerged as the top performers in their respective sectors, suggesting high profitability and effective equity management.
7. SBI showed the lowest performance among public banks in both RoA (1.06%) and RoNW (2.25%)**,** highlighting comparatively weaker profitability despite being a large public sector bank.
8. IndusInd Bank reported the lowest ROA (0.47%) and a low RoNW (4.9%) among private banks**,** indicating inefficiencies in asset use and lower returns to shareholders.
9. Overall, private sector banks outperformed public sector banks in terms of profitability ratios (ROA and RoNW), suggesting better efficiency, asset utilization, and shareholder value generation.
10. Bank of Maharashtra stands out among public banks as the most financially sound and profitable**,** whereas ICICI and Kotak Mahindra lead the private sector in terms of both capital strength and profitability.

[10] Limitations of the Study:

- The study relies on secondary data**,** which may have limitations in terms of completeness and accuracy.
- It covers only 10 banks**,** which may not represent the entire banking sector.
- The study is limited to data from 2025**,** and financial conditions may change over time.
- It does not analyse the effect of technological advancements like artificial intelligence and automation on credit risk management.
- It does not assess the role of cybersecurity threats in credit risk, which is a growing concern for banks
- The study does not examine international banking practices, which could offer useful comparisons.

[11] Conclusion;

The study reveals that both public and private sector banks in India are maintaining the required Capital Adequacy Ratio (CAR), indicating overall financial stability. However, private sector banks generally exhibit stronger capital positions and better profitability, as reflected in their higher Return on Assets (ROA) and Return on Net Worth (RoNW) ratios. Kotak Mahindra Bank and ICICI Bank stand out as top performers among private banks, while Bank of Maharashtra leads among public sector banks in all three financial indicators. Despite the public banks showing improved performance, their profitability still lags behind that of private banks. Overall, the study highlights the more efficient credit risk management and stronger financial health of private sector banks, while also underlining the need for public sector banks to further enhance profitability and capital efficiency.

[12] Suggestions:

1. Public sector banks should strengthen their profitability strategies by improving asset utilization and cost efficiency to enhance their ROA and RoNW.
2. Banks with lower CAR should consider raising additional capital through equity or debt instruments to improve their capital buffers and ensure resilience against future financial shocks.
3. Both public and private sector banks should adopt advanced credit risk management tools, such as credit scoring models, AI-based risk assessment, and early warning systems to better identify and mitigate credit risks.
4. Regular monitoring and review of asset quality and loan performance should be enforced, especially in public sector banks, to reduce non-performing assets (NPAs) and improve overall financial health.
5. Training and development programs in risk management should be enhanced, particularly in public sector banks, to strengthen internal risk governance and decision-making processes.
6. Banks should diversify their loan portfolios across sectors and borrower types to reduce concentration risk and improve credit risk spread.
7. Regulators may encourage greater transparency and disclosure in banks' risk management practices to help stakeholders make better-informed decisions and promote healthy competition.

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