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Research on credit control and management of commercial banks

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Abstract

With mounting economic pressures in China, commercial banks are witnessing a continuous rise in non-performing loans, making credit risk management a renewed focus of attention. Effective risk management and control in credit operations serve as both essential require-ments for maintaining the healthy development of China's financial market and vital strate-gies for commercial banks to sustain competitiveness. When handling complex credit port-folios, how to effectively mitigate credit risks has become a critical challenge requiring in-depth research by grassroots commercial banks. This paper analyzes existing models and challenges in credit risk management within Chinese commercial banks, while proposing practical approaches to enhance risk management capabilities through real-world imple-mentation.

Keywords

Marketization; commercial bank; credit business; risk control

1. Introduction

In the development of commercial banks, risk management and control serve as a critical strategic component. Strictly managing credit business risks ensures sustained competitiveness for commercial banks. However, current risk control practices in China's commercial banking sector still face challenges that hinder sustainable growth. Only by fully recognizing the necessity of credit risk management, comprehensively analyzing existing issues, and implementing effective solutions can commercial banks maintain competitive advantages in the industry. Although recent years have seen improvements in risk management frameworks and operational standards, China's commercial banks still exhibit uneven risk management capabilities across organizational structures, risk management systems, and technical implementation compared to developed Western economies. Strengthening research on credit risk management in Chinese commercial banks will help propose strategies to maximize risk mitigation while laying a solid foundation for adapting to the current macroeconomic environment.

2. Overview of credit granting business of commercial banks

The credit granting business, also known as lending operations, serves as the primary channel for commercial banks to utilize funds and generate operational profits. It can be categorized into broad and narrow interpretations. Broadly speaking, credit granting primarily includes loans, guarantee products, trade financing instruments, and other innovative financing solutions. In a narrower sense, it specifically refers to loan operations. This article focuses on the narrow interpretation of credit granting. Building upon this framework, commercial banks' credit granting activities can be further segmented from multiple perspectives. Given the diverse product categories, these operations are mainly classified into two dimensions: First, based on guarantee mechanisms, they fall into three categories: unsecured loans, guaranteed loans, and bill discounting. Guaranteed loans are further subdivided into suretyship, mortgage, and pledge-based financing. Second, according to loan quality status, they are categorized into four types: normal, overdue, non-performing, and bad debts, with the latter three classified as non-performing loans.[3]

3. Types of credit risk in China's commercial banks[2]

3.1. Risk of distortion in credit investigation

(1) Defects in enterprise data. In addition to the reasons such as imperfect accounting and auditing systems, the main reason for defects in enterprise data is that the financial statements provided by enterprises are not true, but they are falsified to meet the bank's credit conditions, that is, the financial statements are false.
(2) Deficiencies in the investigation process and methodology. In China's commercial banks' actual pre-loan credit review procedures, there exist multiple flaws in the investigation processes and methods, with insufficiently clear and stringent pre-loan review standards. These issues manifest in four aspects: First, uneven professional competence among client managers. Second, failure to conduct on-site enterprise inspections. Third, concealment of enterprises' true risk information. Fourth, inadequate understanding of related-party transactions.

3.2. Risk of inaccurate positioning of credit risk

The positioning of credit risk requires banks to have two requirements. First, commercial banks should understand their own risk management level and tolerance, clarify their risk preference and risk control ability, have a thorough understanding of the overall asset quality, and pay attention to avoiding large risks. Second, commercial banks should fully understand the credit customers.

3.3. Risk of credit decision error

Common pitfalls in credit decision-making primarily manifest in five key areas: First, the lack of separation between loan approval and credit assessment processes, resulting in compromised independence. Second, decision-makers often exhibit deficiencies in professional expertise, practical experience, and operational capabilities. Third, due diligence personnel frequently fail to maintain impartiality, being pressured or influenced by higher-level management or external stakeholders. Fourth, cutthroat competition among banks drives some decision-makers to prioritize short-term gains over long-term strategic considerations.

3.4. Poor management after credit granting

With the continuous expansion of credit granting scale in China's commercial banks, account managers are increasingly busy, and post-loan inspections have become mere formalities. Coupled with the relatively long post-loan management cycle for credit granting by commercial banks, account managers tend to become complacent, resulting in discontinuous supervision and control over credit-granting enterprises, as well as a tendency to prioritize lending over management.

4. Causes of credit risk in China's commercial banks[1]

4.1. Inadequate internal restraint mechanism

Currently, China's commercial banks primarily implement the president responsibility system at their grassroots branches. This system involves bank presidents, vice presidents, credit risk supervisors, and discipline inspection committee secretaries overseeing operations. However, higher-level banks that should bear regular supervision and audit responsibilities have failed to fulfill these duties as required. Additionally, while each grassroots bank has a vice president responsible for credit risk management, their authority remains under the president's control, preventing effective oversight. Furthermore, although financial institutions have established specialized business risk review committees in grassroots banks, the issue lies in the fact that committee members are all internal staff. Their professional competence remains questionable, and they cannot operate independently from the banks. Consequently, the scientific validity and practical significance of decisions made by these committees remain uncertain. From the perspective of higher-level banks, many commercial banks prioritize rapid business growth and profit enhancement over conducting necessary operational reviews of grassroots branches. They delegate all credit approval authority to these lower-level units, allowing unreviewed credit approvals to proceed without proper scrutiny. Some grassroots banks lack dedicated personnel for credit management, and even when such positions exist, staff qualifications fall short of required standards, undermining the intended regulatory function.

4.2. Unreasonable human resource policy

Commercial banks should promptly recognize the importance of professional ethics in their workforce, making business acumen and service orientation key evaluation criteria for hiring staff. However, in reality, many credit officers at grassroots branches lack practical experience. Even those who pass bank-organized exams often struggle to accurately assess corporate operational cycles due to insufficient hands-on exposure. Their credit analysis remains theoretical rather than grounded in real-world scenarios. Furthermore, these junior credit professionals are typically trained through a tiered system without specialized mentorship or professional connections. After accumulating limited experience and client networks, they frequently leave for better opportunities—a trend that undermines risk management in commercial banks' credit operations.

4.3. There are problems in control activities

The so-called control activities constitute a complex operational framework encompassing incompatible duty segregation, bank authorization and approval controls, and banking accounting system management. As a critical component of credit operations, commercial banks face challenges in implementing loan management separation principles. Current practices reveal that many grassroots commercial banks fail to enforce this principle, with client managers retaining post-loan oversight responsibilities. This systemic flaw manifests in three key areas: Firstly, banks cannot promptly identify risks inherent in credit operations. Loan officers' habitual decision-making patterns hinder objective risk assessment. Secondly, post-approval condition fulfillment remains problematic. While loan approval departments typically establish risk mitigation criteria, some managers prioritize loan volume over compliance requirements—a practice undermining effective risk control. Lastly, centralized authority over both loan and credit operations grants unchecked discretion to individual staff, creating opportunities for favoritism and embezzlement.

5. Countermeasures to improve the credit risk management of China's commercial banks

Sub-branches of commercial banks lack independent legal status and operate exclusively under the authorization of their parent headquarters, which must assume corresponding civil liabilities. When internal controls at the grassroots level prove inadequate or risk management proves ineffective, resulting in credit-related consequences, the parent bank is ultimately held responsible for addressing these issues. This operational model clearly contradicts the requirements for sustainable development in commercial banking. Therefore, to strengthen risk control in credit operations, commercial banks should focus on the following key areas in future development.

5.1. Credit risk management strategy

(1) Build a credit risk early warning system quickly.

Credit granting operations inherently carry risks. Proactively identifying and warning about potential risks before they materialize is essential to nip credit risks in the bud. Therefore, banks should analyze key indicators including economic sentiment indices, asset costs, opportunity costs, loan interest rates, and profitability metrics to establish a credit risk early-warning system. This enables predictive risk assessment and proactive risk mitigation before negative impacts occur. Additionally, commercial banks could collaborate with specialized analytical firms to develop credit risk measurement models, thereby refining their credit risk early-warning mechanisms.

(2) Optimize the credit granting operation mechanism.

The current credit granting operations in China's commercial banks face challenges including multiple management entities and complex hierarchical structures, which directly hinder the development of credit services. Under these circumstances, optimizing the credit mechanism has become imperative. Head offices must grant independent authority to risk management departments, ensuring performance evaluations are conducted by higher-level branches or headquarters rather than local branches, thereby establishing vertical management systems that guarantee operational independence. In accordance with strict loan approval separation regulations and internal control requirements, the credit risk management framework should be structured around a tripartite system of checks and balances: decision-making, execution, and supervision. This requires developing relatively independent systems for risk investigation, review, approval, and oversight.

(3) Improve the credit risk rating system.

By collaborating with rating agencies, commercial banks should establish a credit evaluation and rating framework under their leadership. Government departments must also clarify qualification requirements through legislation. As pivotal players in China's socialist market economy development, commercial banks possess significant data advantages. Through partnerships with credit rating agencies to create platforms for assessing corporate and individual creditworthiness, we can enhance the rationality of credit risk rating systems. Simultaneously, relevant government authorities should strengthen comprehensive oversight of credit rating institutions and the industry, ensuring these entities fulfill their responsibilities while improving the stability of commercial banks' credit granting operations.

5.2. Improvement strategies of personal credit granting

(1) Strengthen the audit of the use of funds.

Review the use and use plan of funds to confirm whether they are reasonable and avoid the problem of fraud of credit loans. Common loan purposes mainly include housing loans, auto loans, overseas study loans, small credit loans, etc. In addition to these common loans, special review is required.

(2) To strengthen the analysis of repayment ability.

It is necessary to review the source of repayment funds, determine whether the borrower has stable repayment ability, confirm their occupation and credit evaluation level, and also need to investigate the borrower's occupation, seniority, assets, etc., so as to reduce credit risk as far as possible.

(3) To do a good job of regular credit outlook.

We should select credit granting clients and strictly control the access of credit granting clients. In new customer marketing, we should take the credit granting policies of commercial banks as the guide, focusing on industries supported by credit granting policies and high-quality clients. Chinese commercial banks should adjust industrial structure and actively expand emerging industries.

(4) The credit information should be maintained.

Commercial banks have all kinds of information about borrowers, so they must strictly comply with relevant industry norms to manage and maintain the information of credit customers, establish borrower information files, and improve the control effect of credit risk.

5.3. Improvement strategies of enterprise credit granting

(1) Strengthen the analysis of enterprise data.

Conduct comprehensive analysis of corporate metrics including current ratio, quick ratio, cash flow ratio, and interest coverage ratio to assess financial health. Verify the stability of a borrower's cash flow by evaluating indicators such as financial statement reliability to identify potential risks. Additionally, evaluate operational effectiveness through systematic examination of organizational structure and leadership capabilities to determine the practical value of internal controls. Industry-specific analysis is equally crucial: thoroughly understand sector trends, investigate market potential for core products, and assess industry prosperity levels. Finally, conduct thorough evaluations of collateral quality – including market valuation, liquidity, guarantor credibility, and professional qualifications – to ensure guarantee validity. Chinese commercial banks should implement industrial restructuring by actively developing emerging sectors to optimize economic structures. For new credit applicants, rigorously review business operations and creditworthiness, particularly maintaining strict entry criteria for industries with severe pollution or overcapacity.

(2) To strengthen the control of group-related risks.

Strengthen the review of a series of contents such as the internal structure of the enterprise, the mode of capital operation and the internal related transactions, do a good job in the supervision and control of related transactions, and avoid the group customers from using related transactions to transfer or trade funds.

(3) The functions of relevant levels related to credit granting business should be strengthened.

Credit approval officers must evaluate creditworthiness assessments based on credit scores and formulate tailored proposals. The credit review panel then assesses risk levels of these proposals in accordance with legal regulations, ultimately determining whether to grant credit to enterprises and evaluating potential credit risks. Management should establish the maximum credit risk rating for enterprises by understanding the bank's risk tolerance, while conducting risk evaluations of subordinate credit cases. This process ensures effective internal control and risk management in commercial banking credit operations.

6. Conclusion

Credit granting services refer to financial institutions' provision of funding to non-financial entities such as businesses and individuals. In a broader sense, this encompasses credit guarantee services for clients. These operations involve diverse service subjects including individual and corporate clients, while covering both long-term and short-term credit facilities, demonstrating notable complexity. Moving forward, banks must strengthen risk assessment mechanisms for credit granting, implement risk control measures for corporate and individual clients, and enhance the stability and security of credit services.

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