

## Credit Management

### Principles of good lending

- Safety
- Liquidity
- Profitability
- Spread
- Purpose
- End use
- Need based finance
- Viability oriented instead of security oriented lending
- Own stake
- National priorities

#### Safety

- It is a major concern of a Banker.
- It essentially means ability of a banker to critically assess the borrower's capacity to repay the amount lent to him.
- This factor now assumes great importance due to stringent NPA norms.

#### Liquidity

- It deals with Bankers ability to get advance liquidated expeditiously.
- The deposits are payable on demand or at short notice and hence banker should not lock up funds in long-term loans.
- This aspect has now assumed great importance due to introduction of ALM.

#### Profitability

- Profitability is the key word for every business organization and Bank is not the exception to it.
- The profit is the result of sound business decision and is related to cost of funds and other related risks.

#### Spread

- You should not keep all eggs in one basket.
- Bank should strike a balance between short term, medium term & long term loans.
- Bank should not concentrate advances to one industry or one field.
- Care should also be taken for giving B49 loan to one employer.

### Purpose

- Lending should be for an approved purpose.
- All Banks lend for productive purpose as well as for consumption purpose.
- Bank should formulate its lending policy in respect of purpose.

### End Use

- Banker should invariably ascertain that money lent has been used for the purpose for which the same was granted.
- Banker should obtain supporting papers in respect of same.

### Need based finance

- The Banker should ascertain the credit needs of the borrower and should lend accordingly.
- Banker should neither over finance nor under finance.

### Viability oriented instead of security oriented lending

- Advance should be granted with due regard to profitability of the business & looking into character, capacity and capital of the borrower.
- Security should be considered as insurance or a cushion to fall back.
- Security mainly acts as psychological support to the banker and pressure on the borrower.

### Own stake

- The borrower should have reasonable financial stake in the business.
- Banker should evaluate the project considering Debt-equity ratio, DSCR, Interest coverage ratio, sensitivity analysis, Break-even point, margin of safety etc.

### National priorities

- Co-operative banks are required to lend 40 % of advances to 'priority sector' and 25 % of which should be lent to 'weaker sector' wef 01-04-2008.

### Process of Lending

#### **3 'C's of the borrower**

- Character implies honesty, integrity, and reputation in the market, business morality and dependability.
- Capacity means knowledge of the borrower about his business and ability to conduct the affairs successfully.

- Capital is the funds to be employed by the borrower in the business.
- In case of partnership/ proprietary concerns the banker should also anticipate the problem of succession, sharing of work amongst themselves.
- In case of a limited company, a study of the directors/ key men, managing the unit is essential.

### **Sources of information available to assess the borrower**

- Loan application
- Market reports
- Operation in the account
- Report from other Bankers
- Financial statements, IT return etc.
- Personal interview
- Unit inspection prior to sanction

### **Project / Financial Appraisal**

- Obtain and study the following:
- Past performance.
- Projections with assumptions.
- Sensitivity analysis.
- Funds Flow statement.
- Ratio analysis.
- Break -even & margin of safety.

### **Security Appraisal**

- Primary & collateral security.
- Security should be 'MASTDAY'
- M - Marketability
- A - easy to ascertain its title, value, quantity and quality.
- S --- stability of value.
- T --- Transferability of title.
- D- durability - not perishable.
- A -absence of contingent liability. I.e. the bank may not have to spend more money on the security to make it marketable or even to maintain it.
- Y -Yield. The security should provide some on-going income to the borrower/ bank to cover interest & or partial repayment.

### **Terms & conditions**

- The note covering above aspects namely 3 Cs, Project appraisal and security appraisal should be forwarded by the branch to Loan dept and then to Loan scrutiny committee and Board of directors for their consideration, stipulating the terms and conditions of the advance.

### **Documentation**

- Objectives:
- To create charge on the securities provided, as cover for the advance.
- Stipulate terms & conditions to be complied with by the borrower.
- These documents have to be properly stamped, executed, duly attested and registered.
- The documents should be completed carefully.
- Borrower / surety should be made member of the bank.

### **Disbursement**

- Disbursement should be made as stipulated in sanction letter.
- Visit to the unit prior to disbursement is a must.
- Bills, receipts, installation & commissioning reports of machinery, trial run reports etc. should be obtained.

### **Credit Monitoring**

- Watching the progress of the project in terms cost and time over-runs.
  - Reviewing operations in the account.
  - Obtaining QIS, stock statements, insurance policy etc.
  - Confirm end use of the advance.
  - Watch against diversion of funds.
  - Obtaining Annual financial statements, Audit report, IT return and to conduct annual review of the limit. Renewal of documents.
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### **External Factors affecting borrower's business.**

- Changes in Government Policy.
- Foreign exchange rate variation.
- Competition- Local / Imported products.

### Remedial Strategies

- Scrutiny of Loan proposal.
- Scrutiny of Security.
- Stipulating Terms & conditions of sanction.
- Proper documentation.
- Disbursement and ensuring end use of funds.
- Close monitoring of operations and account.
- Periodic inspection.
- Immediate follow up in case of adverse symptoms.
- Nursing of the account.
- Rescheduling of account.
- Avoid ever greening of loan account.
- Safeguarding of security.
- Timely legal action for recovery.

### Cash Credit Monitoring

- C ---- Credit Summations
- A ---- Adequacy of Credit summations
- S ----- Stock statement
- H ----- HO approval / ratification
- C ----- Cash / cheque operations
- R ---- Return of cheques
- E ----- Expiry of limit
- D ----- Drawing Power
- I ----- Insurance
- T ----- Better / tension of recovery

### Monitoring of Sec.49 Loan

- Maximum loan limit to be specified.
- Preferably close ended.
- Close track of receipt of loan installment cheque from employer.
- Accept local cheques only or DD.
- Timely credit to individual loan a/c.
- Minimum net take home pay should be specified.
- Balance period of service should be considered.
- Periodic goodwill visit to employer with an intention to ascertain news about VRS, Union trouble, entry of other bank etc. Visit can be used for sale of other loan products of the bank.
- First installment date should be carefully fixed.
- OT, Shift allowance should not be considered.

**Loan**

- L: Loss
- O: of
- A: Assets due to
- N: Non-recovery