An Overview of Credit Appraisal System with special reference to Micro Small and Medium Enterprises (MSME)

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Abstract

The Credit Appraisal is a complete exercise which starts from the time a potential borrower walks into the branch and concludes in credit delivery and monitoring with the objective of certifying and maintaining the quality of lending and managing credit risk. Credit appraisal is the assessment of the viability of proposed long term investments in terms of shareholder wealth and the formal analysis of all project costs and benefits which is used to justify the project proposal. The bank has over the years designed and adopted the Best Practices Code. This in effect represents the bank's philosophy towards effective Corporate Governance.

The liberalization of the financial sector demands a new technology to cope with the rising pressures on the profitability of banks and financial sector institutions. Analyzing lending strategies, credit appraisal, risk analysis and lending decisions, while keeping in mind the broad framework of corporate banking strategy, this book emphasizes that lending is no longer an activity restricted to the assets side of the balance sheet. An invaluable tool for practicing managers and students of business and financial management, this book demands no prior specialized knowledge of the subject, taking readers from the rudiments of credit appraisal to advanced levels of decision making. Numerous examples from the world of business have been provided to facilitate a better understanding of the vast and significant changes in the financial market. The objective of credit analysis is to look at both the borrower and the lending facility being proposed and to assign a risk rating. The risk rating is derived by estimating the probability of default by the borrower at a given confidence level over the life of the facility, and by estimating the amount of loss that the lender would suffer in the event of default.

Keywords:

Credit risk and monitoring, Corporate governance, Best practices code, Credit appraisal, Lending strategies, Financial market, Risk rating.

Introduction

The Credit Appraisal is a complete exercise which starts from the time a potential borrower walks into the branch and concludes in credit delivery and monitoring with the objective of certifying and maintaining the quality of lending and managing credit risk. Credit appraisal is the assessment of the viability of proposed long term investments in terms of shareholder wealth and the formal analysis of all project costs and benefits which is used to justify the project proposal. The bank has over the years designed and adopted the Best Practices Code. This in effect represents the bank's philosophy towards effective Corporate Governance.

A good appraisal justifies spending money on a project. A proper consideration of each of the key components of project appraisal is essential. Key issues in appraising projects include the following:

Need, targeting and objectives

The starting point for appraisal: applicants should provide a detailed description of the project; identifying the local need it aims to meet. Appraisal helps to show if the project is the right response, and highlights what the project would be doing and for whom.

Options

Options analysis is concerned with establishing whether there are different ways of achieving objectives. This is a particularly complex part of project appraisal, and one where guidance varies. It is vital though to review different ways of meeting key objectives and local needs.

Inputs

It is important to ensure that all the necessary people and resources are in place to deliver the project. This may mean thinking about funding from various sources and other inputs requirement such as volunteer help or premises. Appraisal should include the examination of detailed budgets.

Outputs and outcomes

Detailed consideration must be given in appraisal to what a project does and achieves: its outputs and more importantly its longer-term outcomes. Benefits to neighbourhoods and their residents are reflected in the improved. Quality of life outcomes (jobs, better housing, safety, health and so on), and appraisals consider if these are realistic.

This is an exploratory research based solely on insights drawn from the analysis of the existing literature of different studies, reports, periodicals and books related to the topic of study in order to investigate the credit appraisal process. This research work will serves as a means to help acquire useful information or knowledge about the subject area. Existing literature, not only topic under consideration is theorizing, but also formulates and discusses the proposition that will help illuminate and discuss the importance of credit appraisal.

Objectives of Study

1. To study the meaning and importance of Credit appraisal
2. To study entire loan system
3. To study the procedure of obtaining loan from Bank.
4. To study the market conditions conducive for credit appraisal process
5. To study and understand the terms and conditions of sanctions and advances
6. To study the credit appraisal process
7. To know on what criteria the bank Appraise the loan to the business.
8. To study the procedure of credit appraisal process in MSME.

This study initiates to study the credit rating process. It seeks to study the various stages that a prospective buyer has to go through as each bank has its own ways to judge the credit worthiness of the prospective buyers. The study will also be studying that how the credit appraisal is done in MSME using term loan or working capital finance.

Need For Appriasal

- An important need of appraisal is obtaining an understanding of the anticipated expenditure and benefits of a project, usually expressed in terms of its inputs (costs) and outputs (results).
- The expected timing of this must also be made clear.
- While detailed appraisal is generally necessary before decisions can be taken and offers made.
- It will enable any obviously poor or ineligible ones to be eliminated, avoid duplication and give an early overall view of the success of the measure.

Scope of The Study

- Be consistent and objective in choosing projects
- Make sure its programme benefits all sections of the community, including those from ethnic groups who have been left out in the past.
- Provide documentation to meet financial and audit requirements and to explain decisions to local people.
- Appraisal is an important decision making tool - Appraisal involves the comprehensive analysis of a wide range of data, judgments and assumptions, all of which need adequate evidence. This helps ensure that projects selected for funding.

Limitations of The Study

- The data collected from various sources cannot be considered as correct information.
- The figures shown in the project are just expected figures.
- The result of project appraisal cannot consider as 100% correct.
- All financial tools which are applied in this appraisal have their own limitations.
- Time was also a major constraint for the study.

Literature Review

According to Banking Strategy, Credit Appraisal and Lending Strategies by Author(s): Hrishikesh

Bhattacharya"Analyses lending strategies, credit appraisal, risk analysis and lending decisions keeping in mind the broad framework of corporate banking strategy, and helps us understand better the vast and significant changes in the financial market. Numerous examples from the world of business have been provided to facilitate better understanding".

Also in, Lending Strategy, Credit Appraisal and Lending Decision by Hrishikesh Bhattacharya;

The liberalization of the financial sector demands a new technology to cope with the rising pressures on the profitability of banks and financial sector institutions. Analyzing lending strategies, credit appraisal, risk analysis and lending decisions, while keeping in mind the broad framework of corporate banking strategy, this book emphasizes that lending is no longer an activity restricted to the assets side of the balance sheet. An invaluable tool for practicing managers and students of business and financial management, this book demands no prior specialized knowledge of the subject, taking readers from the rudiments of credit appraisal to advanced levels of decision making. Numerous examples from the world of business have been provided to facilitate a better understanding of the vast and significant changes in the financial market. In "Credit is inevitable in banking by Dr.RamJassYadav" Credit risk basically means the risk of default made by a customer owing to non repayment of the credit that he had obtained from the bank. Thus a proper evaluation of the customer that measures the financial condition and ability of the customer to repay the loan taken from bank. Credit appraisal, primarily is a process of collecting information related to the customer and thus assessing the risk involved for the bank by checking the technical, financial &economical viability of the project. A major step towards this is the verification of the primary &collateral security that is available with the banks for security purpose or rather recovery purpose. Credit Appraisal thus ascertains the risk that is associated with lending functions in banks. In "Credit Risk Assessment Model by Nancy Arora" Credit Risk is a risk that is related to non- repayment of the credit that was obtained by the customer from the banks. Thus assessing the credibility of the customer in order to mitigate the risk is quite important. Proper evaluation of the customer is required that would assess the financial position of the customer to repay the loan amount in future. Credit Appraisal is the process to ascertain the risks associated with the extension of the credit facility. It is generally carried out by financial institutions who are involved in providing financial funding to its customers. A study on the financial, technical, viability of the proposed project is required. An observation regarding trends to reduce various risk parameters that can be categorized as financial risk, business risk, industrial risk & management risk needs to be done. Also, in "Credit Policy& Credit Appraisal of Banks by SathyaVarathan , PriyaKalyanasundaram and S.Tamilenthi" Credit Appraisal is a holistic exercise that starts from the time when a prospective borrower walks in culminates in credit delivery and monitoring with the objective of ensuring and maintains the quality of lending and managing credit risk within acceptable limits. Credit Appraisal determines whether to accept the proposal or not. There are two types of projects that are received by the banks for the funding purpose. The first is starting of a new project or setting up a new company, the second one is for its working capital needs.

The objective of credit analysis is to look at both the borrower and the lending facility being proposed and to assign a risk rating. The risk rating is derived by estimating the probability of default by the borrower at a given confidence level over the life of the facility, and by estimating the amount of loss that the lender would suffer in the event of default.

The two main function of a bank are to accept deposits and to lend money. Lending has always been one of the principal sources of income for commercial bank. The extension of credit on a sound basis is essential to the growth and prosperity of the bank. The success or failure of a bank would largely depend upon the quality of its advances. Before granting credit facilities, the Bank Officials should satisfy themselves on the five C's of Credit namely:

Character: The honesty and integrity of the borrower is of primary importance. Even if a very good security is being offered by the customer, unless and until, his honesty and integrity is undoubted, no credit request should be entertained. Past performance of the borrower is a good indicator of what can be expected of him in future. Selection of right type of borrower is very essential. Proper enquiry regarding the previous dealings of the proposed customer should be enquired from the market and area surrounding his place of business.

Capacity: This refers to the management's ability to run the business. The advance is safe and secure if the management of the company is able and sound. The capacity or ability of the borrower for business is to be judged in the light of his qualification, experience and leadership qualities.

Capital: This refers to the amount invested in the business by the borrower. In other words, it represents the stake of the owner in the business. It is very important that the prospective borrowers have adequate stake in the business. Capital is the measure of credit that may be granted to those who have earned the right to borrow.

Collateral: To a banker, security is important in order to secure the credit exposure it offers. The security should be one having a good title, stability of value and ready marketability. Security is obtained as an insurance against any unforeseen developments. A security cannot make a bad loan good but it definitely makes a good loan better. Security is not a substitute for character or capacity of borrower. By overlooking character and capacity in favor of security, the banker is simply asking for trouble because the omission of these two factors will ultimately drain the security to the extent where it would become valueless. Whatever security is obtained, care should be taken to see that it is adequately charged and a valid equitable mortgage can be done and all necessary legal formalities are completed so that it can be realized without any difficulty in case of need.

Condition: Particularly in case of industrial advances, the condition of the country and position of the proposed borrower's business in the industrial cycle at the time of credit request is of much importance. One has to make investigation about the existing business conditions and government regulations. One has to consider the overall business cycle, the general condition of the industry as a whole in which this company is engaged, international conditions that could affect the company and the technological development that are taking place in the field in which the company is engaged. Bank should also consider the quantum of advance margin, source of repayment and profitability and value of the account.

A credit analyst, even at the preliminary stage, should view all these things in totality before coming to a decision regarding entertaining the proposals.

The success or failure of a bank would largely depend upon the quality of its advances. The manager is expected to make thorough enquiries about the prospective borrowers and their credit proposals. It is immaterial whether the final decision is to be taken at Branch-level or at Zonal / Head office level. All the information is to be collected and assessment has to be made by the Manager /Credit Officer, initially.

Here the question arises that what is the rationale behind the sanction of credit facility?

The rationale sanction of credit facility must be firmly based on favorable outcome of information collection and appraisal done on the following aspect of the credit proposal.

The prospective borrower: He must have the mental and physical abilities to carry out his scheme of business and the trustworthiness required for fair dealings with the bank.

The market conditions and its trend/cyclicality must be conductive for:

- Satisfactory demand for the relative product/service.

- Generation of sufficient surplus to meet the business-needs, bank instalment/interest and required drawing by the prospective borrower.

Technical feasibility: The prospective borrower must possess/have assured access to know-how, location, land, building, machinery, fixed assets, transport, factory shed (where required), electricity, raw material and other inputs required viz. the requisite license/clearance from the concerned authorities etc.

Financial feasibility: The cost of the project must be estimated on realistic basis for an optimized scale of business and the sources of fund must be adequate and acceptable from the point of view of safety and security of the proposed advance. Availability of collateral security/guarantee is relevant here.

Each of the above aspects is of extreme importance. Now for collecting information on above aspects will require effective tapping of the following sources:

Personal interview of the prospective borrower: The techniques of interviewing effectively are:-

Making the prospective borrower feel at ease and encouraging him to talk more about his proposal but not allowing the conversation to drift from the topic. Listening carefully with an open and receptive mind and also watching non-verbal communication like gesture, manner of talking etc. Not asking probing questions in the beginning but gradually collecting all relevant information. Avoiding communication gaps and allowing the applicant to come emotionally closer so that a free and frank discussion takes place. Any ambiguity should be dealt with the spirit of solving problems rather than finding faults.

Market inquiries: Contacts should be made with the other businessmen in the same line of business, particularly those who know him, as well as friends and relatives associated with his venture, as revealed during the personal interview.

Report from other banks: If prospective borrower has dealing with some other banks, then their confidential credit report should be obtained in IBA format. Credit Report should be obtained directly from the respective bank either through registered post or by receiving it personally to avoid any sort of fraudulent activities.

Study of the account: If the prospective borrower is already having an account with the bank, transactions and dealing should be thoroughly studied. All the transactions should be business related transactions and proper scrutiny should be made regarding diversion of funds. The statement of the account should be thoroughly scrutinized to verify the no of cheques returned which are drawn by the borrower to have a clear idea regarding trustworthiness of the borrower.

Financial statements: If the prospective borrower has a running business, the audited financial statements for last three years should be studied. The Balance sheet should be thoroughly analyzed to verify that the balance sheet has not been manipulated specially the current assets and current liabilities should be properly checked. The Key Financial Indicators should be thoroughly checked to visualize the status of the firm and the financial ability of the borrower to repay the credit offerings.

Statutory returns: Income tax, Wealth tax, Sales tax returns and Assessment orders should be called for and studied. Statutory liability must be ascertained and statement obtained.

Property statements: A complete list of immovable properties, their situation and valuation, owned by the prospective borrower/proposed guarantor should be called for and scrutinized, obtain statement of means duly filled up, signed and dated.

Personal visit: A visit to prospective borrower's premises/business-place/proposed site should be made to gather relevant information.

One obvious important aspect of credit decision is to select the proper mode of advance to fit the transactional need of the prospective borrower and some these need may not be that of an outright advance/contingent demand for bank finance. Commonly the nature of facility may be any one, or a permissible combination of:

(1) Overdraft.

(2) Cash credit.

(3) Demand loan.

(4) Term loan.

(5) Bills purchased/discounted.

(6) Deferred payment guarantees.

(7) Other guarantee.

(8) Letter of credit etc.

Each of these types will require specific supportive securities and relevant controls which has to be duly stipulated in the sanction.

A brief overview of the **modes of securitization** is given below. Caution to be taken in case of advance sanctioned to enable the party to build up essential stocks during particular seasons or as per availability in industry or trade and / or meet cost of productivity/ sales:

1. **Against hypothecation of goods:** Operations in hypothecation accounts are allowed on stock statement by the borrowers. The manager ensures that:

   a) Stocks hypothecated are as per the terms of sanction.

   b) Valuation is done as per the guidelines of the bank.

   c) Facility is allowed well within the drawing power.

   d) Value of security margin relevant to the limit sanctioned.

2. **Against book debts:** cash credit facility against hypothecation of book debts should be granted only after a careful assessment of the credit worthiness of the debtor. Care should be taken to avoid chances of double finance.

   Advance to a party having dealings with more than one bank have an element of risk as the part can, when in difficulties, easily pledge the same goods with another bank as well. Care should be taken that the goods pledged to the bank are demarcated so that they are not mixed up or mistaken to other banks. Possession over the goods should be effective, constructive, apparent and undisputable.

3. **Against Government Supply Bills:** It is a clean advance and thus proper attention is paid by the bankers as to the means of the borrower, his financial position, business integrity beyond doubt, his credit in the market, his experience of the business and past experience of the bank with the party, as also availability of adequate security.

4. **Against pledge of goods:** Advance by pledging of goods say jewelry for productive purpose (agricultural allied activities), nonproductive purposes (for meeting medical, educational, marriage expense etc). Goods to be stored under bank's lock and key or in warehouse against warehouse receipt or with clearing agents.

5. **Against assignment of policies:** Overdrafts and demand loans are granted against the life insurance policies issued by the private sector insurance companies approved by Insurance Regulatory Authority (IRDA) in addition to Life Policies issued by LIC of India. A policy is accepted as security is assigned in favour of the bank by the assured of the bank.

Compliance of Terms and Conditions of Sanction And Advances

The following important terms and conditions are as follows:

- The borrower has given unconditional acceptance of terms of sanction stipulated by sanctioning authority.
- Account is KYC compliant; CIBIL report is generated and reviewed.
- Execution of all relevant documents and ensuring

compliance of sanction terms has been executed.

- Adequate stamp has been taken and documents are completely filled up.
- Creation of securities/ mortgage/ furnishing of letter of guarantor of assets etc as per terms of sanction have been done.
- Certified copies of the deed have been obtained and comparison with the original deed have been undertaken in bank's format.
- Eligible mortgages are registered with CERSAI.
- Proportionate margin amount paid by borrower, applicable as per terms of sanction has been taken.
- In case of UCO COMMERCIAL VEHICLES loan scheme, ensure they are covered under CGTMSE.
- Copy of registration copy and bank's hypothecation clause and duplicate keys are with bank's documents and assets are insured under bank's clause.
- Ensure that the FDs are lien to the bank (through SRM menu), NSC/KVP are pledged to the bank and LIC policies assigned in favor of bank. These instruments should be sent to Post office/ LIC office through bank officials or registered post.
- Stock statement submitted to the branch regularly in case of cash credit.
- Disbursement should be made to the extent possible to the suppliers/ service providers and the element of cash should be minimized whenever payments are made directly, receipts to be obtained directly.
- The end use of the project should be verified through personal inspection of assets created out of bank's loan and should be added in the bank loan document file.
- In case of mortgage loan pre and post disbursement inspection of securities has been conducted for the mortgage property.

Credit Appraisal Process

Receipt of application from the applicant

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Receiving documents from the applicant (KYC compliant, Statement of means, Registered deeds, Memorandum of partition if required, Mortgage Deed, Project Report of the firm constituting its projected balance sheet, all financial indicators etc., hypothecation of goods clause papers.)

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Credit Rating (Credit rating of the firm is done here through ONICRA and that of the borrower through INTERNAL RATINGS OF THE BANK; CIBIL DATABASE also provides vital information about the defaulters list.)

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A clearance report of the property to be obtained from the valuer assigned by the bank as well as a legal opinion is taken. In case of mortgage of property, encumbrance certificate is obtained & memorandum of partition in case of property jointly owned.

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Financial statement analysis

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Setting up of limit in case of cash credit

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Conducting of PSVR 1, 2, 4 before sanction of the loan

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Sanction of loan by the higher authorities & disbursement of loan according to customer's need.)

Credit Pricing: Pricing include following components:

- **Base rate-** The rate below which a bank will not lend loan to anyone. It is decided on the basis of-
  - ➢ Cost of funds- It comprises interest cost of resources raised & cost of reserve requirements, determined periodically.
  - ➢ Operational cost- It includes day to day cost like staff salary, electricity bills, & other operating costs.
  - ➢ Margin- This the minimum profit of the bank.
- **Tenure of the credit-** Higher the tenure, higher will be the pricing.
- **Rating of the company-** Two ratings are considered for pricing.
  - ➢ External rating- Rating given by external agencies like CARE/ ICRA/ FITCH/ CRISIL. AAA being the highest & D being the lowest.
  - ➢ Internal rating- Rating given by the bank, known as Credit Rating Assessment (CRA)
- **Value of connection-** Older the connection with the respective company, lower will be the rate & vice versa.
- **Risk premium-** Risk premium is charges which are

levied on the basis of risk involved in the credit exposure. The higher the risk, the higher would be the risk premium and vice versa.

Credit appraisal in MSME is basically carried on for either working capital finance or for term loan. This is explained as follow:

Working capital Finance: In order to achieve a particular turnover level, to remain viable and operate the BEP level, to earn required amount of profits, the firm requires some minimum level of current assets. Working capital means total amount of circulating current assets.

Working capital comprises	Means to finance
a) Value of raw material in store or in transport.	Credit available from suppliers on purchase
b) Amount of consumable stores and other material required for production purpose	Other current liabilities
c) Value of stock in process.	Surplus of long term funds over long term uses
d) Value of all finished goods including in transit.	Short term bank borrowing
e) Amount of all outstanding receivables or sundry debtors	
f) Monthly expenses generally reflected through the current assets such as cash, advances allowed, prepaid expenses.	

Factors Determinig Working Capital

- Policies of production
- Credit policies of the unit
- Pace of turnover
- Manufacturing process
- Seasonality

Process for assessment of working capital requirements:

There are three methods followed by the banks for assessing the working capital of a firm.

(i) Traditional Method suggested under Tandon Committee

(ii) Turnover Method suggested by Nayak Committee.

(iii) Cash Budget Method followed in case of seasonal industries.

(i) Traditional Method: As per traditional method (Tandon Committee), the level of working capital is determined both by the length of the operating cycle and size of the sales. The method is applicable to working capital limit**, above Rs 5 lakhs**. RBI withdrew the mandatory application of this method and allowed the banks to use their own methods. The sum total level of anticipate level of current assets calculated on the basis of estimated sales and by applying the norms for inventory and receivables is the level of working capital. The amount of bank limit is determined as under:

1. Assess the level of net working capital (surplus of long term sources over long term uses) available, which normally should not be less than 25% of total current assets.

2. Work out bank finance to be sanctioned being gap of total current assets less net working capital and other current liabilities**.**

First method of lending: As per first Method, the borrower is required to bring minimum NWC to the extent of the 25%

of Working Capital Gap. The balance which is maximum 75% of the working capital gap will be the Maximum Permissible Bank Finance. This approach was considered suitable only for very small borrowers i.e. where the requirements of credit were **less than Rs.10 lacs**.

Second method of lending: Under second method, the borrower is required to bring minimum NWC to the extent of 25% of the Total Current Assets & the balance will be MPBF. RBI stipulated that the working capital needs of all borrowers enjoying fund based credit facilities **of more than Rs. 10 lacs** should be appraised (calculated) under this method.

Net working capital = current assets – current liability			
Working capital gap = current assets – (current liability –bank borrowing)			
First Method of lending		Second Method of lending	
Working capital gap	(1)	Working capital gap	(1)
Minimum 25% of WCG from long term sources	(2)	Minimum 25% of WCG from long term sources	(2)
Estimated NWC	(3)	Estimated NWC	(3)
Items (1-2)	(4)	Items	(4)
Items (1-3)	(5)	Items	(5)
MPBF	4 and 5 whichever is less	MPBF	4 and 5 whichever is less
Excess Borrowing	(2)-(3)	Excess borrowing	(2)-(3)

If net working capital is less than required minimum margin then it would result in excess borrowing. This problem can be addressed in the following way:

1. Borrower may be asked to bring additional long term funds by way of capital / long term borrowing etc. so that adequate long term surplus fund is available to augment the NWC at least to the minimum requisite level (i.e. 25% of current assets /WCG) and the element of Excess borrowing is extinguished.

2. Liquidation of the excess current assets, estimated, if any taking into consideration the production/ processing cycle of the industry.

3. If above two are not workable, in exceptional circumstances the Excess Borrowing projected can be converted into Working Capital Term Loan (WCTL) repayable over the period of 3 to 5 years depending on the cash generation on following unit.

Exception under second method of lending

1. Borrowing units engaged in sports activities need not bring in 25% contribution from long term funds in respect of exports receivables.

2. 25% contribution from long term funds in respect of receivables arising out of domestic/ inland sales by drawing bills of exchange under usance of Letter of credit (whether revocable or irrevocable) and negotiated strictly in accordance with the terms of Letter of credit.

Turnover method: As per this method suggested by Nayak committee, the working capital is assessed as minimum 25% of sales turnover, which is financed by way of bank finance at minimum of 20% and borrowers contribution at 5% of projected sales. The norms for inventory and receivables and method of lending are not applicable here. In this method if the available margin is more than 5%, the bank limit is reduced correspondingly. The method applies to working capital limit **up to Rs 5 crore** for manufacturing and **Rs 2 cror**e for other activities.

Cash Budget Method: Under this method monthly cash inflow and outflow statement is prepared and the highest gap between the two becomes the basis of sanction of credit limit. Banks make use of cash budget method in case of:

a) Seasonal industries

b) Software development

c) Film production

d) Service sector activities including construction activities.

Methods of Lending And Assessment of Working Capital: RBI has withdrawn the guidelines based on the concept of Maximum permissible Bank Finance (MPBF), banks are now free to evolve, with the approval of their respective board, methods for assessing the working capital requirements. In the light of the above, the following methods of assessment are to be followed:

Methods of Lending and Assesment of Working Capital Finance: RBI has withdrawn the guidelines based on the concept of Maximum permissible bank finance (MPBF), Banks are now free to evolve, with the approval of their respective board , methods for assessing the working capital requirement are as follows:

SEGMENT	WORKING CAPITAL REQUIREMENT	METHODS OF ASSESEMENT
Industry and Trade	Below Rs 2 crores	Projected turnover method / 2nd method of lending whichever is higher.
	Rs 2 crores and above	2nd method of lending
SME units	Below Rs 5 crores	Projected turnover method / 2nd method of lending whichever is higher.
	Rs 2 crores and above	2nd method of lending
Seasonal industry such as sugar, tea, real estate, construction, software		Cash budget method
Adhoc advances sanction based on bunching of sales		Cash budget method
Leasing and hire purchase companies.		2nd method of lending
Retail or wholesale traders under UCO trader scheme		As per scheme guidelines

Term Loan

Term loan is sanctioned for the acquisition of capital goods excluding (second hand) fixed assets i.e. building, machinery, vehicles and land etc. There is no provision in the policy for allowing term loan against purchase of second hand machinery. . It is not a demand loan, and is repayable in terms i.e. in instalments, irrespective of period or the security cover. Term loans are generally granted to finance capital expenditure, i.e. for acquisition of land, building and plant and machinery, required for setting up a new industrial under taking or expansion/diversification of an existing one and also for acquisition of movable fixed assets. Term loans are also given for modernization, renovation, etc to improve the product quality or increase the productivity and profitability. Term loans are granted for a period varying from 3 to 7 years and in exceptional cases beyond 7 years. Term loans are generally granted for the purpose of acquisition of fixed assets and have to be liquidated from surplus cash generated out of earnings.

Appraisal of Term Loans: Assessment of earning potentials and generation of cash surpluses is the vital ingredient in the appraisal of term loans. The unit should make enough surplus earnings after meeting all the expenses, taxes and other necessary provisions and the same should be adequate for servicing the loan and the interest thereon within a reasonable period of time. The appraisal of term loan broadly involves an analytical assessment of the following:

- Purpose, cost of project and how it is to be tied up,
- Future trends of production and sales,
- Estimates of costs, expenses, earnings and profitability, and
- Cash flow statements during the period of the loan.

While appraising proposal for term loan, the following four fundamentals should be carefully studied and analysed:

a. Technical Feasibility of the project.

b. Financial Feasibility of the project.

c. Market Feasibility of the project.

d. Managerial competence.

Technical Feasibility : Which determine the feasibility of setting up a project to achieve particular level of operations (in terms quantity, quality and timely delivery) and takes into accounts all technical details such as suitability of machinery or equipment , inputs powers skills, products mix, implementation etc.

Financial Feasibility: Takes into accounts aspects such as profitability and the cost generation based on the projects will be able to reward the entrepreneur and also service its financial commitments.

Market Feasibility: It looks into the availability or creation of the market to achieve the sales targets. It takes into consideration the demand forecasting based on overall demand and supply position , including global scenario , product promotion measures , selling strategic , pricing , completion , export potential , product life cycle etc.

Management Competence: It studies the adequacy and sustainability of management structure for the successful implementation and running of the project and achieve the objectives for which the projects has been promoted.

<u>Documents necessary for the credit proposal:</u>

1. Application in relevant format of the bank, project report duly signed by applicant.

2. All KYC documents as per constitution of the borrower (partnership deed /memorandum and articles of associations /trust deed /by laws/ board resolution).

3. Various registration certificates as applicable (SSI registration certificate/ VAT registration certificate/ export promotion council registration certificates /IE code /RBI registration certificate of NBFC).

4. Soft copy of the board memorandum /ST 23 / ST 23A /ST23B.

5. Credit report in prescribed format with income & statement of means.

6. Confidential credit opinion from the other bank as per IBA format.

7. Pollution control certificate /various statutory/ clearance certificates from government department.

8. Inspection report on stock & factory.

9. Viability study.

10. Audited financials for past 3 years of the company/ firm with audited reports.

11. Legal opinion on the properties from the empanelled advocate, with search report as per format.

12. Valuation report of the properties offered as primary /collateral security from empanelled valuer.

13. Chartered engineer certificate/proforma invoice/quotation for the machinery to be purchased.

14. Roc (Registration of Charge) search report in case of company accounts by empanelled statutory auditors.

15. CIBIL verification report in respect of applicant, guarantor.

16. Approved building plan along with Jamabandi, TS-1 and Fard with terms of approval for construction.

17. PSVR 1.2.3.4 duly filled up and signed.

18. Audited financials for the past 3 year of the group company/firm with audit reports.

19. Compliance report of earlier sanction.

20. Net worth of guarantors in statements of means duly signed by the borrower /guarantor with date.

21. MCMR-latest with all particulars/details filled up.

22. Stock inspection/book debts inspection report.

23. Cash flow statement/fund flow statement.

24. CMA (credit monitoring analysis) /if changes required or objection raised party to submit revised CMA with clarifications.

25. Cash budget whenever required.

26. Credit rating sheet generated online with relevant module, signed by branch officials.

27. Fund Flow Statement.

Conclusion

The credit appraisal is done by involving the Evaluation of management, Technical feasibility, Financial viability, Risk analysis and Credit rating. It is on the basis of the credit risk level, collateral securities to be given by the borrower are determined. The credit department thoroughly analyses the credit requirement of the company and the capacity to service the debt. The banks have conservative norms to appraise the project the bank at the max. Banks allow a 20% hike in projections. The credit appraisal passes through various stages and evaluations before it is appraised.

The financial and banking system has placed before the MSME sector a fully dressed up and it is the appreciation of the efforts and also as an incentive to work hard. The sector should avail of the opportunities and scale new heights. With this thesector will be benefited and the society too. This shows MSME has sound system for credit appraisal. The credit appraisal process carried out at MSME has good parameters to appraise.

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