

A  
PROJECT REPORT  
ON  
**A STUDY OF CREDIT APPRAISAL SYSTEM FOR WORKING CAPITAL  
FINANCING TO COMMERCIAL & AGRICULTURE SECTOR**

with special reference to



**State Bank of India**

Regional Business Office of SBI, Nasik.

SUBMITTED TO  
**UNIVERSITY OF PUNE**

SUBMITTED BY

**(NAME)**

Master in Business Administration (Finance)

GUIDED BY

**PROF.**

(institute name)

YEAR

(20 – 20 )

**DECLARATION**

I, (name), MBA – II (2008 – 09) at the (Institute name) hereby solemnly declare that the project on “A Study of Credit Appraisal System for Working Capital financing to Commercial & Agriculture Sector” was completed at State Bank of India, Nasik, as a result of my research work.

The project was undertaken as a part of academic curriculum, according to the university rules & with no commercial interest & motives. It is my original work and not submitted elsewhere for any other purpose earlier.

The project report does not contain any fake information and the data collected is included in the project with the prior permission of Manager at SBI.



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**Place :** Nasik.

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**Date :** / / 2008

**(Name)**

### **ACKNOWLEDGEMENT**

“A study of Credit Appraisal System” has been a successful project because of the efforts of some very special people.

First of all, I express my sincere & profound sense of gratitude to Mr.\_\_\_\_\_, for providing me the opportunity to do a Project Work. I thank him as well as the professors for their encouragement & endless support in project work.

I am deeply grateful to all the people working at Regional Business Office of SBI, Nasik, for their efforts in keeping this project on schedule.

I am thankful to Mr.B.A.Karpate, the Chief Manager (C.S.C.) at Regional Business Office of SBI, for allowing me to carry out the project work in his organisation.

I deeply value the guidance given by Mr. Abhay Chhajed, the Dy. Manager (C.S.C.) & Mr. Manohar Pagare, the Dy. Manager (C.P.C.) at Regional Business Office of SBI. I express my special thanks to them for solving my queries time to time & making valuable suggestions.

I am also indebted to my family & colleagues who have directly & indirectly contributed their time & talent in accomplishing this task.

**Date :** / / 20

**(Name)**

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## Chapter 1.1

### **OBJECT OF THE PROJECT**

Pune University has introduced 'Summer Project' as a compulsory activity for students of MBA. 'Practical Knowledge' is an important milestone in developing the skills of management. Thus, at the end of first year, the students are required to undergo a summer project for a span of 60 days.

The purposes behind the project work can be summarised as follows:-

- 1) It gives the students their first exposure to an organisational set up.
- 2) It provides an opportunity of observing a business activity.
- 3) It enables the students to use the theoretical concepts in the actual business environment.
- 4) It is the best opportunity to communicate with the people working at different levels in the organisation & to get acquainted with their authorities & responsibilities.
- 5) It creates awareness in students about the real organisational problems & challenges faced by business.
- 6) It gives an idea about carrier opportunities available in future for students.
- 7) It gives the chance for students to apply logic in practically solving the recurring problems in business unit.
- 8) A project work always has a social relevance.

## Chapter 1.2

### SELECTION OF THE TOPIC

Over the last two decades, banks in India have expanded & diversified their lending activities with a view to provide services to the society. Banks are making every effort to provide financial & other types of support to the weaker section of the community. They are thus coming nearer to the common man & their involvement in the community development has further increased. Thus, the services provided by bank in this regard have been rightly designated as “Community Banking”.

The major portion of bank’s income is earned from interest charged on loans & advances. But the business of lending is not without certain inherent risks. Thus, a banker follows a very cautious policy & conducts his business on the basis of the well known principles of sound lending in order to minimise the risks. So it is essential to know the bank’s criteria for lending & its procedural aspects, which is termed as “Credit Appraisal System”.

Working capital is required to the industries for their day to day operations & thus financing Working Capital is the viable commercial activity for a bank. Hence, the following topic is selected for a Project:-

“A Study of Credit Appraisal System for Working Capital

Financing to Commercial & Agriculture Sector

With special reference to

State Bank of India, Nasik.”

## Chapter 1.3

### OBJECTIVES OF THE PROJECT

- ❖ To understand the meaning & importance of Credit Appraisal System.
- ❖ To study the eligibility criteria for sanctioning working capital loans to Commercial & Agriculture Sector.
- ❖ To analyse the procedure followed by the bank for sanctioning loans.
- ❖ To study the documentation required for credit appraisal.
- ❖ To know the authorities & committees involved in Credit Appraisal System.
- ❖ To determine the efficiency of Credit Appraisal System of SBI.
- ❖ To identify & suggest the scope for improvement in Credit Appraisal System of the bank.

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## Chapter 1.4

### METHODOLOGY OF THE STUDY

‘Project Methodology’ is the procedure followed by the students for collecting the required data for project. The necessary information is collected by following two types of sources:-

#### **PRIMARY SOURCES OF DATA COLLECTION:-**

Primary Data is the first hand data collected by following ways:-

1. Personal Interview: - By interviewing the Deputy Manager of the bank, essentials for loan sanctioning were understood.
2. Observation: - By observing the working of manager as well as employees in a bank, the actual procedure of loan sanctioning was understood.

#### **SECONDARY SOURCES OF DATA COLLECTION:-**

Secondary Data is the readymade or readily available data obtained from following sources:-

1. Internet: - The use of internet was beneficial for knowing the history & functioning of SBI as well as theory of Credit Appraisal System.
2. Books: - Books are the easily available sources of data. By referring the books from college library & Bank, the required information for project work is collected.

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## Chapter 1.5

### **SCOPE OF THE STUDY**

The project work would focus on the following areas of “State Bank of India”, Nasik:-

1. Importance of the Credit Appraisal System.
2. Credit Appraisal Standards of SBI.
3. SBI’s procedure & criteria for different credit facilities viz. working capital financing to Commercial & Agriculture Sector.
4. Case-studies.

Each of the above areas would be critically analysed in order to determine the **Efficiency of Credit Appraisal System of “State Bank of India, Nasik.”**

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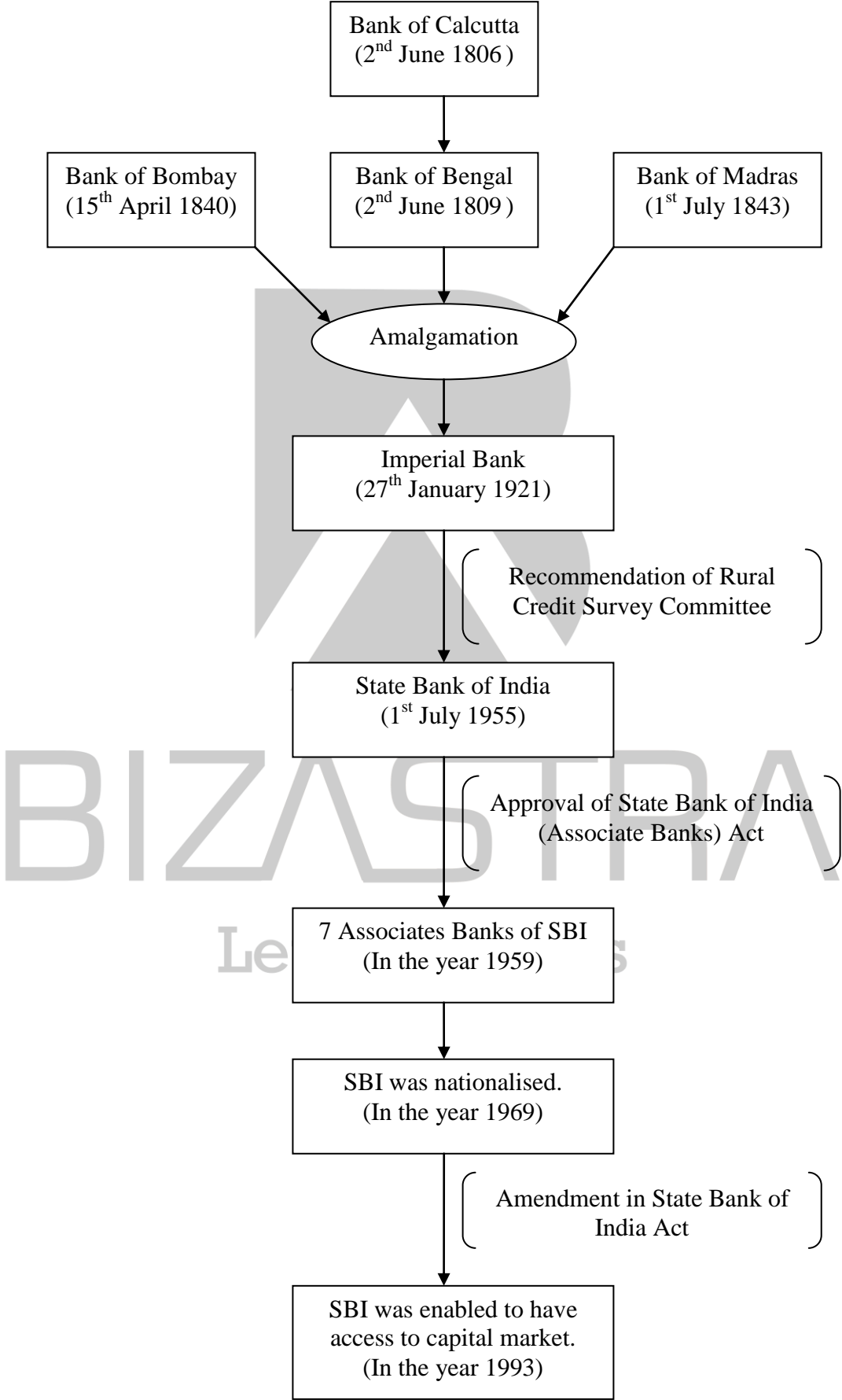
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## Chapter 1.6

### LIMITATIONS OF THE STUDY

1. This project report considers Credit Appraisal System followed by “State Bank of India” only & not that of the other banks.
2. This project report considers the Credit Appraisal System for Working Capital financing to Commercial & Agriculture Sector. It does not consider the following areas:-
  - a) Home loan
  - b) Car loan
  - c) Personal loan
  - d) Education loan
3. The people to be interviewed at SBI were working people & somewhere responsible persons & hence it was difficult to get their time.
4. The time period for the study was short due to which deep study of the concept was not possible to carry out.
5. The study is based on past data & may not be true indicator of future performance.
6. Confidential data was not used.

**Chapter 2.1 – HISTORY & DEVELOPMENT OF SBI**



### **THE ORGANISATION SET – UP OF SBI**

Type of the Bank	Public Sector Bank
Number of SBI Branches all over India	13,533
Number of Associate Banks	7
The Corporate Centre	Mumbai
Local Head Offices	14
Zonal Offices	57
Number of ATM centres all over India	8500
Number of Foreign Branches	67 in 29 countries
Chairman of SBI	Mr. O. P. Bhatt
MD of SBI	Mr. S. K. Bhattacharyya

### **7 ASSOCIATE BANKS OF SBI**

State Bank of Bikaner & Jaipur
State Bank of Hyderabad
State Bank of Mysore
State Bank of Indore
State Bank of Patiala
State Bank of Saurashtra
State Bank of Travancore

### **IMPORTANCE OF SBI IN BANKING BUSINESS**

- Though the SBI was established as a commercial bank, but with its efforts a new era of mixed banking system ushered in the country.
- The operations of SBI are not only confined to the urban sector but also to the rural areas.
- Financing to agriculture & other priority sectors could also be a viable commercial activity was proved by the experience of SBI.
- SBI has accounted for 29% of total banking business.

## Chapter 2.2

### **OUTSTANDING ACHIEVEMENTS OF SBI**

- SBI Chairman Mr. O. P. Bhatt has been declared CNN-IBN's Businessman of the year 2007.
- SBI Chairman Mr. O. P. Bhatt has been awarded the Transformational Leader Award 2007.
- SBI has bagged the awards for 'Most Preferred Bank' & 'Most Preferred Branch for Home Loans' in CNBC Awaaz Consumer Awards of August 2007.
- SBI is the only Indian bank to find place in the Fortune Global 500 list.

### **THE VISION OF SBI**

With 4 National level Apex Training Colleges & 54 Learning Centres spread all over the country, the bank is continuously engaged in skill enhancement of its employees.

SBI is entering into many new businesses with strategic tie-ups – Pension Funds, General Insurance, Custodial Services, Private Equity, Mobile Banking, Advisory Services, Structured Products, etc.

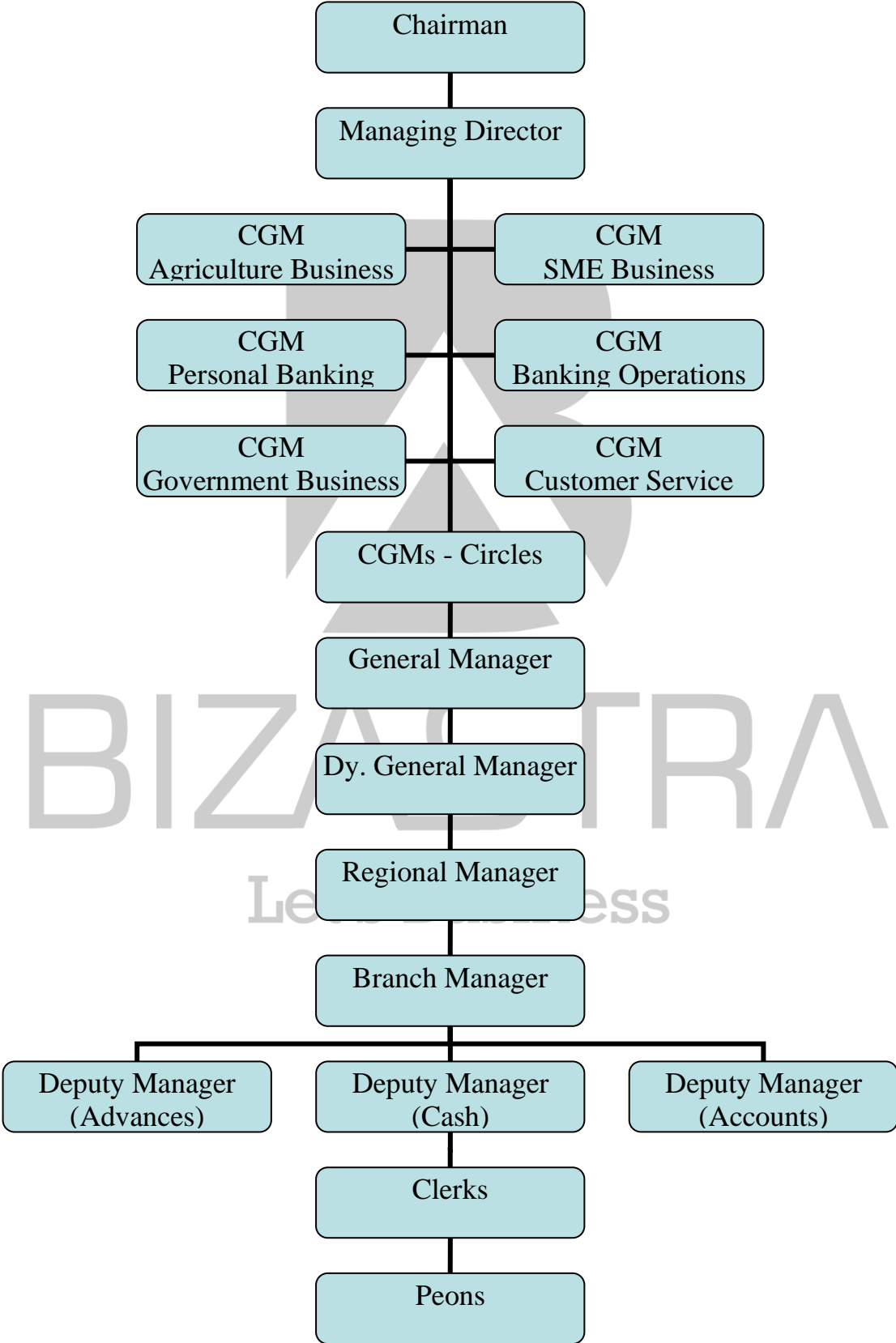
“It's a vision to make SBI a truly global bank.”

### **THE LOGO OF SBI**



Chapter 2.3

**THE ORGANISATION CHART**



## Chapter 2.4

### **PRODUCT & SERVICES OF THE BANK**

#### **Depository Products:-**

SBI is now offering following types of depository products for mobilizing the savings of the general people:-

- Current Account
- Savings Account
- Fixed Deposit
- SBI Recurring Deposits
- Foreign Currency Deposit Account

#### **Loan Products:-**

SBI is offering the following loan & advance products to the client that provide good return to the investment as well as to satisfy the client:-

- SBI Housing Loan
- SBI Personal Loan
- SBI Education Loan
- SBI Car Loan
- SBI Loan for Pensioners
- Loan Against Mortgage of Property
- Loan Against Shares & Debentures
- Loan Schemes like Rent plus Scheme, Modi-Plus Scheme.

#### **Corporate Banking:-**

- Assistance extended both as Fund based and Non-Fund based facilities to Corporates, Partnership firms, Proprietary concerns.
- Working Capital financing to all segments of industries and services sector such as IT.

**Personal Banking Products:-**

- ATM Card Service
- Credit Card Services
- Demat Account Statement
- Bill Payment
- Demand Draft
- Transaction Enquiry

**Government Business:-**

- Centralised Pension Processing Centre (CPPC).
- Government Accounts.
- Public Provident Fund.
- Senior citizens savings scheme.



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## **INTERNET BANKING FACILITIES PROVIDED BY SBI**

The Internet banking portal of SBI, enables its retail banking customers to operate their accounts all across India, removing the restrictions imposed by geography and time. It's a platform that enables the customers to carry out their banking activities from their desktop, aided by the power and convenience of the Internet.

Availing the Internet banking services, the following normal banking transactions can be done online:-

- Self-account funds transfer across India.
- Third party transfers in the same branch
- New account opening
- Demand Draft requests
- New Cheque-book request and much more.

Apart from these, the other salient value-added features available are:-

- Railway tickets booking
- Utility bill payments
- LIC and other insurance premium payments
- SBI Mutual funds Investments
- Credit card dues payments
- Depositing taxes
- Donations to Red Cross and such other organisations

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All this is at no cost - It's free! And most important - the site [www.onlinesbi.com](http://www.onlinesbi.com) is 'VeriSign' certified, indicating that it's absolutely safe and secure to transact online.



## **STATE BANK NETWORKED ATM SERVICES**

State Bank offers the convenience of over 8500 ATMs in India, the largest network in the country and continuing to expand fast! It means, we can transact free of cost at the ATMs of State Bank Group (This includes the ATMs of State Bank of India as well as the Associate Banks) and wholly owned subsidiary viz. SBI Commercial and International Bank Ltd., using the State Bank ATM-cum-Debit (Cash Plus) card.

### **Kinds of Cards accepted at SBI ATMs:-**

- State Bank ATM-Cum-Debit Card
- State Bank International ATM-Cum-Debit Card
- State Bank Credit Card
- Cards displaying Maestro, Master Card, Cirrus, VISA & VISA Electron Logos.



## Chapter 3.1

### WHAT IS CREDIT APPRAISAL?

It is the process by which a lender appraises the creditworthiness of the prospective borrower. This normally involves appraising the borrower's payment history and establishing the quality and sustainability of his income.

Factors like age, income, number of dependents, nature of employment, continuity of employment, repayment capacity, previous loans, credit cards, etc. are taken into account while appraising the credit worthiness of a person. Every bank or lending institution has its own panel of officials for this purpose.

### CREDITWORTHINESS OF BORROWERS

The business of sanctioning unsecured loans & advances is comparatively more risky & needs special care & attention on the part of the banker.

The 'Creditworthiness' of a person means that he deserves a certain amount of credit, which may safely be granted to him. Such creditworthiness is judged by the banker on the basis of his Character, Capacity & Capital (3'C's):-

#### 1) **CHARACTER:-**

In assessing the creditworthiness of a person, the first consideration is 'character' of the person concerned. The word 'Character' implies & includes a number of personal characteristics of a person, e.g. his honesty, integrity, regularity & promptness in fulfilling his promises & repaying his dues, sense of responsibility, good habits & reputation & goodwill which he enjoys in the eyes of others. If a person possesses all these qualities, without any doubt or suspicion in minds of others, he possesses an excellent character & will be considered creditworthy by the banker.

#### 2) **CAPACITY:-**

The success of an enterprise largely depends upon the ability, competence & experience of the entrepreneur. If the borrower possesses necessary technical skill,

managerial ability & experience to run a particular industry or trade, success of such unit may be taken for granted (barring some unforeseen circumstances) & the banker will consider him a deserving case for granting a loan. The significance of this factor is now growing as the banks are willing to grant unsecured loans to technicians & competent persons on the basis of soundness of their business projects, irrespective of their own capital.

### 3) **CAPITAL:-**

The banker also gives importance to the adequacy of capital of the borrower. Banks are the repositories of the public money & lend the borrowed money. The banker, therefore, does not lend money to an entrepreneur who does not have adequate funds of his own. In case of the failure of the business enterprise, the banker will be able to realise if the borrower's own capital is sufficient.

Apart from the above mentioned C's, there are some more criteria which should be examined, before sanctioning the loan. These criteria are as follows:-

- 1) **CASH FLOW:** - Cash flow is the vital factor that is used to identify whether the borrower will have enough cash to repay the loan or advance. Cash keeps the liquidity to ensure repayment. The banker tries to identify the annual cash flow from the submitted statements.
- 2) **CONDITIONS:** - The business & economic conditions may change after the loan is sanctioned. So these changes should be taken into consideration.
- 3) **CAREFULNESS:** - Documentation, follow-up & consistent monitoring are essential to high quality loan portfolios.

## **IMPORTANCE OF CREDIT APPRAISAL SYSTEM**

The function of commercial banks is to collect deposit from the common people and to invest deposited money in different sectors for overall development of the economy of the country. So the banks have to be very much careful in credit appraisal.

Commercial banks and financial institutions are intermediate between lenders and borrowers. These financial intermediaries collect deposit and disburse it as loan and advance to the individual people, business, commercial, industrial entity. The loan and advance should be given to them who have the certain and predicted cash flow to repay the credit. If the bank manager fails to analyze the client's viability of repaying the loan, possibility of default may arise due to the fact.

So the importance of APPRAISAL, in sanctioning the loan, is the key to identify the borrower's ability, expertise, efficiency, industrial analysis & business performance.

**RECOVERY OF CREDIT:** - Appraisal is done to ensure the recovery of the credit along with the good supervision, monitoring and the relationship. In other words, the purpose of appraisal is to be sure that the proposed advance will be safe, liquid, and profitable and for acceptable purpose covered by adequate security.

**SAFETY:** - The most important measure of appraising a loan proposal is safety of the project. Safety means the assurance of repayment of distributed loans. Bank is in business to make money but safety should never be sacrificed for profitability. To ensure the safety of loan, the borrower should be chosen carefully. He should be a person of good character & capacity.

**LIQUIDITY:** - The banker must ensure that the borrower is able to repay the loan on demand or within a short period. This depends upon the nature of assets owned by the borrower & pledged to the banker. E.g. goods & commodities are easily marketable while fixed assets like land & buildings can be liquidated after a time interval. Thus, the banker regards liquidity as important as safety of the funds & grants loans on the security of assets which are easily marketable without much loss.

**PROFIT:-**‘Profit’ is the blood for any commercial institution. Before approval of any loan project, the bank authority has to be sure that the proposed project will be a profitable venture.

**SECURITY:-**Security serves as a safety value for an unexpected emergency. Since risk factors are involved, security coverage has to be taken before a lending.

**DIVERSIFICATION OF RISK:-**During sanctioning any loan, bank has to be attentive about diversification of risk. All money must not be disbursed amongst a small number of people.

**NATIONAL INTEREST & GROWTH: -** Banking industry has significant role to play in the economic development of a country. The bank would lend if the purpose of the advances can contribute more to the overall economic development of the country.



## **CREDIT RISK ASSESSMENT (CRA)**

The CRA models adopted by the Bank take into account the factors which go into appraising the risks associated with a loan. These have been broadly categorised into Financial, Industrial & Management risks & are rated separately. To arrive at the overall risk rating, the factors duly weighted are aggregated & calibrated to arrive at “a single point indicator of risk” associated with the credit decision.

### **1) Financial Parameters: -**

The assessment of financial risk involves appraisal of the financial strength of the borrower based on performance & financial indicators. The overall financial risk is assessed in terms of static ratios, future prospects & risk mitigation (Collateral security / financial standing).

### **2) Industry Parameters: -**

The following characteristics of an industry which pose varying degrees of risk are built into the Bank’s CRA model:-

- ❖ Competition
- ❖ Industry outlook
- ❖ Regulatory risk
- ❖ Contemporary issues like WTO, etc.

### **3) Management Parameters: -**

The management of enterprise / group is rated on following parameters:-

- ❖ Integrity (Corporate governance)
- ❖ Managerial Competence / Commitment
- ❖ Expertise
- ❖ Structure & systems
- ❖ Credibility: ability to meet sales projections  
Credibility: ability to meet profit (PAT) projections
- ❖ Payment Record
- ❖ Strategic initiatives
- ❖ Length of relationship with Bank

## Chapter 3.2

### **THE BASIC TENETS OF SBI'S LOAN POLICY INCLUDE THE FOLLOWING:-**

- 1) The policy applies to all domestic lendings. Foreign branches have their own policies.
- 2) Optimum exposure levels are set out in the policy to different sectors in order to ensure growth of assets in an orderly manner.
- 3) The policy sets out minimum scores / hurdle rates (in terms of Credit Risk Assessment parameters) for new or additional exposures.
- 4) The policy lays down norms for take over of advances from other banks / FIs.
- 5) Bank's stand on granting credit facilities to companies whose directors are in the defaulter's list of RBI is covered in the policy.
- 6) As a matter of policy, the bank does not take over any Non Performing Asset (NPA) from other banks.

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## **CREDIT APPRAISAL STANDARDS OF SBI**

### **QUALITATIVE:-**

At the outset, the proposition is examined from the angle of viability & also from the Bank's prudential levels of exposure to the borrower, group & industry. Thereafter, a view is taken about Bank's past experience with the promoters, if there is a track record to go by. Where it is new connection for the Bank but the entrepreneurs are already in business, opinion reports from existing bankers & published data if available are carefully perused.

### **QUANTITATIVE:-**

The basic quantitative parameters underpinning the Bank's credit appraisal are as follows:-

#### **1) Liquidity:-**

Current Ratio (CR) of 1.33 is generally considered as a benchmark level of liquidity. However, the approach has to be flexible. CR of 1.33 is only indicative & may not be deemed mandatory. In cases, where the CR is projected at a level lower than the benchmark or a slippage in the CR is proposed, it alone will not be a reason for rejection of the loan proposal or for a sanction of the loan at a lower level. In such cases, the reasons for low CR or slippage are carefully examined & in deserving cases, the CR as projected may be accepted. Where it is felt that the projected CR is not acceptable but the borrower deserves assistance subject to certain conditions, suitable written commitment is obtained from the borrower to the effect that he would be bringing in required amounts within a mutually agreed time frame.

#### **2) Net Working Capital:-**

Although this is a corollary of current ratio, the movements in Net Working Capital are watched to ascertain whether there is a mismatch of long term sources vis-à-vis long term uses for purposes which may not be readily acceptable to the Bank so that corrective measures can be suggested.

**3) Financial Soundness:-**

This will be dependent upon the owner's stake or the leverage. Here again the benchmark will be different for manufacturing, trading, hire purchase & leasing concerns. For industrial ventures, a Total Outside Liability (TOL) / Tangible Net Worth (TNW) ratio of 3.0 is reasonable but deviations in selective cases for understandable reasons may be accepted by the sanctioning authority.

**4) Turn-Over:-**

The trend in turnover is carefully gone into both in terms of quantity & value.

**5) Profits:-**

While Net Profit is the ultimate yardstick, cash accruals i.e. profit before depreciation & taxation conveys the more comparable picture in view of changes in rate of depreciation & taxation which may have taken place in the intervening years. However, for the sake of proper assessment, the non-operating incomes are excluded as these are usually one time or extraordinary incomes. Companies incurring net losses consistently over 2 or more years will be given special attention, their accounts will be closely monitored & if necessary, exit options will be explored.

**6) Credit Rating:-**

Wherever the company has been rated by a Credit Rating Agency for any instrument such as Commercial Paper, this will be taken into account while arriving at a final decision. However, as the credit rating involves additional expenditure, the Bank would not normally insist on this & only use this tool, if such an agency had already looked into the company finances.

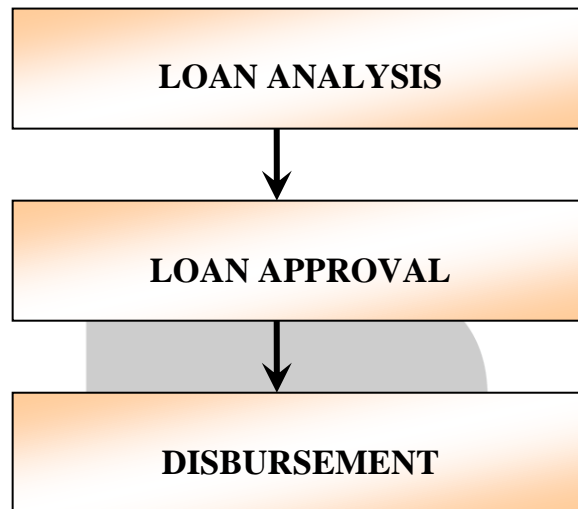
**7) Capital Markets:-**

Where the company's shares are listed on stock exchanges, the movement of the price of its share, the Market Value of shares vis-à-vis those of competitors in the same industry, response to public / rights issues are also kept in view as these are reflective of the corporate image in the eyes of the investor's community.

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## Chapter 3.3

### PROCEDURE FOR SANCTION OF LOAN



#### (1) **Loan Analysis:-**

- a) Receipt of proposal from the borrower at the branch.
- b) Acknowledging the application.
- c) Perusal & calling for additional details of any.
- d) Obtaining additional details & analysing thereon for technical feasibility (by industrial development officers, engineers) & financial viability of the project.
- e) The financial viability is assessed through current ratio, leverage ratio, etc.

#### (2) **Loan Approval:-**

- a) After a careful analysis of ratios, profitability, technical competence, etc. of the project, the proposal is either sanctioned at branch level or forwarded to controlling offices, depending upon the quantum of loan sought.
- b) The proposal is approved by the competent authority & sanction is communicated to the borrower.

#### (3) **Disbursement:-**

- a) The documents concerned are obtained from the borrower.
- b) Pre-release audit is conducted.
- c) Loan amount is disbursed in stages or in full based on type of loan.

**DELEGATION OF POWERS FOR CREDIT APPRAISAL AT SBI**

1. The Executive Committee of the Central Board (ECCB) has full powers for sanctioning all credit facilities.
2. The sanctioning powers have been delegated down the line to committees of officials at various administrative offices & individual line functionaries.
3. An appropriate control system is also in operation in tune with the delegation structure. The powers exercised by various functionaries are required to be reported to the next higher authority as laid down in the Scheme of Delegation of Financial Powers.
4. A system of loan review styled 'Credit Audit' which inter alia covers audit of credit sanction decisions at various levels has been implemented. Presently all accounts with total fund based indebtedness of Rs.5 Cr. & above are subjected to 'Credit Audit'. The audit system serves as an effective control on the system of sanction of loans in the Bank through widely delegated powers.

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## Chapter 3.4

### **DOCUMENTATION FOR SANCTION OF LOAN**

Documentation is obtaining such agreement where all the terms and conditions and securities are written and signed by the borrower. It specifies rights and liabilities of both the banker and the borrower.

In documentation, each type of advances requires a different set of documents. It also differs with the nature of securities.

The documents should be stamped according to the 'Stamp Act'.

There are no hard & fast rules of documentation & it varies from bank to bank.

### **DOCUMENTATION STANDARDS OF SBI**

The systems & procedures for documentation have been laid down keeping in view the ultimate objective of documentation which is to serve as primary evidence in any dispute between the bank & the borrower & for enforcing the Bank's right to recover the loan amount together with interest thereon.

In order to achieve this objective, the Bank's documentation process attempts to ensure that:-

1. The owing of the debt to the Bank by the borrower is clearly established by the documents.
2. The charge created on the borrower's assets as security for the debt is maintained & enforceable.
3. The Bank's right to enforce the recovery of the debt through court of law is not allowed to become time-barred under the Law of Limitation.

Documentation is not confined to mere obtention of security documents at the outset. It is a continuous & ongoing process covering the entire duration of an advance.

**CHECK LIST (DOCUMENTS) FOR HIGH VALUE PROPOSALS**

While sanctioning the high amount of loan, SBI asks for the following documents to the loan applicant:-

- 1) Feedback form: - This form is for the existing unit & it gives the details about percentage utilization of the present limit, interest, exchange, commission earned in the previous financial year & for the current year.
- 2) Application / Request letter for credit facilities.
- 3) Partnership Deed / Memorandum & Articles of Association.
- 4) CMA Data in Bank's prescribed format. (CMA should cover past 3 years data & estimated data of 2 years for working capital & if TL – till the repayment is over).
- 5) Audited financial statements of the company for last 3years along with all schedules / auditor's notes.
- 6) List of sundry creditors, sundry debtors (age-wise) & unsecured creditors / depositors, etc.
- 7) Name of the present bankers / branch. Copy of sanction letter along with terms & conditions received from the present bankers.
- 8) Facilities enjoyed / present position of the account as on a recent date.
- 10) Information of Associate Companies, if any in standard format.
- 11) Audited financial statements of all associate companies, their present bankers, credit facilities, securities offered, etc.
- 12) Statement of personal assets & liabilities of Directors / Partners (where personal guarantee is being offered).
- 13) Bio data of all the partners / directors on the Bank's standard format.
- 14) Copies of latest Income Tax Assessment Order & PAN No., Sales Tax, and Assessment Order.
- 15) Details of collateral security offered.
- 16) Project Report & Details of expansion programme.
- 17) Details of orders on hand.
- 18) Staff / Labour strength, Installed Capacity, Production in quantity.
- 19) Copies of ISO Certification, ratings by any external agencies like ICRA / CRISIL.

## **FINANCIAL STATEMENT ANALYSIS**

Analysis of financial statements constitutes the 'Back-bone of good lending'. Basically, the funds used by a banker for his loaning operations are provided by depositors & consequently, the interests of the latter should be the major factor to determine the criteria for good lending. The principles of good lending are stated as:-

- Yield
- Liquidity
- Safety of Funds
- Purpose.

Analysis of financial statements is done for finding the answers of following two questions:-

- 1) How the liquidity of the enterprise is to be measured?
- 2) What financial & other criteria are to be used to judge the safety of loans?

Analysis of financial statement is thus important to the banker for following two reasons:-

- 1) To decide on whether to extend the advance or not.
- 2) If the advance is to be extended, what the quantum of advance should be?

To assess the working capital limits required, financial statement analysis is used in the Projected Balance Sheet method in large value advances, i.e. above Rs.25lacs for industrial units in C & I segment & above Rs.5 Crore in the SSI segment. Also, even where Projected Balance Sheet method is not used for assessing the credit requirements, analysis of financial statement is still necessary to determine the safety of advance. The Credit Risk Assessment (CRA) process requires an analysis of financial statements of the units & calculation of various ratios, before scoring under the Bank's CRA rating.

### **RATIO ANALYSIS:-**

Basically, the Balance Sheet & Profit & Loss Account provides information which helps us to assess 3 main aspects of an organisation's position viz. its solvency, liquidity & profitability. Instead of studying an item in isolation, it should be studied in comparison with industry average or with a similar type of unit in the same areas and / or the trend for the same enterprise for a period of 3-4 years.

## Chapter 4.1

### **SBI's WORKING CAPITAL FINANCING TO COMMERCIAL SECTOR**

An industry requires funds to acquire 'Fixed Assets' like land, building, plant, machinery, equipments, vehicles, tools, etc. & also to run the business i.e. its day to day operations.

Funds required for day-to-day working will be to finance production & sales. Funds are needed for purchase of raw material, stores, fuel, for employment of labour, for power charges, for storing finished goods till they are sold out & for financing the sales by way of sundry debtors / receivables.

'Working Capital' is defined as the funds necessary to carry the required levels of current assets to enable the unit to carry on its operations at the expected levels uninterrupted.

Thus, working capital required is dependent on:-

- a) The volume of activity (viz. level of operations i.e. production & sales).
- b) The activity carried on (viz. manufacturing process, product, production programme, the materials & marketing mix).

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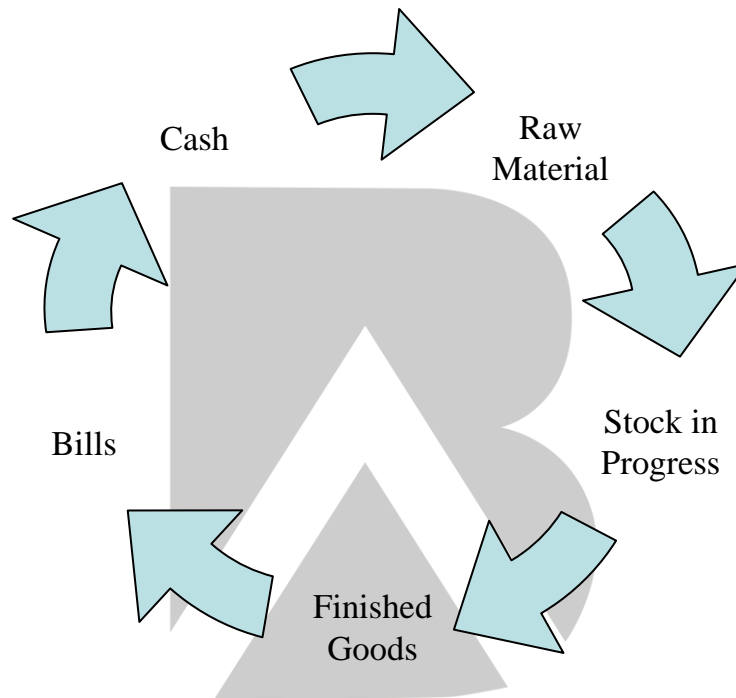
Though there are various methods used by the Bank for assessing the quantum of working capital requirement for an industry, the following are commonly used:-

**Methods & Application:-**

<b>Segment</b>	<b>Limits</b>	<b>Method</b>
SSI	Up to Rs.5 Crore	Traditional Method & Nayak Committee Method
	Above Rs. 5 Crore	Projected Balance Sheet Method
SBF	All loans	Traditional / Turnover Method
C & I Trade & Services	Up to Rs.1 Crore	Traditional Method for Trade & Projected Turnover Method
	Above Rs.1 Crore & up to Rs.5 Crore	Projected Balance Sheet Method & Projected Turnover Method
	Above Rs.5 Crore	Projected Balance Sheet Method
C & I Industrial Units	Below Rs.25 lacs	Traditional Method
	Rs.25 lacs & over up to Rs.5 Crore	Projected Balance Sheet Method & Projected Turnover Method
	Above Rs.5 Crore	Projected Balance Sheet Method

## OPERATING CYCLE METHOD

Any manufacturing activity is characterised by a cycle of operations consisting of purchase of materials for cash, converting these into finished goods & realising cash by sale of these finished goods.



**Fig.:- Operating Cycle**

The time that lapses between cash outlay & cash realisation by sale of finished goods & realisation of sundry debtors is known as length of operating cycle. The length of operating cycle is different from industry to industry. E.g.:- The operating cycle of pharmaceutical unit would be quite different from one engaged in the manufacture of machine tools.

That is, operating cycle consists of:-

- a) Time taken to acquire raw materials & average period for which they are in store.
- b) Conversion process time.
- c) Average period for which finished goods are in store.
- d) Average collection period of receivables (Sundry debtors).

The length of operating cycle = a + b + c + d.

E.g.:- a = 60 days

b = 10 days

c = 20 days

d = 30 days,

The operating cycle is 120 days (nearly 4 months). This means, there are  $365/120 = 3$  cycles of operations in a year.

### ASSESSMENT OF WORKING CAPITAL REQUIREMENT & PERMISSIBLE BANK FINANCE USING OPERATING CYCLE CONCEPT:-

Let us consider a case of a unit where:-

Sales	Rs.20,000 p.m. (A)
Raw Material	Rs.14,000 p.m.
Wages	Rs.2,000 p.m.
Other manufacturing expenses	Rs.3,000 p.m.
Total Expenditure	Rs.19,000 p.m. (B)
Profit	Rs.1000 p.m.

The operating cycle is:-

Raw material	15 days
Stock in process	2 days
Finished goods	3 days
Sundry debtors	15 days

The total length of operating cycle = 35 days (D)

Working Capital Requirement =  $B * D / 30$

$$= 19000 * 35 / 30$$

$$= \text{Rs.}22166 \text{ (approx.)}$$

**TRADITIONAL METHOD OF ASSESSMENT OF  
WORKING CAPITAL REQUIREMENT (WCR)**

The operating cycle concept serves to identify the areas requiring improvement for the purpose of control & performance review. But the bankers require more detailed analysis to assess the various components of WCR viz. finance for stocks, bills, etc.

Bankers provide working capital finance for holding an acceptable level of current asset viz. Raw Material, Stock-in-Process, Finished Goods & Sundry Debtors for achieving a predetermined level of production & sales. Quantification of these funds required to be blocked in each of these items of current asset at any time will therefore provide measure of the WCR of an industry.

While computing the WCR of a unit, it is necessary to take into account two other factors:-

- 1) Credit received on purchases
- 2) Advance received against orders placed for the products for industry.

Thus, WCR can be computed as:-

Raw Material	Months Requirement	Rs.A
Stock-in-Process (for period of processing)	Months cost of Production	Rs.B
Finished Goods	Months cost of Production required to be stocked	Rs.C
Sundry Debtors	Months cost of Production (Outstanding Credits)	Rs.D
Expenses	One month (say)	Rs.E
		A+B+C+D+E
Credit received on purchases		Rs.F
Advance Payment on Order Received		Rs.G
<b>Working Capital Requirement (WCR)</b>		(A+B+C+D+E) - (F+G)

The unit starts with a certain amount of capital which will not normally be sufficient even to meet the cost of Fixed Assets. The unit thus arranges for a long term loan from a financial institution or a bank towards a part of the cost of fixed assets. From these two sources, after meeting the cost of fixed assets, some funds remain to be used for working capital. This amount is 'Net Working Capital' or 'Liquid Surplus' & will be one of the sources of meeting working capital requirement.

The remaining funds for working capital have to be raised from Banks. Banks normally provide working capital finance by way of advances against stocks & sundry debtors.

However, banks do not finance the full amount of funds required for carrying inventories & receivables & normally insist on the stake of the enterprise at every stage, by way of margins. Margins are imposed with a view to have adequate stake of the promoter in the business both to ensure his adequate interest in the business & to act as a bulwark against any stocks that the business may sustain. The margins stipulated will depend on various factors like saleability, quality, durability, price fluctuations in the market for the commodity, etc.

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Taking into account the total working capital requirement as assessed earlier, the permissible limit, up to which the bank finance can be granted is arrived at as shown below:-

**Permissible Limit**

Raw Material	Rs.A
Less : % margin	Rs.B
	$Rs.A - Rs.B = \mathbf{Rs.P}$
Stock-in-process	Rs.C
Less : % margin	Rs.D
	$Rs.C - Rs.D = \mathbf{Rs.Q}$
Finished Goods	Rs.E
Less : % margin	Rs.F
	$Rs.E - Rs.F = \mathbf{Rs.R}$
Sundry Debtors (at sale value)	Rs.G
Less : % margin	Rs.H
	$Rs.G - Rs.H = \mathbf{Rs.S}$
<b>Total Permissible Limit</b>	<b><math>P + Q + R + S = T</math></b>

‘P + Q + R’ will indicate the total limit against stock & ‘S’ the limit against sundry debtors or receivables in the form of bills. The difference between the Working Capital Requirement (WCR) & the total permissible bank borrowing (T) should be met from the Liquid Surplus or Net Working Capital. When the liquid surplus is not sufficient to meet the long term working capital requirements, there will be a ‘deficit’ in meeting the unit’s working capital requirement.

The format in which the Bank assesses the WCR & the permissible limit of bank finance under Traditional Method is shown below:-

### Assessment of WCR

Name of the Unit: - M/s ABC Ltd.

	(Rs. in 000's)
Anticipated monthly sales	Rs.100
Cost of production per month	Rs.90
Cost of Raw Material	Rs.80

Item	Stocking / Payment period	Working capital required	Margin %	Amount	Permissible limit
Imported Raw Material	---	---	---	---	---
Indigenous Raw Material	1 month	80	25	20.00	60.00
Work in Process	2 weeks	45	25	11.00	34.00
Finished Goods	2 weeks	45	25	11.00	34.00
Receivables (at sales value)	1 month	90	33	23.00	67.00
Expenses	1 month	10	100	10.00	---
Total		270		75.00	195.00

Advance payment received	10.00
Credit on purchase	40.00
<b>Working Capital Required (WCR)</b>	$270 - (10 + 40) = 220$

**Sources:-**

Liquid surplus in Balance Sheet as at the end of last year	20
Limits from Bank	195
Total	215
Net deficit	$220 - 215 = 5$

**How the deficit will be met?**

Deficit will have to be met by plough back of profits or unsecured loans. Deficit should be reasonably small when compared to the WCR / Bank Finance / Profitability of the unit.

**Note:-**

1. Sales are to be computed at the maximum level of anticipated production during the next 12 months.
2. Cost of production includes cost of raw material plus all expenses.
3. Work In Process (WIP) & Finished Goods are to be calculated on the basis of Cost of Production.
4. Net deficit, if any, in the balance sheet is to be added to WCR.

Since the limits will be arrived on the projections given by the unit, the assumptions & presumptions made by the unit should be properly analysed before sanction of the limit.



**PROJECTED ANNUAL TURNOVER METHOD FOR SSI UNITS**  
**(NAYAK COMMITTEE)**

For SSI units which enjoy fund based working capital limits up to Rs.5 Crore, the minimum working capital should be fixed on the basis of projected annual turnover. 25% of the output or annual turnover value should be computed as the quantum of working capital required by such unit. The unit should be required to bring in 5% of their annual turnover as margin money & the Bank shall provide 20% of the turnover as working capital finance. Nayak committee guidelines correspond to working capital limits as per the operating cycle method, where the average production or processing cycle is taken to be 3 months. (i.e. working capital would be turned over 4 times in a year.)

**Example: -**

(Rs. in 000's)

Anticipated annual output	1200 (A)
WCR @ 25% of A	300 (B)
Less: Liquid surplus or 5% of A, whichever is higher. (Liquid surplus, say, is Rs.20,000)	60
Minimum Permissible Bank Finance (B-C)	240

**APPRAISAL**

1. It is to be ensured that the projected annual turnover is reasonable & achievable by the unit & further, the estimated growth if any over the previous year is realistic.
2. Date of actual sales pertaining to the last 5 years, estimated for the current year & projected for the next year, together with the trend analysis of the industry to which the unit belongs, would also be useful while appraising the sales projections.
3. Other information regarding modernisation, expansion of the existing manufacturing capacity, government policies, taxation & other relevant internal & external factors also need to be taken into account.

**PROJECTED ANNUAL TURNOVER METHOD FOR BUSINESS  
ENTERPRISES IN TRADE & SERVICES SECTOR**

For working capital limits up to Rs.5 Crore to C & I Trade Sector, the assessment of credit limit is to be based upon annual turnover. The credit limit equal to 15% of projected annual turnover is offered to business enterprises in the T & S Sector. It would be available for utilisation generally as a cash credit limit.



### **PROJECTED BALANCE SHEET (PBS) METHOD**

This method is applicable to all C & I borrowers who are engaged in manufacturing, services & trading activities, including merchant exports & who require fund based working capital finance of Rs.25 lacs & above. In the case of SSI borrowers, who require working capital credit limit up to Rs.5 Crore, the limit shall be computed on the basis of Nayak Committee formula as well as that based on production & operating cycle of the unit & the higher of two may be sanctioned. Fund based working capital limits beyond Rs.5 Crore for SSI units shall be computed in the same way as for C & I units. For business enterprises in T & S sector, where the projected turnover method is not applicable, PBS method shall be followed.

In PBS method, the borrower's total business operations, financial position, management capabilities, etc. are analysed in detail to assess the working capital finance required & to evaluate the overall risk of the exposure.

#### **Collection of Financial Data:-**

For working capital assessment, the required financial data are obtained from the borrower in the following forms:-

<b>Form I</b>	Particulars of existing / proposed limits from the banking system
<b>Form II</b>	Operating Statement
<b>Form III</b>	Analysis of Balance Sheet
<b>Form IV</b>	Comparative Statement of CA / CL
<b>Form VI</b>	Funds Flow Statement

Information provided in the forms II, III, IV & VI serves the detailed financial analysis. In form I, in addition to information relating to working capital & TL borrowings (existing & proposed) information regarding borrowings from NBFCs, borrowings from term lending institutions for working capital purposes, inter corporate deposits taken, lease finance availed will also be collected.

## Chapter 4.2

### **SBI's WORKING CAPITAL FINANCING TO AGRICULTURE SECTOR**

The appraisal is always to be made in the field & only desk studies are not enough for sanctioning agriculture loan. Appraisal should generally cover following 7 aspects:-

#### **1) Technical Aspects:-**

- a) Various inputs – Technical & Material that would go into the project.
- b) Choice of technology – its adaptability.
- c) Technical relationship between soil, water, rainfall & temperature & their implication on the project.

#### **2) Financial Aspects:-**

- a) Investment needed – outlay, unit cost, number of units, margin, loan, refinance, repayment.
- b) Working Capital needed – whether to be met by the Bank or other agencies or the borrower himself.
- c) Time Value of Money.
- d) Cash flow – time frame for generation of benefits.
- e) Benefits Cost ratio (B.C. ratio) – Present worth of benefits over present worth of cost should be more than 1.
- f) Internal Rate of Return.
- g) Earning Power of Project.
- h) Financial impact on individual participant, incentive, etc.
- i) Opportunity Cost.
- j) Sources of funds for investment & working capital – Loan component & subsidy available.

**3) Commercial Aspects:-**

- a) Revenue earning enterprises – how attractive.
- b) Arrangement for supply of raw materials required to build up the projects.
- c) Supply of labour required.
- d) Marketing arrangement for outputs – location of market, its capacity to absorb new / increased production, likely effect on price, etc.

**4) Managerial Aspects:-**

- a) Ability of implementing agency (staff) to manage the project – their expertise & experience as well as that of the participating farmers.
- b) The necessary arrangements like training support & extension service, if new managerial skills are required by the implementing agency's staff or the farmers.

**5) Organisational Aspects:-**

- a) Suitability of organisational structure of the implementing agency & its capacity to implement the project.
- b) Organisation of other concerned agencies, their efficiency & ability to co-ordinate with the project plan.

**6) Social Aspects:-**

- a) Social structure of the project area, custom & culture, attitude towards change, facilities available to hasten change in process.
- b) Social implication of the project effect on income distribution, impact on different groups, impact on quality of life & environmental impact.
- c) Impact on employment opportunity & potential.

**7) Economic Aspects:-**

- a) Project's contribution from the society's point of view.
- b) Whether high priority is accorded by the government?
- c) Economic analysis is generally done in respect of the projects submitted by banks to NABARD.

**GENERAL CONSIDERATIONS FOR APPRAISAL OF  
AGRICULTURE LOAN**

1. The appraisal exercise commences after first determining the prima-facie eligibility of a particular proposal. The appraisal exercise should conclude with a decision on –
  - i. What quantum of loan should be given &
  - ii. On what terms (security, margin, interest, documentation, disbursal, repayment).
  
2. Loan applications should be sanctioned / declined as soon as possible, but in any case within the following limits (in weeks from the date of receipt of completed applications) :

		Those sanctioned at a branch	Those referred To controlling authorities
Crop loans	New	2	4
	Renewal / increase in limit	1	3
Term Loans	New	4	6
	Renewal / increase in limit	2	4
Loans for allied agricultural activities		6	8

3. The credit-worthiness of applicants, market prices, risk, competitive conditions, quality & location of land, technical feasibility, etc. can only be ascertained by independent field enquiries. Pre-sanction inspections are one of the sources of such information.
  
4. All working capital loans should be renewed each year with the exception of crop limits of regular borrowers up to Rs.5000. While term loans need not be renewed, they should nevertheless be reviewed each year.

**CHECK LIST (DOCUMENTS) FOR AGRICULTURE LOAN**

1. No dues certificate from other banks & title investigation report are required to obtain.
2. Report from groundwater surveys & development agency are needed to obtain regarding availability of groundwater.
3. Cost estimates for the proposed investment are reasonable & are supported by estimates / invoices given by suppliers.
4. If irrigated crops are to be taken up, then it is required to ensure that whether adequate irrigation facilities are available. If river water is utilised for irrigation, then it is necessary to confirm that whether permission has been obtained from the government department.
5. In case where irrigated crops are raised for the first time, the suitability of land for irrigation, the likely response from the land, availability of skilled labour, etc. are ensured.
6. The pre-sanction / post-sanction inspection reports are to be obtained from the concerned official & kept record.

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### **DUTIES OF SPECIAL STAFF**

**TECHNICAL OFFICER:** - He is a personnel trained in various disciplines of agriculture. He lends support to the Bank both in planning new strategies as well as in assessing the various agriculture business proposals. He performs the following duties:-

- i. He prepares schemes for agricultural development in the area chosen.
- ii. He determines whether the village selected for financing is suitable for extending loans.
- iii. He organises village meetings for explaining the bank's schemes.
- iv. Wherever necessary, he ensures that the farmers do not experience any difficulty in getting application forms, filling & submitting them to the Bank.
- v. He examines the technical feasibility & economic viability of the proposals, makes pre-sanction inspection & submits recommendations on the proposals to the appropriate authority.

**FIELD OFFICER:** - The role of field officer has 3 important dimensions as follows:-

- i. Appraisal of Agriculture Loans :-

From the moment a demand for Bank credit is received until a credit decision is taken or the demand is rejected by the appropriate authority, all that is required to be done in the nature of scrutiny & processing of the loan application devolves on the field officer.

- ii. Obtention of appropriate documents & registration of the Bank's charge wherever required.

- iii. Supervising disbursement of the loan amount :-

Since the loan is disbursed in phases and / or direct payments made there from to the suppliers of inputs or equipments, it is for the field officer to ensure that payments from the sanctioned limit is made in accordance with the terms of sanction on record with him.



**SCALE OF FINANCE FOR CROPS 2007-08**

(Provided By NABARD)

<b>Name of the Crop</b>	<b>Total finance per Acre</b>
<b>Kharif Crops :</b>	
Bajra (Irrigated / Hybrid)	3000
Bajra (Rain fed)	2000
Jowar (Irrigated / Hybrid)	3100
Jowar (Rain fed)	2100
Paddy (Irrigated / Hybrid)	6000
Paddy (Rain fed)	4000
Maize	3500
<b>Rabbi :</b>	
Wheat (Hybrid / irrigated)	4000
Wheat (Dry)	2700
<b>Oil Seeds &amp; Pulses :</b>	
Soya bean	3500
Sunflower	3000
Ground Nut (Irrigated)	5500
Ground Nut (Rain fed)	4000
Ground Nut (Summer)	550
<b>Cash Crops :</b>	
Cotton (Irrigated)	5000
Onion (Late Kharif)	10000
Onion (Summer)	10000
Potato	12000
Tomato (Hybrid)	15000
Turmeric	35000
<b>Horticultural Plants :</b>	
Grapes (Export)	90000
Grapes (Improved)	70000
Mango (Improved)	5000
Coconut	3000
Cashew	2000
<b>Sugarcane :</b>	
Adsali	22000
Suru (Seasonal)	20000
Adsali (Tissue Culture)	25000
Suru (Tissue Culture)	25000
<b>Floriculture :</b>	
Rose	21000
Gladiola	30000
Gerbera	32000

## Chapter 4.3

### CASE – STUDIES

Banks provide loans to agriculture sector & the majority of enterprises to satisfy their Working Capital Requirements. For each type of enterprise, the credit appraisal criteria differ. It can be well explained through the case – studies. Here, 3 cases of credit appraisal to Commercial Sector & 1 case of credit appraisal to Agriculture Sector are considered. These cases are as follows:-

#### CASE No. 1

**Proposal:** - Sanction of FBWC limit of Rs. 27 lacs under Trader's Easy Loan Scheme including takeover of DCC limit of Rs. 10 lacs from YMC Bank Ltd.

(Trader's Easy Loan scheme is launched by SBI to provide hassle free loan to Traders. Any business man / entrepreneur / Professional and self employed person can avail this loan. Loan under the scheme can be availed to meet normal business requirements and is sanctioned against equitable mortgage of property. Any residential or commercial property in the name of unit / proprietor / partner OR their close relatives is acceptable. Agriculture property or property outside urban limits is not accepted.

Minimum and maximum amount of loan is Rs 25,000/- and Rs 5.00 Crore. Margin is 35% i.e. loan can be up to 65% of the realizable value of the property or the business requirement- whichever is less. Business requirement is assessed on the basis of projected business turnover.

Loan is to be repaid in maximum 5 yrs. No third party guarantee is required to avail the loan.)

Name of the Unit	XYZ Ltd.
Location	Nasik.
Constitution	Proprietorship
Segment	C & I
Name of the Proprietor	Mr. K. K. Deshmukh
Line of Activity	Wholesale Tea Merchant, Agency of Sapat International Ltd & Wholesale Kirana Merchant.
Date of Establishment	Year 1978
Banking with SBI	New connection
Method used for assessing working capital limits	Projected Turnover Method

### Financial Indicators

(Rs. in Lakhs)

As on 31/ 3	Audited 2006	Audited 2007	Provisional 2008	Projected 2009	Projected 2010
Net Sales	171.21	164.37	180.40	205.00	225.00
Operating Profit	1.73	1.53	1.89	0.91	1.48
PBT	2.83	2.83	3.10	2.24	2.95
PAT	2.83	2.83	3.10	2.04	2.65
Cash Accruals	2.90	2.90	3.16	2.09	2.69
PBDIT	4.46	4.59	4.81	6.13	6.80
PUC	10.13	8.80	7.10	7.10	7.10
TNW	12.96	14.46	15.86	17.40	19.30
TOL / TNW	2.35	1.56	1.96	2.60	2.35
Current Ratio	2.31	1.95	1.73	1.44	1.48

All the financial indicators are at acceptable level. As critical financial analysis is not envisaged under Trader's Easy Loan Scheme, the Bank has not commented upon individual parameters.

**Assessment of Working Capital Limit**

(Rs. in Lakhs)

A	65% of Realizable Value of Security Charged	32.10
B	15% of Projected Sales (2008-09)	30.75
C	90% of Working Capital Requirement	27.68
D	Limit Eligible (Lower of A & C)	27.00
E	Loan Applied for	30.00
F	Limit Recommended	27.00

**Comment:-**

The turnover of the firm has increased by 14% during the last year. Thus, the firm requires additional working capital to tune with the increasing sales. As such the proprietor has requested for takeover of DCC limit from YMC Bank Ltd. with enhancement of Rs. 30 lacs. However, as per assessment, the firm is eligible for DCC limit of Rs. 27 lacs.



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**CASE No. 2**

**Proposal:** - Sanction for DCC limit of Rs. 60 lacs under Bank's liberalised scheme.

(Under the liberalised scheme, SBI extends production-linked credit facilities to small-scale industries, ancillary industrial units and village and cottage industrial units on liberal terms & conditions. Under this scheme, the quantum of advances is not linked to the security furnished, but the genuine requirements of the unit.)

Company	M/s ABC Laminations & Coatings Private Ltd.
Branch	Ambad, Nasik.
Constitution	Private Limited Company
Segment	SSI
Industry	Plastic
Activity	Manufacturing & job work of coating, metalizing, laminating, embossing, holographing of plastic films, sheets, papers & manufacturing yarns.
Banking with SBI	New connection
Methods used for assessing working capital limits	Traditional Method & Nayak Committee Method

**I) Working Capital Assessment as per Traditional method:-**

For calculating the Working Capital Requirement of the company, following data is collected.

**Inventory & Receivables levels (Days):-**

<b>Inventory</b>	<b>Estimated 2008-09</b>	<b>Projected 2009-10</b>	<b>Projected 2010-11</b>
Raw Material	45	45	45
Finished Goods	-	-	-
Receivables	60	60	60
Sundry Creditors	19	17	17

	<b>Rs. in lacs for the year 2008-09</b>
Anticipated Monthly Sales	484.92
Cost of Production	371.39
Cost of Raw Material	294.36
Expenses	77.03

From the above data, Working Capital Requirement & Eligible Bank Finance is calculated as follows:-

<b>Particulars</b>	<b>Stocking / Payment Period (Days)</b>	<b>Working Capital</b>	<b>Margin %</b>	<b>Value</b>	<b>Bank Finance</b>
Raw Material	45	36.80	25%	9.20	27.60
Sundry Debtors	60	61.90	40%	24.76	37.14
Expenses	30	6.42	100%	6.42	-
<b>Total Working Capital Required</b>		<b>105.12</b>		<b>40.38</b>	<b>64.74</b>
Less : Credit on Purchases		15.54			
NWC or Liquid Surplus as on 31/3/08		---			
Eligible Bank Finance		89.58			
Loan Applied for		60.00			
Bank Finance Recommended		60.00			
Deficit		29.58			

Deficit of 29.58 lacs will be met through internal cash accruals.

**II) Working Capital Assessment as per Nayak Committee Method**

	<b>Rs. in lacs for the year 2008-09</b>
Projected Annual Turnover	484.92
25% of the Projected Annual Turnover	121.23
5% Margin	24.25
NWC or Liquid Surplus as on 31/3/08	---
Eligible Bank Finance	96.98
Bank Finance Applied for	60.00
Loan Recommended	60.00

**Comments:-**

The unit has applied for the fund based DCC limit of Rs. 60.00 lacs for the Projected Turnover of Rs. 484.92 lacs. The DCC limit of Rs. 60.00 lacs is recommended for sanction, as the unit is eligible for it.

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**CASE No. 3**

**Proposal:** - Enhancement in DCC (Hypothecation of Stocks & Book Debts) limit from Rs. 150 lacs to Rs. 300 lacs.

Unit	M/s PQR Wheat Products Pvt. Ltd.
Branch	Nasik Road
Segment	SSI
Activity	Agro based industry
Methods used for assessing working capital limits	Nayak Committee Method & Projected Balance Sheet Method

**Assessed Bank Finance**

	<b>2005-06 (Actual)</b>	<b>2006-07 (Actual)</b>	<b>2007-08 (Estimated)</b>	<b>2008-09 (Projected)</b>
TCA	416.13	450.83	619.35	640.80
OCL	102.09	102.92	81.02	87.28
WC Gap	314.04	347.91	538.33	553.52
NWC	176.09	228.03	238.33	253.52
Bank finance	137.95	119.88	300.00	300.00

The NWC of the company is showing an improving trend over the years & is expected to strengthen the position in coming years & is acceptable.



**Working Capital Requirement as per Nayak Committee Recommendation**

(Rs. in lacs)

I	Projected Turnover 2007-08	3200.00
II	WCR (25% of Projected Sales)	800.00
III	Margin (5% of Sales)	160.00
IV	NWC as on 31/3/07	234.51
V	Eligible Bank Finance II – (max. of III & IV)	565.49
VI	Bank Finance Applied for	300.00
VII	DCC limit Recommendation	300.00

**Projected Balance Sheet Method**

(Rs. in lacs)

	2007-08	2008-09	2009-10	2010-11
TCA	619.35	640.80	666.70	701.85
OCL	81.02	87.28	92.35	85.90
WC Gap	538.33	553.52	574.35	615.95
NWC	238.33	253.52	274.35	315.95
Bank finance	300.00	300.00	300.00	300.00

**Let's Business****Comment:-**

Considering the availability of liquid surplus (NWC) & in view of what has been stated above, DCC Hypothecation Limit of Rs. 300.00 lacs is recommended for sanction.

**CASE NO. 4**

**Proposal:** - Agriculture Cash Credit under Kisan Credit Card, for grapes (Thompson variety) in 17.25 acres.

[Kisan Credit Card (KCC) is the scheme provided by NABARD / RBI guidelines, through which the running account facility is provided to farmers, to meet their production credit need & cultivation expenses.]

Name of the Borrower	Mr.B.K.Pagar
Education	Diploma in Horticulture
Address	Lakhamapur, Tal. Dindori, Dist. Nasik.
Net Worth (Opinion Report dtd. 16/5/08)	Rs. 64.36 lacs.
Relationship with SBI	Old Customer

**About the Guarantors:-**

Name & Address	Worth in lacs	Opinion Report dated
Mr. A. J. Patil	23.65	16/05/08
Mr. N. S. Mahajan	14.04	16/05/08

**Assessment of KCC Limit:-**

Crop	Scale of Finance	Limit Entitlements (Rs.)
Grape – 17 acres	70000/- per acre	1207500
Contingencies	@ 20%	241500
Loan / Limit Entitlement		1449000
Limit Applied for		1449000

**Repayment:** - On or before 31/5/09 – Rs.1449000 + Interest

**Interest:** - 8% p.a.

**Anticipated Income from Agricultural Operations:-**

Crop	Grape (Thompson)
Area in acres	17.25
Cost of Cultivation on per acre	84000
Total Cost (KCC)	Rs.1449000
Yield per acre	12 Ton
Total Yield	207 Ton
Rate per Ton	Rs.13000
Total Income	Rs.2691000
Net Profit	Rs.1242000

**Reports from Technical & Field Officers:** - The officers have carried pre-sanction inspection on 16/5/08 & kept the following report on record.

1. The applicant is well educated & has completed diploma in Horticulture.
2. The applicant has applied for crop loan of Grape garden (Thompson variety) on 17.25 acres.
3. The water is available from well having sufficient water discharge to take care of plantation.
4. The required load of MSEB is also available.
5. All the inputs are available locally.

**Comment:-**

An anticipated income & above reports form officers indicate that the proposal is technically & economically viable. Also, the applicant & his family members are the valued customers of SBI & have good integrity & credit worthiness. Thus, the Bank has recommended KCC limit of Rs.1449000/- to Mr.B.K.Pagar.

## Chapter 4.4

### **EFFICIENCY OF CREDIT APPRAISAL SYSTEM OF SBI**

The level of Non – Performing Assets (NPA) can be one of the parameters to judge the efficiency of Credit Appraisal System. Because when the borrower fails to repay the loan, it becomes a Non – Performing Asset for the Bank. But the low level of Bank NPA indicates that before sanctioning loan, the creditworthiness & repaying capacity of the loan applicants were judged properly by the Bank.

Following table contains the year-wise data of Working Capital financed by SBI to Commercial & Agriculture Sector. It also contains the data of SBI's NPA formed out of Working Capital financed by it.

<b>Year</b>	<b>Amount of Working Capital financed (in Crore)</b>	<b>NPA formed out of Working Capital financed (in Crore)</b>	<b>% NPA against amount of Working Capital financed</b>
2005	65.63	7.76	11.82
2006	87.11	5.48	6.29
2007	108.06	6.42	5.94
2008	180.94	10.30	5.69

**Table 1.1**

**(Source of Data:** - This data is collected from SBI's Regional Business Office in Panchavati, Nasik, which monitors 40 branches of SBI.)

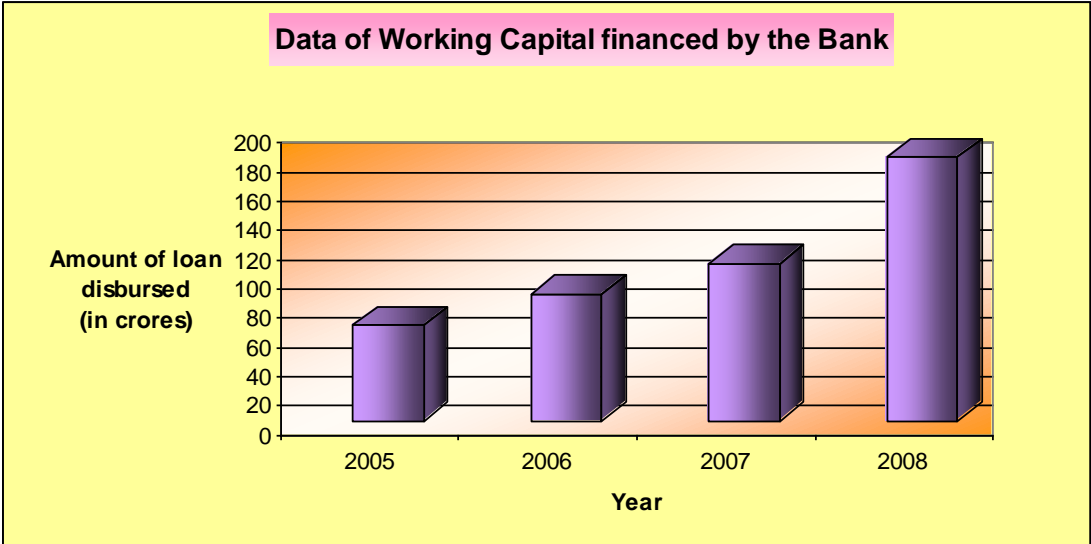


Fig. I

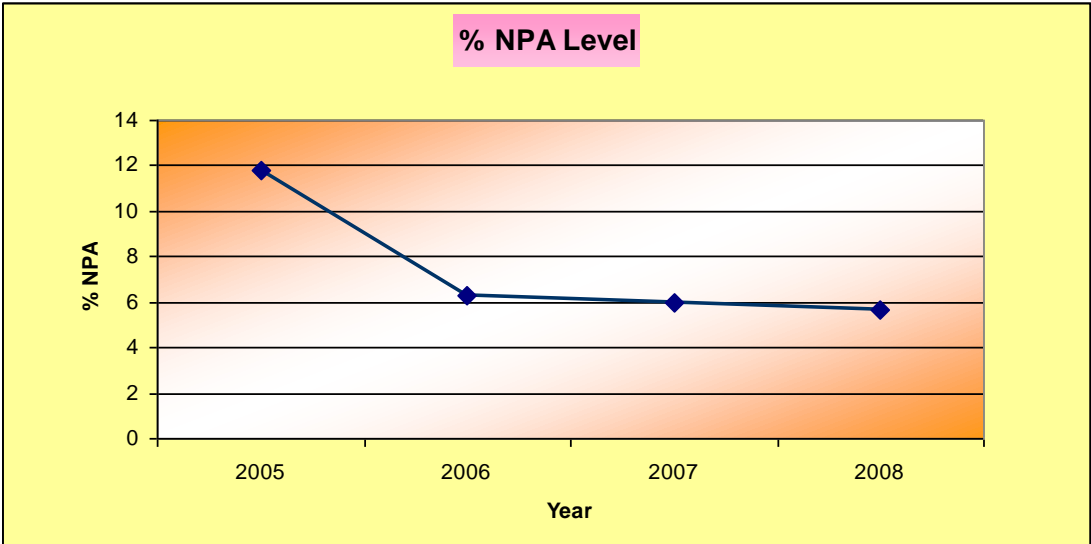


Fig. II

**Remarks: -**

Fig.I shows that the amount of Working Capital financed by the Bank increases from year 2005 to year 2008. But Fig.II shows that the % NPA level goes down from year 2005 to year 2008, which indicates that the maximum amount of loan is repaid by the customers. This in turn indicates that the creditworthiness of most of the borrowers was judged properly by the bank. Hence, it is proved that the efficiency of SBI's Credit Appraisal System is improving in subsequent years.

Table 1.1 shows that the amount of Working Capital financed by SBI has increased in subsequent years. In year 2008, that amount has gone up to 180.94Crores. But the NPA formed out of it has also increased up to 10.30Crores. The reason behind it is:-

While announcing this year's budget, the Finance Minister P. Chidambaram declared debt relief for farmers. So this year (2008), the Bank could not recover the interest & the whole amount of Working Capital loan sanctioned to Agriculture Sector.



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## Chapter 5

### CONCLUSION

- In order to assure the recovery of credit as well as the safety & profitability of the organisation, the bank must follow the Credit Appraisal System, very strictly.
- Though it is a lengthy & critical procedure, SBI is paying special attention to verify the credit worthiness of loan applicants, to avoid any risks in future.
- A study of past data reveals that the percentage of NPA is going down in SBI, though the Working Capital is being financed on large scale by it. This fact proves that the efficiency of Credit Appraisal System of SBI is improving in subsequent years.
- During the project work, some drawbacks in the SBI's process of credit appraisal are pointed out as follows:-

#### **a) More Time Consumption & More Paper Work: -**

For estimating the financial position of the loan applicant as well as for deciding the Maximum Permissible Bank Finance (MPBF) for him, the documents showing his assets & liabilities are required to be collected. In case of High Value proposals, the applicant's income, his loan repaying capacity, his property, etc. are primarily verified at SBI branch & then at SBI's Regional Business Office. Thus, it takes more time for a delivery of credit to customers & it requires a lot of paper work also.

#### **b) No use of Internet facility: -**

Though internet services are the means for easy & fast data collection, it cannot be used in this Credit Appraisal System. Because the information collected about the borrower through internet may not be authentic. This fact prohibits the use of internet.

## Chapter 6

### SUGGESTIONS & RECOMMENDATIONS

During the entire project, it was observed that a credit appraisal process is very critical & thus the problems are faced at every stage in the process. It starts right from the credit demand & continues as the loan sanctioning procedure moves. This is a matter which should not be neglected & be given much importance for Bank's smooth & effective functioning.

A list of suggestions & recommendations is given to the organisation for implementing in their routine. The implication of the following recommendations will surely prove to be beneficial for the Bank:-

1. **Centralised Processing:** - Since SBI has very large banking operations through its various branches, it should adopt the centralised processing with specialised knowledgeable personnel. 'Centralised Processing' means when the customer demands for a high amount of loan to any SBI branch, then the branch will only collect the required documents from the loan applicant & its verification & appraisal will be done directly at SBI's respective Regional Business Office. Implication of this Centralised Processing will result in:-

- Easy & fast delivery of credit.
- Reduction in the extra paper work.

Moreover, the people working at SBI Branch level can concentrate more on other banking operations like accepting deposits, bills, etc., since their work load will be reduced by this centralised processing.

2. **Proper Scheme knowledge:** -The employees working in SBI should provide the Bank's loan schemes & credit norms to the customers in printed form so that the customers can follow it whenever required.
3. **Proper format for loan approval:** - The information required for loan approval should be in specific format, which should ensure that no details are missed out. This will help the credit manager by providing entire details & making his task easy & quick.