Certificate Examination
in
Certified Credit Professionals

IIBF & Other Exams)

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About Certificate Examination in

Certified credit professionals

IIBF Certificate Examination

The world is increasingly getting inter connected and complex. Bank credit mechanism has also undergone phenomenal changes in recent years. Few years ago, credit meant only Cash Credit, Overdraft and Loan. Today quasi credit facilities like Letters of Credit, Bank Guarantees, Co acceptances, Buyer's Credit and Supplier's Credit are gaining predominance. The bank officer dealing with such products should possess a good knowledge of the product itself to assess the risk involved and judge the repayment capacity of the borrower to honour the liabilities within the agreed timeframe. Credit Appraisal and Risk Appraisal can be considered as two sides of the same coin. Hence, when appraisal aspects are being discussed, be it concerning domestic finance or trade finance for international trade, risk aspects are considered so that the credit officer does not lose sight of the same. The course provides a holistic insight into the various dimensions in bank credit management.

- To develop a cadre of credit officers in banks to perform different credit functions across banks
- To inculcate advanced skills for handling credit management issues

The course broadly covers :

a) Loan Policy e) Working Capital Management
b) Credit appraisal f) Export Credits
c) Analysis of Financial statements g) Credit Monitoring
d) Project Finance h) Management of Impaired Assets etc.

- Existing / Newly posted officers in credit department
- Persons identified for the credit department
- People aspiring to become credit officers in banks

Course has two components viz.,

a) Online examination for 100 marks based on a specially designed courseware on credit management
b) Classroom Learning of 5 days in Mumbai or at pre-announced centres.

Candidates are advised to go through the updates put on the IIBF website from time to time and go through Master Circulars / Master Directions issued by RBI and publications of IIBF like IIBF Vision, Bank Quest, etc. All these sources are important from the examination point of view. Candidates are also to visit the websites of organizations like RBI, SEBI, BIS, IRDAI, FEDAI etc. besides going through other books & publications covering the subject / exam concerned etc. Questions based on current developments relating to the subject / exam may also be asked.
The Institute has a practice of asking questions in each exam about the recent developments / guidelines issued by the regulator(s) in order to test if the candidates keep themselves abreast of the current developments. However, there could be changes in the developments / guidelines from the date the question papers are prepared and the dates of the actual examinations.

STUDY MATERIAL / COURSEWARE

Cut-off Date of Guidelines / Important Developments for Examinations

In order to address these issues effectively, it has been decided that:
(i) In respect of the examinations to be conducted by the Institute for the period February to July of a calendar year, instructions / guidelines issued by the regulator(s) and important developments in banking and finance up to 31st December will only be considered for the purpose of inclusion in the question papers".

(ii) In respect of the examinations to be conducted by the Institute for the period August to January of a calendar year, instructions / guidelines issued by the regulator(s) and important developments in banking and finance up to 30th June will only be considered for the purpose of inclusion in the question papers.
The table given below further clarifies the situation.

TUTORIAL / CONTACT PROGRAMMES

Tutorial / Contact programmes may be organized by the Institute at various centres. For details in this regard candidates may visit Institute's website www.iibf.org.in

COURSE STRUCTURE & DELIVERY

Classroom Learning fee :

Certified Credit Officer course has two parts viz. written examination and class room learning. To be declared successful, a candidate has to secure a minimum of 50% marks in the online examination and 50% in class room learning. The steps in completing the course are as under :

1. Study :

A minimum 3 months study of the stipulated courseware is envisaged. Institute will accept application up to a certain period before the dates of announced exams so as to ensure that the study period is adhered to.

2. Examination :

Candidates will have to appear for the online examination conducted by IIBF (Multiple Choice Questions mode) and pass the examination.

3. Classroom Learning :

Candidates who have successfully passed the online examination have to undergo class room learning. For this purpose, the candidate, on passing the examination should log on to IIBF website - www.iibf.org.in and select his/her convenient slot for class room learning (5 days) from the pre-determined dates and venue at select centres announced by the Institute by paying the fees prescribed for class room learning. During the class room learning, candidates will be assessed (Internal assessment) for class room performance for a total of 50 marks. Marks for classroom learning will be awarded to candidates by faculty for their classroom participation, analytical skills, case discussions, dealing ability, presentation skills etc. Candidates who obtain 25 or more marks will be declared as successful.

4. Time Limit for Classroom Learning :

Classroom learning is required to be completed within 15 months from the date of declaration of the online examination results in which the candidate passes.
In case a candidate fails to complete the Class Room Learning either on account of not able to successfully complete the Class Room Learning or by not attending the training for Class Room Learning within the stipulated period of 15 months, the candidate would be required to RE-ENROLL himself for the Online examination foregoing credit for the subject/s passed in the Online examination earlier in case he wants to complete the course.

Refund of fee :

Examination fee is not refundable. For refund of classroom learning fee, application for the same giving sufficient reason/s should reach the Institute one month in advance and in case the refund is effected 25% will be deducted towards administrative charges.

Award of Certificate :
Code of Conduct :
SYLLABUS FOR ONLINE EXAMINATION
Certificate will be issued to candidates within 2 months on successful completion of both online examination and classroom learning. No certificate will be issued for passing only the online examination
All the successful candidates will be encouraged to adhere to a code of conduct which will be issued along with the Certificate.
The details of the prescribed syllabus which is indicative are furnished in the booklet. However, keeping in view the professional nature of examinations, all matters falling within the realm of the subject concerned will have to be studied by the candidate as questions can be asked on all relevant matters under the subject. Candidates appearing for the examination should particularly prepare themselves for answering questions that may be asked on the latest developments taking place under the various subject/s of the said examination although those topics may not have been specifically included in the syllabus.
The Institute also reserves to itself the right to vary the syllabus / rules / fee structure from time to time. Any alterations made will be notified from time to time. Further, questions based on current developments in banking and finance may be asked.
Candidates are advised to refer to financial news papers / periodicals more particularly "IIBF VISION" and "BANK QUEST" published by the Institute.

MODULE - A : INTRODUCTION & OVERVIEW OF CREDIT
Principles of Lending : Safety, Liquidity, Profitability, Purpose of Loan, Diversification Risk.
Model Credit Policy : Importance, Contents, Exposure Norms, Model MSE Policy.
Types of Borrowers : Individuals - Major, Minor, Married Women, Pardhanashin

Women, Illiterate Persons, Agent, Attorney, Joint Borrowers, Hindu Undivided Family (HUF), Proprietorship Firms, Partnership Firms, Limited companies, Statutory Companies, Holding Companies, Government Companies, Private & Pubic Limited Companies, Registration of charges, Limited Liability Partnerships (LLP).
Types of Credit Facilities : Various Types of Credit Facilities - Cash Credit, Overdrafts, Demand Loan, Bills Finance - Drawee Bill Scheme, Bills Discounting.
Credit Delivery : Types of Facilities, Modes of Delivery, Sole Banking Arrangement, Multiple Banking Arrangement, Consortium Lending, Syndication. Credit Thrust, Credit Priorities, Credit Acquisitions, Statutory & Regulatory restrictions on Advances. Credit Appraisal : Validation of proposal, Dimensions of Credit Appraisals, Six "C" s, Structuring of Loan documents, Credit Risk, Credit Risk Rating, Credit Worthiness of Borrower, Purpose of Loan, Source of Repayment, Cash Flow, Collateral.
Credit Rating : Measurement of Risk, Objective of Rating, Internal & External Rating, Model Credit Rating, Methodology of Rating, Internal & External Comparison, Model Rating Formats

MODULE - B : ANALYSIS OF FINANCIAL STATEMENTS

Analysis of Financial Statements : Balance Sheet - Definition, Balance Sheet & Banker, Classification of Assets & Liabilities, Current Assets, Fixed Assets, Non-current Assets, Intangible & Fictitious Assets, Liabilities - Current Liabilities, Medium & Term Liabilities, Capital & Reserve, Classification of Current Assets & Current Liabilities, Balance Sheet Analysis, Analysis of Profit & Loss Account, Auditor's Note. Ratio Analysis - Classification of Ratios, Liquidity Ratios, Leverage Ratios, Activity Ratios, Profitability Ratios, Other important Ratios, Interpretation of important Financial Ratios, Uses of Ratios, Fund Flow Statements, Techniques Fund Flow and Cash Flow Statements, Illustrations.
Project / Term Loan Appraisal : Technical Appraisal, Commercial / Market Appraisal, Managerial Appraisal, Financial Appraisal, Economic Appraisal, Environmental Appraisal, Project Cost & Means of Finance, Cost of Production & Profitability, Sensitivity Analysis, Break-even Analysis, Capital Budgeting - Pay Back Period Method, Time Value Money, Net Present Value, Internal Rate of Return, Life of the Project.

MODULE - C : WORKING CAPITAL MANAGEMENT

Working Capital Assessment : Concept of Working Capital, Gross Working Capital, Net Working Capital, Working Capital Gap, Components of Working Capital, Source of Working Capital, Operating / Working Cycle, Computation of storage / Retention Period, Various Methods of Assessment of Working Capital, Computation of Working Capital - Turnover Method, MPBF Method, Cash Budget System, Illustrations, Impact of inadequate Working Capital, Working Capital Finance to IT. & Software Industry, Loan Delivery System, Cash Flow Analysis, Commercial Paper, Credit Delivery, Analysis of CMAdata.
Quasi Credit Facilities : Advantages of Non-Fund Facilities, Various types of NFB Facilities, Various types Letter of Credits, Assessment of LC limits, Bills Purchase / Discounting under LC.
Various types of Bank Guarantees : Performance Guarantee, Financial Guarantees, Deferred Payment Guarantees, Types of Performance and Financial Guarantees, Assessment of Bank Guarantees Limit, Period of Claim under Guarantee.
Co-acceptance Facilities : RBI Guidelines, Co-acceptance of Bills covering supply of Goods & Machinery

MODULE - D : OTHER CREDITS

Export Finance : Pre-Shipment Finance-Export Packing Credit in Rupees, Running Account Facility, Pre shipment credit to specific sectors - Sub Suppliers, Construction Contractors, Export credit to Processors / exporters-Agri Export Zones, Export Credit Insurance Whole Turnover Packing Credit, Pre-Shipment Credit in Foreign Currency (PCFC), Running Account Facility in all currencies, Deemed Exports, Diamond Dollar Account Scheme, Post Shipment Rupee Export Finance, Purchase / Discount of Export Bills, Negotiation of Export Bills, Export on Consignment basis, Advance against Duty Draw Back Entitlements, ECGC Whole Turnover Post-Shipment Guarantee Scheme, Interest Rate of Rupee

Export Credit, ECNOS, Rupee Export Credit Interest Rate Subvention, Post-Shipment Finance in Foreign Currency, Gold Card Scheme for Exporters, Crystalisation of Export Bills.

Priority Sector Lending / Government Sponsored Schemes : Different Categories of Priority Sector borrowers, Agriculture (Direct & Indirect) Finance, MSME Finance (Direct & Indirect), Micro Credit, Government Sponsored Schemes, Swarnajayanti Gram Swarozgar Yojana (SGSY), Swarna Jayanti Shahari Rozgar Yojana (SJSRY), Self Employment Scheme for Rehabilitation of Manual Scavengers (SRMS), Swarna Jayanti Shahari Rozgar Yojana, Education Loans, Housing Finance, Weaker Sections, Export Credit, Differential Rate of Interest Scheme, Priority Sector Targets. Retail Loans : Characteristic of Retail Loans, Advantages of Retail Loans, Retail Banking Vs Corporate Banking, Various Retail Banking Products, Model Retail Banking Products - Home Loans, Vehicle Loan, Personal Loan, Pensioner Loan Scheme, Property Loan, Holiday Loan Scheme, Gold Loan Scheme, Education Loan, etc., Guidelines on CERSAI registration.

MODULE - E : MONITORING, SUPERVISION & FOLLOW UP AND MANAGEMENT OF IMPAIRED ASSETS

Documentation : Meaning, Importance, Types of documents, Requisites of documentation, Selection of documents, Stamping of different documents, Mode and time of Stamping, Remedy for un-stamped / under-stamped documents, Documents of which registration is compulsory, Time limit of registration, Consequence of non-registration, Execution, Mode of Execution by different executants, Period of Limitation, Law of Limitation to Guarantor, Extension of period of limitation, Enforcement of documents, Death of Borrower / Guarantor.

Types of Charges : Purpose, Various types of charges, Types of Security, Mode of charge, Lien, Negative Lien, Set Off, Assignment, Pledge, Right of Banker as a Pledgee, Duties as a Pledgee, Mode of Charges, Hypothecation, Mortgage - different types of mortgages, Difference between Simple and Equitable Mortgage.

Credit Monitoring, Supervision & Follow Up : Credit Monitoring - Meaning, Monitoring Goals, Process of Monitoring, Different Monitoring Tools, Check-list for Monitoring, Monitoring by using various statements, QIS Formats / guidelines, Supervision & Follow Up.

Management of Impaired Assets : Introduction, Credit Monitoring, NPA why & how?, NPA Management Policy, Definition of Sick Unit, Non-Performing Assets (NPA), Income Recognition Policy, Assets Classification, Guidelines on Asset Classification, Projects under implementation,
Project Loans under Infrastructure and Non-infrastructure Sectors, Projects under Commercial Real Estate Sector, Income Recognition, Take out Finance, Provisioning Norms for NPA, Provisioning Coverage Ratio (PCR), Options available to banks in Stressed Assets, Prudential Guidelines on Restructuring, Eligibility criteria for restructuring, Asset Classification Norms for Restructured

Assets, Mahapatra Committee Recommendations, Revised Prudential Guidelines on Restructuring of Advances, General Provision on Restructured Standard

Accounts, Up-gradation of Restructured Accounts, Rehabilitation, Viability Period, Viability Parameters, Incentives for Quick implementation of Restructuring Package, Corporate Debt Restructuring (CDR) Mechanism, CDR Structure & Operations, New RBI Framework for Distressed Assets, Willful Defaulters, Penal Measures, Compromise, Legal Action, Civil litigation, Pre and Post - filing precautions, Type of Decrees, Modes of Execution of Decree, Lok Adalats, Debt Recovery Tribunal, SARFAESI, Write Off. Fair Practices : Applicability, Practices to be adopted, Loan Processing,Assessment, Disbursement, Administration, Recall / Repayment of Loan, Grievance Redress Mechanisms.

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Credit Rating : Measurement of Risk, Objective of Rating, Internal & External Rating, Model Credit Rating, Methodology of Rating, Internal & External Comparison, Model Rating Formats

Credit management

Credit management is the process of granting credit, the terms it's granted on and recovering this credit when it's due. This is the function within a bank or company to control credit policies that will improve revenues and reduce financial risks. A credit manager is a person employed by an organization to manage the credit department and make decisions concerning credit limits, acceptable levels of risk and terms of payment to their customers. This function is often handled alongside Accounts Receivable and Collections in one department of a company. The role of credit manager is variable in its scope. Credit managers are responsible for:

- Controlling bad debt exposure and expenses, through the direct management of credit terms on the company's ledgers.
- Maintaining strong cash flows through efficient collections. The efficiency of cash flow is measured using various methods, most common of which is Days Sales Outstanding(DSO).
- Ensuring an adequate Allowance for Doubtful Accounts is kept by the company.
- Monitoring the Accounts Receivable portfolio for trends and warning signs.
- Enforcing the "stop list" of supply of goods and services to customers.
- Removing bad debts from the ledge (Bad Debt Write-Offs).
- Setting credit limits.
- Setting credit terms beyond those within credit analysts' authority.
- Setting credit-rating criteria.
- Setting and ensuring compliance with a corporate credit policy.
- Pursuing legal remedies for non-payers.
- Obtaining security interests where necessary. Common examples of this could be PPSA's, letters of credit or personal guarantees.
- Initiating legal or other recovery actions against customers who are delinquent.

Credit management is one of the core processes for all banks and therefore, the ability to manage its process is essential to augment interest income and to enhance its profitability. The success of a bank crucially depends how it manages its Asset Portfolio as it is the major source of income and has direct bearing on the bottomline of the Bank. This demands an ability to perceive the early warning signals, which necessitates control of both the quantitative and qualitative aspects of credit evaluation. Thus, managing credit risk plays an important role and its effectiveness lies in proper identification of borrower and appraisal besides adopting an efficient recovery and exit strategy.

1. Know Your Customer (KYC): Proper identification of the borrower attains utmost importance in the entire credit cycle for which adoption of KYC guidelines is a must. It is observed that majority NPA accounts pertain to either new customers or introduced by strangers or middlemen or consultants. Thus, it is desirable for the banks to approach the customers rather they approach the banks. It is the responsibility of the bank to look into the identity & residential proof, business address, PAN, TAN, GST etc., before inviting the customer into bank's fold. Photocopies of all these must be verified with original and also get them signed by

the borrower and kept on record. Due diligence is to be done either by the bank staff or external agencies as per extant guidelines. With regard to firms/companies etc., the profile of the partners/directors must be checked thoroughly along with the history of the organization. One can get good information from the web about the partners/directors, borrowings and the health of the organization. Obtain confidential reports from other banks and financial institutions.

2. Credit Appraisal: The objective of credit appraisal is to extend the required credit limits to the borrowers to meet their genuine financial/business requirements. To address the issue, banks are required to look in to the following financial aspects with utmost care while appraising the credit requirements of the borrowers:

i) Project Report for containing details of the machinery to be acquired, price, name of suppliers, capacity utilization, assumed production & sales, projected profit & loss and balance sheets for the years till the proposed loan is to be paid. Project report should be analyzed carefully and feasibility of the project is to be arrived duly taking the capacity of the promoters as well as external factors which has bearing on the operations of the proposed activity.

ii) Assets & Liabilities statements of all borrowers/guarantors must be obtained in the prescribed format along with credit proposal and the veracity of the properties is to be verified.

iii) Balance Sheets – In order to assess the credit limits, banks need to obtain copies of the audited balanced sheets, preferably last 3 years, along with Income/Sales tax returns besides projected balance sheets. The estimated figures must be thoroughly analyzed and credit limits are to be assessed realistically. The appraising officials are required to evaluate how capital or fund is raised/used, existing loans and liabilities, business turnover, financial stability of the firm, profitability, repayment capacity, etc.

After verifying all the documents, the concerned official to prepare appraisal note with SWOT (Strong points, Weak points, Opportunities and Threats) analysis and it is expected that the appraisal should reveal the risk factors.

3. Credit History: There are many tools available now to the banks to get the history of the borrowers/guarantors and the following are the few important reports on which the lending institutions can bank upon:

i) Defaulter List is available on RBI's website and banks should ensure that borrower/guarantors name do not appear in the list and confirmation of the same must be put on record.

ii) CIBIL Reports – Search the CIBIL reports of the borrower and guarantors and commercial CIBIL report in case of firms/companies and these reports should be analyzed thoroughly beyond score. The number of loans availed from various banks/financial institutions and the enquiries made provide valid inputs (credit profile) to the lending institutions to take informed decisions.

iii) CERSAI – Wherever mortgage of property is involved, search should be made by the credit officer with CERSAI site before according sanction to ascertain that no mortgage is outstanding against the said property in any other Bank or Financial institution.

iv) Legal Entity Identifier (LEI) – RBI has advised all Scheduled Commercial Banks to obtain LEI code (20 digit unique code) from all large corporate borrowers having total exposure of `50 crore and above. It is a key measure to improve the quality and accuracy of financial data systems for better risk management. It facilitates assessment of aggregate borrowings by corporate groups, and monitoring of the financial profile of an entity/group. Legal Entity Identifier India Ltd., a subsidiary of the Clearing Corporation of India is authorized to issue LEI to the large borrowers. The guideline is applicable to existing borrowal accounts also.

v) Credit Fraud Registry (CFR) – It is a centralized registry of frauds across the banking industry which is accessible to all authorized officials of the bank. It enables

the banks to make detailed and in depth enquiries before granting/reviewing any facility to the parties named in the CFR report.
4. Credit Rating must be done for all borrowal accounts including retail loans as per bank's guidelines. With regard to working capital limits, the rate of interest should be fixed as per credit rating. However, no rating is needed for agriculture loans. Credit rating should be done judiciously based on key financial ratios and account data. It is desirable not to consider the proposal where the credit rating is below 3. External rating is mandatory for high value accounts.
5. Exposure norms – It should be ensured that the credit limits sanctioned falls well within the bank's exposure norms (Individual, Group and Sector) and discretionary powers of the sanctioning authority.
6. Pre-sanction visit to borrower's residence/office/factory and the collateral securities is to be done by the bank staff independently. The objective of the visit is to determine the "bank-ability" and access related riskiness of the proposal. Identification of borrower and site must be ascertained beyond doubt by inquiring from neighbors and other surrounding people. The observations must be noted down and kept on record.
7. Legal opinion - Verification of title deed of the securities is utmost necessary. It must be ascertained from the concerned authorities that the documents submitted are original and not fake. As far as possible, bank should ensure that the securities offered (other than agricultural properties) are enforceable under SARFAESI act 2002. Certificate of change of land must be obtained in case unit to be financed is to be built on agriculture land. The opinion should be clearly spelt-out the properties are having clear and marketable title.
8. Valuation of property is to be done by the bank's approved valuer only. The report should clearly mention the market value as well as realizable value. Normally banks should take realizable value only into consideration while sanctioning credit limits. With regard to agriculture land, the valuation should be done by the Field and income thereon. The valuer report must be thoroughly analyzed and it should not contain any comment which is detrimental to the interest of the bank. The title deed date & number, survey number/Plot or House number, extent of land/building must tally with registered document, legal opinion and valuation report. The valuation report invariably accompany with clear route map with longitude/latitude and land marks for easy access/verification at later stage.
9. Sanction terms & conditions are to be communicated to the borrower in writing without any ambiguity and acknowledgement is to be kept on record. The sanction letter should invariably mention the limits sanctioned, margin requirement, collateral securities, interest rate (fixed or variable & simple or compound) & its frequency and repayment schedule. Wherever, gestation period is allowed, the same is to be mentioned in the sanction letter along with date of first installment.
10. Documentation – Documentation should be done very carefully and thoroughly duly adhering all the sanction terms and conditions as any lapse in this regard may cost the bank heavily on account of protracted litigation.
11. Legal Audit - The executed documents of high value accounts, as decided by the banks, must be got vetted by the approved bank's advocate or law officers of the bank and certificate should be obtained and kept on record before disbursement of the loan.
12. Disbursement - The disbursement should be as per schedule approved by the bank duly ensuring the progress of the project and the amount is to be paid directly to the suppliers. It is the responsibility of the bank to create charge with the concerned authorities well within the time frame.
i) CERSAI: It is mandatory for the bank to register the mortgage details with CERSAI within one month of mortgage. The asset code generated is to be recorded in the loan file.

ii) ROC: In case of corporate borrowers, the bank's charge on assets of the company must be registered with ROC within 30 days of creation of charge. Generate search report and copy of the same should be kept on record.
13. Post sanction visit is very important to verify the end use of funds. Assets to be created by the loan sanctioned must be verified physically and facts noted in the visit report. Transactions with sister concerns should be monitored. Scrutinize the stock statements which are periodically submitted. Ensure proper Drawing Power is present as per the sanction. The review/renewal of accounts must be done on due date on basis of latest financial documents.
14. Periodical inspections enables bank to keep check on the stocks hypothecated and securities mortgaged to bank. The inspecting official should undertake physical verification of the stocks as per the extant norms without any deviation. The bank's name should be prominently displayed onsite the unit where goods are hypothecated to bank. In case of pledge- ensure that storage area is properly maintained, earthquake and flood resistant, goods are stored in a proper manner, stock audit is regularly conducted and a proper register is maintained. Also note that the stocks or securities that are offered should be adequately insured and that too on continuous basis. Maintain inspection register where all the findings at the site should be noted. It is a good idea to take 2-3 snapshots and paste them on register with signature of visiting officials. Inspection should be done vigorously and without information to borrower. In case if housing loans, visit office of sub registrar or revenue office to verify charge of bank on the mortgaged property

Asset Quality and Recovery Management: Timely follow up is the key to keep the quality of assets intact and enables the banks to recover the interest/installments in time. To have better control on the assets created out of borrowings, banks need to watch the functioning of the units by paying frequent visits and this is to be done to all the units irrespective whether the account is performing or non-performing one. Thus, Banks should focus attention on:
i) Awareness Calling – When the first payment is due, a call is initiated to make him aware of the date of payment of installments/dues. This can be done either by the branch or by call centre or through SMS.
ii) Reminder Call – When the demand is not paid, a reminder call may be made with a request to make payment of the dues and note the response or commitment. Repeat calls are made if the borrower fails to honor his promises.
iii) Demand Notice – In case where there is no response to the calls, a written communication is issued to the borrower informing the status of the account with an advise to pay the dues. Banks can also make use of technology and notice may be sent through SMS or E-mail.
iv) Field Visits – It involves paying visits to borrower's office or residence either by bank staff or its agents to appraise the position of the dues and need for repayment. Continuous persuasion definitely yields positive results. These visits also enable the banks to assess the functioning of the activity and quality of the assets. If they found that the financial position of the borrower is deteriorated, bank may strike a compromise deal to recover the dues.
v) Recovery Agents: RBI permitted the banks to appoint recovery agents for recovery of NPA/written-off accounts with more than 2 years old and with Real Account balance of `5 lakh and above. However, in exceptional cases the mandatory period of 2 years can be waived. The agency should be either Partnership or Corporate entity with required expertise to handle NPA accounts. The agents appointed under this scheme are required to be complied BCSBI code and Bank's Model Code of conduct for collection of dues and repossession of secured assets. However, the agency shall not have any right to sub-delegate or appoint any subagent. The engagement of agent is account specific and for a specified period only.

Resolution of NPAs: Inculcating financial discipline among the borrowers is the need of the hour as any delay in payment of interest or installment may lead to slippage of the account from standard to substandard which has adverse impact on the profitability of the banks on account of loss of interest income besides increased provisioning on NPAs. While focusing attention on recovery through normal channels, banks need to initiate steps for recovery through disposal of assets.
i) SARFEASI: In the event of failure of the borrower to repay the dues despite the said initiatives, the bank need to proceed to take possession of the assets including collateral duly invoking provisions of SARFEASI act. Sale of assets can be done by Authorized Officer (AO) by issuing proper notice and taking possession of the securities. Auction of the securities is to be done by AO through bidding process and the auction proceeds are to be credited to the loan account.
ii) Asset Reconstruction Companies (ARC): The sale of high value NPAs to ARCs has gained momentum in the recent years in the light of increased pressure on banks due to introduction of stringent norms on restructuring of stressed assets. However, banks receive around 5% to 15% of the value as upfront and the remaining amount through Security Receipt (SR) which enable them to show improved asset quality in the bank books. Wherever the banks unable to recover the dues in normal course may prefer this route especially with regard to high value NPA accounts.

iii) Legal action: Banks are empowered to recover the dues by initiating legal action against the borrowers/co-obligants by filling suit in DRT or other courts depending on the value of the accounts. As far as possible it is desirable for the banks to initiate SARFEASI action only. However, wherever SARFEASI action is not feasible such agriculture securities, low value accounts etc., banks should go for legal action against the borrowers/co-obligants.
iv) Insolvency and Bankruptcy Code (IBC) is a major reform where once the account is referred by a creditor to National Company Law Tribunal (NCLT), the powers of the management and the board are transferred to an independent insolvency professional and the entire resolution process is to be completed within 180 days, extendable by another 90 days in exceptional cases. If there is no resolution within this period, liquidation must take place. It is an opportunity for the banks to refer high value NPA accounts to NCLT for speedy resolution and clean up the books of the banks. However, this may pose a major challenge to banks to provide higher provisioning where the stressed company is subjected for liquidation.
iv) One Time Settlement Schemes (OTS): Prompt recovery of loans and advances not only increases liquidity and profitability but also keeps funds cycle moving by continuous lending for the development of the economy. As a last resort, RBI permitted banks to negotiate with NPA borrowers under OTS policy duly approved by the respective bank boards. It is a negotiated settlement where it should be ensured to recover dues to the maximum extent possible with a minimum sacrifice. The opportunity cost of funds in hand vis-à-vis that of funds, which could come in hand at a later period should be calculated to establish a comparative advantage of 'now or later'. These guidelines are applicable to NPAs and Technically Written-off accounts. To impart further transparency especially with regard to high value compromise accounts, the proposals need to be vetted by Settlement Advisory Committee headed by Retired Judge, Retired ED/CMD of a Bank and Retired General Manager of a Bank. With regard to small loans, banks are framing their own simplified OTS policies from time to time for recovery of NPAs with increased sacrifice.
v) Wealth Tax Returns of chronic defaulters – Governments of India, Ministry of Finance has informed that Banks may obtain the information about the assets of the loan defaulters from Income Tax Department to enable the banks to proceed against the chronic defaulter's assets for recovery of dues.

The above checklist is only indicative and not exhaustive. The guidelines may slightly vary from bank to bank. Nevertheless, it will help the staff dealing with credit portfolio to take judicious, prompt and prudent credit/recovery decisions.
Credit Management is an important aspect for all banks to enhance its profitability. The proper management of credit will definitely enhance the value of all stakeholders in general shareholders in particular. Thus, it should be the endeavor of all units and staff members to focus attention on this vital activity for survival as well as for further growth.

OVERVIEW CREDIT MANAGEMENT

Credit plays an important role in driving the national economy. It provides leverage to an entrepreneur to undertake a project larger than what he could have undertaken without availability of credit. This results in accelerated industrial production/services. It also enables individuals to first purchase/create assets and repay the loan from their future earnings. Credit enables a consumer to spend more than what he would have otherwise spent. The increased demand drives the producers to step up the production. Thus, adequate and cheap availability of credit propels the economy to higher growth trajectory. But, there is always a time lag between increase in demand and creation of supply to meet that demand. That is why excessive availability of credit, specially, for non-productive purposes, puts inflationary pressure of the

economy.
Principles of Credit: (a) safety of funds (b) purpose (c) profitability (d) liquidity (e) security (f) risk spread
Types of Borrowers: A borrower can be (a) An individual (b) Sole proprietary firm (c) Partnership firm and joint ventures (d) Hindu undivided family (e) Companies (f) Statutory corporations (g) Trusts and co-operative Societies
The laws applicable to all these different kinds of borrowers and different. Individuals are governed by the Indian Contract Act, partnership firris by the Indian Partnership Act, Hindu undivided family by the customary laws pertaining to Hindus, companies by the Companies Act, statutory corporations by the Acts that created them, trusts by the Indian Trusts Act, Public Trusts Act, Religious and Charitable Endowments Act, Wakf Act and Co-operative Societies by the Co-operative Societies Act or the Societies-Registration Act.
Types of Credit: Bank credit can be either fund-based or non fund-based.
1. Fund based credit: In fund-based credit, there is actual transfer of money from the bank to the borrower.
2. Non Fund based credit: In non fund based credit, there is no transfer of money, but the commitment by the bank on behalf of the client, may result in future transfer of money to the beneficiary of such a commitment. For example, a bank guarantee issued in favour of government departments (or any other beneficiary) on behalf of a contractor. If the beneficiary invokes the guarantee, the bank will have to remit the amount to it and the client, for whom guarantee was issued, will be liable to pay this amount to the bank. Thus, a non fund-based credit always has a possibility of getting converted into a fund-based credit. Other of non fund based credit are letters of credit, co-acceptance of bills, forward contracts, and derivatives.
3. Periodwise classification: The fund based credit can be short term credit or long term credit (term loan)
4. Purposewise classification: (a) working capital finance, (b) project finance, (c) export finance, (d) crop loan, etc.
5. Customerwise classification: Banks classify their credit portfolio on the type of the customers like, Corporate, retail, agriculture, international, institutional credit, etc.
Segmentwise classification: As per RBI guidelines, banks have to report their business, based on the geographical segments, as 'domestic' and 'international'. In addition, as per RBI guidelines, banks have adopted the following business segments, for public reporting purposes, from March 31, 2008:(a) Treasury (b) Corporate/Wholesale Banking (c) Retail Banking (d) Other Banking Business
1. Treasury: 'Treasury' for the purpose of Segment Reporting should include the entire investment portfolio.
2. Retail Banking: The Retail Banking .would include exposure which fulfill the following four criteria of orientation, product, granularity and low value of individual exposures for retail exposures laid down in Basel Committee on Banking Supervision document 'International Convergence of Capital Measurement and_ Capital Standards: A Revised Framework':
(a) Orientation Criterion: The exposure is to an individual person or persons or to a small business; Person under this clause would mean any legal person capable of entering into contracts and would include but not be restricted to individual, HUF, partnership firm, trust: private limited companies, public limited companies, co-operative societies, etc. Small business is one where the total annual turnover is less than Rs. 50 crore. The turnover criterion will be linked to the average of the last three years in the case of existing and projected turnover in the case of new entities.
(b) Product Criterion: The exposure takes the form of any of the following: revolving credits and lines of credit (including overdrafts), term loans and leases (e.g. instalment loans and leases, student and educational loans) and small business facilities and commitments.
(c) Granularity Criterion: No aggregate exposure to one counterpart should exceed 0.2 per cent of the overall retail portfolio, 'Aggregate exposure' means gross amount (i.e. not taking any benefit for credit risk mitigation into account) of all forms of debt exposures (e.g. loans or commitments) that individually satisfy the three other criteria. In addition, 'one counterpart' means one or several entities that may be considered as a single beneficiary (e.g. in the case of a small business that is affiliated to another small business, the limit would apply to the bank's aggregated exposure on both business).

(d) Low Value of Individual Exposures: The maximum aggregated retail exposure to one Counterpart should not exceed the absolute threshold limit of Rs.5 crore.
3. Corporate/Wholesale Banking: Wholesale Banking includes all advances to trusts, partnership firms, companies and statutory bodies, which are not included under 'Retail Banking'.

4. Other Banking Business: Other Banking Business' would include all other banking operations not covered under 'Treasury', Wholesale Banking' and 'Retail Banking' segments. It will also include all other residual operations such as banking transactions/activities.

Principles of Lending: In order to protect the interest of all the stakeholders, banks need to adopt six basic principles viz., Safety, Liquidity, Profitability, Purpose, Risk Diversification and Security. Primarily, banks need to consider the borrower's capacity to pay, willingness to pay, and income generation of the activity for which loan is taken. This is a safety check that every bank to consider while extending credit to borrowers. Banks also ensure that the lent amount should be paid in proper repayment schedules. This is possible only when the activity generates adequate income. It is the responsibility of the banks that credit facility is to be extended to individuals/businesses for genuine purposes only and not for speculation or anti social activities. Banks need to diversify their risk by extending credit to various sectors. Lastly, the loan portfolio should be backed by securities so that loan amount can be recovered even the borrower fails to pay, through sale of securities.

Safety: Safety means that the borrower should be able to repay the loan and interest in time at regular intervals without default. Banks are trustee of public money. Bank's deposits are always payable on demand. Bank has to maintain trust of depositor forever. It is just not the capacity of the borrower to repay but also his willingness to repay. The former depends on his tangible assets and the success of his business. The latter depends on the borrower's character

Liquidity: The term liquidity refers to the extent of availability of funds with the banker for providing credit to borrowers. It is to be seen that money lent is not going to be locked up for a long time. The money should return to the bank as per the repayment schedule. This schedule that is drawn up by the banker has to adhere to the requirement that at any point of time the banker should possess liquidity to meet the withdrawals of the depositors. The concept of liquidity entails the banker to look for easy salability and absence of risk of loss on sale of asset, which has been taken as collateral.

Purpose: The purpose should be productive so that the money not only remain safe but also provides a definite source of repayment. Loans may be required for productive purposes, trading purposes, agriculture, transport, self-employment etc. If a loan is required for a non-productive or speculative purpose, the banker should be very much cautious in entertaining such proposals. It is very difficult to ensure that the loan has been utilized for the purpose for which it was sanctioned. Banker should take follow-up measures to ensure end use of fund exactly for the same purpose for which it is borrowed.

Profitability: Banks are not charitable institutions. All banks are profit-earning institutions. The ultimate objective of lending is to earn profits. Banks receive interest on loans and advances lent, and they pay interest to their depositors. This difference between the receipts and payments will be the bank's gross profit. Banks have to earn reasonable amount as net profit (NIM) so that dividends can be paid to its shareholders.

Security: The security offered by a borrower for an advance is as like as the insurance to the banker. It serves as the safety valve for an unforeseen emergency. So another principle of sound lending is the security of lending. Security offered against loan may be various. It may be a plot of land, building, flat, insurance policies; term deposits etc. The security if accepted must be adequate and readily marketable, easy to handle and free from encumbrance. It is the duty of the banker to check the nature of the security

and assess whether it is adequate for the loan granted.
Diversification: A prudent banker always tries to select the borrower very carefully and takes tangible assets as security to safeguard his interests. While this is no doubt an adequate measure, there are other unforeseen contingencies against which the banker has to guard himself. If the bank lends large amounts to a single industry or borrower, then the default by that customer can affect the banking industry as a whole and will affect the basic survival of the industry. Banks have to lend to a large number of industries and borrowers so that the risk gets diversified
National Interest: Even when an advance satisfies all the aforesaid principles, it may still not be suitable. The advance may run counter to national interest. Bank has a significant role in the economic development process of a country. They should keep in mind the national development plan/program while going for lending but maintaining safety, liquidity and profitability.

Credit Policy

Credit policy is a written guidelines that set
(1) The terms andconditions for supplying goods on credit,
(2) customer qualification criteria,
(3)procedure for making collections, and
(4) steps to be taken in case of customer default.

Each bank formulates its own loan policy and sanction of any credit proposal has to be within the framework of this policy. The formulation of loan policy is influenced by various factors like market conditions, policies of the competitors, bank's own SWOT analysis and, of course, the RBI guidelines. The loan policy normally contains guidelines about the following aspects:
(a) Exposure limits for single borrowers and groups
(b) Exposure limits for individual sectors like real estate, capital market, steel, cement, software etc. This is under

constant watch of the bank and if bank's perception about any particular sector deteriorates, the exposure limits is reduced suitably and fresh sanctions of credit proposals, pertaining to that sector, are curtailed. In such cases, bank may even decide to exit some of the existing accounts by formulating suitable exit strategies. The loan policy also covers the thrust areas, low priority areas etc.
(c) Discretionary powers at various powers levels for sanctioning of credit proposals. Normally, the policy also lays down the various authorities for allowing over drawings/ad-hoc limits.
Appraisal: Before a lender agrees to give money to a borrower, as per his proposal, certain issues are checked which are given below:
(a) Trustworthiness of Borrower.
(b) Viability of the project/activity and the risks involved.
(c) Adequacy or otherwise of the amount of loan.
(d) Terms of repayment, interest rate etc.
(e) Prescription of covenants (terms and conditions) for effectivemonitoring of the project/activity.
(f) Need for Collateral security or personal guarantee.
(g) Method of creation of charge over primary/collateral security. Documents to be taken to enforce bank's claim in a court of law in case of default. ?
The complexity of this appraisal will depend on various factors like, amount involved, duration and purpose of loan, category of borrower, risks involved, security available, RBI guidelines etc. Thus, appraisal for a small crop loan or a vehicle loan will be different from that for an industrial project. For appraisal, the lender will normally depend on some or all of the following information/records, depending upon the uniqueness of each case.
(a) The background, credit history, market reports of the borrower.
(b) The financial track record of the borrowers as represented by the financial statements. Where these statements are not available, as in case of most of the individuals, the net worth and repayment capacity is judged by collecting details of assets and liabilities and sources of income.
(c) Techno-economic feasibility report of the activity proposed; The details required in this depend on the nature of activity being successful and bank getting back its principal and interest in time. Mostly, in case of industrial project only a detailed project report is prepared by the competent agency. In other cases, the viability is judged by the analysis of past track record, present financial position, source of income, expenditure and bank's own judgment.
(d) Securities available, their value and realisability.
Delivery: This relates to legal aspects of documentation and creation of charge over security. This also covers the method of delivery (like loan or cash in case of working capital limits) and procedure for disbursal of a term loan.
Control and Monitoring: This is necessary not only to ensure end use of the bank's funds also to ensure safety of it. An efficient monitoring is in the interest of the borrowers as well, as the bank can provide timely help in case of unforeseen difficulties. It is very important for the bank as any delay in taking suitable action in cases of activity not being carried out as projected, reduces the chances and amount of recovery of bank's funds.
Rehabilitation and Recovery: Default is possible either due to genuine business problems or due to intentional (called willful) default. In the first case, the banks normally examine the feasibility of providing additional assistance/concessions/rephrasing etc. to help the enterprise to make its operations viable again. The widely known terms like rehabilitation of sick SSI units and Corporate Debt Restructuring (CDR) are part of this process. However, if rehabilitation is not considered feasible or, if the rehabilitation process does not yield the desired results, and in case of willful defaults, bank has to start the recovery process.

MASTER CIRCULAR ON EXPOSURE NORMS

A. Purpose
This Master Circular provides a framework of the rules/regulations/instructions issued by the Reserve Bank of India to Scheduled Commercial Banks relating to credit exposure limits for single/ group borrowers and credit exposure to specific industry or sectors and the capital market exposure of banks.
B. Classification
A statutory guideline issued by the Reserve Bank in exercise of the powers conferred by the

Banking Regulation Act, 1949.

C. Previous instructions

This Master Circular consolidates and updates the instructions on the above subject contained in the circulars listed in **Appendix.**

D. Application

To all scheduled commercial banks, excluding Regional Rural Banks.

1 INTRODUCTION

As a prudential measure aimed at better risk management and avoidance of concentration of credit risks, the Reserve Bank of India has advised the banks to fix limits on their exposure to specific industry or sectors and has prescribed regulatory limits on banks' exposure to single and group borrowers in India. In addition, banks are also required to observe certain statutory and regulatory exposure limits in respect of advances against / investments in shares, convertible debentures /bonds, units of equity-oriented mutual funds and all exposures to Venture Capital Funds (VCFs). Banks should comply with the following guidelines relating to exposure norms.

2 GUIDELINES

2.1 Credit Exposures to Single/Group Borrowers

2.1.1 Ceilings

2.1.1.1 The exposure ceiling limits would be 15 percent of capital funds in case of a single borrower and 40 percent of capital funds in the case of a borrower group. The capital funds for the purpose will comprise of Tier I and Tier II capital as defined under capital adequacy standards (please also refer to paragraph 2.1.3.5 of this Master Circular).

2.1.1.2 Bank's clearing exposure to a Qualifying CCP (QCCP) will be kept outside of the exposure ceiling of 15 per cent of its capital funds applicable to a single counterparty. Clearing exposure would include trade exposure and default fund exposure as defined in the guidelines on capital requirements for banks' exposure to central counterparties issued vide Circular DBOD.No.BC.28/21.06.201/ 2013-14 dated July 2, 2013. Other exposures to QCCPs such as loans, credit lines, investments in the capital of CCP, liquidity facilities, etc. will continue to be within the existing exposure ceiling of 15 per cent of capital funds to a single counterparty. However, all exposures of a bank to a non-QCCP should be within this exposure ceiling of 15 per cent.

2.1.1.3 Credit exposure to a single borrower may exceed the exposure norm of 15 percent of the bank's capital funds by an additional 5 percent (i.e. up to 20 percent) provided the additional credit exposure is on account of extension of credit to infrastructure projects. Credit exposure to borrowers belonging to a group may exceed the exposure norm of 40 percent of the bank's capital funds by an additional 10 percent (i.e., up to 50 percent), provided the additional credit exposure is on account of extension of credit to infrastructure projects. The definition of infrastructure lending and the list of sub-sectors under infrastructure is included in the Master Circular on 'Loans and Advances – Statutory and other Restrictions' dated July 1, 2015.

2.1.1.4 In addition to the exposure permitted under paragraphs 2.1.1.1 and 2.1.1.2 above, banks may, in exceptional circumstances, with the approval of their Boards, consider enhancement of the exposure to a borrower (single as well as group) up to a further 5 percent of capital funds subject to the borrower consenting to the banks making appropriate disclosures in their Annual Reports.

2.1.1.5 With effect from May 29, 2008, the exposure limit in respect of single borrower has been raised to twenty five percent of the capital funds, only in respect of Oil Companies who have been issued Oil Bonds (which do not have SLR status) by Government of India. In addition to this, banks may in exceptional circumstances, as hitherto, in terms of paragraph 2.1.1.3 of the Master Circular, consider enhancement of the exposure to the Oil Companies up to a further 5 percent of capital funds.

2.1.1.6 The bank should make appropriate disclosures in the 'Notes on account' to the annual financial statements in respect of the exposures where the bank had exceeded the prudential exposure limits during the year.

2.1.1.7 Exposures to NBFCs
The exposure (both lending and investment, including off balance sheet exposures) of a bank to a single NBFC / NBFC-AFC (Asset Financing Companies) should not exceed 10% / 15% respectively, of the bank's capital funds as per its last audited balance sheet. Banks may, however, assume exposures on a single NBFC / NBFC-AFC up to 15%/20% respectively, of their capital funds provided the exposure in excess of 10%/15% respectively, is on account of funds on-lent by the NBFC / NBFC-AFC to the infrastructure sector. Exposure of a bank to Infrastructure Finance Companies (IFCs) should not exceed 15% of its capital funds as per its last audited balance sheet, with a provision to increase it to 20% if the same is on account of funds on-lent by the IFCs to the infrastructure sector. Further, banks may also consider fixing internal limits for their aggregate exposure to all NBFCs put together. Infusion of capital funds after the published balance sheet date may also be taken into account for the purpose of reckoning capital funds. Banks should obtain an external auditor's certificate on completion of the augmentation of capital and submit the same to the Reserve Bank of India (Department of Banking Supervision) before reckoning the additions to capital funds.
2.1.1.8 Lending under Consortium Arrangements
The exposure limits will also be applicable to lending under consortium arrangements.
2.1.1.9 Bills discounted under Letter of Credit (LC)
In cases where the bills discounting/purchasing/negotiating bank and LC issuing bank are different entities, bills purchased/discounted/negotiated under LC (where the payment to the beneficiary is not made 'under reserve'), will be treated as an exposure on the LC issuing bank and not on the third party / borrower. However, in cases where the bills discounting/purchasing/negotiating bank and LC issuing bank are part of the same bank, i.e. where LC is issued by the Head Office or branch of the same bank, then the exposure should be taken on the third party/borrower and not on the LC issuing bank. In the case of negotiations 'under reserve', the exposure should be treated as on the borrower.
2.1.1.10 Disinvestment Programme of the Government of India
On account of banks' financing of acquisition of PSU shares under the Government of India disinvestment programmes, if any bank, is likely to exceed the regulatory ceiling of single / group borrower limit, RBI will consider relaxation on specific requests from banks in the singlel/group credit exposure norms on a case by case basis, provided that the bank's total exposure to the borrower, net of its exposure due to acquisition of PSU shares under the Government of India disinvestment programme, should be within the prudential singlel/group borrower exposure ceiling prescribed by RBI.
2.1.2 Exemptions
2.1.2.1 Rehabilitation of Sick/Weak Industrial Units
The ceilings on single/group exposure limits are not applicable to existing/additional credit facilities (including funding of interest and irregularities) granted to weak/sick industrial units under rehabilitation packages.
2.1.2.2 Food credit
Borrowers, to whom limits are allocated directly by the Reserve Bank for food credit, will be exempt from the ceiling.
2.1.2.3 Guarantee by the Government of India
The ceilings on single /group exposure limit would not be applicable where principal and interest are fully guaranteed by the Government of India.
2.1.2.4 Loans against Own Term Deposits
Loans and advances (both funded and non-funded facilities) granted against the security of a bank's own term deposits should not be reckoned for computing the exposure to the extent that the bank has a specific lien on such deposits.
2.1.2.5 Exposure on NABARD
The ceiling on single/group borrower exposure limit will not be applicable to exposure assumed by banks on NABARD. The individual banks are free to determine the size of the exposure to NABARD as per the policy framed by their respective Board of Directors.

However, banks may note that there is no exemption from the prohibitions relating to investments in unrated non-SLR securities prescribed in terms of the Master Circular on Prudential Norms for Classification, Valuation and Operations of Investment Portfolio by Banks, as amended from time to time.

2.1.3 Definitions

2.1.3.1 Exposure

Exposure shall include credit exposure (funded and non-funded credit limits) and investment exposure (including underwriting and similar commitments). The sanctioned limits or outstandings, whichever are higher, shall be reckoned for arriving at the exposure limit. However, in the case of fully drawn term loans, where there is no scope for re-drawal of any portion of the sanctioned limit, banks may reckon the outstanding as the exposure.

2.1.3.2 Measurement of Credit Exposure of Derivative Products

For the purpose of exposure norms, banks shall compute their credit exposures, arising on account of the interest rate & foreign exchange derivative transactions and gold, using the 'Current Exposure Method', as detailed below. While computing the credit exposure banks may exclude 'sold options', provided the entire premium / fee or any other form of income is received / realised. Bilateral netting of Mark-To-Market (MTM) values arising on account of such derivative contracts cannot be permitted. Accordingly, banks should count their gross positive MTM value of such contracts for the purposes of capital adequacy as well as for exposure norms.

Current Exposure Method

(i) The credit equivalent amount of a market related off-balance sheet transaction calculated using the current exposure method is the sum of current credit exposure and potential future credit exposure of these contracts. While computing the credit exposure banks may exclude 'sold options', provided the entire premium / fee or any other form of income is received / realized.

(ii) Current credit exposure is defined as the sum of the positive mark-to-market value of these contracts. The Current Exposure Method requires periodical calculation of the current credit exposure by marking these contracts to market, thus capturing the current credit exposure.

(iii) Potential future credit exposure is determined by multiplying the notional principal amount of each of these contracts irrespective of whether the contract has a zero, positive or negative mark-to-market value by the relevant add-on factor indicated below according to the nature and residual maturity of the instrument. **CCF for market related off-balance sheet items**

Residual Maturity Credit conversion factors

Interest Rate Contracts Exchange Rate Contracts & Gold

One year or less 0.50% 2.00%

Over one year to five years 1.00% 10.00%

Over five years 3.00% 15.00%

2.3.2.3 The above-mentioned ceilings (sub-paragraphs A and B) are the maximum permissible and a bank's Board of Directors is free to adopt a lower ceiling for the bank, keeping in view its overall risk profile and corporate strategy. Banks are required to adhere the ceilings on an ongoing basis.

2.3.2.4 If acquisition of equity shares, as indicated in paragraph 5.5 of circular DBOD.BP.BC.No.97/21.04.132/2013-14 dated February 26, 2014, results in exceeding the extant regulatory Capital Market Exposure (CME) limit, the same will not be considered as a breach of regulatory limit. However, this will require reporting to RBI and disclosure by banks in the Notes to Accounts in Annual Financial Statements. On account of banks financing acquisition of PSU shares under the Government of India disinvestment programmes, if any bank is likely to exceed the regulatory ceiling the capital market exposure, RBI will consider requests from these banks for relaxation of the ceiling on a case by case basis, subject to adequate safeguards regarding margin, bank's exposure to capital market, internal control and risk management systems, etc. The relaxation of ceiling will be considered in such a manner that the bank's exposure to capital market in all forms, net of its advances for financing of acquisition of PSU shares shall be within the regulatory ceiling limit.

2.3.3 Definition of Net Worth

Net worth would comprise Paid-up capital plus Free Reserves including Share Premium but excluding Revaluation Reserves, plus Investment Fluctuation Reserve and credit balance in Profit & Loss account, less debit balance in Profit and Loss account, Accumulated Losses and Intangible Assets. No general or specific provisions should be included in computation of net worth. Infusion of capital through equity shares, either through domestic issues or overseas floats after the published balance sheet date, may also be taken into account for determining the ceiling on exposure to capital market. Banks should obtain an external auditor's certificate on completion of the augmentation of capital and submit the same to the Reserve Bank of India (Department of Banking Supervision) before reckoning the additions, as stated above.

2.3.4 Items excluded from Capital Market Exposure

The following items would be excluded from the aggregate exposure ceiling of 40 per cent of net worth and direct investment exposure ceiling of 20 per cent of net worth (wherever applicable):

i. Banks' investments in own subsidiaries, joint ventures, sponsored Regional Rural Banks (RRBs) and investments in shares and convertible debentures, convertible bonds issued by institutions forming crucial financial infrastructure such as National Securities Depository Ltd. (NSDL), Central Depository Services (India) Ltd. (CDSL), National Securities Clearing Corporation Ltd. (NSCCL), National Stock Exchange (NSE), Clearing Corporation of India Ltd., (CCIL), a credit information company which has obtained Certificate of Registration from RBI and of which the bank is a member, Multi Commodity Exchange Ltd. (MCX), National Commodity and Derivatives Exchange Ltd. (NCDEX), National Multi-Commodity Exchange of India Ltd. (NMCEIL), National Collateral Management Services Ltd. (NCMSL), National Payments Corporation of India (NPCI) and United Stock Exchange of India Ltd. (USEIL) and other All India Financial Institutions as given in **Annex 2**. After listing, the exposures in excess of the original investment (i.e. prior to listing) would form part of the Capital Market Exposure.

ii. Tier I and Tier II debt instruments issued by other banks;

iii. Investment in Certificate of Deposits (CDs) of other banks;

iv. Preference Shares;

v. Non-convertible debentures and non-convertible bonds;

vi. Units of Mutual Funds under schemes where the corpus is invested exclusively in debt instruments;

vii. Shares acquired by banks as a result of conversion of debt/overdue interest into equity under Corporate Debt Restructuring (CDR) mechanism;

viii Term loans sanctioned to Indian promoters for acquisition of equity in overseas joint ventures / wholly owned subsidiaries under the refinance scheme of Export Import Bank of India (EXIM Bank).

ix. With effect from April 16, 2008, banks may exclude their own underwriting commitments, as also the underwriting commitments of their subsidiaries, through the book running process, for the purpose of arriving at the capital market exposure of the solo bank as well as the consolidated bank. (However, the position in this regard would be reviewed at a future date).

x. Promoters shares in the SPV of an infrastructure project pledged to the lending bank for infrastructure project lending.

xi banks exposure to brokers under the currency derivates segment

2.3.5 Computation of exposure

For computing the exposure to the capital markets, loans/advances sanctioned and guarantees issued for capital market operations would be reckoned with reference to sanctioned limits or outstanding, whichever is higher. However, in the case of fully drawn term loans, where there is no scope for re-drawal of any portion of the sanctioned limit,

banks may reckon the outstanding as the exposure. Further, banks' direct investment in shares, convertible bonds, convertible debentures and units of equity-oriented mutual funds would be calculated at their cost price.
As regards Irrevocable Payment Commitments (IPC) issued by custodian banks in favour of Stock Exchange, the computation of Capital Market Exposure would be as follows:
i. The maximum risk to the custodian banks issuing IPCs would be reckoned at 50%, on the assumption of downward price movement of the equities bought by FIIs/ Mutual Funds on the two successive days from the trade date (T) i.e., on T+1 and T+2, of 20% each with an additional margin of 10% for further downward movement.
ii. Accordingly the potential risk on T+1 would be reckoned at 50% of the settlement amount and this amount would be reckoned as CME at the end of T+1 if margin payment / early pay in does not come in.
iii. In case there is early pay in on T+1, there will be no Capital Market exposure. By T+1, we mean 'end of day' (EOD) as per Indian Time. Thus, funds received after EOD as per Indian Time, will not be reckoned as early pay-in on T+1. CME will have to be computed accordingly.
iv. In case margin is paid in cash on T+1, the CME would be reckoned at 50% of settlement price minus the margin paid. In case margin is paid on T+1 by way of permitted securities to FIIs / Mutual Funds, the CME would be reckoned at 50% of settlement price minus the margin paid plus haircut prescribed by the Exchange on the securities tendered towards margin payment.
v. The IPC will be treated as a financial guarantee with a Credit Conversion Factor (CCF) of 100. However, capital will have to be maintained only on exposure which is reckoned as CME because the rest of the exposure is deemed to have been covered by cash/securities which are admissible risk mitigants as per Basel II. Thus capital is to be maintained on the amount taken for CME and the risk weight would be 125% thereon. As the nature of IPC remains the same irrespective of the client for whom it is issued, the measures prescribed for IPCs will be applicable to all IPCs issued by custodian banks.

2.3.6 Intra-day Exposures

At present, there are no explicit guidelines for monitoring banks' intra-day exposure to the capital markets, which are inherently risky. It has been decided that the Board of each bank should evolve a policy for fixing intra-day limits and put in place an appropriate system to monitor such limits, on an ongoing basis. The position will be reviewed at a future date.

2.3.7 Enhancement in limits

Banks having sound internal controls and robust risk management systems can approach the Reserve Bank for higher limits together with details thereof.

3. Prudential Limits on Intra-Group Exposure

To contain concentration and contagion risks arising out of ITEs, certain quantitative limits on financial ITEs and prudential measures for the non-financial ITEs have been imposed as under:
i Exposure should include credit exposure (funded and non-funded credit limits) and investment exposure (including underwriting and similar commitments). However, exposure on account of equity and other regulatory capital instruments should be excluded while computing exposure to group entities.
ii Banks should adhere to the following intra-group exposure limits :
a. Single Group Entity Exposure
i. 5% of Paid-up Capital and Reserves in case of non-financial companies8 and unregulated financial services companies
ii. 10% of Paid-up Capital and Reserves in case of regulated financial services companies b. Aggregate Group Exposure
i. 10% of Paid-up Capital and Reserves in case of all non-financial companies and unregulated financial services companies taken together
ii. 20% of Paid-up Capital and Reserves in case of the group i.e. all group entities (financial and non-financial) taken together.

iii. Intra-group Exposures Exempted from the Prudential Limits
The following intra-group exposures would be excluded from the stipulated limits :
a. Banks' investments in the equity of group entities and other capital instruments are presently governed by the RBI Circulars DBOD.FSD.BC.62/24.01.001/2011-12 dated December 12, 2011 on 'Investments in Subsidiaries and Other companies - Guidelines' and DBOD.No.BP.BC.2/21.06.201/2013-14 dated July 1, 2013 on 'Basel III Capital Regulations'. Accordingly, banks' exposures to other banks / financial institutions in the group in form of equity and other capital instruments are exempted from the limits stipulated in above guidelines, and the extant instructions as cited above will continue to apply, subject to the prohibitions stipulated at iv below. b. Inter-bank exposures among banks in the group operating in India. However, prudential limits in respect of both outstanding borrowing and lending transactions in call / notice money market for scheduled commercial banks would continue to be governed by extant instructions on Call / Notice Money Market Operations.
c. Letters of Comfort issued by parent bank in favour of overseas group entities to meet regulatory requirements.
iv. Prohibited Exposures
Wherever a bank has been set-up under a NOFHC structure,
a. Bank cannot take any credit or investments (including investments in the equity / debt capital instruments) exposure on NOFHC, its Promoters / Promoter Group entities or individuals associated with the Promoter Group.
b. Bank cannot invest in the equity / debt capital instruments of any financial entities under the NOFHC. (for detailed instructions please refer to circular DBOD.No.BP.BC.96/21.06.102/2013-14 dated February 11, 2014)

4 Financing of equities and investments in shares

4.1 Advances against shares to individual

Loans against security of shares, convertible bonds, convertible debentures and units of equity oriented mutual funds to individuals from the banking system should not exceed the limit of Rs.10 lakh per individual if the securities are held in physical form and Rs. 20 lakhs per individual if the securities are held in demat form. Such loans are meant for genuine individual investors and banks should not support collusive action by a large group of individuals belonging to the same corporate or their inter-connected entities to take multiple loans in order to support particular scrips or stock-broking activities of the concerned firms. Such finance should be reckoned as an exposure to capital market. Banks should formulate, with the approval of their Board of Directors, a Loan Policy for granting advances to individuals against shares, debentures, and bonds keeping in view the RBI guidelines. As a prudential measure, banks may also consider laying down appropriate aggregate sub-limits of such advances.

4.2 Financing of Initial Public Offerings (IPOs)

Banks may grant advances to individuals for subscribing to IPOs. Loans/advances to any individual from the banking system against security of shares, convertible bonds, convertible debentures, units of equity oriented mutual funds and PSU bonds should not exceed the limit of Rs.10 lakh for subscribing to IPOs. The corporates should not be extended credit by banks for investment in other companies' IPOs. Similarly, banks should not provide finance to NBFCs for further lending to individuals for IPOs. Finance extended by a bank for IPOs should be reckoned as an exposure to capital market.

4.3 Bank finance to assist employees to buy shares of their own companies

4.3.1 Banks may extend finance to employees for purchasing shares of their own companies under Employees Stock Option Plan(ESOP)/ reserved by way of employees' quota under IPO to the extent of 90% of the purchase price of the shares or Rs.20 lakh, whichever is lower. Finance extended by banks for ESOPs/ employees' quota under IPO would be treated as an exposure to capital market within the overall ceiling of 40 per cent of their net worth. These instructions will not be applicable for extending financial assistance by banks to their own employees for acquisition of shares under ESOPs/ IPOs, as banks are not allowed to extend advances including advances to their employees / Employees' Trusts set up by them for the purpose of purchasing their own banks' shares under ESOPs / IPOs or from the secondary market. This prohibition will apply irrespective of whether the advances are secured or unsecured.

4.3.2 Banks should obtain a declaration from the borrower indicating the details of the loans / advances availed against shares and other securities specified above, from any other bank/s in order to ensure compliance with the ceilings prescribed for the purpose.

4.3.3 Follow-on Public Offers (FPOs) will also be included under IPO.

4.4 Advances against shares to Stock Brokers & Market Makers

4.4.1 Banks are free to provide credit facilities to stockbrokers and market makers on the basis of their commercial judgment, within the policy framework approved by their Boards. However, in order to avoid any nexus emerging between inter-connected stock broking entities and banks, the Board of each bank should fix, within the overall ceiling of 40 per cent of their net worth as on March 31 of the previous year, a sub-ceiling for total advances to –

i. all the stockbrokers and market makers (both fund based and non-fund based, i.e. guarantees); and

ii. to any single stock broking entity, including its associates/ inter-connected companies.

4.4.2 Further, banks should not extend credit facilities directly or indirectly to stockbrokers for arbitrage operations in Stock Exchanges**.**

4.5 Bank financing to individuals against shares to joint holders or third party beneficiaries

While granting advances against shares held in joint names to joint holders or third party beneficiaries, banks should be circumspect and ensure that the objective of the regulation is not defeated by granting advances to other joint holders or third party beneficiaries to circumvent the above limits placed on loans/advances against shares and other securities specified above.

4.6 Advances against units of mutual funds

While granting advances against units of mutual funds, the banks should adhere to the following guidelines:

i) The units should be listed in the stock exchanges or repurchase facility for the units should be available at the time of lending.

ii) The units should have completed the minimum lock-in-period stipulated in the relevant scheme.

iii) The amount of advances should be linked to the Net Asset Value (NAV) / repurchase priceor the market value, whichever is less and not to the face value of the units.

iv) Advances against units of mutual funds (except units of exclusively debt oriented mutual funds) would attract the quantum and margin requirements as are applicable to advances against shares and debentures. However, the quantum and margin requirement for loans/ advances to individuals against units of exclusively debt-oriented mutual funds may be decided by individual banks themselves in accordance with their loan policy.

v) The advances should be purpose oriented taking into account the credit requirement of the investor. Advances should not be granted for subscribing to or boosting up the sales of another scheme of a mutual fund or for the purchase of shares/ debentures/ bonds etc.

4.7 Bank Loans for Financing Promoters' Contributions

These loans will also be subject to single/group of borrowers exposure norms as well as the statutory limit on shareholding in companies, as detailed above.

4.8 Margin Trading

4.8.1 Banks may extend finance to stockbrokers for margin trading. The Board of each bank should formulate detailed guidelines for lending for margin trading, subject to the following parameters:

(i) The finance extended for margin trading should be within the overall ceiling of 40% of net worth prescribed for exposure to capital market.

(ii) A minimum margin of 50 per cent should be maintained on the funds lent for margin trading.

(iii) The shares purchased with margin trading should be in dematerialised mode under

pledge to the lending bank. The bank should put in place an appropriate system for monitoring and maintaining the margin of 50% on an ongoing basis.
(iv) The bank's Board should prescribe necessary safeguards to ensure that no "nexus" develops between inter-connected stock broking entities/ stockbrokers and the bank in respect of margin trading. Margin trading should be spread out by the bank among a reasonable number of stockbrokers and stock broking entities.
4.8.2 The Audit Committee of the Board should monitor periodically the bank's exposure by way of financing for margin trading and ensure that the guidelines formulated by the bank's Board, subject to the above parameters, are complied with. Banks should disclose the total finance extended for margin trading in the "Notes on Account" to their Balance Sheet.
4.9 Cross holding of capital among banks / financial institutions
4.9.1 (i) Banks' / FIs' investment in the following instruments, which are issued by other banks / FIs and are eligible for capital status for the investee bank / FI, should not exceed 10 percent of the investing bank's capital funds (Tier I plus Tier II):
a. Equity shares;
b. Preference shares eligible for capital status;
c. Subordinated debt instruments;
d. Hybrid debt capital instruments; and
e. Any other instrument approved as in the nature of capital.
(ii) Banks / FIs should not acquire any fresh stake in a bank's equity shares, if by such acquisition, the investing bank's / FI's holding exceeds 5 percent of the investee bank's equity capital.
(iii) It is clarified that a bank's/FI's equity holdings in another bank held under provisions of a Statute will be outside the purview of the ceiling prescribed above.
4.9.2 Banks' / FIs' investments in the equity capital of subsidiaries are at present deducted from their Tier I capital for capital adequacy purposes. Investments in the instruments issued by banks / FIs which are listed at paragraph 2.7.1(i) above, which are not deducted from Tier I capital of the investing bank/ FI, will attract 100 percent risk weight for credit risk for capital adequacy purposes.
5 'Safety Net' Schemes for Public Issues of Shares, Debentures, etc.
5.1 'Safety Net' Schemes
Reserve Bank had observed that some banks/their subsidiaries were providing buy-back facilities under the name of 'Safety Net' Schemes in respect of certain public issues as part of their merchant banking activities. Under such schemes, large exposures are assumed by way of commitments to buy the relative securities from the original investors at any time during a stipulated period at a price determined at the time of issue, irrespective of the prevailing market price. In some cases, such schemes were offered *suo motto* without any request from the company whose issues are supported under the schemes. Apparently, there was no undertaking in such cases from the issuers to buy the securities. There is also no income commensurate with the risk of loss built into these schemes, as the investor will take recourse to the facilities offered under the schemes only when the market value of the securities falls below the pre-determined price. Banks/their subsidiaries have therefore been advised that they should refrain from offering such 'Safety Net' facilities by whatever name called.
5.2 Provision of buy back facilities
In some cases, the issuers provide buy-back facilities to original investors up to Rs. 40,000/- in respect of non-convertible debentures after a lock-in-period of one year, to provide liquidity to debentures issued by them. If, at the request of the issuers, the banks or their subsidiaries find it necessary to provide additional facilities to small investors subscribing to new issues, such buy-back arrangements should not entail commitments to buy the securities at predetermined prices. Prices should be determined from time to time, keeping in view the prevailing stock market prices for the securities. Commitments should also be limited to a moderate proportion of the total issue in terms of the amount and should not exceed 25 percent of the owned funds of the banks/their subsidiaries. These commitments will also be

subject to the overall exposure limits which have been or may be prescribed from time to time.

ANNEX1

List of All-India Financial Institutions

(Counter party exposure - List of institutions guaranteeing bonds of corporates)

[paragraphs 2.1.3.4(c)]

1. Industrial Finance Corporation of India Ltd.
2. Industrial Investment Bank of India Ltd.
3. Tourism Finance Corporation of India Ltd.
4. Risk Capital and Technology Finance Corporation Ltd.
5. Technology Development and Information Company of India Ltd.
6. Power Finance Corporation Ltd.
7. National Housing Bank
8. Small Industries Development Bank of India
9. Rural Electrification Corporation Ltd.
10. Indian Railways Finance Corporation Ltd.
11. National Bank for Agriculture and Rural Development
12. Export Import Bank of India
13. Infrastructure Development Finance Company Ltd.
14. Housing and Urban Development Corporation Ltd.
15. Indian Renewable Energy Development Agency Ltd.

ANNEX 2

List of All-India Financial Institutions

[Investment in equity/convertible bonds/ convertible debentures by banks -
List of FIs whose instruments are exempted from Capital Market Exposure ceiling]

[paragraph 2.3.4(i)]

1. Industrial Finance Corporation of India Ltd. (IFCI)
2. Tourism Finance Corporation of India Ltd. (TFCI)
3. Risk Capital and Technology Finance Corporation Ltd. (RCTC)
4. Technology Development and Information Company of India Ltd. (TDICI)
5. National Housing Bank (NHB)
6. Small Industries Development Bank of India (SIDBI)
7. National Bank for Agriculture and Rural Development (NABARD)
8. Export Import Bank of India (EXIM Bank)
9. Industrial Investment Bank of India (IIBI)
10. Life Insurance Corporation of India (LIC)
11. General Insurance Corporation of India (GIC)

Master Circular - Lending to Micro, Small & Medium Enterprises (MSME) Sector

Short Title and Commencement

Directions are called the "Reserve Bank of India [Lending to Micro, Small & Medium Enterprises (MSME) Sector] Directions, 2016" and shall come into effect on the day they are placed on the official website of RBI.

Applicability

These Directions are applicable to all Scheduled Commercial Bank but excluding RRBs.

Definitions/ Clarifications

(a) The "**MSMED Act, 2006"** means 'Micro, Small and Medium Enterprises Development (MSMED) Act, 2006' as notified by the Government of India on June 16, 2006 and the amendments thereafter, if any, by the Government of India.

(b) '**Micro, Small and Medium Enterprises'** mean the enterprises as defined in the MSMED Act, 2006 and the amendments, if any, from time to time.

(c) '**Manufacturing'** and '**Service' Enterprises** mean the enterprises as defined in the MSMED Act, 2006 or as notified by the Government of India, Ministry of MSME under the MSMED Act, 2006 from time to time.

(d) '**Priority Sector'** means the sectors as defined in Master Direction - Reserve Bank of India (Priority Sector Lending –Targets and Classification) Directions, 2016 dated July 7, 2016 or as modified from time to time.

(e) '**Adjusted Net Bank Credit (ANBC)'** would mean Adjusted Net Bank Credit (ANBC) as defined in Master Direction - Reserve Bank of India (Priority Sector Lending –Targets and Classification) Directions, 2016 dated July 7, 2016 or as modified from time to time.

Micro, Small & Medium Enterprises Development (MSMED) Act, 2006

The Government of India has enacted the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 on June 16, 2006 which was notified on October 2, 2006. With the enactment of MSMED Act 2006, the paradigm shift that has taken place is the inclusion of the services sector in the definition of Micro, Small & Medium enterprises, apart from extending the scope to medium enterprises. The MSMED Act, 2006 has modified the definition of micro, small and medium enterprises engaged in manufacturing or production and providing or rendering of services. The Reserve Bank has notified the changes to all scheduled commercial banks. Further, the definition, as per the Act, has been adopted for purposes of bank credit vide RBI circular ref. RPCD.PLNFS. BC.No.63/ 06.02.31/ 2006-07 dated April 4, 2007.

1.1 Definition of Micro, Small and Medium Enterprises

(a) Manufacturing Enterprises i.e. Enterprises engaged in the manufacture or production, processing or preservation of goods as specified below:

(i) A micro enterprise is an enterprise where investment in plant and machinery does not exceed Rs. 25 lakh;

(ii) A small enterprise is an enterprise where the investment in plant and machinery is more than Rs. 25 lakh but does not exceed Rs. 5 crore; and

(iii) A medium enterprise is an enterprise where the investment in plant and machinery is more than Rs.5 crore but does not exceed Rs.10 crore.

In case of the above enterprises, investment in plant and machinery is the original cost excluding land and building and the items specified by the Ministry of Small Scale Industries vide its notification No.S.O. 1722(E) dated October 5, 2006 (Annex I).

(b) Service Enterprises i.e. Enterprises engaged in providing or rendering of services and whose investment in equipment (original cost excluding land and building and furniture, fittings and other items not directly related to the service rendered or as may be notified under the MSMED Act, 2006) are specified below.

(i) A micro enterprise is an enterprise where the investment in equipment does not exceed Rs. 10 lakh;

(ii) A small enterprise is an enterprise where the investment in equipment is more than Rs.10 lakh but does not exceed Rs. 2 crore; and

(iii) A medium enterprise is an enterprise where the investment in equipment is more than Rs. 2 crore but does not exceed Rs. 5 crore.

1.2 Bank Loans to Micro and Small enterprises, both Manufacturing and Service are eligible to be classified under Priority Sector advance as per the following:

1.2.1 Direct Finance

1.2.1.1 Manufacturing Enterprises

The Micro and Small enterprises engaged in the manufacture or production of goods to any industry specified in the first schedule to the Industries (Development and regulation) Act, 1951 and notified by the Government from time to time. The manufacturing enterprises are defined in terms of investment in plant and machinery.

1.2.1.2. Loans for food and agro processing

Loans for food and agro processing will be classified under Micro and Small Enterprises, provided the units satisfy investments criteria prescribed for Micro and Small Enterprises, as provided in MSMED Act, 2006.

1.2.1.3 Service Enterprises

Bank loans up to Rs.5 crore per borrower / unit to Micro and Small Enterprises engaged in providing or rendering of services and defined in terms of investment in equipment under MSMED Act, 2006.

1.2.1.4 Export Credit

Export credit to MSE units (both manufacturing and services) for export of goods/services produced / rendered by them.

1.2.1.5 Khadi and Village Industries Sector (KVI)

All loans sanctioned to units in the KVI sector, irrespective of their size of operations and location and amount of original investment in plant and machinery. Such loans will be eligible for classification under the sub-target of 60 percent prescribed for micro enterprises within the micro and small enterprises segment under priority sector.

1.2.1.6. If the loans under General credit Card (GCC) are sanctioned to Micro and Small Enterprises, such loans should be classified under respective categories of Micro and Small Enterprises.

1.2.2 Indirect Finance

(i) Loans to persons involved in assisting the decentralised sector in the supply of inputs to and marketing of outputs of artisans, village and cottage industries.

(ii) Loans to cooperatives of producers in the decentralised sector viz. artisans village and cottage industries.

(iii) Loans sanctioned by banks to MFIs for on-lending to MSE sector as per the conditions specified in extant Master Circular on Priority Sector Lending.

1.3 Lending by banks to medium enterprises will not be included for the purpose of reckoning of advances under the priority sector.

1.4 Since the MSMED Act, 2006 does not provide for clubbing of investments of different enterprises set up by same person / company for the purpose of classification as Micro, Small and Medium enterprises, the Gazette Notification No. S.O.2 (E) dated January 1, 1993 on clubbing of investments of two or more enterprises under the same ownership for the purpose of classification of industrial undertakings as SSI has been rescinded vide GOI Notification No. S.O. 563 (E) dated February 27, 2009.

SECTION - II

2 Scheme of Small Enterprises Financial Centres (SEFCs):

As per announcement made by the Governor in the Annual Policy Statement 2005-06, a scheme for strategic alliance between branches of banks and SIDBI located in clusters, named as "Small Enterprises Financial Centres" has been formulated in consultation with the Ministry of SSI and Banking Division, Ministry of Finance, Government of India, SIDBI, IBA and select banks and circulated to all scheduled commercial banks on May 20, 2005 for implementation. SIDBI has so far executed MoU with 15 banks (Bank of India, UCO Bank, YES Bank, Bank of Baroda, Oriental Bank of Commerce, Punjab National Bank, Dena Bank, Andhra Bank, Indian Bank, Corporation Bank, IDBI Bank, Indian Overseas Bank, Union Bank of India, State Bank of India and Federal Bank). List of MSME clusters covered by existing SIDBI branches is furnished in Annex II.

SECTION - III

3 Targets for lending to Micro and Small enterprises (MSE) sector by Domestic Commercial Banks and Foreign Banks operating in India

3.1 Advances to micro and small enterprises (MSE) sector shall be reckoned in computing achievement under the overall Priority Sector target of 40 percent (32 percent for Foreign Banks operating in India with less than 20 branches) of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.

3.2 Bank loans above Rs.5 crore per borrower / unit to Micro and Small Enterprises engaged in providing or rendering of services and defined in terms of investment in equipment under MSMED Act, 2006, shall **not** be reckoned in computing achievement under the overall above Priority Sector targets. However, such loans would be taken into account while assessing the performance of the banks with regard to their achievement of targets prescribed by the Prime Minister's Task Force on MSMEs for lending to MSE sector.

3.3 In terms of the recommendations of the Prime Minister's Task Force on MSMEs, banks are advised to achieve a 20 per cent year-on-year growth in credit to micro and small enterprises and a 10 per cent annual growth in the number of micro enterprise accounts.

3.4 In order to ensure that sufficient credit is available to micro enterprises within the MSE sector, banks should ensure that:

(a) 40 per cent of the total advances to MSE sector should go to micro (manufacturing) enterprises having investment in plant and machinery up to Rs. 10 lakh and micro (service) enterprises having investment in equipment up to Rs. 4 lakh;

(b) 20 per cent of the total advances to MSE sector should go to micro (manufacturing) enterprises with investment in plant and machinery above Rs. 10 lakh and up to Rs. 25 lakh, and micro (service) enterprises with investment in equipment above Rs. 4 lakh and up to Rs. 10 lakh. **Thus, 60 per cent of MSE advances should go to the micro enterprises**.

(c) While banks are advised to achieve the 60% target as above, in terms of the recommendations of the Prime Minister's Task Force, the allocation of 60% of the MSE advances to the micro enterprises is to be achieved in stages viz. 50% in the year 2010-11, 55% in the year 2011-12 and 60% in the year 2012-13.

3.5 The target for lending to Micro Enterprises within the MSE sector (i.e. 60% of total lending to MSE sector should go to Micro enterprises) will be computed with reference to the outstanding credit to MSE sector as on preceding March 31st.

SECTION - IV

4 Common Guidelines / Instructions for Lending to MSME Sector

4.1 Issue of Acknowledgement of Loan Applications to MSME borrowers

Banks have been advised to mandatorily acknowledge all loan applications, submitted manually or online, by their MSME borrowers and ensure that a running serial number is recorded on the application form as well as on the acknowledgement receipt. Banks are further encouraged to start Central Registration of loan applications. The same technology may be used for online submission of loan applications as also for online tracking of loan applications.

4.2 Collateral

Banks are mandated not to accept collateral security in the case of loans upto Rs.10 lakh extended to units in the MSE sector. Banks are also advised to extend collateral-free loans upto Rs. 10 lakh to all units financed under the Prime Minister Employment Generation Programme of KVIC.

Banks may, on the basis of good track record and financial position of the MSE units, increase the limit of dispensation of collateral requirement for loans up to Rs.25 lakh (with the approval of the appropriate authority).

Banks are advised to strongly encourage their branch level functionaries to avail of the Credit Guarantee Scheme cover, including making performance in this regard a criterion in the evaluation of their field staff.

4.3 Composite loan

A composite loan limit of Rs.1 crore can be sanctioned by banks to enable the MSE entrepreneurs to avail of their working capital and term loan requirement through Single Window.

4.4 Specialised MSME branches

Public sector banks have been advised to open at least one specialised branch in each district. Further, banks have been permitted to categorise their MSMEgeneral banking branches having 60% or more of their advances to MSME sector in order to encourage them to open more specialised MSME branches for providing better service to this sector as a whole. As per the policy package announced by the Government of India for stepping up credit to MSME sector, the public sector banks will ensure specialized MSME branches in identified clusters/centres with preponderance of small enterprises to enable the entrepreneurs to have easy access to the bank credit and to equip bank personnel to develop requisite expertise. The existing specialised SSI branches may also be redesignated as MSME branches. Though their core competence will be utilized for extending finance and other services to MSME sector, they will have operational flexibility to extend finance/render other services to other sectors/borrowers.

4.5 Delayed Payment

Under the Amendment Act, 1998 of Interest on Delayed Payment to Small Scale and Ancillary Industrial Undertakings, penal provisions have been incorporated to take care of delayed payments to MSME units. After the enactment of the Micro, Small and Medium Enterprises Development (MSMED), Act 2006, the existing provisions of the Interest on Delayed Payment Act, 1998 to Small Scale and Ancillary Industrial Undertakings, have been strengthened as under:

(i) In case the buyer to make payment on or before the date agreed on between him and the supplier in writing or, in case of no agreement before the appointed day. The agreement between seller and buyer shall not exceed more than 45 days.

(ii) In case the buyer fails to make payment of the amount to the supplier, he shall be liable to pay compound interest with monthly rests to the supplier on the amount from the appointed day or, on the date agreed on, at three times of the Bank Rate notified by Reserve Bank.

(iii) For any goods supplied or services rendered by the supplier, the buyer shall be liable to pay the interest as advised at (ii) above.

(iv) In case of dispute with regard to any amount due, a reference shall be made to the Micro and Small Enterprises Facilitation Council, constituted by the respective State Government.

Further, banks have been advised to fix sub-limits within the overall working capital limits to the large borrowers specifically for meeting the payment obligation in respect of purchases from MSMEs.

4.6 Revised Guidelines for Rehabilitation of Sick Micro and Small Enterprises

In view of the recommendations of Working Group on rehabilitation of potentially viable sick units (Chairman: Dr. K. C. Chakrabarty), regarding changing the definition of sickness and the procedure for assessing the viability of sick MSE units, a Committee was set up by the Ministry of MSME to look into the issue. Based on the recommendation of the Committee, revised guidelines for rehabilitation of sick units in the MSE sector have been issued vide our circular RPCD.CO.MSME & NFS.BC.40/06.02.31/2012-2013 dated November 1, 2012.

The objective of the revised guidelines is to hasten the process of identification of a unit as sick, early detection of incipient sickness, and to lay down a procedure to be adopted by banks before declaring a unit as unviable.

As per the new guidelines, a Micro or Small Enterprise (as defined in the MSMED Act 2006) may be said to have become Sick, if (a) any of the borrowal account of the enterprise remains NPA for three months or more OR (b) there is erosion in the net worth due to accumulated losses to the extent of 50% of its net worth during the previous accounting year.

The revised guidelines also provide the procedures to be adopted by the banks before declaring any unit as unviable. Banks have been advised that the decision on viability of the unit should be taken at the earliest but not later than 3 months of becoming sick under any circumstances and the rehabilitation package should be fully implemented within six months from the date the unit is declared as 'potentially viable' / 'viable'.

4.7 Micro and Small Enterprises Sector – The imperative of Financial Literacy and consultancy support

Keeping in view the high extent of financial exclusion (92 per cent) in the MSME sector, it is imperative for banks that the excluded units are brought within the fold of the formal banking sector. The lack of financial literacy, operational skills, including accounting and finance, business planning etc. represent formidable challenge for MSE borrowers underscoring the need for facilitation by banks in these critical financial areas. Moreover, MSE enterprises are further handicapped in this regard by absence of scale and size. To effectively and decisively address these handicaps, Scheduled commercial banks have been advised vide our circular RPCD.MSME&NFS.BC.No.20/06.02.31/2012-13 dated August 1, 2012 that the banks could either separately set up special cells at their branches, or vertically integrate this function in the Financial Literacy Centres (FLCs) set up by them, as per their comparative advantage. The bank staff should also be trained through customised training programs to meet the specific needs of the sector.

4.8 Structured Mechanism for monitoring the credit growth to the MSE sector

In view of the concerns emerging from the deceleration in credit growth to the MSE sector, an Indian Banks' Association (IBA)-led Sub-Committee (Chairman: Shri K.R. Kamath) was set up to suggest a structured mechanism to be put in place by banks to monitor the entire gamut of credit related issues pertaining to the sector. Based on the recommendations of the Committee, banks have been advised to:

- strengthen their existing systems of monitoring credit growth to the sector and put in place a system-driven comprehensive performance management information system (MIS) at every supervisory level (branch, region, zone, head office) which should be critically evaluated on a regular basis;
- put in place a system of e-tracking of MSE loan applications and monitor the loan application disposal process in banks, giving branch-wise, region-wise, zone-wise and State-wise positions. The position in this regard is to be displayed by banks on their websites; and
- monitor timely rehabilitation of sick MSE units. The progress in rehabilitation of sick MSE units is to be made available on the website of banks.

Detailed guidelines have been issued to the scheduled commercial banks vide our circular RPCD.MSME&NFS.BC.No.74/06.02.31/2012-13 dated May 9, 2013.

4.9 State Level Inter Institutional Committee

In order to deal with the problems of co-ordination for rehabilitation of sick micro and small units, State Level Inter-Institutional Committees (SLIICs) have been set up in all the States. The meetings of these Committees are convened by Regional Offices of RBI and presided over by the Secretary, Industry of the concerned State Government. It provides a useful forum for adequate interfacing between the State Government Officials and State Level Institutions on the one side and the term lending institutions and banks on the other. It closely monitors timely sanction of working capital to units which have been provided term loans by SFCs, implementation of special schemes such as Margin Money Scheme of State Government and reviews general problems faced by industries and sickness in MSE sector based on the data furnished by banks. Among others, the representatives of the local state level MSE associations are invited to the meetings of SLIIC which are held quarterly. A sub-committee of SLIIC looks into the problems of individual sick MSE unit and submits its recommendations to the forum of SLIIC for consideration.

4.10 Empowered Committee on MSMEs

As part of the announcement made by the Union Finance Minister, at the Regional Offices of Reserve Bank of India, Empowered Committees on MSMEs have been constituted under the Chairmanship of the Regional Directors with the representatives of SLBC Convenor, senior level officers from two banks having predominant share in MSME financing in the state, representative of SIDBI Regional Office, the Director of Industries of the State Government, one or two senior level representatives from the MSME/SSI Associations in the state, and a senior level officer from SFC/SIDC as members. The Committee will meet periodically and review the progress in MSME financing as also rehabilitation of sick Micro, Small and Medium units. It will also coordinate with other banks/financial institutions and the state government in removing bottlenecks, if any, to ensure smooth flow of credit to the sector. The committees may decide the need to have similar committees at cluster/district levels.

4.11 Debt Restructuring Mechanism for MSMEs

(i) As part of announcement made by the Hon'ble Finance Minister for stepping up credit to small and medium enterprises, a debt restructuring mechanism for units in MSME sector has been formulated by Department of Banking Operations & Development of Reserve Bank of India and advised all commercial banks vide circular DBOD.BP.BC.No.34/21.04.132/2005-06 dated September 8, 2005. These detailed guidelines have been issued to ensure restructuring of debt of all eligible small and medium enterprises. These guidelines would be applicable to the following entities, which are viable or potentially viable:

(a) All non-corporate MSMEs irrespective of the level of dues to banks.

(b) All corporate MSMEs, which are enjoying banking facilities from a single bank, irrespective of the level of dues to the bank.

(c) All corporate MSMEs, which have funded and non-funded outstanding up to Rs.10 crore under multiple/ consortium banking arrangement.

(d) Accounts involving willful default, fraud and malfeasance will not be eligible for restructuring under these guidelines.

(e) Accounts classified by banks as "Loss Assets" will not be eligible for restructuring.

For all corporate including MSMEs, which have funded and non-funded outstanding of Rs.10 crore and above, Department of Banking Operations & Development has issued separate guidelines on Corporate Debt Restructuring Mechanism vide circular DBOD. No.BP.BC.45/ 21.04. 132/2005-06 dated November 10, 2005.

Prudential Guidelines on MSME Debt Restructuring by banks have been formulated and advised to all commercial banks by Department of Banking Operations & Development vide circular DBOD.No.BP.BC.No.37/21.04.132/2008-09 dated August 27, 2008 read with circular DBOD.BP.BC.No.99/21.04.132/2012-13 dated May 30, 2013 and DBOD Mail Box clarification dated June 6, 2013.

(ii) In the light of the recommendations of the Working Group on Rehabilitation of Sick MSEs (Chairman: Dr. K.C. Chakrabarty), all commercial banks were advised vide our circular ref. RPCD. SME & NFS.BC.No. 102/06.04.01/ 2008-09 dated May 4, 2009to:

(a) put in place loan policies governing extension of credit facilities, Restructuring/Rehabilitation policy for revival of potentially viable sick units/enterprises and non- discretionary One Time Settlement scheme for recovery of non-performing loans for the MSE sector, with the approval of the Board of Directors and

(b) implement recommendations with regard to timely and adequate flow of credit to the MSE sector.

(iii) Banks have been advised to give wide publicity to the One Time settlement scheme implemented by them, by placing it on the bank's website and through other possible modes of dissemination. They may allow reasonable time to the borrowers to submit the application and also make payment of the dues in order to extend the benefits of the scheme to eligible borrowers.

4.12 Cluster Approach

(i) 60 clusters have been identified by the Ministry of Micro, Small and Medium Enterprises, Government of India for focused development of Small Enterprises sector. All SLBC Convenor banks have been advised to incorporate in their Annual Credit Plans, the credit requirement in the clusters identified by the Ministry of Micro, Small and Medium Enterprises, Government of India.

As per Ganguly Committee recommendations banks have been advised that a full-service approach to cater to the diverse needs of the MSE sector may be achieved through extending banking services to recognized MSE clusters by adopting a 4-C approach namely, Customer focus, Cost control, Cross sell and Contain risk. A cluster based approach to lending may be more beneficial:

a. in dealing with well-defined and recognized groups;
b. availability of appropriate information for risk assessment and
c. monitoring by the lending institutions.

Clusters may be identified based on factors such as trade record, competitiveness and growth prospects and/or other cluster specific data.

(ii) As per announcement made by the Governor in paragraph 157 of the Annual Policy Statement 2007-08, all SLBC Convenor banks have been advised vide letter RPCD.PLNFS.No. 10416/06.02.31/ 2006-07 dated May 8, 2007 to review their institutional arrangements for delivering credit to the MSME sector, especially in 388 clusters identified by United Nations Industrial Development Organisation (UNIDO) spread over 21 states in various parts of the country. A list of SME clusters as identified by UNIDO has been furnished in Annex III.

(iii) The Ministry of Micro, Small and Medium Enterprises has approved a list of clusters under the Scheme of Fund for Regeneration of Traditional Industries (SFURTI) and Micro and Small Enterprises Cluster Development Programme (MSE-CDP) located in 121 Minority Concentration Districts. Accordingly, appropriate measures have been taken to improve the credit flow to the identified clusters of micro and small entrepreneurs from the Minorities Communities residing in the minority concentrated districts of the country.

(iv) In terms of recommendations of the Prime Minister's Task Force on MSMEs banks should open more MSE focused branch offices at different MSE clusters which can also act as CounsellingCentres for MSEs. Each lead bank of a district may adopt at least one MSE cluster.

4.13 Credit Linked Capital Subsidy Scheme (CLSS)

Government of India, Ministry of Micro, Small and Medium Enterprises has conveyed their approval for continuation of the Credit Linked Capital Subsidy Scheme (CLSS) for Technology Upgradation of Micro and Small Enterprises from X Plan to XI Plan (2007-12) subject to the following terms and conditions:

(i) Ceiling on the loan under the scheme is Rs.1 crore.

(ii) The rate of subsidy is 15% for all units of micro and small enterprises up to loan ceiling at Sr. No. (i) above.

(iii) Calculation of admissible subsidy will be done with reference to the purchase price of plant and machinery instead of term loan disbursed to the beneficiary unit.

(iv) SIDBI and NABARD will continue to be implementing agencies of the scheme.

4.14 Committees on flow of Credit to MSE sector

4.14.1 Report of the High Level Committee on Credit to SSI (now MSE) (Kapur Committee)

Reserve Bank of India had appointed a one-man High Level Committee headed by Shri S L Kapur, (IAS, Retd.), Former Secretary, Government of India, Ministry of Industry to suggest measures for improving the delivery system and simplification of procedures for credit to SSI sector. The Committee made 126 recommendations covering wide range of areas pertaining to financing of SSI sector. These recommendations have been examined by the RBI and it has been decided to accept 88 recommendations which include the following important recommendations:

(i) Delegation of more powers to branch managers to grant ad-hoc limits;

(ii) Simplification of application forms;

(iii) Freedom to banks to decide their own norms for assessment of credit requirements;

(iv) Opening of more specialised SSI branches;

(v) Enhancement in the limit for composite loans to Rs. 5 lakh. (*since enhanced to Rs.1 crore);*

(vi) Strengthening the recovery mechanism;

(vii) Banks to pay more attention to the backward states;

(viii) Special programmes for training branch managers for appraising small projects;

(ix) Banks to make customers grievance machinery more transparent and simplify the procedures for handling complaints and monitoring thereof.

A circular was issued to all scheduled commercial banks vide RPCD.No. PLNFS.BC.22/06.02.31/98-99 dated August 28, 1998 thereby advising implementation of the Kapur Committee Recommendations.

4.14.2 Report of the Committee to Examine the Adequacy of Institutional Credit to SSI Sector(now MSE) and Related Aspects (Nayak Committee)

The Committee was constituted by Reserve Bank of India in December 1991 under the Chairmanship of Shri P. R. Nayak, the then Deputy Governor to examine the issues confronting SSIs (now MSE) in the matter of obtaining finance. The Committee submitted its report in 1992.

All the major recommendations of the Committee have been accepted and the banks have been inter-alia advised to:

(i) give preference to village industries, tiny industries and other small scale units in that order, while meeting the credit requirements of the small scale sector;

(ii) grant working capital credit limits to SSI (now MSE) units computed on the basis of minimum 20% of their estimated annual turnover whose credit limit in individual cases is upto Rs.2 crore [since raised to Rs.5 crore];

(iii) prepare annual credit budget on the `bottom-up' basis to ensure that the legitimate requirements of SSI (now MSE) sector are met in full;

(iv) extend 'Single Window Scheme' of SIDBI to all districts to meet the financial requirements (both working capital and term loan) of SSIs(now MSE);

(v) ensure that there should not be any delay in sanctioning and disbursal of credit. In case of rejection/curtailment of credit limit of the loan proposal, a reference to higher authorities should be made;

(vi) not to insist on compulsory deposit as a `quid pro-quo' for sanctioning the credit;

(vii) open specialised SSI (now MSE) bank branches or convert those branches which have a fairly large number of SSI (now MSE) borrowal accounts, into specialised SSI (now MSE) branches;

(viii) identify sick SSI (now MSE) units and take urgent action to put them on nursing programmes;

(ix) standardise loan application forms for SSI (now MSE) borrowers; and

(x) impart training to staff working at specialised branches to bring about attitudinal change in them.

A circular was issued to all scheduled commercial banks vide RPCD. PLNFS/ BC. No. 61/06.0262/ 2000-01 dated March 2, 2001 thereby advising implementation of the Nayak Committee Recommendations.

4.14.3 Report of the Working Group on Flow of Credit to SSI (now MSE) Sector (Ganguly Committee)

As per the announcement made by the Governor, Reserve Bank of India, in the Mid-Term Review of the Monetary and Credit Policy 2003-2004, a "Working Group on Flow of Credit to SSI sector" was constituted under the Chairmanship of Dr. A S Ganguly.

The Committee made 31 recommendations covering wide range of areas pertaining to financing of SSI sector. The recommendations pertaining to RBI and banks have been examined and RBI has accepted 8 recommendations so far and commended to banks for implementation vide circular RPCD.PLNFS.BC.28/06.02.31(WG)/2004-05 dated September 4, 2004which are as under:

(i) adoption of cluster based approach for financing MSME sector;

(ii) sponsoring specific projects as well as widely publicising successful working models of NGOs by Lead Banks which service small and tiny industries and individual entrepreneurs;

(iii) sanctioning of higher working capital limits by banks operating in the North East region to SSIs (now MSE) , based on their commercial judgment due to the peculiar situation of hilly terrain and frequent floods causing hindrance in the transportation system;

(iv) exploring new instruments by banks for promoting rural industry and to improve the flow of credit to rural artisans, rural industries and rural entrepreneurs, and

(v) revision of tenure as also interest rate structure of deposits kept by foreign banks with SIDBI for their shortfall in priority sector lending.

4.14.4 Policy Package for Stepping up Credit to Small and Medium Enterprises - Announcements made by the Union Finance Minister on August 10, 2005

The Hon'ble Finance Minister, Government of India had announced on August 10, 2005, a Policy Package for stepping up credit flow to Small and Medium enterprises. Some of the salient features of the policy package are as under:

• Definition of Small and Medium Enterprises (MSMEs)

• Fixing of self-targets for financing to MSME sector by banks

• Measures to rationalize the cost of loans to MSME sector

• Measures to increase the outreach of formal credit to the MSME sector

• Cluster based approach for financing MSME sector

• Constitution of Empowered Committees for MSMEs in the Regional Offices of Reserve Bank

• Steps to rationalize the cost of loans to MSME sector by adopting a transparent rating system with cost of credit being linked to the credit rating of enterprise.

• Banks to consider taking advantage of Credit Appraisal & Rating Tool (CART), Risk Assessment Model (RAM) and the comprehensive rating model for risk assessment of MSME proposals, developed by SIDBI for reduction of their transaction costs.

• Banks to consider the ratings of MSE units carried out through reputed credit rating agencies under the Credit Rating Scheme introduced by National Small Industries Corporation.

• Wider dissemination and easy accessibility of the policy guidelines formulated by Boards of banks as well as instructions/guidelines issued by Reserve Bank by displaying them on the respective banks' web sites as well as web site of SIDBI and also prominently displaying them at the bank branches.

4.14.5 Major Instructions issued to Public Sector banks subsequent to the policy announcements

On the basis of the Policy Package as announced by the Union Finance Minister, some of the major instructions issued by Reserve Bank to all public sector banks were as under:

Public sector banks were advised to fix their own targets for funding SMEs in order to achieve a minimum 20% year on year growth in credit to SMEs. The objective is to double the flow of credit from Rs. 67,600 crore in 2004-05 to Rs. 1,35,200 crore to the SME sector by 2009-10, i.e. within a period of 5 years.

Public sector banks were advised to follow a transparent rating system with cost of credit being linked to the credit rating of the enterprise.

All banks, may make concerted efforts to provide credit cover on an average to at least 5 new small/ medium enterprises at each of their semi-urban/ urban branches per year.
The banks may ensure specialized MSME branches in identified clusters/ centres with preponderance of small Enterprises to enable the entrepreneurs to have easy access to the bank credit.

(The circulars issued by Reserve Bank in this regard are vide RPCD.PLNFS.BC.No.31/06.02.31/200506 dated August 19, 2005and RPCD.PLNFS.BC.No.35/06.02.31/2005 -06 dated August 25, 2005)

4.14.6 Working Group on Rehabilitation of Sick SMEs (Chairman: Dr. K.C. Chakrabarty)

In the light of the recommendations of the Working Group on Rehabilitation of Sick MSEs (Chairman: Dr. K.C. Chakrabarty, the then CMD of Punjab National Bank), all commercial banks were advised vide our circular RPCD.SME & NFS.BC.No.102/06.04.01/2008-09 dated May 4, 2009 to:

a) put in place loan policies governing extension of credit facilities, Restructuring/Rehabilitation policy for revival of potentially viable sick units/enterprises and non- discretionary One Time Settlement scheme for recovery of non-performing loans for the MSE sector, with the approval of the Board of Directors and

b) implement the recommendations with regard to timely and adequate flow of credit to the MSE sector as detailed in the aforesaid circular.

4.14.7 Prime Minister's Task Force on Micro, Small and Medium Enterprises

A High Level Task Force was constituted by the Government of India (Chairman: Shri T K A Nair) to consider various issues raised by Micro, Small and Medium Enterprises (MSMEs).The Task Force recommended several measures having a bearing on the functioning of MSMEs, viz., credit, marketing, labour, exit policy, infrastructure/technology/skill development and taxation. The comprehensive recommendations cover measures that need immediate action as well as medium term institutional measures along with legal and regulatory structures and recommendations for North-Eastern States and Jammu & Kashmir.

Banks are urged to keep in view the recommendations made by the Task Force and take effective steps to increase the flow of credit to the MSE sector, particularly to the micro enterprises.

A circular was issued to all scheduled commercial banks vide RPCD.SME & NFS BC.No.90/06.02.31/2009-10 dated June 29, 2010 advising implementation of the recommendations of the Prime Minister's task Force on MSMEs.

The report of the Prime Minister's Task Force on Micro, Small and Medium Enterprises is available on the website of Ministry of Micro, Small and Medium Enterprises (msme.gov.in)

4.14.8 Working Group to Review the Credit Guarantee Scheme for Micro and Small Enterprises

A Working Group was constituted by the Reserve Bank of India under the Chairmanship of Shri V.K. Sharma, Executive Director, to review the working of the Credit Guarantee Scheme of CGTMSE and suggest measures to enhance its usage and facilitate increased flow of collateral free loans to MSEs.

The recommendations of the Working Group included, inter alia, mandatory doubling of the limit for collateral free loans to micro and small enterprises (MSEs) sector from Rs.5 lakh to Rs.10 lakh and enjoining upon the Chief Executive Officers of banks to strongly encourage the branch level functionaries to avail of the CGS cover and making performance in this regard a criterion in the evaluation of their field staff, etc. have been advised to all banks.

A circular was issued to all scheduled commercial banks vide RPCD.SME&NFS.BC.No.79/06.02.31/2009-10 dated May 6, 2010 mandating them not to accept collateral security in the case of loans upto Rs 10 lakh extended to units in the MSE sector and advising them to strongly encourage their branch level functionaries to avail of the CGS cover, including making performance in this regard a criterion in the evaluation of their field staff.

Necessary action is being taken to implement the other recommendations of the Group which would result in enhanced usage of the Guarantee Scheme and facilitate increase in quality and quantity of credit to the presently included, as well as excluded, MSEs, leading eventually, to sustainable inclusive growth.

4.15 Banking Codes and Standard Board of India (BCSBI)

The Banking Codes and Standard Board of India (BCSBI) has formulated a Code of Bank's Commitment to Micro and Small Enterprises. This is a voluntary Code, which sets minimum standards of banking practices for banks to follow when they are dealing with Micro and Small Enterprises (MSEs) as defined in the Micro Small and Medium Enterprises Development (MSMED) Act, 2006. It provides protection to MSE and explains how banks are expected to deal with MSE for their day to-day operations and in times of financial difficulty.

The Code does not replace or supersede regulatory or supervisory instructions issued by the Reserve Bank of India (RBI) and banks will comply with such instructions /directions issued by the RBI from time to time.

4.15.1 Objectives of the BCSBI Code

The Code has been developed to

(a) Give a positive thrust to the MSE sector by providing easy access to efficient banking services.

(b) Promote good and fair banking practices by setting minimum standards in dealing with MSE.

(c) Increase transparency so that a better understanding of what can reasonably expected of the services.

(d) Improve understanding of business through effective communication.

(e) Encourage market forces, through competition, to achieve higher operating standards.

(f) Promote a fair and cordial relationship between MSE and banks and also ensure timely and quick response to banking needs.

(g) Foster confidence in the banking system.

The complete text of the Code is available at the BCSBI's website (www.bcsbi.org.in)

Annex I

MINISTRY OF SMALL SCALE INDUSTRIES
NOTIFICATION
New Delhi, the 5th October, 2006

S.O. 1722(E) – In exercise of the powers conferred by sub-section (1) of 2006) herein referred to as the said Act, the Central Government specifies the following items, the cost of which shall be excluded while calculating the investment in plant and machinery in the case of the enterprises mentioned in Section 7(1)(a) of the said Act, namely:

(i) equipment such as tools, jigs, dyes, moulds and spare parts for maintenance and the cost of consumables stores;

(ii) installation of plant and machinery;

(iii) research and development equipment and pollution controlled equipment

(iv) power generation set and extra transformer installed by the enterprise as per regulations of the State Electricity Board;

(v) bank charges and service charges paid to the National Small Industries Corporation or the State Small Industries Corporation;

(vi) procurement or installation of cables, wiring, bus bars, electrical control panels (not mounded on individual machines), oil circuit breakers or miniature circuit breakers which are necessarily to be used for providing electrical power to the plant and machinery or for safety measures;

(vii) gas producers plants;

(viii) transportation charges (excluding sales-tax or value added tax and excise duty) for indigenous machinery from the place of the manufacture to the site of the enterprise;

(ix) charges paid for technical know-how for erection of plant and machinery;

(x) such storage tanks which store raw material and finished produces and are not linked with the manufacturing process; and

(xi) firefighting equipment.

2. While calculating the investment in plant and machinery refer to paragraph 1, the original price thereof, irrespective of whether the plant and machinery are new or second handed, shall be taken into account provided that in the case of imported machinery, the following shall be included in calculating the value, namely;

(i) Import duty (excluding miscellaneous expenses such as transportation from the port to the site of the factory, demurrage paid at the port);

(ii) Shipping charges;

(iii) Customs clearance charges; and

(iv) Sales tax or value added tax.

Refer RBI Circulers:s

https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=8192

Development Commissioner (DC-MSME) Schemes :::

Related scheme: 1. Credit Guarantee
Description Ministry of Micro, Small and Medium Enterprises, GoI and Small Industries Development Bank of India (SIDBI), established a Trust named Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) to implement Credit Guarantee Fund Scheme for Micro and Small Enterprises. The corpus of CGTMSE is being contributed by GoI and SIDBI.
Nature of assistance Collateral free loans up to a limit ofRs.50 lakh - for individual MSEs
Who can apply Both existing and new enterprises are eligible to be covered under the scheme.
How to apply Candidates meeting the eligibility criteria may approach banks/financial institutions, which are eligible under the scheme, or scheduled commercial banks and select Regional Rural Banks.
Related scheme: 2. Credit Linked Capital Subsidy (CLCS) forTechnology Upgradation
Description Technology upgradation would ordinarily mean induction of state-of-the-art or near state-of-the-art technology. In the varying mosaic of technology obtaining in more than 7,500 products in Indian small scale sector, technology upgradation would mean a significant step up from the present technology level to a substantially higher one involving improved productivity, and/or improvement in quality of products and/or improved environmental conditions including work environment for the unit. It includes installation of improved packaging techniques as well as anti-pollution measures and energy conservation machinery. Further, units in need of introducing facilities for in-house testing and on-line quality control would qualify for assistance,

as the same are a case oftechnology up-gradation.
Replacement of existing equipment/technology with same equipment/ technology will not qualify for subsidy under this scheme, nor would the scheme be applicable to units upgrading with second-hand machinery.
Nature of assistance The revised scheme aims at facilitating technology upgradation by providing 15% up-front capital subsidy to SSI units, including tiny, khadi, village and coir industrial units, on institutional finance availed by them for induction of well established and improved technologies in specified sub-sectors/products approved under the scheme.
Revised CLCS has been amended as follows:
(a) Ceiling on loans under the scheme has been raised from Rs.40 lakh to Rs.1 crore
(b) Rate of subsidy has been enhanced from 12% to 15%.
(c) Admissible capital subsidy is calculated with reference to purchase price of plant and machinery, instead of term loan disbursed to the beneficiary unit.
(d)Practice of categorisation of SSI units in different slabs on the basis of their present investment for determining eligible subsidy has been done away with; and
(e)Operation of the scheme has been extended up to 31st March, 2007. The above revisions/amendments are effective from September 29, 2005.
Who can apply Eligible beneficiaries include sole proprietorships, partnerships, co-operative societies, and private and public limited companies in the SSI sector. Priority shall be given to woman entrepreneurs.
How to apply Candidates meeting the eligibility criteria may approach all scheduled commercial bank, scheduled cooperative bank [including urban cooperative bank co-opted by SIDBI under Technological Upgradation Fund (TUF)], Regional Rural Bank (RRB), State Financial Corporation (SFC) and North-Eastern Development Financial Institution (NEDFi).
Related scheme: 3. ISO 9000/ISO 14001 Certification Reimbursement
Description SME has emerged as dynamic and vibrant and is making significant contribution to industrial production, export and employment generation. The process of economic liberalisation and market reforms has opened up Indian SMEs to global competition. In order to enhance the competitive strength of SME, the Government has introduced an incentive scheme for their technological upgradation/quality improvement and environment management. The scheme provides incentives to those SMEs/ancillary undertakings who have acquired ISO 9000/ISO 14001/HACCP certification. The scheme is enlarged so as to include reimbursement of expenses for acquiring ISO 14001 certification.
Nature of assistance The scheme envisages reimbursement of charges for acquiring ISO-9000/ISO14001/HACCP certification to the extent of 75% of expenditure subject to a maximum ofRs.75,000 in each case.
Who can apply Permanent registered micro and small enterprises (MSEs) are eligible to avail the incentive scheme. The scheme is applicable to those MSEs/ancillary/SSSB units who have already acquired ISO-9000/ISO-14001/ HACCPcertification.
How to apply MSEs with their EM No. are required to submit their application, duly completed, to their local Director, MSME-DI addresses given in the following website:www.dcmsme.gov.in
Related scheme: 4. Micro & Small Enterprises Cluster Development Programme (MSE-CDP)
Description The Ministry has adopted cluster development approach as a key strategy for enhancing productivity and competitiveness as well as capacity building of MSEs and their collectives in the country. Clustering of units also enables the providers of various services to them, including banks and credit agencies, to provide their services more economically, thus reducing the costs and improving the availability of services for these enterprises.
Objectives ofthe scheme:
i. To support sustainability and growth of MSEs by addressing common issues such as improvement of technology, skills and quality, market access and access to capital.
ii. To build the capacity of MSEs for common supportive action through the formation of self-help groups, consortia, upgradation of associations, etc.
also has provision of funding for producing publicity material (up to 25% of costs), sector specific studies (up to Rs.2 lakh) and for contesting anti-dumping cases (50% up to Rs.1

lakh) - for individual MSMEs & associations.
Who can apply Individual MSMEs & industry associations.
How to apply Candidates meeting the eligibility criteria may send their applications to Office of the DC (MSME) through the concerned MSME DIs.
Related scheme 7. NationalAwards (Individual MSEs)
Description MSMEs have registered tremendous growth and progress in terms of quality of production, exports, innovation, product development and import substitution, very much beyond the expected objectives of the setting up of MSMEs. Entrepreneurial efforts have made it possible to produce a number of items, which were hitherto imported. In quite a few cases new variants so produced are having additional attributes over their original versions and are capable of solving a multitude of user problems. All this has become possible owing to the ambitions and visionary spirit of entrepreneurs of MSMEs.
The MoMSME with a view to recognising the efforts and contribution of MSMEs, gives NationalAwards annually to selected entrepreneurs and enterprises under the scheme ofNationalAwards.
Deserving entrepreneurs managing MSMEs having permanent registration/have filed Entrepreneurs' Memorandum Part-II with notified authorities. The MSMEs should have been in continuous production/servicing at least during the last three years.
How to apply Eligible enterprises may send nominations in the prescribed proforma (may download from the Ministry of MSME website) to Director, MSME-DI of the state where their MSME is registered/they have filed Entrepreneurs' Memorandum (EM).
Related scheme 8. National Manufacturing Competitiveness Programme (NMCP)
Description The National Manufacturing Competitiveness Council (NMCC) has finalised a five-year national manufacturing programme. Ten schemes have been drawn up including schemes for promotion of ICT, mini tool room, design clinics and marketing support for SMEs. Implementation will be in PPP mode, and financing will be tied up. Under this plan following schemes are being implemented.
1 Marketing support/Assistance to MSMEs (Bar Code).
2 Support for entrepreneurial and managerial development of SMEs through incubators.
3 Enabling manufacturing sector to be competitive through Quality Management Standard & Quality Tech. Tools (QMS/QTT).
4 Building awareness on Intellectual Property Rights (IPR) for MSME.
5 (a) Lean manufacturing competitiveness scheme for MSMEs. (b) Compendium of success stories.
6 (a) Design clinic scheme for design expertise to MSMEs manufacturing sector (DESIGN).
(b) Case studies of design projects under design clinic scheme for MSMEs.
7 Marketing assistance & technology upgradation scheme in MSMEs.
8 Technology and quality upgradation support to MSMEs.
9 Promotion of ICT in Indian manufacturing sector (ICT)
Nature of assistance Varies for each scheme; visit the following website:http://www.dcmsme.gov.in/schemes/nmcp_scm.htm
Who can apply MSMEs
How to apply Submit the proposal in the prescribed form to be obtained from the DC (MSME).

CGTMSE:

INTRODUCTION

The Board of Trustees of Credit Guarantee Fund Trust for Small Industries, having decided to frame a Scheme for the purpose of providing guarantees to a substantial extent in respect of credit facilities to borrowers in Micro and Small Enterprises, hereby make the following Scheme:

1. Title and date of commencement
   (i) The Scheme shall be known as the Credit Guarantee Fund Scheme for Small Industries (CGFSI)
   (ii) It shall come into force from August 1, 2000.
   (iii) It shall cover eligible credit facility extended by the lending institutions to eligible borrowers effective June 1, 2000.

Subsequent to the enactment of MSMED Act-2006 the Trust was renamed as Credit Guarantee Fund Trust for Micro and Small Enterprises and scheme as Credit Guarantee Scheme for Micro and Small Enterprises.

2. Definitions
   For the purposes of this Scheme -

   (i) "Amount in Default" means the principal and interest amount outstanding in the account(s) of the borrower in respect of term loan and amount of outstanding working capital facilities (including interest), as on the date of the account becoming NPA, or the date of lodgment of claim application whichever is lower or such of the date as may be specified by CGTMSE for preferring any claim against the guarantee cover subject to a maximum of amount Guaranteed.

(ii) "Collateral security" means the security provided in addition to the primary security, in connection with the credit facility extended by a lending institution to a borrower.

(iii) "Credit facility" means any financial assistance by way of term loan and / or fund based and non-fund based working capital (e.g. Bank Guarantee, Letter of credit etc) facilities extended by the lending institution to the eligible borrower. For the purpose of calculation of guarantee fee, the "credit facility extended" shall mean the amount of financial assistance committed by the lending institution to the borrower, whether disbursed or not. For the purpose of the calculation of service fee, the credit facility extended shall mean the credit facilities (both fund and non-fund based) covered under CGS and for which guarantee fee has been paid, as at March 31, of the relevant year.

(iv) "Eligible borrower" means new or existing Micro and Small Enterprises to which credit facility has been provided by the lending institution without any collateral security and/or third party guarantees.

(v) 'Guarantee Cover' means maximum cover available per eligible borrower of the amount in default in respect of the credit facility extended by the lending institution.

(vi) "Lending institution(s)" means a commercial bank for the time being included in the second Schedule to the Reserve Bank of India Act, 1934 and Regional Rural Banks as may be specified by the Trust from time to time, or any other institution (s) as may be directed by the Govt. of India from time to time. The Trust may, on review of performance, remove any of the lending institution from the list of eligible institution.

(vii) "Material date" means the date on which the guarantee fee on the amount covered in respect of eligible borrower becomes payable by the eligible institution to the Trust.

(viii) "Non Performing Assets" means an asset classified as a non-performing based on the instructions and guidelines issued by the Reserve Bank of India from time to time.

(ix) "Primary security" in respect of a credit facility shall mean the assets created out of the credit facility so extended and/or **existing unencumbered assets**which are directly associated with the project or business for which the credit facility has been extended.

(x) "Prime Lending Rate" for a lending institution means the rate so declared by that lending institution for the relevant time period / duration for which the credit facility has been extended.

(xi) "Scheme" means the Credit Guarantee Fund Scheme for Micro and Small Enterprises

(xii) "SIDBI" means the Small Industries Development Bank of India, established under Small Industries Development Bank of India Act, 1989 (39 of 1989).

(xiii) 'Micro and Small Enterprises' As per the MSMED Act, 2006 an "enterprise" means an industrial undertaking or a business concern or any other establishment, by whatever name called, engaged in the manufacture or production of goods, in any manner, pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 or engaged in providing or rendering of any service or services; and "Micro and Small Enterprises" are defined in 7.1.a.i) and ii) & in 7.1.b.i) and ii) of the said Act .

(xiv) "Tenure of guarantee cover" means the maximum period of guarantee cover **from Guarantee start date** which shall run through the agreed tenure of the term credit and for a period of 5 years or block of a 5 years where working capital facilities alone are extended or **loan termination date**, which ever is earlier or such period as may be specified by the Trust.

(xv) "Trust" means the Credit Guarantee Fund Trust for Micro and Small Enterprises set up by Government of India and SIDBI with the purpose of guaranteeing credit facility (ies), extended by the lending institution(s) to the eligible borrowers.

SCOPE AND EXTENT OF THE SCHEME

3. Guarantees by the Trust

(i.) Subject to the other provisions of the Scheme, the Trust undertakes, in relation to credit facilities extended to an eligible borrower from time to time by an eligible institution which has entered into the necessary agreement for this purpose with the Trust, to provide a guarantee on account of the said credit facilities.

(ii.) The Trust reserves the discretion to accept or reject any proposal referred by the lending institution which otherwise satisfies the norms of the Scheme.

4. Credit facilities eligible under the Scheme:

The Trust shall cover credit facilities (Fund based and/or Non fund based) extended by Member Lending Institution(s) to a single eligible borrower in the Micro and Small Enterprises sector for credit facility (i) not exceeding Rs. 50 lakh (Regional Rural Banks/Financial Institutions) and (ii) not exceeding Rs.100 lakh (Scheduled Commercial Banks and select Financial Institutions) by way of term loan and/or working capital facilities on or after entering into an agreement with the Trust, without any collateral security and\or third party guarantees **or such amount as may be decided by the Trust from time to time.**
Provided that the lending institution applies for guarantee cover in respect of credit proposals sanctioned in the quarter April-June, July-September, October-December and January-March prior to expiry of the following quarter viz. July-September, October-December, January-March and April-June respectively

Provided further that, as on the material date

(i) The dues to the lending institution have not become bad or doubtful of recovery; and / or

(ii) The business or activity of the borrower for which the credit facility was granted has not ceased; and / or

(iii) The credit facility has not wholly or partly been utilised for adjustment of any debts deemed bad or doubtful of recovery, without obtaining a prior consent in this regard from the Trust.

Credit facilities extended by more than one bank and/or financial institution jointly and/or separately to eligible borrower upto a maximum upto Rs.100 lakh per borrower subject to ceiling amount of individual MLI or such amount as may be specified by the Trust.

5. Credit facilities not eligible under the Scheme

The following credit facilities shall not be eligible for being guaranteed under the Scheme: -

(i) Any credit facility in respect of which risks are additionally covered under a scheme operated / administered by Deposit Insurance and Credit Guarantee Corporation or the Reserve Bank of India, to the extent they are so covered.

(ii) Any credit facility in respect of which risks are additionally covered by Government or by any general insurer or any other person or association of persons carrying on the business of insurance, guarantee or indemnity, to the extent they are so covered.

(iii) Any credit facility, which does not conform to, or is in any way inconsistent with, the provisions of any law, or with any directives or instructions issued by the Central Government or the Reserve Bank of India, which may, for the time being, be in force.

(iv) Any credit facility granted to any borrower, who has availed himself of any other credit facility covered under this scheme or under the schemes mentioned in clause (i), (ii) and (iii) above, and where the lending institution has invoked the guarantee provided by the Trust or under the schemes mentioned in clause (i), (ii) and (iii) above, but has not repaid any portion of the amount due to the Trust or under the schemes mentioned in clause (i), (ii) and (iii) above, as the case may be, by reason of any default on the part of the borrower in respect of that credit facility.

(v) Any credit facility which has been sanctioned by the lending institution against collateral security and / or third party guarantee.

(vi) Any credit facility which has been sanctioned by the lending institution with interest rate more than 3% over the Prime Lending Rate (PLR) of the lending institution.

6. Agreement to be executed by the lending institution

A lending institution shall not be entitled to a guarantee in respect of any eligible credit facility granted by it unless it has entered into an agreement with the Trust in such form as may be required by the Trust for covering by way of guarantee, under the Scheme all the eligible credit facilities granted by the lending institution, for which provision has been made in the Scheme.

7. Responsibilities of lending institution under the scheme:

(i) The lending institution shall evaluate credit applications by using prudent banking judgement and shall use their business discretion / due diligence in selecting commercially viable proposals and conduct the account(s) of the borrowers with normal banking prudence.

(ii) The lending institution shall closely monitor the borrower account.

(iii) The lending institution shall safeguard the primary securities taken from the borrower in respect of the credit facility in good and enforceable condition.

(iv) The lending institution shall ensure that the guarantee claim in respect of the credit facility and borrower is lodged with the Trust in the form and in the manner and within such time as may be specified by the Trust in this behalf and that there shall not be any delay on its part to notify the default in the borrowers account which shall result in the Trust facing higher guarantee claims.

(v) The payment of guarantee claim by the Trust to the lending institution does not in any way take away the responsibility of the lending institution to recover the entire outstanding amount of the credit from the borrower. The lending institution shall exercise all the necessary precautions and maintain its recourse to the borrower for entire amount of credit facility owed by it and initiate such necessary actions for recovery of the outstanding amount, including such action as may be advised by the Trust.

(vi) The lending institution shall comply with such directions as may be issued by the Trust, from time to time, for facilitating recoveries in the guaranteed account, or safeguarding its interest as a guarantor, as the Trust may deem fit and the lending institution shall be bound to comply with such directions.

(vii) The lending institution shall, in respect of any guaranteed account, exercise the same diligence in recovering the dues, and safeguarding the interest of the Trust in all the ways open to it as it might have exercised in the normal course if no guarantee had been furnished by the Trust. The lending institution shall, in particular, refrain from any act of omission or commission, either before or subsequent to invocation of guarantee, which may adversely affect the interest of the Trust as the guarantor. In particular, the lending institution should intimate the Trust while entering into any compromise or arrangement, which may have effect of discharge or waiver of personal guarantee(s) or security. The lending institution shall also ensure either through a stipulation in an agreement with the borrower or otherwise, that it shall not create any charge on the security held in the account covered by the guarantee for the benefit of any account not covered by the guarantee, with itself or in favour of any other creditor(s) without intimating the Trust. Further the lending institution shall secure for the Trust or its appointed agency, through a stipulation in an agreement with the borrower or otherwise, the right to list the defaulted borrowers' names and particulars on the Website of the Trust

CREDIT GUARANTEE FUND SCHEME FOR MICRO AND SMALL ENTERPRISES

INDEX

CREDIT GUARANTEE FUND SCHEME FOR MICRO AND SMALL ENTERPRISES

CHAPTER I

INTRODUCTION

The Board of Trustees of Credit Guarantee Fund Trust for Small Industries, having decided to frame a Scheme for the purpose of providing guarantees to a substantial exten in respect of credit facilities to borrowers in Micro and Small Enterprises, hereby make the following Scheme:

1. Title and date of commencement

(i) The Scheme shall be known as the Credit Guarantee Fund Scheme for Small Industries (CGFSI)

(ii) It shall come into force from August 1, 2000.

(iii) It shall cover eligible credit facility extended by the lending institutions to eligible borrowers effective June 1, 2000.

Subsequent to the enactment of MSMED Act-2006 the Trust was renamed as Credit Guarantee Fund Trust for Micro and Small Enterprises and scheme as Credit Guarantee Scheme for Micro and Small Enterprises.

2. Definitions

For the purposes of this Scheme -

(i) "Amount in Default" means the principal and interest amount outstanding in the account(s) of the borrower in respect of term loan and amount of outstanding working capital facilities (including interest), as on the date of the account becoming NPA, or the date of lodgment of claim application whichever is lower or such of the date as may be specified by CGTMSE for preferring any claim against the guarantee cover subject to a maximum of amount Guaranteed.

(ii) "Collateral security" means the security provided in addition to the primary security, in connection with the credit facility extended by a lending institution to a borrower.

(iii) "Credit facility" means any financial assistance by way of term loan and / or fund based and non-fund based working capital (e.g. Bank Guarantee, Letter of credit etc) facilities extended by the lending institution to the eligible borrower. For the purpose of calculation of guarantee fee, the "credit facility extended" shall mean the amount of financial assistance committed by the lending institution to the borrower, whether disbursed or not. For the purpose of the calculation of service fee, the credit facility extended shall mean the credit facilities (both fund and non-fund based) covered under CGS and for which guarantee fee has been paid, as at March 31, of the relevant year.

(iv) "Eligible borrower" means new or existing Micro and Small Enterprises to which credit facility has been provided by the lending institution without any collateral security and/or third party guarantees.

(v) 'Guarantee Cover' means maximum cover available per eligible borrower of the amount in default in respect of the credit facility extended by the lending institution.

(vi) "Lending institution(s)" means a commercial bank for the time being included in the second Schedule to the Reserve Bank of India Act, 1934 and Regional Rural Banks as may be specified by the Trust from time to time, or any other institution (s) as may be directed by the Govt. of India from time to time. The Trust may, on review of performance, remove any of the lending institution from the list of eligible institution.

(vii) "Material date" means the date on which the guarantee fee on the amount covered in respect of eligible borrower becomes payable by the eligible institution to the Trust.

(viii) "Non Performing Assets" means an asset classified as a non-performing based on the instructions and guidelines issued by the Reserve Bank of India from time to time.

(ix) "Primary security" in respect of a credit facility shall mean the assets created out of the credit facility so extended and/or **existing unencumbered assets**which are directly associated with the project or business for which the credit facility has been extended.

(x) "Prime Lending Rate" for a lending institution means the rate so declared by that lending institution for the relevant time period / duration for which the credit facility has been extended.

(xi) "Scheme" means the Credit Guarantee Fund Scheme for Micro and Small Enterprises

(xii) "SIDBI" means the Small Industries Development Bank of India, established under Small Industries Development Bank of India Act, 1989 (39 of 1989).

(xiii) 'Micro and Small Enterprises' As per the MSMED Act, 2006 an "enterprise" means an industrial undertaking or a business concern or any other establishment, by whatever name called, engaged in the manufacture or production of goods, in any manner, pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 or engaged in providing or rendering of any service or services; and "Micro and Small Enterprises" are defined in 7.1.a.i) and ii) & in 7.1.b.i) and ii) of the said Act .

(xiv) "Tenure of guarantee cover" means the maximum period of guarantee cover **from Guarantee start date** which shall run through the agreed tenure of the term credit and for a period of 5 years or block of a 5 years where working capital facilities alone are extended or **loan termination date**, which ever is earlier or such period as may be specified by the Trust.

(xv) "Trust" means the Credit Guarantee Fund Trust for Micro and Small Enterprises set up by Government of India and SIDBI with the purpose of guaranteeing credit facility (ies), extended by the lending institution(s) to the eligible borrowers.

CHAPTER II

SCOPE AND EXTENT OF THE SCHEME

3. Guarantees by the Trust

(i.) Subject to the other provisions of the Scheme, the Trust undertakes, in relation to credit facilities extended to an eligible borrower from time to time by an eligible institution which has entered into the necessary agreement for this purpose with the Trust, to provide a guarantee on account of the said credit facilities.

(ii.) The Trust reserves the discretion to accept or reject any proposal referred by the lending institution which otherwise satisfies the norms of the Scheme.

4. Credit facilities eligible under the Scheme:

The Trust shall cover credit facilities (Fund based and/or Non fund based) extended by Member Lending Institution(s) to a single eligible borrower in the Micro and Small Enterprises sector for credit facility (i) not exceeding Rs. 50 lakh (Regional Rural Banks/Financial Institutions) and (ii) not exceeding Rs.100 lakh (Scheduled Commercial Banks and select Financial Institutions) by way of term loan and/or working capital facilities on or after entering into an agreement with the Trust, without any collateral security and\or third party guarantees **or such amount as may be decided by the Trust from time to time.**

Provided that the lending institution applies for guarantee cover in respect of credit proposals sanctioned in the quarter April-June, July-September, October-December and January-March prior to expiry of the following quarter viz. July-September October-December, January-March and April-June respectively

Provided further that, as on the material date

(i) The dues to the lending institution have not become bad or doubtful of recovery; and / or

(ii) The business or activity of the borrower for which the credit facility was granted has not ceased; and / or

(iii) The credit facility has not wholly or partly been utilised for adjustment of any debts deemed bad or doubtful of recovery, without obtaining a prior consent in this regard from the Trust.

Credit facilities extended by more than one bank and/or financial institution jointly and/or separately to eligible borrower upto a maximum upto Rs.100 lakh per borrower subject to ceiling amount of individual MLI or such amount as may be specified by the Trust.

5. Credit facilities not eligible under the Scheme

The following credit facilities shall not be eligible for being guaranteed under the Scheme: -

(i) Any credit facility in respect of which risks are additionally covered under a scheme operated / administered by Deposit Insurance and Credit Guarantee Corporation or the Reserve Bank of India, to the extent they are so covered.

(ii) Any credit facility in respect of which risks are additionally covered by Government or by any general insurer or any other person or association of persons carrying on the business of insurance, guarantee or indemnity, to the extent they are so covered.

(iii) Any credit facility, which does not conform to, or is in any way inconsistent with, the provisions of any law, or with any directives or instructions issued by the Central Government or the Reserve Bank of India, which may, for the time being, be in force.

(iv) Any credit facility granted to any borrower, who has availed himself of any other credit facility covered under this scheme or under the schemes mentioned in clause (i), (ii) and (iii) above, and where the lending institution has invoked the guarantee provided by the Trust or under the schemes mentioned in clause (i), (ii) and (iii) above, but has not repaid any portion of the amount due to the Trust or under the schemes mentioned in clause (i), (ii) and (iii) above, as the case may be, by reason of any default on the part of the borrower in respect of that credit facility.

(v) Any credit facility which has been sanctioned by the lending institution against collateral security and / or third party guarantee.

(vi) Any credit facility which has been sanctioned by the lending institution with interest rate more than 3% over the Prime Lending Rate (PLR) of the lending institution.

6. Agreement to be executed by the lending institution

A lending institution shall not be entitled to a guarantee in respect of any eligible credit facility granted by it unless it has entered into an agreement with the Trust in such form as may be required by the Trust for covering by way of guarantee, under the Scheme all the eligible credit facilities granted by the lending institution, for which provision has been made in the Scheme.

7. Responsibilities of lending institution under the scheme:

(i) The lending institution shall evaluate credit applications by using pruden banking judgement and shall use their business discretion / due diligence ir selecting commercially viable proposals and conduct the account(s) of the borrowers with normal banking prudence.

(ii) The lending institution shall closely monitor the borrower account.

(iii) The lending institution shall safeguard the primary securities taken from the borrower in respect of the credit facility in good and enforceable condition.

(iv) The lending institution shall ensure that the guarantee claim in respect o the credit facility and borrower is lodged with the Trust in the form and in the manner and within such time as may be specified by the Trust in this behalf anc that there shall not be any delay on its part to notify the default in the borrowers account which shall result in the Trust facing higher guarantee claims.

(v) The payment of guarantee claim by the Trust to the lending institution does not in any way take away the responsibility of the lending institution to recover the entire outstanding amount of the credit from the borrower. The lending institution shall exercise all the necessary precautions and maintain its recourse to the borrower for entire amount of credit facility owed by it anc initiate such necessary actions for recovery of the outstanding amount, including such action as may be advised by the Trust.

(vi) The lending institution shall comply with such directions as may be issuec by the Trust, from time to time, for facilitating recoveries in the guaranteec account, or safeguarding its interest as a guarantor, as the Trust may deem fi and the lending institution shall be bound to comply with such directions.

(vii) The lending institution shall, in respect of any guaranteed account, exercise the same diligence in recovering the dues, and safeguarding the interest of the Trust in all the ways open to it as it might have exercised in the normal course i no guarantee had been furnished by the Trust. The lending institution shall, ir particular, refrain from any act of omission or commission, either before oi subsequent to invocation of guarantee, which may adversely affect the interest of the Trust as the guarantor. In particular, the lending institution shoulc intimate the Trust while entering into any compromise or arrangement, which may have effect of discharge or waiver of personal guarantee(s) or security. The lending institution shall also ensure either through a stipulation in an agreement with the borrower or otherwise, that it shall not create any charge on the security held in the account covered by the guarantee for the benefit of any account not covered by the guarantee, with itself or in favour of any other creditor(s) without intimating the Trust. Further the lending institution shal secure for the Trust or its appointed agency, through a stipulation in ar agreement with the borrower or otherwise, the right to list the defaultec borrowers' names and particulars on the Website of the Trust

GUARANTEE FEE

8. Guarantee Fee and Annual Service Fee

(i) One-time guarantee fee at specified rate ((a)currently 1.00% in the case o credit facility upto Rs. 5 Lakh and 1.5% in the case of credit facility above Rs. 5 Lakh (b) 0.75%, in case of credit facilities upto Rs.50 lakh sanctioned to units ir

North Eastern Region including State of Sikkim) of the credit facility sanctionec (comprising term loan and / or working capital facility) shall be paid upfront tc the Trust by the institution availing of the guarantee within 30 days from the date of first disbursement of credit facility **(not applicable for Working capital)**or 30 days from the date of Demand Advice (CGDAN) of guarantee fee whichever is later ***or such date as specified by the Trust.***

(ii) The annual service fee at specified rate (currently 0.50% in the case o credit facility upto Rs. 5 Lakh and 0.75% in the case of credit facility above Rs. 5 Lakh) ***on pro-rata basis for the first and last year and in full for the intervening years on*** the credit facility sanctioned (comprising term loan and / or working capital facility) shall be paid by the lending institution within 60 days ie. on or before May 31, of every year. In the event of non-payment of annua service fee by May 31 of that year or any other specified date, the guarantee under the scheme shall not be available to the lending institution unless the Trust agrees for continuance of guarantee and the lending institution pays pena interest on the service fee due and unpaid, with effect from the subsequent June 01, at four per cent over Bank Rate, per annum, or at such rates specified by the Trust from time to time, for the period of delay.

- Provided further that in the event of non-payment of annual service fee within the stipulated time or such extended time that may be agreed to by the Trust on such terms, liability of the Trust to guarantee such credit facility would lapse in respect of those credit facility against which the service charges are due and not paid,
- Provided further that, the Trust may consider renewal of guarantee cover for such of the credit facility upon such terms and conditions as the Trust may decide.
- In the event of any error or discrepancy or shortfall being founc in the computation of the amounts or in the calculation of the guarantee fee / annual service fee, such deficiency / shortfall shal be paid by the eligible lending institution to the Trust together with interest on such amount at a rate of four per cent over and above the Bank Rate, or as may be prescribed by the Trust from time to time. Any amount found to have been paid in excess would be refunded by the Trust. In the event of any representation made by the lending institution in this regard, the Trust shall take a decision based on the available information with it and the clarifications received from the lending institution, anc its decision shall be final and binding on the lending institution.

(iii) The amount equivalent to the guarantee fee and / or the service fee payable by the eligible lending institution may be recovered by it, at its discretion from the eligible borrower.

The guarantee fee and / or annual service fee once paid by the lending institution to the Trust is non-refundable. Guarantee fee / Annual Service Fee, shall not be refunded, except under certain circumstances like -

(i) Excess remittance,
(ii) Remittance made more than once against the same credit application,
(iii) Guarantee fee & / or annual service fee not due,
(iv) Guarantee fee paid in advance but application not approved for guarantee cover under the scheme, etc.

9. Extent of the guarantee

The Trust shall provide guarantee as under :

Category	Maximum extent of Guarantee where credit facility is		
	Upto Rs.5 lakh	Above Rs.5 lakh upto Rs.50 lakh	Above Rs.50 lakh upto Rs.200 lakh
Micro Enterprises	85% of the amount in default subject to a maximum of Rs.4.25 lakh	75% / Rs.37.50 lakh	Rs.37.50 lakh plus 50% of amount in default above Rs.50 lakh subject to overall ceiling of Rs.62.50 lakh
Women entrepreneurs/ Units located in North East Region (incl. Sikkim) **other than credit facility upto Rs.5 lakh to micro enterprises**	80% of the amount in default subject to a maximum of Rs.40 lakh		Rs.40 lakh plus 50% of amount in default above Rs.50 lakh subject to overall ceiling of Rs.65 lakh
All other category of borrowers	75% / Rs.37.50 lakh		Rs.37.50 lakh plus 50% of amount in default above Rs.50 lakh subject to overall ceiling of Rs.62.50 lakh

All proposals for sanction of guarantee approvals for credit facilities above Rs. 50 lakh and upto Rs.200 lakh will have to be rated internally by the MLI and should be of investment grade. Proposals approved by the MLIs on or after December 8, 2008 will be eligible for the coverage upto Rs.200 lakh.

The guarantee cover will commence from the date of payment of guarantee fee and shall run through the agreed tenure of the term credit in respect of term credit / composite credit. Where working capital alone is extended to the eligible borrower, the guarantee cover shall be for a period of 5 years or a block of 5 years, or for such period as may be specified by the trust in this behalf.

CLAIMS

10. Invocation of guarantee

(i) The lending institution may invoke the guarantee in respect of credit facility ***within a maximum period of one year from date of NPA, if NPA is after lock-in period or within one year of lock-in period, if NPA is within lock-in period***, if the following conditions are satisfied: -

a. The guarantee in respect of that credit facility was in force **at the time of account turning NPA**.

b. The lock-in period of 18 months from either the date of last disbursement of the loan to the borrower or the date of payment of the guarantee fee in respect of credit facility to the borrower, whichever is later, has elapsed;

c. The amount due and payable to the lending institution in respect of the credit facility has not been paid and the dues have been classified by the lending institution as Non Performing Assets. Provided that the lending institution shall not make or be entitled to make any claim on the Trust in respect of the said credit facility if the loss in respect of the said credit facility had occurred owing to actions / decisions taken contrary to or in contravention of the guidelines issued by the Trust

d. The credit facility has been recalled and the recovery proceedings have been initiated under due process of law. Mere issuance of recall notice under SARFAESI Act 2002 cannot be construed as initiation of legal proceedings for purpose of preferment of claim under CGS. MLIs are advised to take further action as contained in Section 13 (4) of the above Act wherein a secured creditor can take recourse to any one or more of the recovery measures out of the four measures indicated therein before submitting claims for first installment of guaranteed amount. In case the MLI is not in a position to take any of the action indicated in Section 13(4) of the aforesaid Act, they may initiate fresh recovery proceeding under any other applicable law and seek the claim for first installment from the Trust.

(rii) The claim should be preferred by the lending institution in such manner and within such time as may be specified by the Trust in this behalf.

(iii) The Trust shall pay 75 per cent of the guaranteed amount on preferring of eligible claim by the lending institution, within 30 days, subject to the claim being otherwise found in order and complete in all respects. The Trust shall pay to the lending institution interest on the eligible claim amount at the prevailing Bank Rate for the period of delay beyond 30 days. The balance 25 per cent of the guaranteed amount will be paid on conclusion of recovery proceedings by the lending institution. On a claim being paid, the Trust shall be deemed to have been discharged from all its liabilities on account of the guarantee in force in respect of the borrower concerned.

(iv) In the event of default the lending institution shall exercise its rights, if any, to takeover the assets of the borrowers and the amount realised, if any, from the sale of such assets or otherwise shall first be credited in full by the lending institutions to the Trust before it claims the remaining 25 per cent of the guaranteed amount.

(v) The lending institution shall be liable to refund the claim released by the Trust together with penal interest at the rate of 4% above the prevailing Bank Rate, if such a recall is made by the Trust in the event of serious deficiencies having existed in the matter of appraisal / renewal / follow-up / conduct of the credit facility or where lodgement of the claim was more than once or where there existed suppression of any material information on part of the lending institutions for the settlement of claims. The lending institution shall pay such penal interest, when demanded by the Trust, from the date of the initial release of the claim by the Trust to the date of refund of the claim.

The Guarantee Claim received directly from the branches or offices other than respective operating offices of MLIs will not be entertained.

11. Subrogation of rights and recoveries on account of claims paid

(i) The lending institution shall furnish to the Trust, the details of its efforts for recovery, realisations and such other information as may be demanded or required from time to time. The lending institution will hold lien on assets created out of the credit facility extended to the borrower, on its own behalf and on behalf of the Trust. The Trust shall not exercise any subrogation rights and that the responsibility of the recovery of dues including takeover of assets, sale of assets, etc., shall rest with the lending institution;

(ii) In the event of a borrower owing several distinct and separate debts to the lending institution and making payments towards any one or more of the same, whether the account towards which the payment is made is covered by the guarantee of the Trust or not, such payments shall, for the purpose of this clause, be deemed to have been appropriated by the lending institution to the debt covered by the guarantee and in respect of which a claim has been preferred and paid, irrespective of the manner of appropriation indicated by such borrower or the manner in which such payments are actually appropriated.

(iii) Every amount recovered and due to be paid to the Trust shall be paid without delay, and if any amount due to the Trust remains unpaid beyond a period of 30 days from the date on which it was first recovered, interest shall be payable to the Trust by the lending institution at the rate which is 4% above Bank Rate for the period for which payment remains outstanding after the expiry of the said period of 30 days.

TYPE OF CUSTOMERS

In this Chapter, for the convenience of study, types of Borrowers have been classified as under:

1. Individual

2. Partnership firm.
3. Hindu Undivided Family
4. Companies
5. Statutory Corporations
6. Trusts and Co-op Societies
7. Limited liability Patnership

One of the essential elements of a contract is "capacity of the parties to Contract".

The Bank while dealing with an individual should ensure that he is competent to enter into contract. An individual is not competent to contract and money lent to him cannot be recovered in the following circumstances:

a) If an individual is a minor:

A person is minor in the eyes of the law if has not attained the age of 18 years under Indian Majority Act and the age of 21 years, if he/she is a ward, under the Guardians and Wards Act. The money lent to a minor cannot be recovered, if the minor fails to repay. Exception to this is a contract with a minor for supply of necessaries to the minor. If a Bank lends money to a minor to meet expenses for purchasing necessaries of life, then bank can recover the money from the estate of the minor.

b) If an individual is not of sound mind:

According to the Contract Act, if a person is not of sound mind, then he is incompetent to enter into a contract. The Act says that a person at the time when he makes the contract, he is not capable of understanding it and of forming a rational judgment as to its effect upon his interests, will be considered that he is 'not of sound mind'. Hence, a contract would be invalid if it is proved that the time of entering into contract, the person was not in sound state of mind and could not understand what he was doing and could not understand the implications of entering into the contract.

c) Disqualified persons:

If a person is disqualified by the law in respect of his capacity to contract, then the contract entered into by such a person cannot be enforced. For example, a person might have been declared as insolvent under the Insolvency law. As long as the person continues to be undischarged insolvent, he cannot enter into contract.

2. PARTNERSHIP FIRM

'Partnership Firm' is another entity with which a Banker deals with in the course of his business. Partnership firm is governed by Indian Partnership Act 1932. A partnership is the relation between persons who have agreed to share the profits of a business, carried on by all or any of them acting for all. The relationship between partners is governed by partnership deed which can be written or unwritten.

Legal Position of a partnership:

A partnership is not distinct from its partners. The liability is joint and several. It means that they responsible for the act of the partnership firm in their capacity as partner as well as individual. The Indian Partnership Act 1932, provides for registration of the partnership and it is necessary that a Banker dealing with partnership firm, should verify as to whether the firm is registered or not. This would help him to know all the names of the partners and their relationship.

Authority of the Partners:

Section 19 of the Indian Partnership Act 1932 deals with the implied authority of a partner as an agent of the firm; and Section 22 deals with the mode of doing act to bind the firm. In view of the provisions of Section 19 and 22, it should be noted that the act of a partner shall be binding on the firm if done:

a) in the usual business of the partnership;
b) in the usual way of the business; and
c) as a partner, i.e. on behalf of the firm and not solely on his own behalf.

Business of partnership firm: Mode of Operation

Rights and duties of the partners are determined by Partnership Deed. It provides for opening of bank accounts, borrowing powers, signing of cheques etc. Generally there may be a managing partner, who conducts business on behalf of other partners. While dealing with partnership firms it should be ensured that business is conducted as per partnership deed. If the Managing Partner does not have power to conduct certain transaction, then it should be ensured that consent of all partners is obtained.

Partnership firm and transaction in immovable property:

Section 19 of the Indian Partnership Act 1932 states that a partner cannot effect transfer of immovable property of the firm unless expressly authorized. While taking mortgage security of firm's immovable property, it should be ensured that the partner creating mortgage is expressly authorized to create mortgage. If the partner has no authority to create mortgage, then the banker should ensure that all the partners jointly create the mortgage.

Insolvency of the firm:

The banker on receiving notice of insolvency of the firm must immediately stop further transaction in the account irrespective of the fact that the account is in credit or debit. In case there is a credit balance, and the banker does not intend to set off the same against the dues in any other account, then the balance has to be handed over to the official receiver appointed by the Court or as directed by the Court. In case the account is in debit then the banker would be required to prove his debt before the Court and thereafter will be entitled to receive the same from the Official Receiver either in full or as per the dividend declared by the Court.

Insolvency of the Partner:

If at the time of insolvency of one of the partners the firms account is in credit then the same can be operated by the other partners, but the banker should obtain a fresh mandate and all previous cheques issued by the insolvent partner may be paid provided the other partners confirm the same. In case the account is in debit then further transactions in the account should be stopped.

Death of a partner:

In case of death, the principles, as stated* in the case of Insolvency of a partner, applies.

3. JOINT HINDU FAMILY (JHF) or HINDU UNDIVIDED FAMILY (HUF)

Joint Hindu Family is an entity of customary law among Hindus. This is governed by personal laws. In Bengal and other parts of erstwhile Bangal province, a Hindu Undivided Family is governed by Dayabhaga Law. In other parts of India, it is governed by Mitakshara Law.

Constitution of a Joint Hindu Family:

A Joint Hindu Family consists of male members descended lineally from a common male ancestor, together with their mothers, wives or widows and unmarried daughters bound together by fundamental principle of family relationship. The Joint Hindu Family is purely a creature of Law and cannot be created by act of parties.

in so far as he manages the family property or business or looks after the family interests on behalf of the other members. The Managership of the JHF property comes to a person by birth and he does not owe his position as Manager on consent of the other co-parceners. The liability of the Karta is unlimited, whereas the liability of the co-parceners is limited to their shares in the Joint Family Estate.

Powers and Duties of the Manager

A Manager or Karta of a Joint Hindu Family has the following powers and duties:

Powers:

i. Right to possession and management of the joint family property.

ii. Right to income from the joint family property

iii. Right to represent the joint family

iv. Right to sell the joint family property for family purpose.

Duties:

v. Duty to run the family business and manage the property for the benefit of the family

vi. Duty to account the income from the joint family business and property.

Banker and his dealings with Joint Hindu Family

i. A banker dealing with JHF, should know the Karta of the family.

ii. Banker should ensure that Karta of the Joint Hindu Family deals with the Bank and borrows only for the benefit of Joint Family Business.

iii. The application to open the account must be signed by all the members and all adult members should be made jointly and severally liable for any borrowings or if the account gets overdrawn.

4. COMPANIES

A Company is another type of customer, which a banker deals with. A company is a juristic person created by law, having a perpetual succession and Common Seal distinct from its members. A Company depending upon its constitution is governed by various laws.

Basic Law Governing Company:

In India Companies are governed by Companies Act, 1956. All the companies are required to be registered under Companies Act, 1956.

The Business and objectives of a company are known by two important documents called Memorandum of Association and Article of Association. Therefore for the formation of company these documents are essential.

Memorandum of Association

The Memorandum of Association is charter of a company. Its purpose is to enable the shareholders, creditors and those dealing with the company to know its permitted range of business.

Memorandum of Association of a company contains the following details among others:

i. Name of the company
ii. Place of the business of the company
iii. Objects of the Company
iv. Name of the first Directors of the company
v. Share capital of the company

Articles of Association

Articles of Association are rules and regulations governing the internal management of the company. They define the powers of the officers of the company. Articles of Association are subordinate to Memorandum of Association and it contains the following details among other things:

i. Number of Directors of the company
ii. Procedure for conducting meeting of shareholders, Board of Directors etc.
iii. Procedure for transfer and transmission of shares.
iv. Borrowing powers of the company
v. Officers of the company and other details

Types of Companies:

A. Private Company:

According to Section 3 (1) (iii), a Private Company is one which contains following provisions in its Articles of Association:

i. Restriction on the right to transfer its shares.
ii. ii. Limitation on number of members to fifty excluding the people, who are employees and ex-employees of the company.
iii. iii. Prohibition as to participation by General public in its capital requirements.
iv. B. Public Company:
v. A Public Company is one which is not a Private Company i.e. a Public Company does not have any restrictions of the Private Company and its main features are as follows:
vi. i. Shares are freely transferable.
vii. ii. No restriction on number of members
viii. iii. Public at large can participate in its share capital.
ix. The Public Company can be further classified as
x. (a) Limited Liability Company – Liability is limited to the share in capital.
xi. (b) Unlimited Liability Company – Liability of the members is unlimited
xii. (c) Limited by Guarantee - liability is limited to the amount guaranteed
xiii. C. Government Company:
xiv. A company in which Central Government or State Government or both has not less than 51 % of share capital.
xv. D. Statutory Companies:
xvi. There are some companies established by an act of Parliament. These are called Statutory Corporations. For example, State Bank of India is established under State Bank of India Act, 1955. Nationalised Banks are established under Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970.
xvii. E. Other Companies:
xviii. Besides the above, Companies Act, 1956 classifies companies on the basis of time, place of incorporation and nature of working into the following categories:

xix. i.Existing Company:A company existing already before the coming into force of Companies Act, 1956.
xx. ii.Foreign Company: A company registered in a Foreign Country.
xxi. iii.Holding Company: A company owning more than 50 % of share capital in another company or a company which can appoint majority of Directors in another company.
xxii. iv. Subsidiary Company: it can be seen that when there is a holding company the other company is called Subsidiary Company.
xxiii. **5. OTHER TYPE OF CUSTOMERS**
xxiv. (i) Clubs, Societies, Schools:
xxv. These bodies are usually governed by Companies Act or co-operative Societies Act and function within the ambit of those laws. For example clubs can be registered either under the Companies Act, 1956 or under Societies Registration Act or Co- operative Societies Act. In the case of lending to these bodies a Banker should study the bye-laws, rules and regulations applicable to them and ascertain the legality of lending to them.
xxvi. (ii) Trusts:

These are governed by Indian Trusts Act, 1882, if they are Private Trusts and if they are public trust, they are governed by Public Trusts Act or Religious and Charitable Endowments Act, if they are Trusts of Hindus and in the case of Muslims they are governed by Wakf Act.
A Banker dealing with Trusts should acquaint himself with the respective laws applicable to them and shall ensure that his lending is within the ambit of those laws.

(iii) Trustee:

The Trusts are managed by Trustees. The powers and duties of the Trustees are either provided in Trust deed or regulated by the respective laws applicable to such Trusts. For example in the case of Public Trusts, Charity Commissioners, or Commissioner of Endowments appointed by Government has power to supervise the activities of the Trusts. The Trustee of Muslim Wakf is called Mutawali and his conduct and function is regulated by Wakf Board. Therefore a Banker dealing with a Trust should ensure that all the permissions required for taking a loan is obtained from the respective Government authorities.

7. Limited Liability Partnership :

Limited Liability Partnership (LLP) is a new corporate structure that combines the flexibility of a partnership and the advantages of limited liability of a company at a low compliance cost. In other words, it is an alternative corporate business vehicle that provides the benefits of limited liability of a company, but allows its members the flexibility of organizing their internal management on the basis of a mutually arrived agreement, as is the case in a partnership firm.
Owing to flexibility in its structure and operation, it would be useful for small and medium enterprises, in general, and for the enterprises in services sector, in particular. Internationally, LLPs are the preferred vehicle of business, particularly for service industry or for activities involving professionals.

Types of Credit Facilities

1) Fund based lending
2) Non fund based lending

Fund based lending, where the lending bank commits the physical outflow of funds.
The various forms in which fund based lending may be made by banks.

The facilities like Overdrafts,Cash Credit A/c, Bills Finance, Demand Loans, Term Loans etc, wherein immediate flow of funds available to borrowers, are called funds based facility. The non fund based facilities like issuance of letter of guarantee, letter of credit wherein banks get fee income and there is no immediate outfow of funds from bank.

Overdrafts: Overdraft means allowing the customer to draw cheques over and above credit balance in his account. Overdraft is normally allowed to Current Account
Customers and in exceptional case SB A/c holders are also allowed to overdraw their account. The high rate of interest is charged but only on daily debit balance. An
overdraft is repayable on demand. There are two types of overdraft prevalent in Banks i.e. (i) Temporary overdraft or clean overdraft (ii) Secured overdraft. Temporary
overdrafts are allowed purely on personal credit of the party and it is for party to meet some urgent commitments on rare occasions. Allowing a customer to draw against
his cheques sent in clearing also falls under this category. Secured overdraft is allowed up to a certain limit against some tangible security like bank deposits, LIC policies,
National Saving Certificates, shares and other similar assets. Secured overdraft is most popular with traders as lesser operating cost, simple application and document
formalities are involved in this facility.

Cash Credit Account (CC A/C): Cash credit account is a running account just like a current account where debit balance in the account up to a sanctioned limit or drawing
power xed based on stock holding whichever is less. Sanction of Limit generally for 1 year. The limits are renewed or enhanced/reduced based on assessment ofcustomer's actual requirement on the basis of working of the unit.
Customer has to submit periodic Stock statements depending on Operating Cycle, Turnover, and Cash
Budget or Projected Balance Sheet. Cash Credit facility is o ered normally against pledge (Key Cash Credit) or hypothecation of prime security such as, book debts
(receivables), stocks of raw materials, semi nished goods and nished goods. In some cases, customers, mainly traders nd it di cult to maintain stock register and
submitting periodic stock statements. For such customers also CC facility is provided by banks against pledge of gold jewellary, assignment of Life policies, or against security
of customer's deposit in the same bank. When prime security is, jewels or life policies, NSC, bank deposits, there is no need to submit periodic stock statements. In case of
manufacturing units this facility is required for purchase of raw materials, processing and converting them into nished goods. In case of traders, the limit is allowed for
purchase of goods which they deal.
Bills Finance: Bills finance is short term and self liquidating finance in nature. Demand Bill is purchasedand Usance bill is discounted by the banks. The bills drawn under
Letter of Credit (LC may be on sight draft or usance draft) are negotiated by the banks. The advantage of bills nance is that the seller of goods (borrower) gets immediate

money from the bank for the goods sold by him irrespective of whether it is a purchase, discount or negotiation by the bank according to type of bills.Demand bills can be documentary or clean. Usually banks accept only documentary bills for purchase. However purchase of clean bills from good parties also permitted by banks based on sanction terms of the limit. Usance bills means bills maturing on a future date. Documentary usance bills may be on D/P (Delivery against payment) or D/A (Delivery against Acceptance) terms. In case of D/P terms the documents of title to goods are delivered to the buyer of the goods (drawee) against payment of bill amount. In case of D/A bills, the documents to the title of goods are to be delivered to the drawee (Buyer) against acceptance of bills. Hence a banker will take into consideration the credit worthiness not only of the borrower but also of the drawee because bills become clean after it is delivered to drawee on acceptance.

Demand Loans: Demand loans are secured loans repayable on demand. Demand loan is granted against marking lien on bank's own fixed deposits (Not against deposits of other banks), Assignment of Life Insurance Policies with adequate surrender value (loan can not be granted against policies issued under married woman property act or beneficiary is a minor etc) , National Saving Certificates and so on. Demand loans can be gradually liquidated over a period generally in monthly, quarterly, half yearly installments or lump-sum payment at one shot or it can be closed from maturity proceeds of the security offered.

Term Loans: The nature of a term loan commitment is long term. Maximum maturity for a term loan including moratorium is normally 10 years and in exceptional cases 15 years. Repayment of loan is from the cash generation out of operation of the unit/company. Term Loan appraisal must cover appraisal of the borrower and appraisal of the project. Appraisal of the borrower must cover integrity, standing of the borrower, business capacity, managerial competence,   nancial resources in relation to size of the project. The sources of information for the above may be from Merchant reports, Bank reports, CIBIL report, declaration received from the promoters about their assets and liabilities, internal and external Credit rating and so on. Assistance from venture capitalists like UTI venture, ICICI ventures etc. can also be solicited. Appraisal of a project would cover market demand for the product, competition, quality and price sensitivity of the product, terms of sales and after sales services arrangements envisaged by the company. Competition perception according to minds of customer and bankers can be di erent. Technical feasibility like location that is proximity to raw material, availability of infrastructure should be favorable to the unit/company. Production Process should be contemporary and spare parts whether easily be available lest there would be stoppage of production due to non availability of spare parts. Issues like arrangement of working capital nance, break even point of sales are to be discussed.

Working capital   nance has to be decided before sanctioning of term loan to the borrower. Regulatory issues: As per sec1 of the banking regulation act a bank can not lend beyond 30% of paid up capital of the company or 30% of paid up reserve of the bank whichever is lower.

Retail Credit: Retail credits are Car Loans, Consumer Durables/, Educational Loans, Housing Loans, House improvement Loan, Professionals Personal Loans, Clean Loans, Jewel Loan, Pensioners Loan, Credit Cards etc. KYC formalities like verification of proof of identity and proof of address etc, are important and   rst step to entertain loans under retail schemes. SB pass book or statement of account is to be verified to match the details submitted by the applicant. In case of employed persons, normally loan will be considered only to confirmed employees. Employer's no objection certificate/salary certificates are other requirements for retail loans. In case of self employed, IT return for past 2-3 years would be verified to asses the repayment capacity of the applicant. No due certificate from existing banker, CIBIL report is the other requirement to consider retail loans.

Leasing Finance: A lease is a contract between the owner (lessor) and the user (lessee). There is various type of lease viz. operating lease, finance lease etc. In terms of lease

agreement the lessor pays money to the supplier who in turn delivers the article to the lessee. The lessee (hirer of the article) makes periodical payment to the lessor. At the
end of lease period the asset is restored to the lessor. Commercial banks in India have been financing the activities of leasing companies, by providing overdraft/Cash credit
account/Demand loan against fully paid new machineries or equipment by hypothecation of security. The repayment should be from rentals of machineries/ equipment
leased out. The maximum period of repayment is ve years or economic life of the equipment which ever is lower. The bank is allowed to periodical inspection of the asset.

Lease contracts are only for productive purpose and not for consumer durables.

Hire-Purchase _nance: Hire-Purchase transactions are very similar to leasing transactions. In hire –purchase agreement, at the end of the stipulated period, the hirer(lessee)
has options either to return the asset to leasing company while terminating the agreement or purchase the asset upon terms set out in the agreement In terms of leasing
agreement the ownership continues to remains with the Leasing company(Lessor). Since hire-purchase finance takes place predominantly in automobile sector, banks have
started direct finance to transport operator as the nature of advance being classified as priority sector lending.

Non Fund Business

Bank Guarantee: As a part of Banking Business, Bank Guarantee (BG) Limits are sanctioned and guarantees are issued on behalf of our customers for various purposes. Broadly, the BGs are classified into two categories:
i) Financial Guarantees are direct credit substitutes wherein a bank irrevocably undertakes to guarantee the payment of a contractual financial obligation. These guarantees essentially carry the same credit risk as a direct extension of credit i.e. the risk of loss is directly linked to the creditworthiness of the counter-party against whom a potential claim is acquired. Example – Guarantees in lieu of repayment of financial securities/margin requirements of exchanges, Mobilization advance, Guarantees towards revenue dues, taxes, duties in favour of tax/customs/port/excise authorities, liquidity facilities for securitization transactions and deferred payment guarantees.

ii) Performance Guarantees are essentially transaction-related contingencies that involve an irrevocable undertaking to pay a third party in the event the counterparty fails to fulfill or perform a contractual obligation. In such transactions, the risk of loss depends on the event which need not necessarily be related to the creditworthiness of the counterparty involved. Example – Bid bonds, performance bonds, export performance guarantees, Guarantees in lieu of security deposits/EMD for participating in tenders, Warranties, indemnities and standby letters of credit related to particular transaction.
Though, BG facility is a Non-fund Facility, it is a firm commitment on the part of the Bank to meet the obligation in case of invocation of BG. Hence, monitoring of Bank Guarantee portfolio has attained utmost importance. The purpose of the guarantee is to be examined and it is to be spelt out clearly if it is Performance Guarantee or

Financial Guarantee. Due diligence of client shall be done, regarding their experience in that line of activity, their rating/grading by the departments, where they are registered. In case of Performance Guarantees, banks shall exercise due caution to satisfy that the customer has the necessary experience, capacity and means to perform the obligations under the contract and is not likely to commit default. The position of receivables and delays if any, are to be examined critically, to understand payments position of that particular activity. The financial position of counter party, type of Project, value of Project, likely date of completion of Project as per

agreement are also to be examined. The Maturity period, Security Position, Margin etc. are also to be as per Policy prescriptions and are important to take a view on charging BG Commissions.
Branches shall use Model Form of Bank Guarantee Bond, while issuing Bank Guarantees in favour of Central Govt. Departments/Public Sector Undertakings. Any deviation is to be approved by Zonal Office. It is essential to have the information relating to each contract/project, for which BG has been issued, to know the present stage of work/project and to assess the risk of invocation and to exercise proper control on the performance of the Borrower. It is to be ensured that the operating accounts of borrowers enjoying BG facilities route all operations through our Bank accounts. To safeguard the interest of the bank, Branches need to follow up with the Borrowers and obtain information and analyze the same to notice the present stage of work/project, position of Receivables, Litigations/Problems if any leading to temporary cessation of work etc.
The Financial Indicators/Ratios as per Banks Loan Policy guidelines are to be satisfactory. Banks are required to be arrived Gearing Ratio (Total outside liabilities+proposed non-fund based limits / Tangible Networth - Non Current Assets) of the client and ideally it should be below 10.
In case where the guarantees issued are not returned by the beneficiary even after expiry of guarantee period, banks are required to reverse the entries by issuing notice (if the beneficiary is Govt. Department 3 months and one month for others) to avert additional provisioning. Banks should stop charging commission on expired Bank Guarantees with effect from the date of expiry of the validity period even if the original Bank Guarantee bond duly discharged is not received back.
Letter of Credit: A Letter of Credit is an arrangement by means of which a Bank (Issuing Bank) acting at the request of a customer (Applicant), undertakes to pay to a third party (Beneficiary) a predetermined amount by a given date according to agreed stipulations and against presentation of stipulated documents. The documentary Credit are akin to Bank Guarantees except that normally Bank Guarantees are issued on behalf of Bank's clients to cover situations of their non performance whereas, documentary credits are issued on behalf of clients to cover situation of performance. However, there are certain documentary credits like standby Letter of Credit which are issued to cover the situations of non performance. All documentary credits have to be issued by Banks subject to rules of Uniform Customs and Practice for Documentary Credits (UCPDC). It is a set of standard rules governing LCs and their implications and practical effects on handling credits in various capacities must be possessed by all bankers. A documentary credit has the seven parties viz., Applicant (Opener), Issuing Bank (Opening of LC Bank), Beneficiary, Advising Bank (advises the credit to beneficiary), Confirming Bank – Bank which adds guarantee to the credit opened by another Bank thereby undertaking the responsibility of payment/negotiation/acceptance under the credit in addition to Issuing Bank), Nominated Bank – Bank which is nominated by Issuing Bank to pay/to accept draft or to negotiate, Reimbursing Bank – Bank which is authorized by the Issuing Bank to pay to honour the reimbursement claim in settlement of negotiation/acceptance/payment lodged with it by the paying / negotiating or accepting Bank. The various types of LCs are as under:
i) Revocable Letter of Credit is a credit which can be revoked or cancelled or amended by the Bank issuing the credit, without notice to the beneficiary. If a credit does not indicate specifically it is a revocable credit the credit will be deemed as irrevocable in terms of provisions of UCPDC terms.
ii) Irrevocable Letter of credit is a firm undertaking on the part of the Issuing Bank and cannot be cancelled or amended without the consent of the parties to letter of credit, particularly the beneficiary.
iii) Payment Credit is a sight credit which will be paid at sight basis against

presentation of requisite documents as per LC terms to the designated paying Bank.
iv) Deferred Payment Credit is a usance credit where payment will be made by designated Bank on respective due dates determined in accordance with stipulations of the credit without the drawing of drafts.
v) Acceptance Credit is similar to deferred credit except for the fact that in this credit drawing of a usance draft is a must.
vi) Negotiation Credit can be a sight or a usance credit. A draft is usually drawn in negotiation credit. Under this, the negotiation can be restricted to a specific Bank or it may allow free negotiation whereby any Bank who is willing to negotiate can do so. However, the responsibility of the issuing Bank is to pay and it cannot say that it is of the negotiating Bank.
vii) Confirmed Letter of Credit is a letter of credit to which another Bank (Bank other than Issuing Bank) has added its confirmation or guarantee. Under this, the beneficiary will have the firm undertaking of not only the Bank issuing the LC, but also of another Bank. Confirmation can be added only to irrevocable and not revocable Credits.
the amount is revived or reinstated without requiring specific amendment to the credit. The basic principle of a revolving credit is that after a drawing is made, the credit reverts to its original amount for re-use by beneficiary. There are two types of revolving credit viz., credit gets reinstated immediately after a drawing is made and credit reverts to original amount only after it is confirmed by the Issuing Bank.
ix) Installment Credit calls for full value of goods to be shipped but stipulates that the shipment be made in specific quantities at stated periods or intervals.
x) Transit Credit – When the issuing Bank has no correspondent relations in beneficiary country the services of a Bank in third country would be utilized. This type of LC may also be opened by small countries where credits may not be readily acceptable in another country.
xi) Reimbursement Credit – Generally credits opened are denominated in the currency of the applicant or beneficiary. But when a credit is opened in the currency of a third country, it is referred to as reimbursement credit.
xii) Transferable Credit – Credit which can be transferred by the original beneficiary in favour of second or several second beneficiaries. The purpose of these credits is that the first beneficiary who is a middleman can earn his commission and can hide the name of supplier.
xiii) Back to Back Credit/Countervailing credit – Under this the credit is opened with security of another credit. Thus, it is basically a credit opened by middlemen in favour of the actual manufacturer/supplier.
xiv) Red Clause Credit – It contains a clause providing for payment in advance for purchasing raw materials, etc.
xv) Anticipatory Credit – Under this payment is made to beneficiary at preshipment stage in anticipation of his actual shipment and submission of bills at a future date. But if no presentation is made the recovery will be made from the opening Bank.
xvi) Green Clause Credit is an extended version of Red Clause Credit in the sense that it not only provides for advance towards purchase, processing and packaging but also for warehousing & insurance charges. Generally money under this credit is advanced after the goods are put in bonded warehouses etc., up to the period of shipment.
Other concepts
i)Bill of Lading: It should be in complete set and be clean and should generally be to order and blank endorsed. It must also specify that the goods have been shipped on board and whether the freight is prepaid or is payable at destination. The name of the opening bank and applicant should be indicated in the B/L.
ii) Airway Bill: Airway bills/Air Consignment notes should always be made out to

the order of Issuing Bank duly mentioning the name of the applicant.
iii)Insurance Policy or Certificate: Where the terms of sale are CIF the insurance is to be arranged by the supplier and they are required to submit insurance policy along with the documents.
iv) Invoice: Detailed invoices duly signed by the supplier made out in the name of the applicant should be called for and the invoice should contain full description of goods, quantity, price, terms of shipment, licence number and LC number and date.
v) Certificate of Origin: Certificate of origin of the goods is to be called for. Method of payment is determined basing on the country of origin.
vi) Inspection Certificate: Inspection certificate is to be called for from an independent inspecting agency (name should be stipulated) to ensure quality and quantity of goods. Inspection certificate from the supplier is not acceptable

Multiple Banking / Consortium / JLA

Large banks do have the capability to meet the credit needs of most of their business clients. However, when the amount involved is huge, the bank may ask the borrower to approach other banks for the part of the credit requirements as they may not wish to take up the risk of lending the entire amount. Multiple banks may finance the borrower under two arrangements viz., Consortium arrangement and multiple banking arrangements.
i) Consortium of Banks – Under this the banks come together and collaborate with each other in assessing the credit requirements of the borrower duly sharing the credit facilities as well as sharing securities with “Pari Pasu” charge. Normally, the bank which has larger exposure act as leader who conduct meetings, assess the credit requirements of the borrower and share all the information with member banks from time to time. However, the decisions taken at the consortium meetings are not binding on the individual banks and the management of each bank has to approve in its respective boards.
ii) Multiple Banking – Under this, the borrower approaches various banks and avails credit facilities across banks. Each bank undertakes their own assessment of risk, decide the mix of credit facilities and stipulate their own terms and conditions. Each of the banks takes the security and gets the charges registered with the ROC in their favour. Practically there is no co-ordination between the banks and they compete with each other to protect their business and interests. This is giving scope to the borrowers to take undue advantage from the banking system i.e. excess borrowings and interest concessions. In order to ensure financial discipline RBI issued guidelines on sharing of information between banks and making the lead bank responsible for ensuring proper assessment of credit requirements of the borrower so that over financing can be averted.
Joint Lending Arrangement (JLA) – Under the existing system of Credit Delivery, it is observed that high value borrowers have been availing credit limits through Multiple Banking over the years which has led to dilution of asset quality as well as control on the borrowers. In order to address the challenges associated with Multiple Lending, Govt. of India has introduced ground rules governing Joint Lending Arrangements. The scheme shall be applicable to all lending arrangements, with a single borrower with aggregate credit limits (both fund and non-fund based) of `150 crore and above involving more than one Public Sector Bank. Further, all borrowers with external rating of below BBB or equivalent, are to be brought under JLA irrespective of the amount of exposure. Borrowers having multiple banking arrangements below `150 crore may also be encouraged to come under JLA, so that the wholesome view of the assessment of credit requirement as well as the entire

operations of the customers can be taken by banks. The Bank from which the borrower has sought the maximum credit will be the designated Lead Bank for the JLA. If a member-bank is unable to take up its enhanced share, such enhanced share in full or in part could be reallocated among the other existing willing members. In case of any contentious issue, the decision will be taken by member banks having more than 50% share in the exposure to the borrower. An existing member-bank may be permitted to withdraw from the JLA after two years provided other existing member-banks and/or a new bank is willing to take its share by joining the JLA. It is necessary that lead bank and member bank(s)/institution(s) ensure that formal JLA does not result in delay in credit delivery. The Lead Lender will make all efforts to tie up the Joint Lending Arrangement within 90 days of taking a credit decision regarding the proposal. Lead bank will be responsible for preparation of appraisal note, its circulation, and arrangements for convening meetings, documentation, etc. In case of any contentious issue, the decision will be taken by the member banks having more than 50% share in the exposure to the borrower.

Takeover of accounts from other Banks

Corporates seeking better facilities/higher credit from Banks often approach different lenders for sanction of credit facilities. Central Vigilance Commissioner observed that sometimes existing accounts with one bank already showing signs of sickness are taken over by another bank and such accounts predictably turn NPA within a short time. To arrest unethical/unjustified practice of takeover of accounts, Department of Financial Services, Govt. of India has issued the following guidelines to all Banks.

_ For taking over of any accounts, Banks must put in place, a Board approved Policy with regard to take over of accounts from another Bank and the same should be incorporated in the credit policy of the Bank.

_ Normally, the accounts having ratings above the level approved by the Board should only be taken over and the concessionary facilities should be extended only in extremely deserving cases with specific reasons recorded in writing.

_ In all cases of takeover of accounts, it is necessary to do proper due diligence including visit to the premises of the customer, if needed, before the account is considered for takeover by the bank.

_ The guidelines of joint lending should be strictly applied in all cases where the borrower seeks to have additional exposure from the bank after taking over the account.

_ No cases should be taken over by a Bank from any Bank where any of its ED or CMD had worked earlier. In case, any such cases need to be taken over, the proposal will need to be put up to the Board with specific reasons justifying the need for taking over the accounts.

The operational guidelines with regard to Take over of accounts are as under:

_ The account should be a Standard Asset with Positive Net Worth & profit record. P & C Report is mandatory preferably before sanction, if not, at least before disbursement.

_ Obtain credit information in prescribed format, which enables the transferee bank to be fully aware of irregularities, if any, existing in the borrower's account with the transferor bank.

_ Account Statement – The account copies of all the borrowal accounts with the present bankers/financial institution shall be obtained at least for the last 12 months and ensure that the conduct of the a/c is satisfactory and no adverse features are noticed.

_ Existence & Previous profit track record - i) In existence for a minimum of 3 years with Audited B/S ii) Profit making in preceding 2 years & iii) Availing Credit facilities with the previous Banker at least for 3 years.

_ Enhancement on Existing Limits with the present Banker: i)

Enhancement not beyond 50% ii) No further Enhancement/Additional Limits
till one year or next ABS, whichever is earlier.
_ TOL/TNW should not exceed 4:1 in case of takeover accounts.
_ Group Accounts – In case of having Sister / Associate concerns, Groups
consolidated position has to be examined.
Branches should ensure that Assessment is to be made independently as per our
Loan Policy guidelines. Administrative clearance is to be obtained from Zonal Office /
Head Office. To take all existing securities and to complete the documentation
expeditiously duly complying with our loan policy guidelines on takeover norms,
compliance, legal audit, permission for release of limit etc. While other bank is taking
over our borrowal account, Branches are advised to inform adverse features if any,
in the conduct of the accounts to the transferee bank duly obtaining permission from
competent authority for issuing P & C Report.

Numerical:

1.Credit Guarantee Fund Trust For Micro And Small Enterprises (CGTMSE) or Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH):::

In case the advance covered by CGTMSE or CRGFTLIH guarantee becomes nonperforming, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing assets.

An illustrative example is given below:

Example

Outstanding Balance Rs. 10 lakhs
CGTMSE/CRGFTLIH Cover 75% of the amount outstanding or 75% of the unsecured amount or Rs.37.50 lakh, whichever is the least
Period for which the advance has remained doubtful More than 2 years remained doubtful (say as on March 31, 2014)
Value of security held Rs. 1.50 lakhs
Provision required to be made
Balance outstanding Rs.10.00 lakh
Less: Value of security Rs. 1.50 lakh
Unsecured amount Rs. 8.50 lakh
Less: CGTMSE/CRGFTLIH cover (75%) Rs. 6.38 lakh
Net unsecured and uncovered portion: Rs. 2.12 lakh

Provision for Secured portion @ 40% of Rs.1.50 lakh Rs.0.60 lakh
Provision for Unsecured & uncovered portion @ 100% of Rs.2.12 lakh Rs.2.12 lakh

Total provision required Rs.2.72 lakh

2. Altman z score

Application of Altman Z Score / Bankruptcy Score Formula

The formula is used to predict corporate defaults or bankruptcy or in academic language, financial distress position of companies.

The formula is based on discriminant analysis technique in statistical analysis.

The formula uses multiple variables from income statement and balance sheet of companies.

What's the formula?

Formula =

Altman Z-Score = 1.2*T1 + 1.4*T2 + 3.3*T3 + 0.6*T4 + 1.0*T5

Here are the key definitions from the above formula:

T1 = Working Capital / Total Assets

This ratio measures liquid assets. The companies in trouble will usually experience shrinking liquidity.

T2 = Retained Earnings / Total Assets

This ratio calculates the overall profitability of the company. Dwindling profitability is a warning sign.

T3 = Earnings before Interest and Taxes / Total Assets

This ratio shows how productive a company is in generating earnings, relative to its size.

T4 = Market Capitalization / Total Liabilities

This ratio suggests how far the company's assets can decline before it becomes technically insolvent (i.e., its liabilities become higher than its assets).

T5 = Sales / Total Assets

This is the asset turnover ratio and is a measure of how effectively the firm uses its assets to generate sales

Calculate Altman Z score (useful Certified Credit professionals , CAIIB exam)

a) 1.945
b) 2.945
c) 3.945
d) 4.945

Q. The prediction that the company
a) non bankrupt company
b) is not on the verge of financial ruin
c) bankrupt company
d) is on the verge of financial ruin
e) a and b
d) c and d

(i) Using Altman's (1968) model compute the Z value of business 'A Ltd.', from the provided data (Balance Sheet extract)

A Ltd. Balance Sheet (extract)

(All Figures in ₹)

Liabilities		*Assets*	
Share capital of ₹10 each	1,00,000	Fixed Assets	2,10,000
Reserves & Surplus	30,000	Inventories	90,000
10% Debentures	1,50,000	Book Debts	35,000
Sundry Creditors	40,000	Loans and advances	10,000
Outstanding Expenses	30,000	Cash and bank	5,000
	3,50,000		3,50,000

Additional information:

(i) Market value per share ₹15

(ii) Operating profit (25% on sales) ₹2,00,000 13

Solution

1. Working capital = Current assets - current liabilities = 140000 - 70000 = 70,000
2. Total assets = 210000+90000+35000+10000+5000 = 350000
3. Retained earnings. = Reserves & surplus = 30000
4. EBIT = operating profit = 200000
5. Market value of shares = 10000 x 15 = 150000
6. Book value of total debts = Long term liabilities + current liabilities = 150000 + 70000 = 220000.
7. Sales = 200000 x 4 = 800000, since operating profit is 25% on sales.

Conclusion:

$Z = 1.2\times0.20 + 1.4 \times 0.09 + 3.3 \times 0.57 + 0.6 \times 0.68 + 1.0 \times 2.29 = 4.945$, say 4.95

3.

Altman Z-Score Calculation			
The following data, for a given firm			
Current Assets	1000000	Z score Bench Marks	
Current Liabilities	500000	<1.81=Distress Zone	
Total liabilities	1000000	(may go bankrupt within 1 year)	
Total Assets	2000000	1.81<2.99= Grey Zone	
Retained Earning	1000000	(could goeither way)	
Market Value of Equity	3000000	>2.99= Safe Zone	
		(considered financially Healthy)	
EBIT	500000		
Sale	1000000		
Solution	Rato	Value	Z score=Ratio*Z Value
X1=(Working Captal/Total Assets)	0.25	1.2	0.30
X2=(Retained Earning/Total Assets)	0.50	1.4	0.70
X3 =(EBIT/Total Assets)	0.25	3.3	0.83
X4 =(Market Value of Equity/Total liabilities)	3.00	0.6	1.80
X5=(Sales/Total Assets	0.50	0.999	0.4995
Altman's Z-score for this firm			4.1245

MODULE - B : ANALYSIS OF FINANCIAL STATEMENTS

Analysis of Financial Statements : Balance Sheet - Definition, Balance Sheet & Banker, Classification of Assets & Liabilities, Current Assets, Fixed Assets, Non-current Assets, Intangible & Fictitious Assets, Liabilities - Current Liabilities, Medium & Term Liabilities, Capital & Reserve, Classification of Current Assets & Current Liabilities, Balance Sheet Analysis, Analysis of Profit & Loss Account, Auditor's Note. Ratio Analysis - Classification of Ratios, Liquidity Ratios, Leverage Ratios, Activity Ratios, Profitability Ratios, Other important Ratios, Interpretation of important Financial Ratios, Uses of Ratios, Fund Flow Statements, Techniques Fund Flow and Cash Flow Statements, Illustrations.
Project / Term Loan Appraisal : Technical Appraisal, Commercial / Market Appraisal, Managerial Appraisal, Financial Appraisal, Economic Appraisal, Environmental Appraisal, Project Cost & Means of Finance, Cost of Production & Profitability, Sensitivity Analysis, Break-even Analysis, Capital Budgeting - Pay Back Period Method, Time Value Money, Net Present Value, Internal Rate of Return, Life of the Project

FINANCIAL STATEMENT ANALYSIS

1. **INTRODUCTION**

Financial statements: The statement which provides us the financial position of a Balance Sheet are called “Finance Statements”, which includes – Trading Account (in case of Manufacturing concerns), Profit & Loss Account, Balance Sheet, Cash Flow Statement and Funds Flow Statement. The analysis of Balance Sheet is a process of bringing down the difficult matter into a simple and easily understandable one. To have a clear understanding of the financial position of the Business concern, at least three years financial statements are to be ascertained. They provide us treasure of information. Balance Sheet of a business concern shows the strength of the concern on a given date but not reveal the current state of affairs of the concerns. Balance Sheet is having certain limitations, because it does not disclose the critical factors, such as Managerial Efficiency, Technical competence, Marketing capabilities and Competition in the market.

1.1 It is a generally accepted dictum among the bankers and other credit institutions that Analysis of Financial Statement constitutes the ‘back-bone of good lending’. It follows that the parameters taken for this analysis must satisfy the criteria for good lending. What, then is good lending and how does one judge this? Basically, the funds used by a banker for his loaning operations are provided by depositors and consequently the interests of the latter should be the major factor to determine the criteria for good lending.

1.2 The depositor or for that matter any investor looks primarily to two aspects, while taking an investment decision (i) Yield and (ii) Safety of funds. A secondary but none the less relevant aspect would be liquidity or the ease with which the deposit could be encashed in times of need. Based on these, the principles of good lending can be stated to be as follows -

i) Yield
ii) Safety of Funds
iii) Liquidity and
iv) Purpose

Purpose has been added to the above criteria because the general purpose and content of a banker’s loan portfolio would go a long way in ensuring depositors confidence, although the latter does not as such stipulate any conditions regarding purpose of loans at the time the deposit is made. Analysis of Financial Statements must, therefore, seek out answers for the above questions before a lending decision is made. The scope of Financial Statement Analysis boils down to finding answers to two questions basically

i) How is the liquidity of the enterprise to be measured?
ii) What financial and other criteria are to be used to judge the safety of loans?

These two issues are elaborated in the subsequent paragraphs.0

1.3 Analysis of Financial Statements is therefore important to the banker for two reasons : (a) to decide on whether or not to extend the advance; and (b) 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 25 lacs for industrial units in C&I segment and above Rs 5 cr in the SSI segment. Also, even where Projected Balance Sheet method is not used for assessing the credit requirements (as in the case of Nayak Committee method for SSI units), 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 unit and calculation of various ratios, before scoring under the Bank’s CRA rating can be attempted. Even where CRA rating is not necessary - as in the case of loan products like SME Credit Card and SME Smart Score - weightage is still given for financial ratios representing liquidity and gearing such as the Current Ratio, Total Outside Liability to Tangible Networth Ratio which in turn requires a basic understanding of analysis of financial statements. Granting an advance for less than Rs 10 lacs using SME Credit Card requires the use of a simple balance sheet.

2. Definition of Financial Statement:

2.1 Every business enterprise needs money constantly for its operations and such money is provided by the owners themselves, the gap, if any, being bridged by outsiders, viz., creditors. These funds are constantly in movement, involved in various financial transactions, thus continuously altering their form and content. A periodical assurance about their safety is, therefore, required by both the owners and the creditors. Further, if the enterprise happens to be limited company-the owners are the shareholders who do not exercise any direct control over the day-to-day affairs or administration of the Company, this being entrusted to the Board of Directors or the Management team. The management is, therefore, bound by law as well as contractual obligations to use such funds in accordance with the mandate of the purveyors of funds and produce evidence of having done so at periodical intervals. Financial Accounting is the manner of recording all financial transactions so as to enable extraction of the evidence mentioned above.

2.2 Financial Accounting is the "art of recording, classifying and summarizing, in a significant manner and in terms of money, transactions and events, which are, in part at least, of a financial character and interpreting the results thereof. Financial Accounting, therefore produces a significant summary of all recorded financial operations for the purpose of interpreting the end-result of such operations. Such a summary is called the Financial Statements, which comprise the Balance Sheet and the Profit and Loss Statement.

2.3 American Institute of Public Accounts describes Financial Statements as under:
"Financial Statements are prepared for the purpose of presenting a periodical review or report on the progress by the Management. They deal with the status of investment in the business as also with the results achieved during the period. They reflect a combination of recorded facts, accounting conventions and personal judgments. And, the judgments and conventions applied affect them materially. The soundness of judgment necessarily depends upon the competence and integrity of those who make them and on their adherence to generally accepted accounting principles and conventions."

2.4 This definition is very appropriate as it succinctly but nonetheless effectively brings out the characteristic features of Financial Statements, their strengths and weaknesses and their reliability and limitations. This understanding is very important to us since the reliability or authenticity of the Analysis of the Financial Statements would, it will be appreciated, be just as much as that of the Financial Statements themselves. This definition indicates the following characteristic features of the Financial Statements:

I) They are periodical review of the status of investment and progress made by the Management

ii) They contain facts recorded on the basis of accounting conventions and exercise of personal judgments.

iii) Integrity and competence of accountants who prepare them have a vital bearing on the ultimate results furnished by them.

2.5 A major weakness of Financial Statements is its lack of objectivity, being influenced largely by subjective exercise of judgments. For instance, in the hands of unscrupulous management with fraudulent intentions, manipulations are possible, which could distort, to a large extent, the ultimate results, thus camouflaging the real picture. Nevertheless, if the accountant compiles the statements diligently and without personal bias and on the basis of established and generally accepted accounting conventions, the Financial Statements do reflect the financial conditions of the limited companies to examine, among others, the accounting practices, and procedures and comment on whether the Financial Statements give a 'true and fair view' of the state of affairs and the net result. The Auditor's Report is, therefore, an independent professional guarantee for compliance with the generally accepted accounting principles and to that extent, takes care of lack of objectivity, and an intelligent scrutiny of the Annual Report is bound to bring out Auditors reservations, if any, on this subject.

To ensure the genuineness of the financial statements and that of the signatures of the chartered accountants therein, in case of large borrowers, viz. borrowers whose fund based limits are Rs.1 cr and above, a confirmation is to be obtained by sending a letter by Post/ e-mail regarding certification of financial statements from the Chartered Accountant who has signed the balance sheet / financial statements of the borrowers and this confirmation will be kept with the files of correspondence pertaining to the borrower.

3. Criteria for Analysis

3.1 As mentioned earlier, the outsiders or creditors who provide funds to the enterprise, do so on certain conditions to be fulfilled by the latter, the most important being the payment of interest and repayment of principal in time. Liquidity, therefore, connotes the availability of cash resources with the enterprise to liquidate such dues to the creditors and other pressing liabilities. The analysis of the Financial Statements should be such as to indicate or forecast the above performance capabilities on the part of the enterprise.

3.2 Safety of funds lent was, till recently, considered to be synonymous with security by way of physical or tangible assets. But the events occurring not only in India but elsewhere have conclusively proved that the banker can no longer look to encashment of the assets through sale for liquidation of his dues and such repayment can be expected only from out of the surpluses generated by the enterprise in its operations. It will, therefore, be noted that viability of the enterprises is the primary and real security for the lender.

3.3 Like the proverbial blind men trying to describe an elephant, viability is such a general term, lending itself to many different interpretations according to the perceptions and even predilections of the persons. For the purpose of this discussion, it can broadly be stated that viability connotes the ability of the enterprise basically to produce a product and market it at a profit or carry on an activity with a profit which is sufficient to meet the following 'charges' or 'claims' against it.

i) Service and repay the external indebtedness incurred for setting up the factory as well as carrying on its operations.

ii) Service the paid-up share capital at a reasonable rate or yield, considered good on market comparisons.

iii) Leave a surplus, adequate to meet its own 'growth' needs.

Accomplishment of the above objectives is the broad or the ultimate goal of the enterprise but it involves a lot many management policies and decision-factors as under:

i) Selection of the sources of funds or in other words the distribution of the requirements of funds between share-holders and creditors in such a manner as to (a) satisfy the various purveyors of funds on their expectation of return on their investment (b) satisfy the norms on the desirable mix between owned funds and borrowed funds.

ii) The funds provided, by the share-holders/creditors must be 'judiciously' used to create certain assets. Judicious use of funds denotes a careful evaluation of various options available to it before an investment decision is taken.

iii) The assets so created ought to generate a net surplus, through their use, which is the highest or optimum return on investment after meeting all expenses and charges.

3.4 In order to understand these issues better, let us look at a typical Balance Sheet of a manufacturing enterprise. The monies it needs for initially setting up its factory and later on carrying on its operations in the factory and the sources providing such funds can be illustrated as under

Sources of Funds
(Liabilities)
Uses of Funds
(Assets)

Share-holders' Funds (Paid-up capital and Reserves)
(1)
Factory assets (Land, Building, Plant and Machinery etc.)

(4)
Term Liabilities(Debentures
Term Loan etc.)
(2)
Investments, Other loans
loans and advances
(5)
Bank Loans and other
short-term creditors
(3)
Operating assets (Cash, inventory
accounts receivables etc.)
(6)
The aggregate requirement of funds (4+5+6) is met from the total sources (1+2+3). The relative proportion of the funds deployed in various assets depends on the Management's discretion. For instance, how much to invest in the factory assets would be governed by (i) capacity to be installed, (ii) whether to acquire own land and building or acquire it on lease, (iii) whether to install all the machineries or decide to outsource some components from subcontractors, (iv) whether to construct a housing colony for employees or not. Employment of funds in operating results would be determined, inter alia, by level of activity proposed while use of funds in trade investments or in giving out loans and advances to others would depend upon surplus cash available after use in the factory and operating assets.
3.5 Basically, an enterprise looks to the ultimate 'return on investment' concept while deciding about deployment of funds in various assets; ,of course it is also true that availability of funds and the conditions attached to such availability would also be other determining factors in this exercise of discretion by the Management.
3.6 While deciding upon the several sources of funds, the Management, takes into consideration factors like
i) Promoter's capacity to bring in capital (otherwise known as promoters' contribution)
ii) Availability of capital resource in the country & state of capital market for a public issue.
iii) Repaying capacity of the enterprise.
iv) Norms on Debt Equity gearing stipulated by Term Lenders.
v) Nature of the project and
vi) Life of the project.
3.7 In summary, it may be stated that the Analysis of Financial Statements indicates three broad decision factors, viz.,
I) checking the investment (or deployment) of funds decision of the enterprise,
ii) verifying the financing (funding) pattern proposed/in use by the enterprise and
iii) examining its operating efficiency.

BALANCE SHEET - ANALYSIS & INTERPRETATION

4. What is a Balance Sheet?
4.1 Balance Sheet, as the name indicates, is a statement of balances, depicting the state of affairs or position of a business enterprise. Since it is an aggregation of balances, it pertains obviously to a particular date. As on the date of reckoning, it discloses to the user of the statement of the investment of funds made by the enterprise on various classes or categories of assets and the various sources from which funds have been drawn to enable such investment. It would be useful to visualise a Balance Sheet essentially in terms of the resources of an enterprise and claims held against such resources provided to it. Clearly every person or organisation providing funds to the enterprise (either directly as investors and lenders or indirectly by providing credit or

deferring payments due to them) will have claims against the assets or resources of the enterprise and will expect such claims to be met at appropriate times, inevitably there is a cost attached to claims, which needs to be reimbursed to all outsiders either in a lumpsum at the time of repayment of the principal amount of the claim or in installments at the option of the providers of funds. Thus, it behoves of the manager of the enterprise to conduct the affairs of the business in such a way that the following objectives are met

i) the funds provided to the manager by the owners/shareholders and lenders/other creditors are judiciously invested to create certain assets,
ii) the assets so created should be capable, through their operation and use by the manager, of yielding the highest return in terms of the net income after meeting all expenses and charges incurred in earning that income.
iii) the net income so earned should be adequate to service the cost of funds, viz, interest on loans and dividend on capital, in addition to redemption of the capital funds (principal) where stipulated, and to leave a surplus for future growth.
iv) the surplus funds should be so invested as to enable their prompt and ready encashment to meet maturing claims against the enterprise.
4.2 The Balance Sheet of an enterprise is basically analysed to test the above hypotheses and can, therefore, be deemed to reflect the financial condition of the enterprise. It was for this reason that some of the U.S. accountants and business organisations refer to Balance Sheet as ' A Statement of Financial Condition'. While this is so, the Balance Sheet has certain limitations and cannot be treated as the sole indicator of financial position of a unit.
5.0 Format of Balance Sheet:
5.1 The Balance Sheet can be presented either in a ' T' form or in a vertical order, beginning with assets. While the Companies Act, 1956, prescribes the form in which the Balance Sheet has to be presented by the limited liability corporations, there is no such standard form for non-corporate organisations.
5.2 Schedule VI Companies Act, 1956 contains the format in which limited companies should present the Balance Sheet to the shareholders. The format has been devised by the framers of the Act, keeping essentially the interests of the shareholders in view, though there are provisions in the Act to protect the interests of all classes of persons or organisations who transact business with the Company.
5.3 The grouping of the various assets and liabilities in Schedule VI follows the familiar dictum that assets and liabilities should be detailed in their order of permanence. For instance, assets start from fixed assets-the near permanent assets - and go down to current assets, loans and advances which are regarded as being closest to cash in terms of their convertibility to cash within a short period. Similarly, the liabilities start with share capital - the near permanent source of funds to an enterprise - and travel through long term loans down to current liabilities and provisions, the last-mentioned items requiring layout of funds by the enterprises at short notice.
5.4 In accountant's parlance, current assets, could, therefore, be converted into cash within a period of 12 months and current liabilities are those liabilities that mature for payment within 12 months. Thus "advances to staff and group companies" for instance can be a current asset, if they satisfy the test of conversion to cash within one year.
6.0 Assets
6.1 Assets can be described as economic sources, owned by an enterprise, whose cost at the time of their acquisition can be objectively measured. Thus, any item to be called an

asset should satisfy three attributes, viz., (i) capacity to generate an economic benefit; (ii) ownership and (iii) measurement of cost. Thus, skilled labour and managerial personnel, though a very powerful asset, doubtless, is not regarded as such by the accountant for the Balance Sheet purposes, since they do not satisfy the third criterion of measurement of acquisition cost.. However, concept of ownership for the accountant is not the legal ownership but connotes eligibility of the enterprise to possess it and derive an economic benefit there from thus, materials and machinery, although not paid for, either in cash or otherwise, will become assets, nevertheless.

6.2 Fixed Assets

6.2.1 Fixed Assets are those assets which are operated by the enterprise to produce certain goods for sale at a profit. This would mean that fixed assets are something of a 'permanent' nature, acquired by an enterprise to help generation of a certain productive activity and not held by it for the purpose of 'resale'. Thus they are often referred to as 'productive assets'. Obviously, the various components of a factory, when initially set up, would constitute fixed assets. They are land, building, plant and machinery furniture and fittings, transport vehicles etc.

6.2.2. As an analyst examining the Balance Sheet, one should look into the intrinsic worth of the assets rather than their rupee value. Thus, our examination should cover the qualitative aspects of these assets. For instance, land and buildings should be examined from the angle of their adequacy for current needs and scope for future expansion. Plant and machinery needs to be looked at from the points of view of (i) the nature of machinery, whether special purpose or standard, (ii) their productivity or machine efficiency, (iii) their age and future useful life and (iv) the policy of the enterprise for their modernisation and/or replacement. One cardinal principle is that since investment in fixed asset is irrevocable and represents money sunk irretrievably, the enterprise should evaluate all alternatives viz., leasing or hiring or sub-contracting, before deciding upon acquiring any fixed asset. The same concern which he displays while considering a request for a term loan viz., "Is the administrative block necessary?" should guide the analyst's examination of all fixed assets.

6.2.3 One important feature of fixed assets accounting is depreciation. Many persons entertain wrong notions about depreciation.

i) Does it provide funds for replacement?

ii) Does the depreciated block denote its current worth?

II) What, then, is depreciation?

Depreciation is nothing but a deferred amortisation of the cost of fixed assets on a notional wear and tear of the asset. Every asset has a limited time span of usefulness and every time it is operated there is a usage of its life. Therefore, to the extent of such usage, a reduction in value should be accounted. Two methods of depreciation are in use in India.

i) Straight line method

ii) Written Down Value method :

Under the first method, a fixed amount is written off every year while under the second method, depreciation is provided at a fixed percentage of the outstanding net block each year. Suppose that under both methods, the asset is required to be depreciated upto 95% of its original cost and the time taken to reach this point under either method is the same based on the useful life of the machinery. Such being the case, it will be appreciated that the aggregate depreciation provisions, being restricted to 95% of original cost, cannot provide funds for replacement, under inflationary conditions nor does the depreciated value of the asset have any correlation with its current market value. Depreciation thus, is a non cash charge on the profit, being yearwise allocation of expenditure on fixed assets already incurred at the time of acquisition of such fixed assets.

6.3 Investments:

6.3.1 A company, not being an investment company, takes an investment decision in the following circumstances

i) To promote a subsidiary or other company either for the purpose of creating an outlet for sale of its products or for manufacture of materials required by it for its own production. Such investments are called trade investments, i.e., those made

to promote its own business.
ii) To acquire substantially or otherwise shares of another company, with a view to exercise control over the latter.
iii) To invest purely as a yielding proposition, idle cash for which it has no other productive use.
6.3.2 Since all such investments excepting, perhaps, item (iii) result in contraction of resources available for productive use to carry on the activity for which the company was set up, the analyst will do well to verify that such investments would not curtail the level of productive activities. Thus the banker should examine the genuine need for investments and ask the question, "Is the investment necessary"?
6.4 Current Assets, loans and advances:
6.4.1 As per the Companies Act, the above category of assets would comprise the following items:
I) Interest accrued on investments;
ii) Spares and spare-parts;
iii) Loose-tools;
iv) Stock-in-trade;
v) Work-in-progress;
vi) Sundry Debtors;
(a) Outstanding for a period exceeding 6 months;
(b) Other debts
Less: Provision for bad debts.
vii) Cash and bank balances.
viii) a) Loans and advances to subsidiaries;
b) Loans and advances to partnership firms where the company or any of its directors is a partner.
ix) Bills of Exchange
x) Advances recoverable in cash or kind or for value to be received.
xi) Balance with customs, port trusts, etc.
6.4.2 As stated earlier, while for the purpose of other users of Balance Sheet, all the above assets may be called "current assets", the restrictive connotation adopted by the bankers in India for current assets makes use of the concept known as 'operating cycle' or 'cash cycle'. Operating cycle is simply the cyclical process of use of cash to purchase materials, their subsequent processing into finished products and sale and realisation of sale proceeds in cash. The time taken for this cycle to complete depends on various factors, some controllable and many uncontrollable in Indian conditions, and varies from industry to industry, why, even from unit to unit, within the same industry, say engineering or textiles. Thus, our definition of a current asset is that any asset that gets converted into cash within the operating cycle and forms an integral part of the cycle will be a current asset. The definition stems from our anxiety that short term bank finance should be utilised only for meeting working capital needs and not diverted for acquiring other assets or frittered away in outlays, not related to the business of the unit. Thus investments in group companies and advances to group companies will not qualify for a current asset. Similarly, deposits made with public utility bodies like Electricity Board etc., which are non-returnable during the pendancy of service of the utility to the enterprise and other advances to staff, officers etc., would not be regarded as current assets. Again the bankers look askance at any unduly large advances to employees, unrelated to the company's operations or objects.
6.4.3 Cash / bank balance (credit) cannot co-exist in any large bulk with bank borrowings. Further, any unduly large amount of cash and current account credit balance held by any enterprise would mean, unless there are good reasons for it, that its cash managements is poor as it is sacrificing opportunities for expansion of its trade, for idle cash is a dead investment. Thus, it should be at the irreducible minimum, just adequate to meet its dayto-day needs.

6.4.4 Receivables:
6.4.4.1 Receivables represent claims against customers to receive cash at a certain point of time in future. For our analysis, only claims arising out of sale of products manufactured/ traded or rendering of services by the enterprise would be classified as current assets. Receivables arising out of any other transaction will not be current assets. For instance, dues on account of sale of fixed assets will not be a current asset. Further, credit sales to its own staff or officers or group companies do not generally come under current assets unless the analyst can be certain that the terms of credit would be on par with sales to general public or that the enterprise would not show some indulgence in collection of debt.

6.4.4.2 Invariably, a break-up of the receivables customer-wise would be useful. An examination of the customer-profile would disclose undue favours, if any, shown to any particular customer: in particular, whether the enterprise siphons away funds to group companies under some pretext or other or through what is known as "benami" transactions. Similarly an ageing analysis of debts would indicate whether the debts are current or overdue, considered in conjunction with terms of credit offered. This might mean one of two things, viz., either tardy and lax debt collection or inability of customers (retailers) to push the products due to stiff competition or inferior quality.
6.4.4.3 A useful test for examining receivables would be
Receivables X 365
Annual Credit Sales
This denotes the number of days for which credit sales are outstanding. For the numerator one could take either the year-end receivables or monthly average, if available. In any case, it is a reflection of the enterprise's credit policy or experience in recovery of receivables, in relation to market terms: a higher ratio being generally indicative of unsatisfactory conditions unless there are genuine reasons for it, on account of customer mix - i.e., more sales to Government parties who may take longer time to pay for their purchases. Although receivables are nearer to cash than inventory and hence more liquid, they entail more risk to the financing banker especially if customers are restricted to very few numbers.
6.4.5. Non Current Assets:
Following items are examples of non current assets:
i) Deferred Receivables (maturity exceeding one year)
ii) Security Deposits (kept with Electricity Boards, Telephone Dept, others..)
iii) Advances to group companies as also to capital equipment suppliers.
iv) Investments in subsidiaries/group companies.
It will bear repetition that lock-up of monies in non-current assets restricts their availability for productive operations and hence this locking up of funds has to be at the minimum level, consistent with corporate needs and policy.
6.5 Intangible Assets
These include intangible assets like goodwill, patent, trade mark, franchise, etc., as well as expenditure like preliminary and pre-operative expenses (to the extent not written off), etc. In certain cases, even the accumulated losses, will appear under this head. The total of intangible assets should be subtracted from the enterprise's net worth, to arrive at its Tangible Net Worth.
71**7. Liabilities:**
7.1 The liabilities are the sources from which funds were drawn by the enterprise to acquire the various assets. Thus, liabilities represent claims against the enterprise, requiring payment at a point in future by converting the assets into cash. The three sources from which funds are drawn are
i) Proprietor or owners or share-holders who contribute the risk capital.
ii) The lenders-banks and others who grant the debt capital; and
iii) The outsiders (creditors) who defer payments due to them for materials delivered or

services rendered to the enterprise.
7.2 Share-holders Contribution
7.2.1 The funds contributed by the share-holders constitute the capital of the enterprise. It denotes the stake of the owners in the enterprise and serves as the basis or leverage to negotiate loan funds from the lender. For a corporate unit, its Memorandum fixes the ceiling upto which capital can be raised, which is called the authorised capital. The memorandum also stipulates the class, number and face value of shares that can be issued. The capital structure is as under:
i) Authorised Capital Divided into ....
equity and ....
preference shares of
Rs. .... (face value).
ii) Issued Capital .... shares....................................
equity and ....preference......................
issued for subscription either by prospectus or otherwise.
iii) Subscribed Capital .... shares....................................
equity and ....preference......................
subscribed to by the public and others
iv) Paid-up-capital: .... shares....................................
equity and ....preference....................
paid-up (fully or partly).
For the enterprise, the last-mentioned item represents the funds made available through share capital, while the others indicate cushion for further raising of capital in future.
7.2.2 It will be well-worth noting that raising of capital is time-consuming and calls for knowledge, on the part of the management, of the environment, the Govt. policies, investment climate in the country, other capital issues on the anvil etc. It does not happen that all issues are subscribed in full and in some cases, a portion devolves on the underwriters. Any capital issue to be successful would generally require the following conditions to be satisfied.
i) Basically, the industrial unit should belong to a growth-oriented industry, preferably free of undue government controls or to a core sector, enjoying Govt. patronage.
ii) The promoters or the management should have a good track record of having successfully managed other companies.
iii) The gestation period should not be unduly long.
iv) The timing of the issue should be such that it does not clash with other betterknown issues
v) The investment climate should be conducive and there should not be discouraging threats.
vi) Above all, the issue should be appropriately timed, when the investors do not have to meet other statutory commitments like advance tax etc.
7.3 Reserves and Surplus

7.3.1 The reserves are of two kinds : Capital and Revenue. Capital reserves arise in the following cases
i) Surplus due to revaluation of fixed assets.
ii) Issue of shares at a premium.
iii) Capital profits on sale of assets (fixed assets and investments).
iv) Redemption of shares or bonds or debentures at a discount.
v) Capital subsidy by the Govt. (State or Central).
7.3.2 Generally, capital reserves are not available for dividend distribution and they are perpetual reserves. Revenue reserves represent the profits earned from operations, after meeting all expenses and retained in business. In other words, the revenue reserves are accumulated past profits, not drawn by the shareholders as dividends. Some of the wellknown reserves are as follows:

i) General Reserve.
ii) Dividend equalisation reserve.
iii) Plant rehabilitation reserve.
iv) Reserve for contingencies like future loss, fall in value of investments held etc.
v) Capital reserve or debenture redemptions reserve.

Some of the reserves are specific reserves, created in terms of external stipulations while others are free reserves, arising basically at the management's discretion. For instance, the capital or debenture redemption reserve arises in terms of stipulations by the debenture-holders or in terms of the statute (for capital redemption). These reserves are for specific purpose and cannot be utilised by the company for declaring dividends. All the same, all the reserves whether specific or free, whether capital or revenue, belong to the holders in the final analysis and hence, the entire reserves together with the paid-up capital constitute the net worth. In other words, net worth reflects theoretically, the surplus that might remain at the time of company's liquidation after paying off all outside liabilities (lenders and creditors) from the proceeds of sale of all assets of the company. For instance, if net worth accounts for 40% of the total assets, it would mean that at the time of reckoning, in case every asset realises at least 60 paise of each rupee invested in it, then the creditors and lenders would not come to grief. The surplus of net worth over paid up capital depends on the policy of plough-back of profits followed by the management.

7.4 Term liabilities

7.4.1 These, together with net worth, constitute the long-term or semi permanent source for the enterprise with which the initial cost of factory as well as subsequent additions are to be financed. The term liabilities comprise all debt contracted by the enterprise, not requiring to be liquidated within 12 months. Following items are examples of term liabilities.

i) Debentures.
ii) Redeemable preference shares (whose redemption falls within 12 years from date).
iii) Term loans,
iv) Deferred credit from suppliers of capital equipments/materials
v) Deposits from the public (payable beyond one year).
vi) Other term liabilities such as provision for gratuity liabilities.

7.4.2 A salient feature of term liabilities excepting items (ii) (v) and (vi) is that they are usually secured debt, covered by a charge over the under-taking's fixed assets. While debentures are transferable securities, with a secondary market for trading and are repayable either in a lump-sum or instalments after a lapse of certain period, term loans and deferred credit are held by lending institutions throughout its currency-but requiring to be liquidated in certain stipulated instalments as per repayment schedule. Another feature of term liabilities, particularly term loans, is that the lenders as part of their loan arrangement prescribe a number of positive and negative covenants, the non-compliance of which may result in penal action, including takeover of management. This aspect needs to be studied by the analyst to foresee contingencies and eventualities, affecting the interests of short term lenders.

7.4.3 While the debentures and term loans are raised from the public or term lending institutions (including banks), as the case may be and hence subject to such stipulations as Debt: Equity gearing, necessity to create a redemption reserve, necessity to create a charge over assets etc. the other two long-term sources viz., deferred suppliers credit and public deposits are virtually without any strings or onerous conditions.

7.4.4 Supplier's credit is of two kinds, foreign currency or rupee, depending on whether the item purchased under the credit is imported or local purchase. Supplier's credit is generally available in a competitive free market where either due to competition or otherwise, inducements like longer payment terms are necessary to promote sales of capital equipment. Branches should familiarise themselves with the RBI regulations regarding sellers' credit for imports from abroad.

7.4.5 Companies are permitted to collect deposits from public and from shareholders for maturity periods ranging from 6 months to 3 years. There is a ceiling on rates of interest payable on such public deposits. This is an easy and comfortable source of finance for well-run companies.

7.5 Current Liabilities and Provisions

7.5.1 These are liabilities either payable on demand or within a maximum period of 12 months. They are:

i) Short-term bank borrowings
ii) Unsecured loans.
iii) Sundry creditors (Trade)
iv) Deposits from the public maturing within 1 year.
v) Advances and deposits from dealers/customers.
vi) Accrued interest and other charges.
vii) Provision for taxation.
viii) Dividend payable.
ix) Statutory liabilities.
x) Instalments of term loans etc. payable within 12 months.
xi) Other liabilities and provisions.

Of these current liabilities, we take the following two items for further discussion:

i) Trade creditors and
ii) Statutory liabilities.

7.5.2 Trade creditors are unpaid purchases outstanding on Balance Sheet date. This represents the credit enjoyed by the company on its purchases of raw materials and stores. The relevant test for this will be:

Trade Creditors
Total annual Credit Purchases
X 365

This figure reflects the no. of days the purchases remain unpaid. This, when compared with the normal trade credit period offered by market, could be interpreted in different ways. A much higher period than normal market credit could mean either of the following

i) The company's liquidity is under pressure and it is unable to meet its creditors within normal credit due to cash flow problems: or
ii) The company being a dominant unit dictates terms to its suppliers, by extending the period of credit allowed by the market.

Similarly a lower ratio may indicate one of the two:

a) The unit's liquidity is so comfortable that it does not require the normal period of market credit or the company's cash management is rather poor since it does not avail of the normal market credit available to it.
b) Reluctance of suppliers to grant the normal credit due to the company's past track record of poor payments.

In any case, trade creditors is very important to the Analyst as it is a barometer of the company's liquidity. The first casualty under any liquidity strain is only the trade creditors, which get extended. It is noteworthy that one of the signals of industrial sickness is an unduly extended trade creditors portfolio.

7.5.3 Similarly, statutory liabilities is another sure index of unit's liquidity. Generally no credit is available in respect of statutory liabilities like EPF and ESI dues (employer's and employee's contributions) and the units venture to defer their payments only braving penal action by the government. Hence, unless the liquidity position becomes one of extreme strain, these liabilities are not normally postponed.

7.5.4 In respect of other current liabilities, a general examination of their nature, repayment terms etc., will have to be conducted to understand the overall position. One may also mention the difference between provisions and reserves. While the former is a current liability, created mostly for meeting a specific and known obligation by charging it to the profit & loss account, as an expense incurred for earning the revenue, the latter is simply an appropriation from the after tax profit. It represents basically the monies belonging to the shareholders which by common consent are retained in business for meeting future needs. Thus, reserves form part of the unit's net worth.

8. Contingent Liabilities

Another feature of Balance Sheet to be closely analysed by the credit analyst is the contingent liabilities. It often happens that at the time the Balance Sheet is drawn up, the accountant is not fully aware of some obligations of the enterprise : they may or may not accrue as a liability, because of dispute regarding their tenability as a claim against the enterprise or if they do arise, he is not certain about their quantum. For instance, quality disputes, tax appeals, etc. are obligations of this nature. These obligations are termed contingent liabilities and must be detailed as a footnote. A few examples of these contingent liabilities are :

i) Pending law-suits.
ii) Claims against the company not acknowledged as debts.
iii) Guarantees issued by the company
iv) Unexpired portion of Letters of Credit established by the Bank on behalf of the unit.
v) Taxes and duties under dispute with authorities.
vi) Bills/Cheques discounted with bankers.

The relevance of these to the credit analyst lies in the likelihood of their occurrence. He will have to examine each of these and judge for himself to what extent chances exist for their materialising into real liabilities. If, in his judgment they are more likely to materialize, he must make a suitable provision in his own analysis, by setting it off against the net worth, even though the enterprise itself had not done so.

9. Limitations of a Balance Sheet

While the above analysis of the Unit's Balance Sheet does disclose certain important indicators to the analyst, he will do well to remember that conclusions based purely on the Balance Sheet may quite be misleading, due to its inherent limitations. The Balance Sheet is often likened to a snapshot of a moving train and hence reveals just as much about the financial condition as the photograph does of the moving train, capturing only a particular position. Hence, any undue reliance on Balance Sheet is fraught with risks.

The limitations of balance sheets are four-fold.

i) Inexactness owing to personal bias of the accountant in exercise of his judgment: e.g. valuation of stocks, provision for bad debts etc.
ii) Non-recognition of diminishing value of rupee and treating all assets only in terms of their recorded rupee value: inflation accounting is the answer
iii) Exclusion of all non-monetary transactions and factors, howsoever important they may be.
iv) Pertains to a date and hence liable to abuse like window-dressing.

In order to eliminate at least some of these limitations, the analyst could examine a series of balance sheets and discern a trend of the various financial and performance indicators. Such a comparison could be internal i.e. with past performance or external i.e., with those of similar units. A Balance Sheet analysis, it will be appreciated, is only the first step in the whole analysis, an indicator ordering a further probe, but definitely not the final conclusion.

10. CLASSIFICATION OF CURRENT ASSETS AND CURRENT LIABILITIES

11. CURRENT LIABILITIES:

i) Short term borrowings (including bills purchased and discounted not drawn under LCs opened by first class banks / correspondent banks) from
a) Banks
b) Others
ii) Unsecured loans
iii) Public deposits maturing within one year.
iv) Sundry creditors (trade) for raw materials and consumable stores and spares.
v) Interest and other charges accrued but not due for payment.
vi) Advance/progress payments from customers.
vii) Instalments of term loan, deferred payment credits, debentures, redeemable preference shares and long term deposits, payable within one year
ix) Statutory Liabilities
a) Provident fund dues
b) Provision for taxation (see Note(2) below)
c) Sales Tax, excise duty etc.
d) Obligations towards workers considered as statutory
e) Others (to be specified)
x) Miscellaneous Current Liabilities
a) Dividends (see Note (2) below)
b) Liabilities for Expenses
c) Gratuity payable within one year
d) Other provisions
e) Any other payments due within 12 months

12. CURRENT ASSETS:
i) Cash and Bank Balances.
ii) Investment (see Note (3) below)
a) Government and other Trustee Securities (Other than for long term purposes e.g. sinking fund, gratuity fund etc.)
b) Fixed deposits with banks & margin money deposits (margin for LC/ BG established by the banker for working capital purposes).
iii) Receivables arising out of sales other than deferred receivables, (including bills purchased and discounted by bankers).
iv) Instalments of deferred receivables due within one year.
v) Raw materials and components used in the process of manufacture including those in transit (see Note(4) below).
vi) Stocks-in-process including goods in transit.
vii) Finished goods including goods in transit.
viii) Other consumable spares (see Note (4) below).
ix) Advance payment of tax. (see Note (5) below).
x) Pre-paid expenses.
xi) Advances for purchase of raw materials, components and consumable stores.
xii) Deposits kept with public bodies etc., for the normal business operations e.g. earnest deposits kept by construction companies etc., maturing within the normal operation cycle.
xiii) Monies receivable from contracted sale of fixed assets during the next 12 months.
Notes (1) The concept of current liabilities would include estimated accrued amounts which are anticipated to cover expenditure within the year for known obligations, viz., the amount of which can be determined only approximately, as for example, provisions for accrued bonus payments, taxes, etc.
(2) In cases where specific provisions have not been made for those liabilities and the liabilities will be eventually paid out of general reserves, estimated amounts.
(3) Investments in shares and advances to other firms/companies, not

connected with the business of the borrowing firm, should be excluded from current assets.
(4) "Dead inventory" i.e. slow moving or obsolete items should not be classified as current assets.
(5) Provision for taxes and advance payment of tax can be netted out.
(6) Amount representing inter-connected company transactions should be treated as current only after examining the nature of transactions and merits of the case. For example advance paid for supplies for a period more than the normal trade practice, out of any considerations other than regular and assured supply, should not be considered as current.
(7) The above list of current liabilities and current assets is only illustrative and not exhaustive.

13. PROFIT AND LOSS STATEMENT ANALYSIS

13. Importance of the Profit and Loss Statement

13.1 The profit and loss statement summarises the transactions which together result in a profit (or loss) for a specific period of time. This profit or loss is shown on the balance sheet as an increase or decrease in owners' equity. People who invest in securities believe that a study of the profit and loss statement of a business enterprise will give them information regarding future expectations of profits and dividends. It is in this context that the profit and loss statement has gained importance.

13.2 The profit and loss statement reports the results of operations and indicates areas contributing to profitability or otherwise of the business enterprise. Analysis of profit and loss statements for several years may reveal desirable or undesirable trends in the profit earning capacity of a business enterprise.

13.3 Revenues, Expenses and Changes in Owners' Equity

Defined more precisely, revenues are increases in owners' equity that result from operations of a business enterprise while decreases in owners' equity are expenses. Revenues take the form of an inflow of assets like cash and sundry debtors from customers or clients to whom products have been sold or services rendered. Revenues might also be earned from investments, for instance, interest on Govt. securities or dividends. It should be noted that revenues are not the only source for increase in owners' equity. An inflow of capital funds invested by owners increases owners' equity but it is not revenue.

13.4 Expenses connote "sacrifice made", "cost of services or benefits received", or 'resources consumed' during a specified period. Expenses are costs incurred for generating revenue and are therefore related to the operations of a business enterprise. As stated earlier, expenses decrease owners' equity, however they are incurred in the expectation that the revenues generated will more than offset the decrease in owners' equity. The excess of earned revenues over the incurred expenses in a specific period is called profit or income. If expenses exceed revenues the difference is called a loss resulting in net decrease in owners' equity.

Ratio means a comparison of two items which are having cause and relationship. Ratios can be expressed in percentage or in number of times. Depending upon the nature, the ratios are broadly classified in to four categories viz., Liquidity Ratios, Leverage Or Solvency Ratios, Activity Ratios and Profitability Ratios

Types of Ratios

There is a two way classification of ratios: (1) traditional classification, and (2) functional classification. The traditional classification has been on the basis of financial statements to which the determinants of ratios belong. On this basis the ratios are classified as follows:
1. 'Statement of Profit and Loss Ratios: A ratio of two variables from the statement of profit and loss is known as statement of profit and loss ratio. For example, ratio of gross profit to revenue from operations is known as gross profit ratio. It is calculated using both figures from the statement of profit and loss

2. Balance Sheet Ratios: In case both variables are from the balance

sheet, it is classified as balance sheet ratios. For example, ratio of current assets to current liabilities known as current ratio. It is calculated using both figures from balance sheet.

3. Composite Ratios: If a ratio is computed with one variable from the statement of profit and loss and another variable from the balance sheet, it is called composite ratio. For example, ratio of credit revenue from operations to trade receivables (known as trade receivables turnover ratio) is calculated using one figure from the statement of profit and loss (credit revenue from operations) and another figure (trade receivables) from the balance sheet.

Although accounting ratios are calculated by taking data from financial statements but classification of ratios on the basis of financial statements is rarely used in practice. It must be recalled that basic purpose of accounting is to throw light on the financial performance (profitability) and financial position (its capacity to raise money and invest them wisely) as well as changes occurring in financial position (possible explanation of changes in the activity level). As such, the alternative classification (functional classification) based on the purpose for which a ratio is computed, is the most commonly used classification which is as follows:

1. Liquidity Ratios: To meet its commitments, business needs liquid funds. The ability of the business to pay the amount due to stakeholders as and when it is due is known as liquidity, and the ratios calculated to measure it are known as 'Liquidity Ratios'. These are essentially short-term in nature.

2. Solvency Ratios: Solvency of business is determined by its ability to meet its contractual obligations towards stakeholders, particularly towards external stakeholders, and the ratios calculated to measure solvency position are known as 'Solvency Ratios'. These are essentially long-term in nature.

3. Activity (or Turnover) Ratios: This refers to the ratios that are calculated for measuring the efficiency of operations of business based on effective utilisation of resources. Hence, these are also known as 'Efficiency Ratios'.

4. Profitability Ratios: It refers to the analysis of profits in relation to revenue from operations or funds (or assets) employed in the business and the ratios calculated to meet this objective are known as 'Profitability Ratios

1. LIQUIDITY RATIOS: These Ratios helps to find out the ability of the business concern to pay the short term liability of its liquidity. Any adverse position in liquidity leads to sudden fall of the unit.

i) Current Ratio: Current Ratio denotes the capacity of the business concern to meet its current obligation out of the total value of the Current Assets. Current Ratio = Current Assets / Current Liabilities. Term Loan installments falling due for payment in next 12 months are to be taken as Term Liability for the purpose of calculation of Current Ratio /MPBF. Inter-corporate deposits are to be treated as Non-Current Assets. Ideal Current Ratio is 2:1. Acceptable Ratio as per our Loan Policy guidelines is 1.33:1 for the limits enjoying above `6.00 crores and 1.15:1 for the business concerns availing limits of below `6.00 crores. Any deviation below the required ratio requires ratification of Higher Authority.

ii) Quick Ratio Or Acid Test Ratio: This ratio is a comparison of Quick Assets to Current Liabilities. Quick Assets mean the assets which have instant liquidity of the business concern. Though the Inventory and Prepaid expenses are part of Current Assets, it may be difficult to sell and realize the inventory. Hence, Inventory and

Prepaid expenses are to be excluded for arriving the Quick Asset Ratio.
Current Assets – (Inventory+Prepaid Exp) Quick
Ratio or Acid Test Ratio = ---
Current Liabilities
Ideal Quick Ratio is 1:1. Current Ratio is always to be read along with Quick Ratio. A fall in the Quick Ratio in comparison to the Current Ratio indicates high inventory holdings.
2. LEVERAGE AND SOLVENCY RATIOS: These Ratios helps to find out the Long Term Financial stability of the business concern
i)Debt Equity Ratio: Long Term Debt / Equity – Here, Equity refers Tangible Net worth. The Ideal ratio is 2:1 and the higher may also be considered as safe.
ii) Debt Service Coverage Ratio: It helps to know the capacity of the firm to repay the Long Term Loan Instalment and Interest. Ideal DSCR is 2:1. The higher the DSCR, we may fix the lower repayment period. However, banks may also

consider DSCR 1.20:1 where fixed income generation is assured, such as Rent Receivables etc.
Net Profit After Tax + Depreciation +Int. on TL
DSCR = --
Int. on TL + Instalment on TL
iii) Fixed Assets Coverage Ratio (FACR): This ratio indicates the extent of Fixed assets met out of long term borrowed funds. Ideal Ratio is 2:1
Net Block
FACR = --------------------------- (Net Block means Total Assets– Depreciation)
Long Term Debt
iv) Interest Coverage Ratio:
EBIDT
Interest Coverage Ratio = ---------------
Interest
Where EBIDT is Earning Before Interest, Depreciation and Tax. This ratio indicates the interest servicing capacity of the unit. Higher the ratio has probability of nonservicing of interest and hence avoidance of slippage of asset.
3. ACTIVITY RATIOS:
i) Inventory Turnover Ratio: Inventory constitutes raw material, work in process, finished goods etc. The ratio is arrived by dividing Inventory by average monthly Net sales to arrive at inventory levels in number of months. Lower the ratio, the faster the movement of inventories and Higher the ratio slower the movement of inventories. It also indicates the time taken to replenish the inventories. Separate parameters are laid down for fabrication units & seasonal industries (maintaining peak level inventories as at March) where operating cycle is longer compared to other businesses and others.
Inventory x (RM+WIP+FG) x 12 (OR) Cost of Goods Sold
Net Sales = Average Stock ((Opening Stock+Closing stock)/2)
ii) Debtors Velocity Ratio: Debtors
------------ x period
Credit sales
Lower the collection period indicates efficiency in realization of receivables and viceversa.
iii) Creditors Velocity Ratio: Trade Creditors
---------------------- x period
Credit Purchase
Higher velocity denotes that the company is enjoying credit from its suppliers and it has bearing on Maximum Permissible Bank Finance (MPBF)

iv) Assets Turnover Ratio:
Net Sales
ASSET TURNOVER RATIO=-----------------------------
Total Operating Assets
Total Operating Assets= Total Assets – Intangible Assets. Higher the ratio indicates favorable situation of optimum utilization of all the fixed assets.

4. PROFITABILITY RATIOS:

i) Gross Profit Ratio -> Gross Profit/Net Sales*100 – Gross Profit Ratio indicates the manufacturing efficiency and Pricing policy of the concern. Higher percentage indicates higher sales volume, better pricing of the product or lesser cost of production

ii) Net Profit Ratio: Net Profit After Tax
----------------------------------- X 100
Net Sales
A decline trend is a pointer to some unhealthy development unless the company had made usurious profits in the past and has consciously decided to reduce its profits by lowering the prices of its product.

iii) Return on Equity: Net Profit After Tax
----------------------------------- X 100
Tangible Networth

Working Capital Assessment

i) Turnover Method: (for WC limits up to & inclusive of `6.00 Crore)
A. Accepted Projected Sales Turnover
B. 25% of Sales Turnover
C. Margin @ 5 % of Sales Turnover
D. Actual NWC available as per latest Audited Balance Sheet
E. B-C
F. B-D
G. M.P.B.F = E or F, whichever is less.

ii) Inventory Method – For WC limits up to & inclusive of `6.00 Crore
A. Total Current Assets
B. Current Liabilities (other than Bank Borrowings)
C. Working Capital Gap = A – B
D. Margin @ 13% of Projected Current Assets
E. Actual NWC available as per latest Audited Balance Sheet
F. C-D
G. C-E
H. M.P.B.F = F or G, whichever is less.

_ Maximum Working Capital credit limit up to which Turn Over method can be extended is `6 Crores. Where the limits of above `6.00 Crore, the margin is to be taken as 25% projected current assets. If actual NWC is less than required margin, the borrower has to bring in the short fall.
_ The minimum acceptable Current Ratio for working capital credit facility up to `6 crore & above `6 crore is 1.15 & 1.33 respectively.
_ Maximum acceptable level of Total Debt- Equity Ratio is 4.
_ Maximum permissible Gearing Ratio while assessing the eligibility for nonfunded limits is 10.
_ Standard average DSCR specified for all Term Loans is 1.50 to 2.00. However, in case of assured source of income, it can be taken as 1.20. Lower DSCR can be accepted for Rural Godowns.

Terms used in Financial statement analysis

1	Net Sales	Gross Sales minus returns, discounts, excise duty.
2	Raw Materials consumed	Opening Stock of raw materials plus purchases of raw materials less Dosing stock of raw material .
3	Cost of Production	Raw materials consumed, stores and spares consumed, power and fuel, direct labour, repairs and maintenance, other manufacturing expenses and depredation plus opening stock of stock in process minus dosing stock of stock in process.
4	Cost of Sales	Cost of production (3) plus opening stock of finished goods minus dosing stock of finished goods.
5	Gross Profit	Net Sales - Cost of Sales (Item 1 minus Item 1)
6	Operating Profit	Gross Profit (5) minus interest, selling general and administrative expenses.
7	Net Profit before tax	Operating profit plus other incomes minus other expenses
8	Net Profit after tax	Profit before taxation minus provision for taxes.
9	Retained Profit	Net profit minus dividend paid / dedared
10	Cash Profit	Profit before charging Depreciation (Net Profit + Depredation)
11	Cash-Loss	Loss before charging Depredation (Net Loss — Depredation)
12	Assets	Things owned by a business Not converted into cash in normal course of business, These are acquired to use them in the production of other goods and services.
13	Fixed Assets	
14	Current Assets	Assets which are meant to be converted into cash or consumed in normal course of business say within 1 year. These are also called as gross working capital.
15	Intangible Assets	Expenditure on invisible assets, likely to yield benefit to the company in future e.g. goodwill, patent, trade marks, designs.
16	Fictitious Assets	Which have notional value only e.g. losses, preliminary expenses.
17	Miscellaneous Assets or Non current assets	Which can't be classified as current, fixed or intangible e.g. inter Corporate investment
18	Tangible Assets	Total asset side of balance sheet minus intangible assets.
19	Quick Assets	Assets which can be converted to cash quickly. Cash, bank balances, marketable investments, bills receivables and sundry debtors considered goal. (Current Assets minus-Inventories & Prepaid Expenses)
20	Liabilities	Things owed by the business.
21	Owners Equity (Net Worth)	Paid up share capital, reserves and surplus, preference shares with more than 12 years maturity.
22	Long term liabilities or Debt	Outsiders funds, payable in more than 12 months. Term loan (exduding instalment payable within 12 months) plus debentures maturing within more than one year, preference shares redeemable within 12years, deposits payable beyond one year.
23	Current Liabilities	Liabilities which are payable in less than one year e.g. sundry creditors, unsecured loans, advances from customers, interest accrued but not due, dividends payable, statutory liabilities, provisions, Bank borrowings for working capital etc
24	Total Outside Liabilities	Total of the liability side of balance sheet minus net worth
25	Tangible Net Worth	Total tangible assets minus total outside liabilities. Owner's funds minus Intangible & Fictitious assets ; Paid up capital plus reserves minus intangible assets
26	Gross Working Capital	Total of Current Assets
27	Net Working Capital	Current assets minus total current liabilities or Long Term Sources minus long term uses
28	Working Capital gap	Current Assets minus current liabilities other than Bank Borrowings.
29	Long term sources	Paid up capital, reserves and surplus (excluding specific reserves) i.e. Net Worth and long term liabilities.
30	Short Term Sources	Current Liabilities
31	Long Term Uses	Fixed Assets, Miscellaneous or Non. current assets, Intangible and Fictitious Assets (assets other than current assets)
32	Short Term Uses	Current Assets
33	Contingent Liabilities	Likely liability which may or may not arise on the happening or non happening of an event

(i) As per RBI guidelines installments of term loans due within 12 months are not to be treated as

Balance Sheet and Ratio Analysis

Balance sheet is a statement which depicts financial position of a unit as on particular date. Assets and Liabilities are placed in the balance sheet as under:

Balance Sheet of M/s_________ as on ______________

Liabilities	Amount	Assets	Amount
Capital and Reserves		Fixed Assets	
Opening Capital + Fresh Capital		Land & Building	
+Interest on Capital		Machinery	
+Profit during the year		Furniture	
(-)Drawings		Vehicles	
(-)Interest on Drawings		Less Depreciation against each	
Closing Capital & Reserves		Total Fixed Assets	
Long Term Liabilities:		Non-Current Assets	
Secured Loans		Investments	
Unsecured Loans		Securities Etc.	
Total Long term Liabilities		Total Non-Current Assts	
Current Liabilities		Current Assets	
Creditors and Bills Payable		Cash and Bank Balance	
Expenses Outstanding		Debtors and Bills Receivable	
Income Received in Advance		Closing Stock	
Advances from Customers		Prepaid Expenses	
Provisions against Liabilities		Accrued Income	
Short term bank borrowings like		Advances to suppliers	
CC and OD limit		Etc.	
Total Current Liabilities		Total Current Assets	
		Intangible Assets	
		Goodwill, Patents, Trade Mak	
		Preliminary or Pre-operative Exp	
		Deferred Revenue Expenditure	
		Debit Balance of P&L account	
		Total Intangible Assets	
TOTAL		TOTAL	

Net Worth = Capital + Reserves + Surplus
Tangible Net Worth (TNW) = Net Worth – Intangible Assets

Long Term Sources = Net Worth + Long Term Liabilities
Long Term Uses = Fixed Assets + Non-Current Assets + Intangible Assets

NWC (Net Working Capital)
There are two methods to calculate NWC
Ist Method = Current Assets – Current Liabilities
2nd Method = Long term sources- Long term Uses

Capital Employed (Total Investment) = TNW + Long term Liabilities

Liabilities

Net worth/Equity Funds brought in by the promoters as their investment in business or generated by and retained in business
Share capital/partner's capital/ Paid up equity share capital,/owners funds
Reserves & Surplus e.g. General Reserve, Capital Reserve, Revaluation Reserve and Other Reserves),Retained Earnings
Undistributed Profits,Preference share capital (not redeemable within 12 years

Long term liabilities:
Liabilities which are not due for payment within 12 months from the date of the Balance Sheet)
Term loans from financial institutions;
Term loan from banks; Debentures/Bonds;
Deferred payment liability;Preference Shares redeemable within 12 years;
Fixed Deposits maturing after one year;
Provision for gratuity; Unsecured Loans

Short term for CurrentyLiabilities Liabilities which are due for payment within 12 months from the date of the balance sheet and are to be repaid out of proceeds of current assets,Short term borrowings from banks (C/C, 0/D or B/P, B/D limits) for working capital.,Sundry/trade creditors/creditors/ Account payable,Bills Payable / trade acceptances
Fixed Deposits from public payable within one year,Short duration loans or deposits
Provision for taxation, Proposed Dividends, Provision for bonus, unclaimed dividend.
Deposits from dealers, selling agents etc.
Advance payments from customers, outstanding expenses and Accruals e.g. wages

Assets

Fixed Assets :Assets which are purchased for long term and not meant to be sold but used for production.
Land & Building,Plant & Machinery
Vehicles,Furniture & Fixture
Office equipment,Capital Work in Progress These are represented as under:
Original value (Gross Bock) Less depreciation

Net Block or book value or written down
Value Method

Non Current Assets:
Assets which cannot be classified as current or fixed or intangible assets Book Debts or Sundry Debtors more than 6 months old/ Disputed Debts, Investment of long term nature in shares, govt. securities, associates or sister firms or companies. Long term security deposits. Unquoted investments; Investments in subsidiaries or sister concerns; Loans & Advances to directors, officers; Accounts receivables in respect of sale of plant & machinery; Advances to concerns in which directors are interested; Deposits with customs port trust etc Intangible & fictitious Assets Which do not have physical existence. For example: Goodwill, Patents, Trade Mark, Copy Right, Preliminary or pre operative expenses, other formation expenses, debit balance of P & L account, accumulated losses, bad debts, Capital issue expenses e.g. discount on issue of share & debentures, commission on underwriting of shares & debentures; Deferred revenue expenditure e.g. Advertisement

Current Assets : Cash in hand, Bank balance including fixed ,deposits with banks. Stocks/inventory (such as raw material, stock in process, finished goods, consumable stores and spares),Book debts/Sundry debtors/Bills Receivable/ Accounts receivable/ debtors, Government and other trustee securities
(other than for long term purposes e.g. sinking funds, gratuity funds etc.),Readily Marketable/quoted govt. or other securities meant for sale,Interest accrued and receivables,Advance payment of taxes, pre-paid expenses,Advance payments for merchandise; unexpired insurance

Balance Sheet can be analysed by calculating various ratios which are as under:

Liquidity Ratios

1. Current Ratio (Benchmark 1.33 : 1)

The ratio is worked out by dividing the Current Assets with Current Liabilities.

$$\frac{\textbf{Current Assets}}{\textbf{Current Liabilities}}$$

Current Assets	Cash and Bank balances + Receivables (Debtors + B/R) + Inventories (Closing Stock) + Advance payment of taxes + Prepaid expenses + Advances for purchases (excluding advances for purchase of fixed assets) + Accrued Income +Govt. Securities (Tradable) Following are not to be included in Current Assets • Debtors more than 6 M • Dead Inventory or Obsolete Stock
Current Liabilities	Trade Creditors + Bills Payable + Outstanding Expenses + Income Received in Advance + Advances from Customers + Statutory Liabilities + Provisions + CC and OD account balance with bank + Bills Discounted

2. Quick Ratio or Acid Test Ratio (Benchmark 1 : 1)

$$\frac{\textbf{Quick Assets}}{\textbf{Current Liabilities}}$$

Quick assets= Current assets – stock – prepaid expenses
Current Liabilities are same as in Current Ratio

Solvency ratios

3. Debt Equity Ratio (Benchmark 2 : 1)

It is a relation between Long term Funds raised and Tangible Net Worth. The ratio is as under:

$$\frac{\textbf{Long term Liabilities}}{\textbf{Tangible Net Worth (TNW)}}$$

Tangible net worth (TNW)	Capital + Reserves + Surpluses - Intangible Assets (goodwill, patents, preliminary expenses, discount on issue of shares, Deferred revenue

	expenditure and Profit & Loss A/C debit balance)

4. Fixed Asset Ratio

Fixed assets/ Long Term Funds

5. DCSR (Debt Service Coverage Ratio)

The profit before depreciation and interest is divided with instalments due during the year plus interest on term loan.

$$\frac{\text{Cash Profit (Profit + Depreciation) + Interest on Long term debts}}{\text{Interest on Long Term Debts + Instalments}}$$

PBDIA = Profit after Tax + Depreciation + Salary to partners +Interest on capital to Partners + Interest on long term debts + Amortization + Extra ordinary expenses – Extra ordinary income.

6.TOL/TNW (Total Indebtedness Ratio) = TOL/TNW

TOL = Long term liabilities

TNW = Tangible Net worth

Turnover Ratios

1. **Stock Turnover ratio**

$$\frac{\text{Cost of goods sold or sales}}{\text{Average inventory}}$$

Cost of goods sold= Sale – GP

or Opening Stock + Purchases + Direct expenses – Closing Stock

The ratio can be calculated in days or months by dividing 12 / 365 by the ratio

2. **Debtor turnover ratio**

$$\frac{\text{Credit sales}}{\text{Average receivables}}$$

A. Receivables = Debtors + B/R

B. If credit sales are not given , total sales are presumed as credit sales

C. Average collection period in months is arrived at by dividing 12 by the ratio .

D. Average collection period= average receivables/ (credit sales X 12)

E. Average collection period= account receivables/ Average monthly or daily credit sales

3. **Creditor Turnover Ratio**

$$\frac{\textbf{Credit purchases}}{\textbf{Account payables}}$$

Account Payables= creditors + bills payable

4. **Total asset Turnover= Cost of goods sold/ Average total assets**

5. **Fixed asset turnover= Cost of goods sold / Average Fixed assets**

12. **Capital Turnover ratio= Cost of goods sold/ average capital employed**

Profitability Ratios

13 **GP Ratio= (GP/ Sales) X 100**

14. **NP Ratio= (NP/Sales) X100**

15. **Operating ratio= (Profit before interest and tax/ sales) X100**

16. **Return On Capital Employed**

$$\frac{\textbf{PBIT (Profit before Interest and Tax)}}{\textbf{Average capital employed}}$$

PBIT	Profit before Tax + Interest on long term debts + Intt. on capital to Partners + Salary to partners + Extra ordinary expenses – Extra ordinary income.
Capital employed	Tangible Net Worth + Total Long term Liabilities

Average capital employed = (Capital employed at the beginning of the year + capital employed at the end of the year) divided by 2.

17. **Return on shareholders' equity**

$$\frac{\textbf{NP after taxes}}{\textbf{Average shareholders' equity}}$$

18. **Earnings per share**

$$\frac{\text{NP after taxes and preference dividend}}{\text{No. of Equity shares}}$$

Notes:

1. Working capital or NWC= Current assets - Current liabilities
2. Gross working capital= Total Current assets
3. Working capital gap as per Tandon committee = Current assets- Other current liabilities(OCL)
4. OCL= Current liabilities excluding bank Overdraft and CC.

Additional Examples of Ratio Analysis

Example:1 Bank receives a Balance Sheet from a borrower as under:

Capital and Reserves	24 lac
Trade Creditors	12 lac
Bank CC	20 lac
Security for Electricity	4 lac
Stock	30 lac
Cash and Bank Balance	6 lac
Sales	120 lac
Term Loan	16 lac
Expenses payable	8 lac
Fixed Assets	24 lac
Preliminary Expenses	2 lac
Book Debts	14 lac
Net Profits	6 lac (Included in Capital and Reserves)

Current Ratio = 50/40 = 1.25 :1
Debt Equity Ratio =16/22 = .73:1

Quick Ratio= 20/40 = .50:1
Debtor Velocity =120/14=8.57
In period = 12/8.57= 1.4 M

Stock Turnover Ratio = 120/30 =4 times

Example:2

Bank receives a Balance Sheet from a borrower as under:

Partners' Capital	16 lac
Loan from NBFC	12 lac
Bank Limit	28 lac
Trade Creditors	7 lac
Land and Building	24 lac
Investment in NSC	8 lac
Stock	14 lac
General Reserves	4 lac
Loans from friends	6 lac

Bills Payable	5 lac
Provisions	2 lac
Vehicles	8 lac
Pre-operative expenses	2 lac
Consumable Stores	2 lac
Bills Receivable	8 lac
Cash in hand	4 lac
Purchases	160 lac
Sundry Debtors	10 lac
Sales	200 lac
Profits (included in reserves)	3 lac

Current Ratio =38/42= 090:1
Acid Test Ratio:=24/42= 057:1
Debt Equity Ratio =18/18= 1:1
Stock Turnover Ratio = 200/14=14.3 times
Creditor Velocity = 12/13.33=.9 months

Example:3 Bank receives a Balance Sheet from a borrower as under:

Capital and Reserves	50 lac
Bank CC	50 lac
Fixed Assets	70 lac
Cash and Bank Balance	20 lac
Book Debts	30 lac
Sales	300 lac
Bank TL	50 lac
Other Current Liabilities	50 lac
Preliminary Expenses	10 lac
Stocks	60 lac
Prepaid Expenses	10 lac
Profits	10 lac

Net Worth = 50 lac **TNW (Tangible Net Worth) = 50-10 =40 lac**

Current Ratio= 120/100 = 1.2:1 **Acid Test Ratio=50/100=.50:1**

Debt Equity Ratio= 50/40=1.25:1 **TOL/TNW (Total Indebtedness) = 150/40=3.75:1**

Q.1	Long term Uses of a firm are 40, total liabilities are 120. Its Current Ratio is 2:1. Find Current assets and Current Liabilities.
	Current Liabilities :40 Current assets: 80
Q. 2	If Current Ratio works out to 2:1 and NWC (Net Working Capital) is 50000. What will be current liabilities?
	50000/-
Q. 3	Total Assets are Rs. 20 lac, Long term Uses are Rs. 11.00 lac and Current Ratio is 1.5:1. What will be the amount of Current Liabilities?
	6 lac.
Q. 4	Balance sheet of firm reveals that Current assets are 300 lac, Long term sources are

	300 lac. Total of Balance sheet is 500 lac. What will be the amount of NWC and Current Ratio?
	100 lac and 1.5:1
Q. 5	Net Profit is 60, Depreciation is 40, Term Loan Interest is 20, Term Loan Balance is 300, Instalment is 40, Capital and Reserves are 150. Find out DSCR.
	2 or 200%
Q. 6	Find out Debt Equity Ratio in the above said example.
	2:1
Q. 7	A firm has 3 months Debt Collection Period. Its Sales are 180 lac. What will be the average Book Debts?
	Rs. 45 lac
Q.8	Net Working Capital is 8 lac and Current Ratio is 1.5:1. What will be the amount of Current assets
	24 lac
Q. 9	Net Profit = 15.00 lac (Profit After Interest and Tax) Interest = 2.00 lac Tax = 3.00 lac Capital and Reserves = 80 lac Pre-operative expenses = 10 lac Long term loans = 130 lac Find ROCE
	Find Tangible Net Worth TNW= 80-10 = 70 lac LTL= 130 lac Capital Employed = 70+130=200 lac PBIT (Profit Before Interest and Tax) = 15+2+3= 20 lac ROCE (Return on Capital Employed) = PBIT/Capital Employed=20/200*100=10%
Q. 10	Net Profit = 15 lac Depreciation = 1.00 lac Interest on Long term loans= 2.00 lac Instalment = 7.00 Lac Find our DSCR (Debt Service Coverage Ratio)
	DSCR= $\dfrac{\text{Cash Profit (Profit + Depreciation) + Interest on Long term debts}}{\text{Interest on Long Term Debts + Instalments}}$ $= \dfrac{(15+1+2)}{7+2} = \dfrac{18}{9} =$ 2 times or 200%

Notes:

1. Working capital or NWC= Current assets - Current liabilities
2. Gross working capital= Total Current assets

3. Working capital gap as per Tandon committee = Current assets- Other current liabilities(OCL)
4. OCL= Current liabilities excluding bank Overdraft and CC.
5. Nayak committee applicable on working capital limits (manufacturing up to 5 crore and trading up to 2 crore)

   Working capital requirement = 25% of Projected Annual Turnover

   Margin = 5% of Projected Annual Turnover

   Working capital limit= 20% of Projected Annual Turnover

Numericals:

Assets
Net Fixed Assets - 800
Inventories - 300
Preliminary Expenses - 100
Receivables - 150
Investment In Govt. Secu - 50
Total Assets - 1400
Liabilities
Equity Capital - 200
Preference Capital - 100
Term Loan - 600
Bank C/C - 400
Sundry Creditors - 100
Total Liabilities – 1400

1. Debt Equity Ratio = ?
a. 1:1
b. 1:2
c. 2:1
d. 2:3
Ans - c
Explanation :
600 / (200+100) = 2 : 1
2. Tangible Net Worth = ?
a. 100
b. 200
c. 300
d. 400
Ans - b
Explanation :
Only equity Capital i.e. = 200
3. Total Liabilities to Tangible Net Worth Ratio = ?
a. 7:2
b. 11:2
c. 13:2
d. 15:2
Ans - b
Explanation :
Total Outside Liabilities / Total Tangible Net Worth : (600+400+100) / 200 = 11 : 2
4. Current Ratio = ?
a. 1:1
b. 1:2
c. 2:1
d. 3:1
Ans - a

Explanation :
(300 + 150 + 50) / (400 + 100) = 1 : 1

Q.2
Assets
Net Fixed Assets - 265
Cash - 1
Receivables - 125
Stocks - 128
Prepaid Expenses - 1
Intangible Assets - 30
Total - 550
Liabilities
Capital + Reserves - 355
P & L Credit Balance - 7
Loan From S F C - 100
Bank Overdraft - 38
Creditors - 26
Provision of Tax - 9
Proposed Dividend - 15
Total - 550
1. Current Ratio = ?
= (1+125 +128+1) / (38+26+9+15)
= 255/88
= 2.89 : 1
2. Quick Ratio = ?
(125+1)/88
= 1.43 : 11
3. Debt Equity Ratio = ?
= LTL / Tangible NW
= 100 / (362 – 30)
= 100 / 332
= 0.30 : 1
4. Proprietary Ratio = ?
= (T NW / Tangible Assets) x 100
= [(362 - 30) / (550 – 30)] x 100
= (332 / 520) x 100
= 64%
5. Net Working Capital = ?
= CA - CL
= 255 - 88
= 167
6. If Net Sales is Rs.15 Lac, then What would be the Stock Turnover Ratio in Times ?
= Net Sales / Average Inventories/Stock
= 1500 / 128
= 12 times approximately
7. What is the Debtors Velocity Ratio if the sales are Rs. 15 Lac?

= (Average Debtors / Net Sales) x 12
= (125 / 1500) x 12
= 1 month
8. What is the Creditors Velocity Ratio if Purchases are Rs.10.5 Lac?
= (Average Creditors / Purchases) x 12
= (26 / 1050) x 12
= 0.3 months
…………………………………………

Q.3 Current Ratio of a firm is 1 : 1. What will be the Net Working Capital ?
a. 0
b. 1
c. 100
d. 200
Ans - a
Explanation :
It suggest that the Current Assets is equal to Current Liabilities hence the NWC would be 0
(since NWC = C.A - C.L)
....
Q.4 Suppose Current Ratio is 4 : 1. NWC is Rs.30,000/-. What is the amount of Current Assets ?
a. 10000
b. 30000
c. 40000
d. 50000
Ans - c
Explanation :
Let Current Liabilities = a
4a - 1a = 30,000
a = 10,000 i.e. Current Liabilities is Rs.10,000
Hence Current Assets would be
4a = 4 x 10,000 = Rs.40,000/-
....
Q.5 The amount of Term Loan installment is Rs.10000/ per month, monthly average interest on TL is Rs.5000/-. If the amount of Depreciation is Rs.30,000/- p.a. and PAT is Rs.2,70,000/-. What would be the DSCR ?
a. 1
b. 1.5
c. 2
d. 2.5
Ans - C
Explanation :
DSCR = (PAT + Depr + Annual Intt.) / Annual Intt + Annual Installment
= (270000 + 30000 + 60000) / 60000 + 12000
= 360000 / 180000
= 2
....
Q. 6 A Company has Net Worth of Rs.5 Lac, Term Liabilities of Rs.10 Lac. Fixed Assets worth RS.16 Lac and Current Assets are Rs.25 Lac. There is no intangible Assets or other Non Current Assets. Calculate its Net Working Capital.
a. 1 lac
b. 2 lac
c. - 1 lac

d. - 2 lac
Ans - c
Explanation :
Total Assets = 16 + 25 = Rs. 41 Lac

Total Liabilities = NW + LTL + CL = 5 + 10 + CL = 41 Lac
Current Liabilities = 41 – 15 = 26 Lac
Therefore Net Working Capital = CA – CL = 25 – 26 = (-) 1 Lac
…………………………………….
Q. 7 Merchandise costs - Rs. 250000, Gross Profit - Rs. 23000, Net Profit - Rs. 15000. Find the amount of sales.
a. 227000
b. 235000
c. 265000
d. 273000
Ans - d
Explanation :
Amount of sales = Merchandise costs + Gross Profit
= 250000 + 23000
= 273000
…………………………………….
Q.8 Total Liabilities of a firm is Rs.100 Lac and Current Ratio is 1.5 : 1. If Fixed Assets and Other Non Current Assets are to the tune of Rs. 70 Lac and Debt Equity Ratio being 3 : 1. What would be the Long Term Liabilities?
a. 40 Lacs
b. 60 Lacs
c. 80 Lacs
d. 100 Lacs
Ans - b
Explanation :
Total Assets = Total Liabilities = 100 Lac
Current Asset = Total Assets - Non Current Assets
= Rs. 100 L - Rs. 70 L
= Rs. 30 L
If the Current Ratio is 1.5 : 1
then Current Liabilities works out to be Rs. 20 Lac.
That means, Net Worth + Long Term Liabilities = Rs. 80 Lacs.
If the Debt Equity Ratio is 3 : 1,
then Debt works out to be Rs. 60 Lacs and equity Rs. 20 Lacs.
Therefore the Long Term Liabilities would be Rs.60 Lac.
…………………………………….
Q.9 Current Ratio = 1.2 : 1.
Total of balance sheet being Rs.22 Lac.
The amount of Fixed Assets + Non Current Assets is Rs. 10 Lac.
What would be the Current Liabilities?
a. 10 Lacs
b. b. 12 Lacs
c. 16 Lacs
d. 22 Lacs
Ans - a
Explanation :
Total Assets is Rs.22 Lac.
Fixed Assets + Non Current Assets is Rs. 10 Lac
Then Current Assets = 22 – 10 = Rs. 12 Lac.
Current Ratio = 1.2 : 1
Current Liabilities = Rs. 10 Lac
…………………………………….

Q.10 M/s Raj&co's balance sheet included the following accounts:
Cash: 10,000
Accounts Receivable: 5,000
Inventory: 5,000
Stock Investments: 1,000
Prepaid taxes: 500
Current Liabilities: 15,000
Find the Quick Ratio
Quick Ratio = Cash + Cash Equivalents + Short Term Investments + Marketable Securities + Accounts Receivable) / Current Liabilities
= (10000+5000+1000) / 15000
= 16000 / 15000
= 1.07
....
Q.11 M/s Raj&co's balance sheet included the following accounts:
Inventory : 5,000
Prepaid taxes : 500
Total Current Assets : 21,500
Current Liabilities : 15,000
Find the Quick Ratio
Quick Ratio = (Current assets – Inventory - Advances - Prepayments Current Liabilities) / Current Liabilities
= (21500 - 5000 - 500) / 15000
= 16000 / 15000
= 1.07
....
Q.12 XYZ Pvt Ltd has the following assets and liabilities as on 31st March 2015 (in Lakhs) :
Non Current Assets
Goodwill 75
Fixed Assets 75
Current Assets
Cash in hand 25
Cash in bank 50
Short term investments 45
Inventory 25
Receivable 100
Current Liabilities
Trade payables 100
Income tax payables 60
Non Current Liabilities
Bank Loan 50
Deferred tax payable 25
Find the Quick Ratio
Quick Ratio = (Cash in hand + Cash at Bank + Receivables + Marketable Securities) /

Current Liabilities
= (25+50+45+100) / 160
= 220 / 160
= 1.375
....

Q.14 GHI Ltd. manufacturers two products :Product G and Product H. The Variable cost of the manufacture is as follows:
Product G Product H
Direct Material 3 10
Direct Labour (Rs.6 per hour) 18 12
Variable Overhead 4 4
Product G sells for Rs.40 and Product H at Rs.30. During the month of January, the Company is having only 21000 of direct labour. The maximum production capacity of Product G is 5000 units and Product H is 10000 units.
From the above facts, answer the following:
I. The contribution from Product G and H together is-----
a) Rs.32
b) *Rs*.19
c) Rs.27
d) Rs.40
II. The contribution per labour hour from Product H is-----
e) Rs. 4
f) *Rs*. 2
g) Rs. 3
h) Rs. 5
III. The contribution per labour hour from Product G is-----
a) Rs.2
b) *Rs*.5
c) Rs.15
d) Rs.3

Q.15 Read the following and answer
Cost / unit
Raw material 50
Direct labour 20
Overheads 40
Total cost 110
No. of units 10,000
No. of units
Sold on credit 8000
Average raw material in stock : 1 month
Average work in progress : ½ month
Average finished goods in stock : ½ month
Credit by supplier : 1 month
Credit to debtor : 2 months
Take 1 year = 12 months
1) Investment of working capital in raw material inventory is
(a) 41666
(b) 50000
(c) 33333
(d) 10000
2) Investment in working capital for finished goods is
a) *45833*
b) 49090

c) 56453
d) 50000
3)current assets in respect of debtors
a) 174541
b) 146666
c) 152500
d) 154326

Q.16 A company with equity of Rs. 10 crore earns PBIDT of Rs. 40 crore. It incurs interest of Rs.5 crore, depreciation of Rs. 5 crore and pays tax of Rs. 10 crore. It has reserves of Rs. 30 crore (Excluding current years profits) and long term debt of Rs. 50 crore. It pays 100% dividend and transfers remaining profit to reserves. Its share of Rs. 10 face value is quoted at price of Rs. 200. Find the following :
(i) Book value of share after current year's profit transferred to reserves.
Book Value = Equity + Reserves + Current year's (PAT – Div)
= 10 + 30 + (20 – 10) = Rs..50
(ii) Earning per share
40 – (5+5+10)
EPS = PAT / Equity = ------------------ x 10
10
20
--- x 10 = Rs.20

23
10
(iii) Return on net worth
PAT x 100 20
40% Return on net worth = ------------ = ------- x 100 = 40%
NW 50
(iv) Debt-equity ratio
50
1:1 Debt equity ratio = ------ = 1:1
50
(v) P/E ratio
10 M.P. = EPs x PE
200 = 20 x PE
PE = 10
(vi) Payout ratio
50%
Dividend 10
----------- = ---- = 50%
PAT 20

Q.17 Following information is given by a company from its books of accounts as on

March 31, 2018:
Particulars Rs.
Inventory 1,00,000
Total Current Assets 1,60,000
Shareholders' funds 4,00,000
13% Debentures 3,00,000
Current liabilities 1,00,000
Net Profit Before Tax 3,51,000
Cost of revenue from operations 5,00,000
Calculate:
i) Current Ratio
ii) Liquid Ratio
iii) Debt Equity Ratio
iv) Interest Coverage Ratio
v) Inventory Turnover Ratio

Solution:
i) Current Ratio =
Current Assets
Current Liabilities
=
Rs. 1,60,000
Rs. 1,00,000
= 1.6

ii) Liquid Assets = Current assets – Inventory
= Rs. 1,60,000 – Rs. 1,00,000
= Rs. 60,000
Liquid Ratio =
Liquid Assets
Current Liabilities
=
Rs. 60,000
Rs. 1,00,000
= 0.6 : 1
iii) Debt-Equity Ratio =
Long-term Debts
Shareholders' Funds
=
Rs. 3,00,000

Rs. 4,00,000
= 0.75 : 1
iv) Net Profit before Interest = Net Profit before Tax + Interest on Long
& Tax term Debts
= Rs. 3,51,000 + (13% of Rs. 3,00,000)
= Rs. 3,51,000 + Rs. 39,000 = Rs. 3,90,000
Interest Coverage Ratio =
Net Profit before Interest & Tax
Interest on Long Term Debts
=
Rs. 3,90,000
Rs. 39,000
= 10 times
v) Inventory Turnover Ratio =
Cost of Revenue from Operations
Average Inventory
=
Rs. 5,00,000
Rs. 1,00,000
= 5 times

Q.18 Gross profit ratio of a company was 25%. Its credit revenue from operations was Rs. 20,00,000 and its cash revenue from operations was 10% of the total revenue from operations. If the indirect expenses of the company were Rs. 50,000, calculate its net profit ratio.

Solution:
Cash Revenue from Operations = Rs.20,00,000 × 10/90
= Rs.2,22,222
Hence, total Revenue from Operations are = Rs.22,22,222
Gross profit = 0.25 × 22,22,222 = Rs. 5,55,555
Net profit = Rs.5,55,555 – 50,000
= Rs.5,05,555
Net profit ratio = Net profit/Revenue from Operations
× 100
= Rs.5,05,555/Rs.22,22,222 × 100
= 22.75%.

Q.19 From the following details, calculate Return on Investment:

Share Capital : Equity (Rs.10) Rs. 4,00,000 Current Liabilities Rs. 1,00,000
12% Preference Rs. 1,00,000 Fixed Assets Rs. 9,50,000
General Reserve Rs. 1,84,000 Current Assets Rs. 2,34,000
10% Debentures Rs. 4,00,000

Also calculate Return on Shareholders' Funds, EPS, Book value per share
and P/E ratio if the market price of the share is Rs. 34 and the net profit after tax
was Rs. 1,50,000, and the tax had amounted to Rs. 50,000.

Solution:
Profit before interest and tax = Rs. 1,50,000 + Debenture interest + Tax
= Rs. 1,50,000 + Rs. 40,000 + Rs. 50,000
= Rs.2,40,000
Capital Employed = Equity Share Capital + Preference Share
Capital + Reserves + Debentures
= Rs. 4,00,000 + Rs. 1,00,000 + Rs. 1,84,000
+ Rs. 4,00,000 = Rs. 10,84,000
Return on Investment = Profit before Interest and Tax/
Capital Employed × 100
= Rs. 2,40,000/Rs. 10,84,000 × 100
= 22.14%
Shareholders' Fund = Equity Share Capital + Preference Share Capital
+ General Reserve
= Rs. 4,00,000 + Rs. 1,00,000 + Rs. 1,84,000
= Rs. 6,84,000
Return on Shareholders' Funds = Profit after tax/shareholders' Funds × 100
= Rs. 1,50,000/Rs. 6,84,000 × 100
= 21.93%
EPS = Profit available for Equity Shareholders/
Number of Equity Shares
= Rs. 1,38,000/ 40,000 = Rs. 3.45
Preference Share Dividend = Rate of Dividend × Prefence Share Capital
= 12% of Rs. 1,00,000
= Rs. 12,000
Profit available to equity = Profit after Tax – Preference dividend on
Shareholders preference shares

where, Dividend on Prefrence = Rate of Dividend × Preference Share Capital
shares = 12% of Rs. 1,00,000
= Rs.12,000
= Rs. 1,50,000 – Rs. 12,000 = Rs. 1,38,000
P/E Ratio = Market price of a share/ Earnings per share
= 34/3.45
= 9.86 Times
=
Rs. 4,00,000
Rs.10
= Rs. 40,000
Book Value per share = Equity Shareholders' fund/No. of
equity shares
where, Number of Equity Shares =
Equity share capital
Face value per share
Hence, Book value per share = Rs. 5,84,000/40,000 shares = Rs. 14.60

Some more problems for Practice::

Current Ratio of a firm is 1 : 1. What will be the Net Working Capital ?
a. 0
b. 1
c. 100
d. 200
Ans - a
Explanation :
It suggest that the Current Assets is equal to Current Liabilities hence the NWC would be 0
(since NWC = C.A - C.L)
....
Suppose Current Ratio is 4 : 1. NWC is Rs.30,000/-. What is the amount of Current Assets ?
a. 10000
b. 30000
c. 40000
d. 50000
Ans - c
Explanation :
Let Current Liabilities = a
4a - 1a = 30,000
a = 10,000 i.e. Current Liabilities is Rs.10,000
Hence Current Assets would be
4a = 4 x 10,000 = Rs.40,000/-
....
The amount of Term Loan installment is Rs.10000/ per month, monthly average interest on TL is Rs.5000/-. If the amount of Depreciation is Rs.30,000/- p.a. and PAT is Rs.2,70,000/-. What would be the DSCR ?
a. 1
b. 1.5
c. 2
d. 2.5
Ans - C
Explanation :
DSCR = (PAT + Depr + Annual Intt.) / Annual Intt + Annual Installment
= (270000 + 30000 + 60000) / 60000 + 120000
= 360000 / 180000
= 2
....
A Company has Net Worth of Rs.5 Lac, Term Liabilities of Rs.10 Lac. Fixed Assets worth RS.16 Lac and Current Assets are Rs.25 Lac. There is no intangible Assets or other Non Current Assets. Calculate its Net Working Capital.
a. 1 lac
b. 2 lac
c. - 1 lac
d. - 2 lac

Ans - c
Explanation :
Total Assets = 16 + 25 = Rs. 41 Lac
Total Liabilities = NW + LTL + CL = 5 + 10 + CL = 41 Lac
Current Liabilities = 41 – 15 = 26 Lac
Therefore Net Working Capital = CA – CL = 25 – 26 = (-) 1 Lac
....

Merchandise costs - Rs. 250000, Gross Profit - Rs. 23000, Net Profit - Rs. 15000. Find the amount of sales.
a. 227000
b. 235000
c. 265000
d. 273000
Ans - d
Explanation :
Amount of sales = Merchandise costs + Gross Profit
= 250000 + 23000
= 273000
....
Total Liabilities of a firm is Rs.100 Lac and Current Ratio is 1.5 : 1. If Fixed Assets and Other Non Current Assets are to the tune of Rs. 70 Lac and Debt Equity Ratio being 3 : 1. What would be the Long Term Liabilities?
a. 40 Lacs
b. 60 Lacs
c. 80 Lacs
d. 100 Lacs
Ans - b
Explanation :
Total Assets = Total Liabilities = 100 Lac
Current Asset = Total Assets - Non Current Assets
= Rs. 100 L - Rs. 70 L
= Rs. 30 L
If the Current Ratio is 1.5 : 1
then Current Liabilities works out to be Rs. 20 Lac.
That means, Net Worth + Long Term Liabilities = Rs. 80 Lacs.
If the Debt Equity Ratio is 3 : 1,
then Debt works out to be Rs. 60 Lacs and equity Rs. 20 Lacs.
Therefore the Long Term Liabilities would be Rs.60 Lac.
....
Current Ratio = 1.2 : 1.
Total of balance sheet being Rs.22 Lac.
The amount of Fixed Assets + Non Current Assets is Rs. 10 Lac.
What would be the Current Liabilities?
a. 10 Lacs
b.b. 12 Lacs
c. 16 Lacs
d. 22 Lacs
Ans - a
Explanation :
Total Assets is Rs.22 Lac.
Fixed Assets + Non Current Assets is Rs. 10 Lac
Then Current Assets = 22 – 10 = Rs. 12 Lac.
Current Ratio = 1.2 : 1
Current Liabilities = Rs. 10 Lac

....

A company has 1,00,000 of bank lines of credit and a 5,00,000 mortgage on its property. The shareholders of the company have invested 12,00,000. Calculate the debt to equity ratio.
DER = TL / Total Equity
= (100000+500000) / 1 200000
= 600000 / 1200000
= 0.5
....
A company has total assets at 1,50,000 and its total liabilities are 50,000. Based on the accounting equation, we can assume the total equity is 1,00,000. Find the Equity Ratio.
ER = Total Equity / TA
= 100000 / 150000
= 0.67
....
A company has total assets at 1,50,000 and its total liabilities are 50,000. Based on the accounting equation, we can assume the total equity is 1,00,000. Find the Debt Ratio.
DR = TL / TA
= 50000 / 150 000
= 0.33
....
A company has 1,00,000 of bank lines of credit and a 5,00,000 mortgage on its property. The shareholders of the company have invested 12,00,000. Calculate the debt to equity ratio.
a. 0.25
b. 0.5
c. 0.75
d. 1
Ans - b
Solution :
DER = TL / Total Equity
= (100000+500000) / 1 200000
= 600000 / 1200000
= 0.5
....
A company has total assets at 1,50,000 and its total liabilities are 50,000. Based on the accounting equation, we can assume the total equity is 1,00,000. Find the Equity Ratio.
a. 0.33
b. 0.5
c. 0.67
d. 0.75
Ans – c
Solution :
ER = Tota l Equity / TA
= 100000 / 150000
= 0.67
....
In balance sheet, amount of total assets is Rs 10 lac, current liabilities Rs 5 lac and capital and reserves Rs 2 lac. What is the debt-equity ratio?
a. 1:1
b. 1.5: 1

c. 1.75:1
d. 2:1
Ans - b
Let me Explain
As per Balance sheet rule Total assets = Total liabilities
Since total assets here is Rs 10 lac hence total liabilities must be 10 lac.
Now Long term debt = 10-(5+2) = 3 lac and capital + reserve(TNW i.e tangible net worth) = 2 lac
Since DER = TL/TNW or debt/equity or TL/equity hence 3/2 = 1.5 : 1
....
DER is 3:1, the amount of total assets Rs 20 lac, current ratio is 1.5:1 and owned funds Rs 3 lac. What is amount of current assets?
a. 3 lac
b. 5 lac
c. 12 lac
d. 15 lac
Ans - c
Let me Explain
Owned fund = equity = 3 lac
Since DER = 3:1
i.e Debt : equity = 3:1
Hence Debt = 9 lac
(if we consider debt and equity as long term liabilities then term liability works out to 12(9+3 lac)
Here total assets is 20 lac
Now as per balance sheet equation total Assets = total liabilities
Hence here total liabilities will also be 20 lac.
Now as the term liabilities is Rs 12 lac, curren t liabilities will be Rs 8 lac (20-12=8)
CR=1.5:1, so
1.5:1=CA:8
i.e CA= 1.5× 8=12 lac
....
In balance sheet, amount of total assets is Rs 20 lac, current liabilities Rs 5 lac and capital and reserves Rs 2 lac. What is the debt-equity ratio?
a. 1:1
b. 1.5: 1
c. 1.75:1
d. 2:1
Ans - d
Let me Explain
As per Balance sheet rule Total assets = Total liabilities
Since total assets here is Rs 20 lac hence total liabilities must be 20 lac.
Now Long term debt = 20-(5+5) = 10 lac and capital + reserve(TNW i.e tangible net worth) = 5 lac
Since DER = TL/TNW or debt/equity or TL/equity hence 10/5 = 2 : 1
....
DER is 2:1, the amount of total assets Rs 40 lac, current ratio is 1:1 and owned funds Rs 10 lac. What is amount of current assets?
a. 8 lac
b. 10 la c
c. 12 lac
d. 15 lac
Ans - b
Let me Explain
Owned fund = equity = 10 lac
Since DER = 2:1

i.e Debt : equity = 2:1
Hence Debt = 20 lac
(if we consider debt a nd equity as long term liabilities then term liability works out to 30 (20+10 lac)
Here total assets is 40 lac
Now as per balance sheet equation total Assets = total liabilities
Hence here total liabilities will also be 40 lac.
Now as the term liabilities is Rs 30 lac, curren t liabilities will be Rs 10 lac (40-30=10)
CR=1:1, so
1:1=CA:10

i.e CA= 1× 10=10 lac

The amount of term loan installment is Rs 10000/- per month, monthly average interest on TL is Rs 5000/-. If the amount of depreciation is Rs 30000/- p.a and PAT is Rs 270000/-. What would be the DSCR?
a. 1.75
b. 2
c. 1. 65
d. 1.33
Ans - b
Let me Explain
Since DSCR = (interest + PAT + Depriciation) / (interest + instalment of TL)
Hence (5000×12 + 270000 + 30000)/(5000×12 + 10000×12)
i.e 360000/18000
i.e 2
....
The amount of term loan instalment is Rs 15000/- per month, Monthly average interest on TL is Rs 10000/-. If the amount of depreciation is Rs 30000/- p.a and PAT is Rs 300000/-. What would be the DSCR?
a. 1
b. 1 .5
c. 2
d. 2 .5
Ans - c
Let me Explain
Since DSCR = (interest + PAT + Depriciation) / (interest + instalment of TL)
= (10000×12 + 300000 + 30000)/(10000×12 + 15000×12)
= (120000 + 330000) / (120000 + 180000)
= 450000/300000
= 1.5
....
The amount of term loan installment is Rs 15000/- per month, monthly average interest on TL is Rs 7500/-. If the amount of depreciation is Rs 100000/- p.a and PAT is Rs 350000/-. What would be the DSCR?
a. 1.75
b. 2
c. 1. 65
d. 1.33
Ans - b
Let me Explain
Since DSCR = (interest + PAT + Depriciation) / (interest + instalment of TL)
DSCR = (7500×12 + 350000 + 100000)/(7500×12 + 15000×12)

= (90000 + 350000 + 100000) / (90000 + 180000)
= 540000 / 270000
= 2

……

BREAK EVEN ANALYSIS

Profit

Business organisations have profit as their primary goal and various management decisions (such as product pricing, production levels, expansion, diversification, etc.) are aimed at subserving this goal.

Profit, simplistically stated, is the difference between sales realisations and the costs incurred. The profit and loss statements of organisations give details of sales

realisations as well as costs.
In other words, one could say, Profit = Sales - Costs
Profit could, therefore, be increased by increasing sales and by taking steps to see that costs do not increase, at least correspondingly.

Profit and Loss Account:
Profit, however, is not directly related to the level of activity or volume of sales of an organisation. Stated differently, profit does not necessarily increase or decrease directly in proportion to the volume of sales. This is because costs consist of various components, all of which do not vary proportionately with sales. There are some components of costs, which vary proportionately, but there are others, which are not dependent on the volume.

Types of costs
Broadly speaking, costs could be divided into two categories -fixed costs arid variable costs.
Fixed Costs
Fixed Costs are those costs which tend to remain the same irrespective of the volume of output. In other words, they do not vary when output changes. Factory rent, Managing Director's salary etc. are all examples of Fixed Costs.
Fixed Costs are, however, not truly fixed at all times but only over a comparatively shorter time period e.g. a quarter or even over a year. Over a very long period, fixed costs may undergo some changes.
Similarly fixed costs remain the same within a well defined range of output, but once a new range is reached the costs change. For example one foreman may be adequate for one shift, but once the organisation decides to operate two shifts, one more foreman may have to be employed and the fixed costs, representing the salary of foremen, would double. Fixed costs are, therefore, referred to as "stepped costs" also in such cases.
Variable casts
40.1 Variable costs are those costs which do vary in relation to the output. As a result, when output increases, variable costs go up proportionately. Raw materials consumed, stores and spares consumed etc., are examples of variable costs.
Semi-variable Casts:
There are some costs which are called semi-variable costs or semi-fixed costs. These are hybrid costs made up of a fixed element and a fully variable element. There is a tendency for the costs to vary with output, but the variation is irregular.
If costs could be segregated into fixed and variable costs, it becomes easier to study the behaviour of profit in relation to volume. For a very broad understanding and use of contribution analysis, one could divide all costs into two categories only viz, fixed costs and variable costs. In other words, semi-fixed/semi variable costs could be treated as fixed. If such broad analysis should indicate the need for deeper probe into the profitplans, an in-depth study could be made by breaking up such semi-fixed/semi-variable costs into fixed and variable components.
Contribution
The difference between the sales price and the variable costs is called Contribution. The "contribution" is the term used to describe this relationship between variable costs and selling price.
Contribution = Sales - Variable Costs
In view of the fact that variable costs by definition are directly related to sales, the contribution will increase when sales increase and contribution will go down, when sales go down. The two important features of contribution are:
a) Contribution increases directly in proportion to the volume i.e., there is a linear relationship between the two and
b) if nothing is produced and sold, the variable cost is nil and the loss incurred is

equal to fixed costs.

Importance of contribution in profit planning:

As stated earlier,

Profit = Sales - Costs

In view of the fact that we have now been able to identify that costs consist of two components viz., fixed and variable, the above statement could be restated as under:

Profit = Sales - (Variable Costs + Fixed Costs)

or Profit =(Sales - Variable Costs)- Fixed Costs Where,

sales – variable costs = contribution.

or Profit = Contribution - Fixed Costs

In view of the fact that contribution increases directly in relation to sales and as fixed costs by definition remain the same, profit could be maximised by increasing contribution. In other words, organisations should have maximisation of contribution as one of their major goals and various management decisions must subserve this goal.

Profit Volume Ratio

The ratio of contribution to sales turnover is called profit volume ratio (or P/ V ratio). The P/ V ratio is a measure of the rate of contribution made by each rupee of sale out of which fixed expenses must be met.

The profit volume ratio thus becomes an important factor in taking various management decisions. If there are two alternatives open to the management as a result of which two profit/volume ratios would emerge, the management would prima facie choose the alternative which gives a higher profit volume ratio.

Break-Even Analysis: Problem with Solution # 1.

From the following particulars, calculate:

(i) Break-even point in terms of sales value and in units.

(ii) Number of units that must be sold to earn a profit of Rs. 90,000.

	₹
Fixed Factory Overheads Cost	60,000
Fixed Selling Overheads Cost	12,000
Variable Manufacturing Cost per unit	12
Variable Selling Cost per unit	3
Selling Price per unit	24

Solution:

(i) ***Break–even point*** $= \dfrac{\text{Fixed Cost}}{\text{Selling Price per unit} - \text{Variable Cost per unit}}$

Variable Cost per unit $= ₹\ 12 + 3 = ₹\ 15$

Total Fixed Cost $= ₹\ 60{,}000 + 12{,}000 = ₹\ 72{,}000$

B.E.P. $= \dfrac{72{,}000}{24-15} = 8{,}000$ units

B.E.P. (in sales values) $= 8{,}000 \times 24 = ₹\ 1{,}92{,}000$

(ii) ***Number of units that must be sold to earn profit of ₹90,000***

$$= \frac{\text{Fixed Cost} + \text{Profit}}{\text{Selling Price per unit} - \text{Variable Cost per unit}}$$

$$= \frac{72{,}000 + 90{,}000}{24-15} = \frac{1{,}62{,}000}{9} = 18{,}000 \text{ units.}$$

Break-Even Analysis: Problem with Solution # 2.

From the following data, you are required to calculate:

(a) P/V ratio

(b) Break-even sales with the help of P/V ratio.

(c) Sales required to earn a profit of Rs. 4,50,000

Fixed Expenses = Rs. 90,000

Variable Cost per unit:

Direct Material = Rs. 5

Direct Labour = Rs. 2

Direct Overheads = 100% of Direct Labour

Selling Price per unit = Rs. 12.

Solution:

Break-Even Analysis: Problem with Solution # 3.

From the following data, you are required to calculate break-even point and net sales value at this point:

	₹
Direct material cost per unit	10
Direct labour cost per unit	5
Fixed overhead	50,000
Variable overheads @ 60% on direct labour	
Selling price per unit	25
Trade discount	4%

If sales are 10% and 25% above the break even volume, determine the net profits.

Solution:

		₹
Selling price per unit		25
Less : Trade discount ($25 \times 4/100$)		1
Net selling price per unit		24
Less : Variable cost per unit	₹	
Direct material	10	
Direct labour	5	
Variable overheads ($5 \times 60/100$)	3	18
Contribution per unit		6

$$\textbf{Break-even point (in units)} = \frac{\text{Fixed Cost}}{\text{Contribution Per Unit}}$$

$$= \frac{50{,}000}{6} = 8{,}333 \text{ units}$$

$$\textbf{Break - even Point} \text{ (in sales value)} = \frac{\text{Fixed Cost}}{\text{P/V Ratio}}$$

$$\text{P/V Ratio} = \frac{\text{Contribution}}{\text{Sales}} \times 100$$

$$= \frac{6}{24} \times 100 = 25\%$$

$$\text{Hence, B.E.P. (in sales value)} = \frac{50{,}000}{25\%} = 50{,}000 \times \frac{100}{25}$$

$$= ₹\ 2{,}00{,}000$$

Profit when sales are 10% above the break even volume

Sales = 2,00,000 + 10% of 2,00,000 = ₹ 2,20,000

Contribution = Sales × P/V Ratio = 2,20,000 × 25/100 = ₹ 55, 000

Contribution = Fixed Cost + Profit

₹ 55,000 = 50,000 + Profit

Profit = **₹ 5,000**

Profit when sales are 25% above the break even volume

Sales = 2,00,000 + 25% of 2,00,000 = ₹ 2,50,000

Contribution = 2,50,000 × 25/100 = ₹ 62,500,

Contribution = Fixed Cost + Profit

62,500 = 50,000 + Profit

Profit = **₹ 12,500**

Break-Even Analysis: Problem with Solution # 4.

From the following particulars, find out the break-even-point:

	₹
Variable Cost per unit	15
Fixed Expenses	54,000
Selling Price per unit	20

What should be the selling price per unit, if the break-even point should be brought down to 6,000 units?

Solution:

Contribution per unit $= \text{Selling Price} - \text{Variable cost per unit}$

$= ₹\ 20 - 15 = ₹\ 5$

(a) ***B.E.P.***

$$= \frac{\text{Fixed Expenses}}{\text{Contribution per unit}}$$

$$= \frac{54,000}{5} = 10,800 \text{ units}$$

(b) ***What should be the selling price per unit, if the break–even–point should be brought down to 6000 units:***

$$\text{B.E.P.} = \frac{\text{Fixed Expenses}}{\text{Contribution per unit}}$$

Or, $$6,000 = \frac{54,000}{\text{Contribution per unit}}$$

Or, Contribution per unit $$= \frac{54,000}{6,000} = \text{Rs. } 9$$

Contribution $= \text{S.P.} - \text{V.C.}$

Or, $9 = \text{SP} - 15$

Or, Selling Price $= ₹\ 24.$

Break-Even Analysis: Problem with Solution # 5.

The fixed costs amount to Rs. 50,000 and the percentage of variable costs to sales is given to be 66 ⅔%.

If 100% capacity sales are Rs. 3,00,000, find out the break-even point and the percentage sales when it occurred.

Determine profit at 80% capacity:

Solution:

Percentage of Variable Cost to Sales is $66\frac{2}{3}\%$ i.e., $\frac{200}{3}$

$\therefore$ Percentage of Contribution to Sales is $100-\frac{200}{3}=\frac{100}{3}$

$$\text{P/V ratio} = \frac{\text{Contribution}}{\text{Sales}} \times 100$$

$$= \frac{100}{3} \times \frac{1}{100} \times 100 = \frac{100}{3} = 33\frac{1}{3}\%$$

$$\text{Break–even Sales} = \frac{\text{Fixed Cost}}{\text{P/V Ratio}}$$

$$= \frac{50,000}{33\frac{1}{3}\%} = \frac{50,000}{100} \times 300 = \text{Rs. } 1,50,000.$$

100% Capacity Sales = ₹ 3,00,000

Hence, B.E.P. occurs at $\frac{1,50,000}{3,00,000} \times 100 = 50\%$ capacity.

Profit at 80% Capacity

At 100% Capacity Sales are ₹ 3,00,000

$\therefore$ 80% Capacity Sales $3,00,000 \times \frac{80}{100} = \text{Rs. } 2,40,000$

Total Contribution at 80% capacity $= 2,40,000 \times \frac{100}{3} \times \frac{1}{100}$

= ₹ 80,000

Fixed Expenses = ₹ 50,000

Profit at 80% capacity = ₹ 30,000

Break-Even Analysis: Problem with Solution # 6.

From the following information, ascertain by how much the value of sales must be increased by the company to break-even:

	₹
Sales	3,00,000
Fixed Cost	1,50,000
Variable Cost	2,00,000

Solution:

$$\text{Break–even point} = \frac{\text{Fixed Cost} \times \text{Sales}}{\text{Sales– Variable Cost}}$$

$$= \frac{1,50,000 \times 3,00,000}{3,00,000 - 2,00,000}$$

$$= \frac{1,50,000 \times 3,00,000}{1,00,000} = \text{Rs. } 4,50,000.$$

Hence, Sales to be increased by the company to break-even are = ₹ 4,50,000 – 3,00,000 = ₹ 1,50,000.

Break-Even Analysis: Problem with Solution # 7.

Calculate:

(i) The amount of fixed expenses.

(ii) The number of units to break-even.

(iii) The number of units to earn a profit of Rs. 40,000.

The selling price per unit can be assumed at Rs. 100.

The company sold in two successive periods 7,000 units and 9,000 units and has incurred a loss of Rs. 10,000 and earned Rs. 10,000 as profit respectively.

Solution:

	Period I	*Period II*
Sales	₹ 7,00,000	₹ 9,00,000
Profit/Loss (—)	(—) ₹ 10,000	₹ 10,000

Thus for an additional sales of ₹ 2,00,000 there is an additional contribution of ₹ 20,000 which has wiped off the loss or ₹ 10,000 of period I and earned a profit of ₹ 10,000 in period II.

$$\text{P/V Ratio} = \frac{\text{Change in Contribution}}{\text{Change in Sales}} \times 100$$

$$= \frac{20,000}{2,00,000} \times 100 = 10\%$$

$$\text{Contribution of Period I} = 7,00,000 \times \frac{10}{100} = \text{Rs. } 70,000$$

Loss of period I (given) = ₹ 10,000

(i) Fixed Cost = ₹ 80,000

Contribution = Fixed Cost ± Profit/Loss

Fixed Cost = Contribution ± Loss/Profit

(ii) Break–Even Point

$$= \frac{\text{Fixed Cost}}{\text{P/V Ratio}}$$

$$= \frac{80,000}{\frac{10}{100}} = \frac{80,000 \times 100}{10} = \text{Rs. } 8,00,000$$

Number of units to break–even

$$= \frac{\text{Break– Even Sales}}{\text{Selling Price per unit}}$$

$$= \frac{8,00,000}{100} = 8,000 \text{ units.}$$

(iii) Number of units required to earn a profit of ₹40,000.

$$= \frac{\text{Fixed Cost} + \text{Desired Profit}}{\text{P/V Ratio}}$$

$$= \frac{80,000 + 40,000}{10\%}$$

$$= \frac{1,20,000 \times 100}{10} = \text{Rs. } 12,00,000$$

Break-Even Analysis: Problem with Solution # 8.

A company is making a loss of Rs. 40,000 and relevant information is as follows:

Sales Rs. 1,20,000; Variable Costs Rs. 60,000; Fixed costs Rs. 1,00,000.

Loss can be made good either by increasing the sales price or by increasing sales volume. What are Break even sales if

(a) Present sales level is maintained and the selling price is increased.

(b) If present selling price is maintained and the sales volume is increased. What would be sales if a profit of Rs. 1,00,000 is required ?

Solution:

(a) Break-even sales = Variable Cost + Fixed Cost = ₹ 60,000 + 1,00,000 = ₹ 1,60,000.

(b) Sales = ₹ 1,20,000

Variable cost = ₹ 60,000

∴ Contribution = ₹ 1,20,000 – 60,000 = ₹ 60,000

$$\text{P/V Ratio} = \frac{\text{Contribution}}{\text{Sales}} \times 100$$

$$= \frac{60,000}{1,20,000} \times 100 = 50\%$$

$$\text{Break–even sales} = \frac{\text{Fixed Costs}}{\text{P/V Ratio}}$$

$$= \frac{1,00,000}{50} \times 100 = \text{Rs. } 2,00,000$$

Desired sales to earn a profit of ₹ 1,00,000 :

$$\text{Desired Sales} = \frac{\text{Fixed Cost + Desired Profit}}{\text{P/V Ratio}}$$

$$= \frac{1,00,000 + 1,00,000}{50\%}$$

$$= \frac{2,00,000 \times 100}{50} = \text{Rs. } 4,00,000$$

CAPITAL BUDGETING

DISCOUNTED CASH FLOWTECHNIQUES

Financing fixed assets either by replacement of existing assets or addition of new assets forms part of any company's overall capital budget and this kind of budgeting is extremely difficult due to uncertainties of future economic conditions and need for ensuring reasonable return on the long term investment. The capital budgeting decisions are based on (a) conventionalmethod of (i) return on capital or investment and (ii) payback period and (b) discounted cash flowmethods of (i) net present value and (ii) internal rate of return.

CONVENTIONAL METHODS - RETURN ON CAPITAL OR INVESTMENT

This is calculated as a **percentage of operating profit on total investment** and is a crude method of estimating financial viability of the project and suffers from following:

a the percentage indicator will vary from year to year in view of the variations in operating profit. It may be difficult to identify one figure which correctly represents the return on the total capital employed.

b The term capital is vague and is subject to more than one interpretation. It is not clear whether the return should be calculated on the equity capital or total owned resources plus borrowed funds.

C it is not clear as to what should be operating period of the project on which the return on capital should be calculated. There is no basic assumption regarding the total economic life of the project in this technique.

d It ignores the time value of money concept. A rupee earned tomorrow is worth fess than a rupee in hand today. Earlier we get the return, it carries greater value to us.

CONVENTIONAL METHODS - PAYBACK METHOD ,

It is commonly usedmethod of investment appraisal in view of the simplemode of its calculation. The payback period represents the number of years it takes for the operating earnings froma project to recoup the total investment on the project and is computed taking into account:

Net investment / Profit before depreciation and tax = Payback period (years).

The method is useful both for firms with plenty of investment opportunities but limited financial resources and for those projects which have obsolescence risk i.e. larger wear and tear.

Themethod has following **limitations:**

a It can lead to incorrect ranking of industrial projects as the method ignores return of the project after the payback period.

b The method does not give us any objective cut-off criterion. What should be the minimum or maximum payback ?
c The projects which have low return initially but a longer economic life may be preferable to those projects which have high earning capacity initially but have shorter life span.
d Thismethod like return on investment ignores the time value of money.
eThis method attaches undue importance to the quick yield and gives the impression that the projects have little or no development significant. It is a not enough to recoup the investment. The principal concern of the investor is to optimise the return/benefits. In view of the aforesaid limitations, the payback method is better accepted as a secondary method of investment appraisal rather than the final criterion for investment.
The calculation is made from the year investment is made to the period when the capital has been recovered plus the project has yielded a minimum return on the investment. This can be examined in the light of the following:

examined in the light of the following:

Year	Cash flow	Present value of Re.1 at 11% cash flow	Discounted Cumulative present value
0	(2500)	1.000	(2500)
1	1000	0.901	(1599)
2	1000	0.812	(787)
3	1000	0.731	(56)
4	1000	0.659	603
The payback of 3.1 years in the above project = 3 + 56/659 = 3.085 (say 3.1 years)			

DISCOUNTED CASH FLOW METHODS
It is stated to be realistic and rationalmethod of investment appraisal and takes into account the actual timing of cash outgo and cash inflow. It is rational as it fulfills the needs ofmodern financialmanagement and economic analysis of projects. Any investment appraisal technique should serve the objective that it should help the analyst in ranking projects in order of preference and it should give a cut-off criterion which should be used to accept or reject the project. The DCF techniques canmeet these objectives.

The technique involves discounting cash flows at discount rate carefully selected taking into account the prevailing cost of credit or the return from competing projects within the frame-work of undernoted assumptions:
a DCF technique clearly recognises the time value of money. Both the compounding and discounting processesmay be used to express the time value of money. In compounding, the present sum grows as the interest at a given rate is added. Discounting is reverse of compounding. From a future value the present value is determined at a discount rate.
b DCF focus attention on cash receipts and expenditures as against profits after depreciation on accrual basis of receipts and expenses.
c it is assumed that all operating cash inflows or outflows are assumed to take place at the end of the year in question, for simplifying the calculations.

d The cost of capital, opportunity cost of capital or discount rate is selected by the management having regard to various relevant factors.
DCF criteria is based on total cash flow over the life of the project and as such it is independent of annual variations of cash flows.
The **important rules** regarding application of DCF techniques are as under:
a Higher the rate of discount applied in calculation, the less point there is in spreading the exercise over distant years. Thismay be 50%for 7-8 years, 20%for 16-17 years and 12%for 25-26 years.
b Higher returns in later years of project's life do not materially affect the DCF rate.What really matters is the cash flow during the early years. Or shorter the period during which positive returns are received, higher would be rate of return.
c Higher the rate of discount, the more important are the returns earned during the early years of an assets life.

Limitation of DCF

a The application of DCF technique has become primarily the function of the financemanager. Other departments of a project have little say in assumptions selected for DCF calculations. This adversely affects the reliability of the DCF criterion. An acceptable DCF rate of return is one which is the result of a compositemanagerial, economic and technical assessment of the project over a fairly long period. Such an integrated forecast is the dreamof every project analyst which is rarely realised.
b The external effects of the project such as pollution, noise congestion etc. are not ordinarily accounted for in DCF calculations for financial analysis. As a result, the economic cost-benefit analysis is necessary. The full utility of DCF therefore depends on the fact whether or not the exercise is comprehensive one including economic cost-benefit analysis, particularly in case of large and complex projects.
c Future being uncertain, no investment appraisal technique can accurately forecast the future viability of projects. Reliability of DCF, as such, is no better than other conventional methods.
d It is difficult to estimate the economic life of a project. Some assets depreciate faster than others. Some projects need major replacement or renovation within 4-5 years of their working. No general rule such as assumption of project life of 15 years in all cases, would yield a helpful solution.
e Irregular cash flows including a negative cash flow following some positive flows, pose a problem, which would yield more than one IRR.
f There is an unresolved controversy whether or not inflation should be taken into account while finalising cash outlays for DCF. it is claimed that inflation has come to stay and any financial forecasting which does not take into account the impact of inflation is by and large meaningless.
g It is difficult to forecast the future salvage/terminal value of assets. The current practice of valuing fixed assets only at 5% of their original value is somewhat arbitrary.
There are two principalmeasure of DCF, namely Net Present Value and Internal Rate of Return:

DISCOUNTED CASH FLOW (DCF) METHODS

DCF takes into account the actual timing of cash outgo and cash inflow. It is based on total cash flow over the life of the project. There are two principal measures of DCF, i.e. NPV & IRR.
Net present value (NPV) : NPV is the difference between cash outflows at base period and present value of future cash inflows. It helps the bank to ascertain, whether a oroject should be taken up for financing or not.

Year	Discount rate (DCF) 10%	Project A Cash inflow	NPV	Project B Cash inflow	NPV
0		(-)5000	-5000	(-) 5000	
5000					
1	0.91	1100	1000	1125	1024
2	0.83	1210	1000	1235	2025
3	0.75	1330	999	1355	1016
4	0.68	1460	997	1485	1010
5	0.62	1500	931	1525	945
Total		6600	4927	6725	5020
Net present value		4927 - 5000	= (-) 73	5020-5000	= 20

This is initial investment in the project is an outflow.
In project A while the cash outflow is 5000 (original investment), the future cash inflow is 6600 and its net present value at 10% discount rate is 4927. Hence the NPV is less than Zero (i.e. — 73). On the other hand, for project B, against cash outflow of 5000, the net present value of the inflow of 6725 is 5020 which is more than Zero. Hence, the project B can be taken up for financing.
If the above project had positive NPV and many other projects also had positive NPVs the choice would be limited by raising the discount rate and by selecting that project which has the highest present value relative to investment expenditure. For calculating NPV, we require a statement of cash outgoes and inflows, assumptions regarding total economic life of the project and a rate of discount. The selection of economic life and rate of discount can pose certain problems.
In the case of industrial projects, it is customary to assume a working life of 10-20 years depending upon the expected life of the equipment. The selection of rate of discount depends on a composite of factors such as:
a Weighted average of the borrowing rate for funds.
b The expected rate of return from the competing projects.
c The company's internal record of growth.
d An acceptable price earnings ratio for equity shares and
e The industrial growth rate assumption accepted by the government or planning authorities.

Internal rate of return (IRR)

IRR is the rate of discount at which the net present value is ZERO. In the following example it is 34.62%. At this discount rate the discounted value of the net cash flow from a project is equal to the amount which has been invested to obtain that net cash flow (in the following case, the investment is 1500. At 30% discount, the NPV of cash inflow is 1633 and at 35% it is — 11, but at 34.62%, it will be 1500, making the net value as Zero).
Illustration:
The exact IRR would be 34.62% which can be worked out as under, at which the net present value of the cash Inflow would be Zero which is (-) 11 at 35% and 133 at 30% discount rate.
(Lower discount rate + difference between two discount rates) X Net present value of the cash flow at lower discount rate / absolute difference between the NPV of cash flow stream at two discount rates.
= 30 + 5 (133/144) i.e. = 30 + 5 (.924) = 34.62%
Year Cash flow DCF-30% Discounted DCF-35% Discounted

0			Cash flow (-)1500	cash flow (-)1500
1	500	0.769	384	0.741 370
2	750	0.592	444	0.549 412
3	1000	0.455	455	0.406 406
4	1000	0.350	350	0.301 301
5	3250		1633	1489

Net position 1633-1500 = 133 1489-1500=(-)11This is initial investment. Hence an outflow.

MODULE - C : WORKING CAPITAL MANAGEMENT

Working Capital Assessment : Concept of Working Capital, Gross Working Capital, Net Working Capital, Working Capital Gap, Components of Working Capital, Source of Working Capital, Operating / Working Cycle, Computation of storage / Retention Period, Various Methods of Assessment of Working Capital, Computation of Working Capital - Turnover Method, MPBF Method, Cash Budget System, Illustrations, Impact of inadequate Working Capital, Working Capital Finance to IT. & Software Industry, Loan Delivery System, Cash Flow Analysis, Commercial Paper, Credit Delivery, Analysis of CMAdata.

Quasi Credit Facilities : Advantages of Non-Fund Facilities, Various types of NFB Facilities, Various types Letter of Credits, Assessment of LC limits, Bills Purchase / Discounting under LC.

Various types of Bank Guarantees : Performance Guarantee, Financial Guarantees, Deferred Payment Guarantees, Types of Performance and Financial Guarantees, Assessment of Bank Guarantees Limit, Period of Claim under Guarantee.

Co-acceptance Facilities : RBI Guidelines, Co-acceptance of Bills covering

WORKING CAPITAL

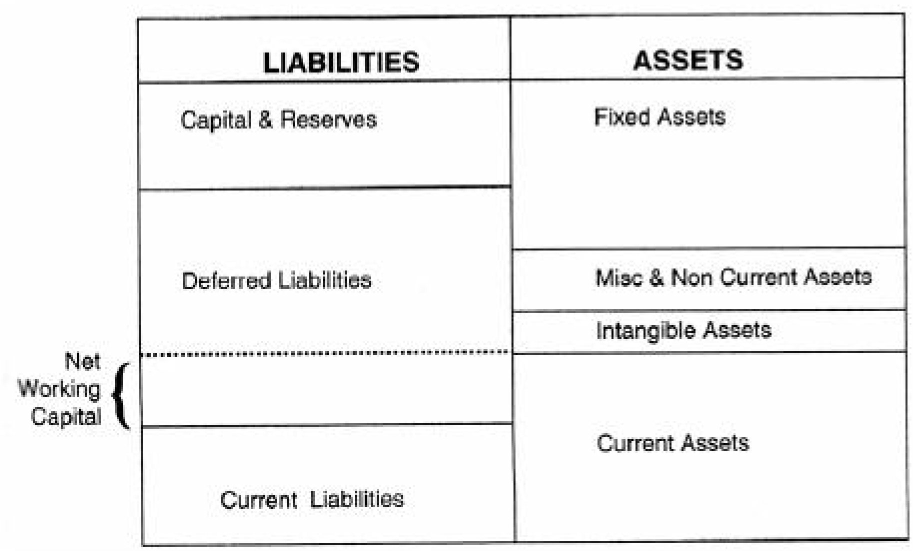
Working capital, also known as net working capital, is the difference between a company's current assets, like cash, accounts receivable (customers' unpaid bills) and inventories of raw materials and finished goods, and current liabilities, like accounts payable.

Working Capital = Current Assets - Current Liabilities

The objective of running any industry is earning profits. An industry will require funds to acquire "fixed assets" like land, building, plant, machinery, equipments, vehicles, tools etc., and also to run the business i.e. its day to day operations.
Funds required for day to-day working will be to finance production and sales. For production, funds are needed for purchase of raw materials/stores/fuel, for employment of labour, for power charges etc., for storing finished goods till they are sold out and for financing the sales by way of sundry debtors/ receivables.
Capital or funds required for an industry can therefore be bifurcated as fixed capital and working capital. Working capital in this context is the excess of current assets over current liabilities. Current assets are those assets that in the ordinary course of business will be converted into cash within a brief period (during the operating cycle of the industry and normally not exceeding one year) without undergoing diminution in value and without disrupting the operation. Current liabilities are those liabilities intended at their inception, to be paid in the ordinary course of business within a reasonably short time (normally within a year) out of the current assets or the income of the business. The above definition of working capital, however, takes into account only the funds available to the industry from long term sources like capital and long term borrowings, after meeting the expenses towards fixed and other non-current assets. It does not represent the total funds required

by the industry for working capital to sustain its level of operations.
The excess of current assets over current liabilities is treated as net working capital or liquid surplus and represents that portion of the working capital which has been provided

from the long term source. This can be explained by the following diagram.



Working Capital Assessment :
Concept of Working Capital: Working capital denotes the amount of funds needed for meeting day-to-day operations of a concern.
This is related to short-term assets and short-term sources of financing. Hence it deals with both, assets and liabilities
There are two concepts or senses used for working capital.
1. Gross Working Capital: The concept of gross working capital refers to the total value of current assets. In other words, gross working capital is the total amount available for financing of current assets. However, it does not reveal the true financial position of an enterprise. How? A borrowing will increase current assets and, thus, will increase gross working capital but, at the same time, it will increase current liabilities also.
As a result, the net working capital will remain the same. This concept is usually supported by the business community as it raises their assets (current) and is in their advantage to borrow the funds from external sources such as banks and the financial institutions.
In this sense, the working capital is a financial concept. As per this concept:
Gross Working Capital = Total Current Assets
2. Net working Capital: The net working capital is an accounting concept which represents the excess of current assets over current liabilities. Current assets consist of items such as cash, bank balance, stock, debtors, bills receivables, etc. and current liabilities include items such as bills payables, creditors, etc. Excess of current assets over current liabilities, thus, indicates the liquid position of an enterprise.
The ratio of 2:1 between current assets and current liabilities is considered as optimum

or sound. What this ratio implies is that the firm/ enterprise have sufficient liquidity to meet operating expenses and current liabilities. It is important to mention that net working capital will not increase with every increase in gross working capital. Importantly, net working capital will increase only when there is increase in current assets without corresponding increase in current liabilities.

Working Capital Gap :

Is defined as current assets minus current liabilities excluding bank borrowings. Current assets will be taken at estimated values or values as per the tendon committee norms, whichever is lower. Current assets will consist of inventory and receivables, referred as chargeable current assets (CCA) and other current assets (OCA).

Maximum permissible bank finance (MPBF) in view of the above approach to bank lending, the Tandon committee suggested the following three methods of determining the permissible level of bank borrowings:

1. First method:- in the first method, the borrower will contribute 25 per cent of the working capital gap; the remaining 75 per cent be financed from bank borrowings this method will give a minimum current ratio of
2. Second method:- in the second method, the borrower will contribute 25 per cent of the total current assets. The remaining of the working capital gap (the working capital gap less the borrower's contribution) can be bridged from the bank borrowings. This method will give a current ratio of .
3. Third method:- in the third method, borrower will contribute 100 percent of core assets, as defined and 25 per cent of the balance of current assets. The remaining of the working capital gap can be met from the borrowings. This method will further strengthen the current ratio

Components of Working Capital: Three main components associated with working capital management:

1. Accounts Receivable

Accounts receivable are revenues due – what is owed to a company by its customers for sales made. Timely, efficient collection of accounts receivable is essential to a company's smooth financial operation.

Accounts receivable are listed as assets on a company's balance sheet, but they are not actually assets until they are collected. A common metric analysts use to assess a company's handling of accounts receivable is days sales outstanding, which reveals the average number of days a company takes to collect sales revenues.

2. Accounts Payable

Accounts payable, the money that a company is obligated to pay out over the short term, is also a key component of working capital management. Companies seek to strike a balance between maintaining maximum cash flow by delaying payments as long as is reasonably possible and the need to maintain positive credit ratings while sustaining good relationships with suppliers and creditors. Ideally, a company's average time to collect receivables is significantly shorter than its average time to settle payables.

3. Inventory

Inventory is a company's primary asset that it converts into sales revenues. The rate at which a company sells and replenishes its inventory is an important measure of its success.

Investors consider the inventory turnover rate to be an indication of the strength of sales and as a measure of how efficient the company is in its purchasing and manufacturing

process. Inventory that is too low puts the company in danger of losing out on sales, but excessively high inventory levels represent wasteful, inefficient use of working capital.
Source of Working Capital:
SPONTANEOUS (URGENT) SOURCES OF WORKING
CAPITAL FINANCE
The word ‗spontaneous' itself explains that this source of working capital is readily or easily available to the business in the normal course of business affairs. The quantum and terms of this credit depend on the industry norms and the relationship between buyer and seller. These sources include trade credit allowed by the sundry creditors, credit from employees, and other trade-related credits. The biggest benefit of spontaneous sources as working capital is its ‗effortless raising' and ‗insignificant cost' compared to traditional ways of financing.
List of spontaneous sources of working capital
TRADE CREDIT
SUNDRY CREDITORS
BILLS PAYABLE
NOTES PAYABLE
ACCRUED EXPENSES
The cost factor and the quantum depends a lot on the terms of such credit viz. maximum credit limit, the period of credit, and discount on cash payment. Each supplier will have a maximum credit limit defined for the buyer depending on the business capacity and creditworthiness of the buyer. Similarly, the credit period is defined say 30 days, 45 days etc. Discount on cash payment is allowed to the buyer if the payment immediately on buying the materials. This percentage of discount is an opportunity cost for the buyer.
SHORT TERM SOURCES OF WORKING CAPITAL FINANCE
Short term sources can be further divided into internal and external sources of working capital finance. The
Short-term Internal Sources
TAX PROVISIONS
DIVIDEND PROVISIONS
Short-term External Sources

Short-term working capital financing from banks such as

BANK OVERDRAFTS,
CASH CREDITS,
TRADE DEPOSITS,
BILLS DISCOUNTING,
SHORT-TERM LOANS OR WORKING CAPITAL LOANS,
INTER-CORPORATE LOANS,
COMMERCIAL PAPER, ETC.
Tax and dividend provisions are current liabilities and cannot be delayed. The fund that would have been used in paying these provisions act as working capital till the point these are not paid.
Short-term working capital finance availed from banks and financial institutions are costly compared to spontaneous and long-term sources in terms of rate of interest but have a great time flexibility. Due to time flexibility, the finance manager can use the funds and pay interest on the money which his business utilizes and can pay them anytime when cash is available. Overall, in comparison to long-term sources where you have to hold funds even when not required, these facilities prove cheaper.

LONG-TERM SOURCES OF WORKING CAPITAL FINANCING
Long-term sources can also be divided into internal and external sources. Long-term internal sources of finance are retained profits and provision for depreciation whereas external sources are Share Capital, long-term loan, and debentures.
Long-term Internal Sources
RETAINED PROFITS
PROVISION FOR DEPRECIATION
Long-term External Sources
SHARE CAPITAL
LONG-TERM LOAN
DEBENTURES
Retained profits and accumulated depreciation are as good as funds available to the business without any explicit cost. These are the funds completely earned and owned by the business itself. They are utilized for expansion as well as working capital finance.
Long-term external sources of finance like share capital is a cheaper source of finance but are not commonly used for working capital finance.
Working capital can be classified as temporary working capital and permanent working capital. It is advisable to use long-term sources for permanent and short-term sources for temporary working capital requirements. This will optimize the working capital cost

and enforce good working capital management practices.

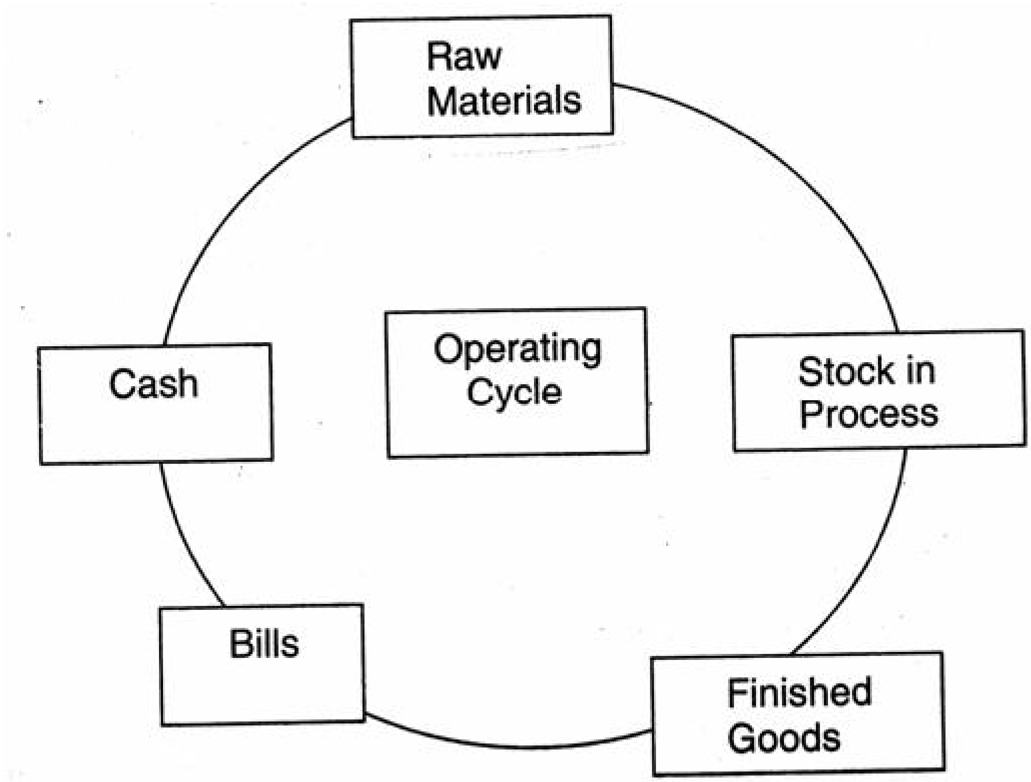
Various Methods of Assessment of Working Capital:
• Operating Cycle Method
• Drawing Power Method.
• Turnover Method.
• MPBF method (II method of lending) for limits of Rs 6.00 crores and above
• Cash Budget method - A cash budget is an estimation of the cash inflows and outflows for a business over a specific period of time, and this budget is used to assess whether the entity has sufficient cash to operate. Companies use sales and production forecasts to create a cash budget, along with assumptions about necessary spending and accounts receivable. If a company does not have enough liquidity to operate, it must raise more capital by issuing stock or by taking on debt.
Under this method, monthly cash inflow and outflow statement is prepared and the highest gap between the two becomes the basis for sanction of credit limit.
Banks make use of cash budget method in case of seasonal industries, software development, services sector activities including construction activity, etc.
Based on procurement and cash inflow) . It is mainly used for Seasonal Industries (Sugar/ Rice Mills/Textiles/Tea/Tobacco/Fertilizers) Contractors &

Real Estate Developers , Educational Institutions, etc.

Operating Cycle :

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

Diagrammatically, the operating cycle is represented as under'



The time that lapses between cash outlay and cash realisation by sale of finished goods and realisation of sundry debtors is known as the length of the operating cycle.

That is, the operating cycle consists of:
a. Time taken to acquire raw materials and average period for which they are in store.
b. Conversion process time
c. Average period for which finished goods are in store and
d. Average collection period of receivables (Sundry Debtors)

Operating Cycle is also called the cash-to-cash cycle and indicates how cash is converted into raw materials, stocks in process, finished goods, bills(receivables) and finally back to cash. Working capital is the total cash that is circulating in this cycle. Theref

Traditional Method of Assessment of Working Capital Requirement

The operating cycle concept serves to identify the areas requiring improvement for the purpose of control and performance review. But, as bankers, we require a more detailed analysis to assess the various components of working capital requirement viz., finance for stocks, bills etc.

Bankers provide working capital finance for holding an acceptable level of current assets, viz. raw materials, stocks-in-process, finished goods and sundry debtors for achieving a predetermined level of production and sales. Quantification of these funds required to be blocked in each of these items of current assets at any time will, therefore provide a measure of the working capital requirement (WCR) of an industry.

Raw Materials: Any industrial unit has to necessarily stock a minimum quantum of materials used in its production to ensure uninterrupted production. Factors which affect or influence the funds requirement for holding raw materials are

i. Average consumption of raw materials.
ii. Their availability - locally or from places outside, easy availability / scarcity, number of sources of supply.
iii. Time taken to procure raw materials (procurement time or lead time)
iv. Imported or indigenous.
v. Minimum quantity supplied by the market (Minimum Order Quantity (MOQ)).
vi. Cost of holding stocks (e.g. insurance, storage, interest)
vii. Criticality of the item.
viii. Transport and other charges (Economic Order Quantity (EOQ)).
ix. Availability on credit or against advance payment in cash
x. Seasonality of the materials.
This raw material requirement is generally expressed as so many months' requirement (consumption).

Stocks-in-process : Barring a few exceptional types of industries, when the raw materials get converted into finished products within a few hours, there is normally a time lag or delay or period of processing only after which the raw materials get converted into finished product. During this period of processing, the raw materials are being processed and expenses are being incurred. The period of processing may vary from a few hours to a number of months and unit will be blocking working funds in the stocks-in-process during this period. Such funds blocked in SIP depend on:
i. The processing time
ii. Number of products handled at a time in the process
iii. Average quantities of each product, processed at each time. (batch quantity)
iv. The process technology adopted
v. Number of shifts
A rough and ready formula for computing the requirement of funds is to find out the cost of production for the period of processing. viz. (raw materials consumed per month + expenses per month) x period of processing in months.

Finished goods: All products manufactured by an industry are not sold immediately. It will be necessary to stock certain amount of goods pending sale. This stocking depends on:
i. Whether the manufacture is against firm order or against anticipated order
ii. Supply terms
iii. Minimum quantity that can be despatched
iv. Transport availability and transport cost
v. Pre-despatch Inspection
vi. Seasonality of goods
vii. Variation in demand
viii. Peak level/ low level of operations
ix. Marketing arrangement - e.g. direct sale to consumers or through dealers (wholesalers).
The requirement of funds against finished goods is expressed as so many months' cost of production.

Sundry Debtors (Receivables) :
Sales may be effected under three different methods:
a. Against Advance Payment
b. Against Cash
c. On Credit
In the case of (a) no funds are blocked up. Instead it helps in meeting the working capital needs. In case of Cash Sales (b) no funds are blocked up and hence there is no need for additional working capital requirement. It is in the case of (c) credit sales that working funds are required to meet delays in sales realisation. The entire sales of the industry will not be on cash basis. In fact a major portion will be on credit. A unit grants trade credit because it expects this investment to be profitable. It would be in the form of sales expansion and fresh customers or it could be in the form of retention of existing customers. The extent of credit given by the industry normally depends upon:
i. Trade Practices
ii. Market conditions
iii. Whether it is a bulk purchase by the buyer.
iv. Seasonality (e.g. rain coats, woolen products).
v. Price advantage.
Even in cases where no credit is extended to buyers, the transit time for the goods to reach the buyer may take some time and till the cash is received back, the unit will have to be out of funds. The period from the time of sale to the receipt of funds will have to be reckoned for the purpose of quantifying the funds blocked in Sundry Debtors. Even through the amount of Sundry Debtors according to the unit's books will be on the basis of Sale price, the actual amount blocked will be only the cost of production of the materials against which credit has been extended - the difference being the unit's profit margin - (which the unit does not obviously have to spend).
The working capital requirement against Sundry Debtors will therefore be computed on the basis of cost of production (whereas the permissible Bank Finance will be computed on the basis of sale value since profit margin varies from product to product and buyer to buyer and cannot be uniformly segregated from the sale value).
The working capital requirement is normally expressed as so many months' cost of production.

Expenses : It is customary in assessing the working capital requirement of industries, to provide for one month's expenses also. A question might be raised as to why expenses should be taken separately, whereas at every stage the funds required to be blocked had been taken into account. This amount is provided merely as a cushion, to take care of temporary bottlenecks and to enable the unit to meet expenses when they fall due. Normally one month total expenses, direct and indirect, salaries etc. are taken into account. In cases where the operating cycle is very short say one month or 2 months the provision for expenses can be reduced. Similarly, where the operating cycle is very long, say 12 months or more, the provision for expenses may have to be increased, to take care of contingencies.
While computing the working capital requirements of a unit, it will be necessary to take into account two other factors, one is the credit received on purchases. Trade Credit is a normal practice in trading circles. The period of such credit will vary from place to place, material to material and person to person. The amount of credit received on purchases

reduces the working capital funds required by the unit. Secondly, industries often receive advance against orders placed for their products.

necessarily give advance to producers e.g. Custom-made machinery. Such funds are used for the working capital of an industry. It can thus be summarised as follows:
1. Raw Materials Months requirements Rs. A
2. Stocks-in- Process Months (Cost of Rs. B
(for Period of Processing) Production)
3. Finished Goods Months cost of Rs. C
production required
to be stocked
4. Sundry Debtors Months cost of production Rs. D
(outstanding credits)
5. Expenses One month(say) Rs. E

A+B+C+D+E

Less: Credit received on purchases - Rs. F
(Months' Purchases value)
Advance payment on order received - Rs.G
Working Capital Required (H) = (A+B+C+D+E) - (F+G)
The purpose of assessing the W/C requirement of the industry is to determine how the total requirements of funds will be met. The two sources for meeting these requirements are the unit's long term sources (like capital and long term borrowings) and the short term borrowings from banks

Drawing Power (DP) Method :
(for units with small limits)
Drawing power is arrived at on the basis of valuation of current assets charged to the bank in the shape of hypothecation and assignment , after deducting the stipulated margin
Illustration:
Paid stock – 4 Margin 25% - DP = 3
Semi-finished goods – 4 Margin 50% - DP=2
Finished goods -4 Margin 25% - DP = 3
Book Debts – 4 Margin 50% - DP = 2
Total DP= 10

Turnover Method :

(originally suggested by Nayak Committee for SSI units)
The WC requirements may be worked out on the basis of Naik Committee recommendations for working capital limit upto Rs.6 crores from the banking system, on the basis of minimum of 20% of their projected annual turnover for new as well as existing units, beyond which WC be computed on the basis of WC cycle, after fixing stipulated margins , on each component of the WC. In case of borrowers desiring facilities under Naik Committee recommendations and having a WC cycle of more than 3 months in a year, the WC requirements will be funded after assessing his requirements on the basis of his WC cycle, after fixing proper margins.
Example:
Applicable for limits upto Rs.6 crores

(a) Projected sales = Rs. 10,00,000
(b) Working capital requirements: 25% of projected sales i.e. Rs.2,50,000

(c) Margin (contribution of Owner) : 5% of projected sales i.e. Rs.50,000
(d) Working capital to be funded by bank : Rs.2,00,000

MPBF Method
(Tandon's II method of lending)

Tandon Committee also recommended inventory/ receivable norms for 22 major industries.

Approach to lending
Regarding approach to lending, the Committee suggested three methods for assessment of working capital requirements.
FIRST METHOD
The quantum of bank's short-term advances will be restricted to 75% of working capital gap where "working capital gap" is equal to "Current Assets" minus "Current Liabilities Other Than Bank Borrowings". Remaining 25% is to be met from long-term sources (Net Working Capital)
SECOND METHOD
Net Working Capital should at least be equal to 25% of total value of acceptable level of current assets. The remaining 75% should first be financed by Other Current Liabilities (OCL) and the bank may finance balance of the requirements.
THIRD METHOD
The borrower should provide for entire core current assets and 25% balance current assets from the Net Working Capital.
To compute the level of working capital requirement of the unit, the analyst has to assess the level of current assets it has to carry, consistent with its projected level of production and sales. Inventory and receivables constitute most of the current assets. On the basis of the Committee report, RBI gave inventory norms and advised the banks to decide the levels of inventory and receivables taking into account, production, processing cycles and other relevant factors

- Working capital gap : Current assets – current liabilities (other than bank borrowings)
- Minimum stipulated net working capital= 25% of current assets (excluding exports receivables)
- Actual projected NWC

Example:

Method I		Method II		Method III	
Current Assets	**200**	Current Assets	**200**	Current Assets	**200**
Other Current Liabilities	40	25% of this from long-term sources	50	Core current assets (say)	56
Working capital gap	160	Difference	150	'Real' current assets	144
25% of this from long-term sources of the borrower	40	Other Current Liabilities	40	25% of this from long-term sources of the borrower	36
				Difference	108
				Other Current Liabilities	40
Maximum Permissible Bank Finance	**120**	Maximum Permissible Bank Finance	**110**	Maximum Permissible Bank Finance	**68**
Minimum net w.c. (CA-CL)	40	Minimum net w.c.	50	Minimum net w.c.	92
Current Assets	200	Current Assets	200	Current Assets	200
Current Liabilities	160	Current Liabilities	150	Current Liabilities	108
Current Ratio (min)	1.25	Current Ratio (min)	1.33	Current Ratio	1.85

Cash budget method::

Assessment of working capital

The assessment of working capital is done through the Projected Balance Sheet Method (PBS), Cash Budget method or Turnover Method.

Under the PBS method, the fund requirements computed on the basis of borrower's projected balance sheet, the funds flow planned for the current/ following year and examination of the profitability, financial parameters. etc. The key determinants for the limit can, inter-alia, be the extent of financing support required by the borrower and the acceptability of the borrower's overall financial position including the projected level of liquidity. The projected Bank borrowing thus arrived at, is termed as 'Assessed bank Finance' (ABF). This method is applicable for borrowers who are engaged in manufacturing, services and trading activities and who require fund bases working capital (WC) finance of above Rs. 5 crores.

Cash budget method is used for assessing working capital finance for seasonal industries like sugar, tea and construction activity. This method is also used for sanction of ad-hoc WC limits. In these cases, the required finance is quantified from the projected cash flows and not from the projected values of current assets and current liabilities. Other aspects of assessment like examination of funds flow, profitability, financial parameters, etc, are also carried out

.

Collection of financial data

CMA DATA

Introduction: Credit Monitoring Arrangement (CMA) data is a very important area to understand a person who deals with finance in an organization. This is a critical analysis of current and projected financial statements of a loan applicant by the banker. Data CMA is a systematic analysis of working capital management of the borrower and the purpose of this statement is to ensure the use of long-term and short-term funds have been used . for the particular purpose . In this article I want to discuss the content database CMA CMA Basically contains data that, following the seven states.

1. particular existing and proposed limits: It is the first statement in the CMA data that contains this fund and fund based limits of non-borrower credit limits and their use and history. With the current limitations of funds, which is the limit proposed or the borrower will be mentioned in this statement is a basic document information provided by the borrower, the banker.

2. operating Declaration: This is the second statement provided by the borrower, it indicates that the business plan of the borrower gives the current sales, direct and indirect costs, pre-and after tax, as well as projections of sales, expenses and profit situation for 3-5 years based on the borrower's working capital demand. This statement is a scientific analysis of the capacity of production and financial current and projected income of the borrower.

3. analysis of balance: balance sheet analysis for current and projected statement is the third in the CMA data. This statement gives a detailed analysis of current and non-current assets, fixed assets, cash and bank, the current position and long-term debt of the borrower. Moreover, this declaration indicates the position of the net worth of the borrower for the projected years. budget analysis gives a complete financial situation of the borrower and the generating capacity cash over the planned exercises.

4. Comparative table of current assets and liabilities: . Fourth statement which gives a comparative analysis of current assets and current liabilities of the borrower movement This basically decides the cycle capital of actual work for the projection period and ability of the borrower to meet their working capital needs.

5. Calculate MPBF: This is a very important statement and calculation that indicates the **M** Aximum **P** ermissible **B** ank **F** inance. This statement, which calculates the borrower working capital GAP and finance eligible in two methods loan, the first method of loan will enable MPBF 75% of the work GAP net capital is Current assets less current liabilities, Second method loan will enable MPBF 75% of current assets less current liabilities. As limit MPBF is the credit component of cash the borrower generally known drawing power (DP Limit). So it is very important statement that decide the borrower `s borrowing limit of the bank.

6. fund cash flow: cash flow analysis statement for the current period and projected is one of the states in the CMA data. fund this position analysis of the borrower's account with reference to the analysis of capital given in the calculations MPBF and projected balance sheets. Objective basis of this statement capture the movement of funds to the borrower for the period.

. 7 Ratio Analysis: This is the last statement that gives the key ratios for the bank on the basis of data from the AMC prepared and presented to the bank financing. Ratios basic gross margin rate net margin, current ratio, limit DP MPBF, net worth, the ratio of the net value of liabilities, the liquidity ratio, inventory turnover, asset turnover, fixed asset turnover, the number of current business assets, working capital turnover, Debt Equity ratio etc.

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

Form I : Particulars of existing / proposed limits from the banking system
Form II : Operating statement
Form Ill : Analysis of balance sheet
Form IV : Comparative Statement of CA / CL,
Form VI: Funds flows statement.

Form VII: Statement showing the total cost of the project and sources of finance

Information provided in the Forms II, III. IV, and VI serves the detailed financial analysis. In Form I, in addition to information relating to working capital and term loan borrowings (existing and proposed) information regarding borrowings from NBFCs, borrowings from term leading institutions for WC purposes, Inter Corporate Deposits taken, lease finance availed will also be collected..

Working capital: Numerical

A newly formed company has applied to the Commercial Bank for the first time for financing its working capital requirements. The following information is available about the projections for the current year:
Per unit
Elements of cost: (Rs.)
Raw material 40
Direct labour 15
Overhead 30
Total cost 85
Profit 15
Sales 100
Other information:
Raw material in stock : average 4 weeks consumption, Work – in progress (completion stage, 50 per cent), on an average half a month. Finished goods in stock : on an average, one month.
Credit allowed by suppliers is one month.
Credit allowed to debtors is two months.
Average time lag in payment of wages is 1½ weeks and 4 weeks in overhead expenses.
Cash in hand and at bank is desired to be maintained at Rs. 50,000.
All Sales are on credit basis only.
Required:
(i) Prepare statement showing estimate of working capital needed to finance an activity level of 96,000 units of production. Assume that production is carried on evenly throughout the year, and wages and overhead accrue similarly. For the calculation purpose 4 weeks may be taken as equivalent to a month and 52 weeks in a year.

(ii) From the above information calculate the maximum permissible bank finance by all the three methods for working capital as per Tondon Committee norms; assume the core current assets constitute 25% of the current assets.
Answer
Calculation of Working Capital Requirement
(A) Current Assets
Rs.
(i) Stock of material for 4 weeks (96,000 × 40 × 4/52) 2,95,385
(ii) Work in progress for ½ month or 2 weeks
Material (96,000 × 40 × 2/52) .50 73,846
Labour (96,000 × 15 × 2/52) .50 27,692
Overhead (96,000 × 30 × 2/52) .50 55,385 1,56,923
(iii) Finished stock (96,000 × 85 × 4/52) 6,27,692
(iv) Debtors for 2 months (96,000 × 85 × 8/52) 12,55,385
Cash in hand or at bank 50,000
Investment in Current Assets 23,85,385
(B) Current Liabilities
(i) Creditors for one month (96,000 × 40 × 4/52) 2,95,385

(ii) Average lag in payment of expenses
Overheads (96,000 × 30 × 4/52) 2,21,538
Labour (96,000 × 15 × 3/104) 41,538 2,63,076
Current Liabilities 5,58,461
Net working capital (A – B) 18,26,924
Minimum Permissible Bank Finance as per Tandon Committee
Method I : .75 (Current Assets – Current Liabilities)
.75 (23,85,385 – 5,58,461)
.75 (18,26,924) – 5,58,461 = Rs. 13,70,193
Method II : .75 × Current Assets – Current Liabilities
.75 × 23,85,385 – 5,58,461
17,89,039 – 5,58,461 = Rs. 12,30,578
Method III: .75 (Current Assets – CCA) – Current Liabilities
7.3
.75 (23,85,385 – 5,96,346) – 5,58,461
.75 (17,89,039) – 5,58,461
13,41,779 – 5,58,461 = Rs. 7,83,318

Quasi credit (Non Fund based):

Quasi Credit signifies financing for trade, and it concerns both domestic and international trade transactions. A trade transaction requires a seller of goods and services as well as a buyer. Various intermediaries such as banks and financial institutions can facilitate these transactions by financing the trade

Non Fund Business

Bank Guarantee: As a part of Banking Business, Bank Guarantee (BG) Limits are sanctioned and guarantees are issued on behalf of our customers for various purposes. Broadly, the BGs are classified into two categories:
i) Financial Guarantees are direct credit substitutes wherein a bank irrevocably undertakes to guarantee the payment of a contractual financial obligation. These guarantees essentially carry the same credit risk as a direct extension of credit i.e. the risk of loss is directly linked to the creditworthiness of the counter-party against whom a potential claim is acquired. Example – Guarantees in lieu of repayment of financial securities/margin requirements of exchanges, Mobilization advance, Guarantees towards revenue dues, taxes, duties in favour of tax/customs/port/excise authorities, liquidity facilities for securitization transactions and deferred payment guarantees.

ii) Performance Guarantees are essentially transaction-related contingencies that involve an irrevocable undertaking to pay a third party in the event the counterparty fails to fulfill or perform a contractual obligation. In such transactions, the risk of loss depends on the event which need not necessarily be related to the creditworthiness of the counterparty involved. Example – Bid bonds, performance bonds, export performance guarantees, Guarantees in lieu of security deposits/EMD for participating in tenders, Warranties, indemnities and standby letters of credit related to particular transaction.
Though, BG facility is a Non-fund Facility, it is a firm commitment on the part of the Bank to meet the obligation in case of invocation of BG. Hence, monitoring of Bank Guarantee portfolio has attained utmost importance. The purpose of the guarantee is to be examined and it is to be spelt out clearly if it is Performance Guarantee or

Financial Guarantee. Due diligence of client shall be done, regarding their experience in that line of activity, their rating/grading by the departments, where they are registered. In case of Performance Guarantees, banks shall exercise due caution to satisfy that the customer has the necessary experience, capacity and means to perform the obligations under the contract and is not likely to commit default. The position of receivables and delays if any, are to be examined critically, to understand payments position of that particular activity. The financial position of counter party, type of Project, value of Project, likely date of completion of Project as per agreement are also to be examined. The Maturity period, Security Position, Margin etc. are also to be as per Policy prescriptions and are important to take a view on charging BG Commissions.
Branches shall use Model Form of Bank Guarantee Bond, while issuing Bank Guarantees in favour of Central Govt. Departments/Public Sector Undertakings. Any deviation is to be approved by Zonal Office. It is essential to have the information relating to each contract/project, for which BG has been issued, to know the present stage of work/project and to assess the risk of invocation and to exercise proper control on the performance of the Borrower. It is to be ensured that the operating accounts of borrowers enjoying BG facilities route all operations through our Bank accounts. To safeguard the interest of the bank, Branches need to follow up with the Borrowers and obtain information and analyze the same to notice the present stage

of work/project, position of Receivables, Litigations/Problems if any leading to temporary cessation of work etc.
The Financial Indicators/Ratios as per Banks Loan Policy guidelines are to be satisfactory. Banks are required to be arrived Gearing Ratio (Total outside liabilities+proposed non-fund based limits / Tangible Networth - Non Current Assets) of the client and ideally it should be below 10.
In case where the guarantees issued are not returned by the beneficiary even after expiry of guarantee period, banks are required to reverse the entries by issuing notice (if the beneficiary is Govt. Department 3 months and one month for others) to avert additional provisioning. Banks should stop charging commission on expired Bank Guarantees with effect from the date of expiry of the validity period even if the original Bank Guarantee bond duly discharged is not received back.
Letter of Credit: A Letter of Credit is an arrangement by means of which a Bank (Issuing Bank) acting at the request of a customer (Applicant), undertakes to pay to a third party (Beneficiary) a predetermined amount by a given date according to agreed stipulations and against presentation of stipulated documents. The documentary Credit are akin to Bank Guarantees except that normally Bank Guarantees are issued on behalf of Bank's clients to cover situations of their non performance whereas, documentary credits are issued on behalf of clients to cover situation of performance. However, there are certain documentary credits like standby Letter of Credit which are issued to cover the situations of non performance.
All documentary credits have to be issued by Banks subject to rules of Uniform Customs and Practice for Documentary Credits (UCPDC). It is a set of standard rules governing LCs and their implications and practical effects on handling credits in various capacities must be possessed by all bankers. A documentary credit has the seven parties viz., Applicant (Opener), Issuing Bank (Opening of LC Bank), Beneficiary, Advising Bank (advises the credit to beneficiary), Confirming Bank – Bank which adds guarantee to the credit opened by another Bank thereby undertaking the responsibility of payment/negotiation/acceptance under the credit in addition to Issuing Bank), Nominated Bank – Bank which is nominated by Issuing Bank to pay/to accept draft or to negotiate, Reimbursing Bank – Bank which is authorized by the Issuing Bank to pay to honour the reimbursement claim in settlement of negotiation/acceptance/payment lodged with it by the paying / negotiating or accepting Bank. The various types of LCs are as under:
i) Revocable Letter of Credit is a credit which can be revoked or cancelled or amended by the Bank issuing the credit, without notice to the beneficiary. If a credit does not indicate specifically it is a revocable credit the credit will be deemed as irrevocable in terms of provisions of UCPDC terms.
ii) Irrevocable Letter of credit is a firm undertaking on the part of the Issuing Bank and cannot be cancelled or amended without the consent of the parties to letter of credit, particularly the beneficiary.
iii) Payment Credit is a sight credit which will be paid at sight basis against presentation of requisite documents as per LC terms to the designated paying Bank.
iv) Deferred Payment Credit is a usance credit where payment will be made by designated Bank on respective due dates determined in accordance with stipulations of the credit without the drawing of drafts.
v) Acceptance Credit is similar to deferred credit except for the fact that in this credit drawing of a usance draft is a must.
vi) Negotiation Credit can be a sight or a usance credit. A draft is usually drawn in negotiation credit. Under this, the negotiation can be restricted to a specific Bank or it may allow free negotiation whereby any Bank who is willing to negotiate can do so. However, the responsibility of the issuing Bank is to pay and it cannot say that it is of the negotiating Bank.
vii) Confirmed Letter of Credit is a letter of credit to which another Bank (Bank

other than Issuing Bank) has added its confirmation or guarantee. Under this, the beneficiary will have the firm undertaking of not only the Bank issuing the LC, but also of another Bank. Confirmation can be added only to irrevocable and not revocable Credits.

the amount is revived or reinstated without requiring specific amendment to the credit. The basic principle of a revolving credit is that after a drawing is made, the credit reverts to its original amount for re-use by beneficiary. There are two types of revolving credit viz., credit gets reinstated immediately after a drawing is made and credit reverts to original amount only after it is confirmed by the Issuing Bank.

ix) Installment Credit calls for full value of goods to be shipped but stipulates that the shipment be made in specific quantities at stated periods or intervals.

x) Transit Credit – When the issuing Bank has no correspondent relations in beneficiary country the services of a Bank in third country would be utilized. This type of LC may also be opened by small countries where credits may not be readily acceptable in another country.

xi) Reimbursement Credit – Generally credits opened are denominated in the currency of the applicant or beneficiary. But when a credit is opened in the currency of a third country, it is referred to as reimbursement credit.

xii) Transferable Credit – Credit which can be transferred by the original beneficiary in favour of second or several second beneficiaries. The purpose of these credits is that the first beneficiary who is a middleman can earn his commission and can hide the name of supplier.

xiii) Back to Back Credit/Countervailing credit – Under this the credit is opened with security of another credit. Thus, it is basically a credit opened by middlemen in favour of the actual manufacturer/supplier.

xiv) Red Clause Credit – It contains a clause providing for payment in advance for purchasing raw materials, etc.

xv) Anticipatory Credit – Under this payment is made to beneficiary at preshipment stage in anticipation of his actual shipment and submission of bills at a future date. But if no presentation is made the recovery will be made from the opening Bank.

xvi) Green Clause Credit is an extended version of Red Clause Credit in the sense that it not only provides for advance towards purchase, processing and packaging but also for warehousing & insurance charges. Generally money under this credit is advanced after the goods are put in bonded warehouses etc., up to the period of shipment.

Other concepts

i)Bill of Lading: It should be in complete set and be clean and should generally be to order and blank endorsed. It must also specify that the goods have been shipped on board and whether the freight is prepaid or is payable at destination. The name of the opening bank and applicant should be indicated in the B/L.

ii) Airway Bill: Airway bills/Air Consignment notes should always be made out to the order of Issuing Bank duly mentioning the name of the applicant.

iii)Insurance Policy or Certificate: Where the terms of sale are CIF the insurance is to be arranged by the supplier and they are required to submit insurance policy along with the documents.

iv) Invoice: Detailed invoices duly signed by the supplier made out in the name of the applicant should be called for and the invoice should contain full description of goods, quantity, price, terms of shipment, licence number and LC number and date.

v) Certificate of Origin: Certificate of origin of the goods is to be called for. Method of payment is determined basing on the country of origin.

vi) Inspection Certificate: Inspection certificate is to be called for from an independent inspecting agency (name should be stipulated) to ensure quality and quantity of goods. Inspection certificate from the supplier is not acceptable

Co-acceptance Facilities : RBI Guidelines, Co-acceptance of Bills covering supply of Goods & Machinery

Bills co-acceptance Co-acceptance is a means of non-fund based import finance whereby a **Bill of Exchange** drawn by an exporter on the importer is co-accepted by a Bank. By co-accepting the Bill of Exchange, the Bank undertakes to make payment to the exporter even if the importer fails to make payment on due date

RBI guidelines on co-acceptances:

In the light of the above, banks should keep in view the following safeguards:

(i) While sanctioning co-acceptance limits to their customers, the need therefor should be ascertained, and such limits should be extended only to those customers who enjoy other limits with the bank.

(ii) Only genuine trade bills should be co-accepted and the banks should ensure that the goods covered by bills co-accepted are actually received in the stock accounts of the borrowers.

(iii) The valuation of the goods as mentioned in the accompanying invoice should be verified to see that there is no over-valuation of stocks.

(iv) The banks should not extend their co-acceptance to house bills/ accommodation bills drawn by group concerns on one another.

(v) The banks discounting such bills, co-accepted by other banks, should also ensure that the bills are not accommodation bills and that the co-accepting bank has the capacity to redeem the obligation in case of need.

(vi) Bank-wise limits should be fixed, taking into consideration the size of each bank for discounting bills co-accepted by other banks, and the relative powers of the officials of the other banks should be got registered with the discounting banks.

(vii) Care should be taken to see that the co-acceptance liability of any bank is not disproportionate to its known resources position.

(viii) A system of obtaining periodical confirmation of the liability of co-accepting banks in regard to the outstanding bills should be introduced.

(ix) Proper records of the bills co-accepted for each customer should be maintained, so that the commitments for each customer and the total commitments at a branch can be readily ascertained, and these should be scrutinised by Internal Inspectors and commented upon in their reports.

(x) It is also desirable for the discounting bank to advise the Head Office/ Controlling Office of the bank, which has co-accepted the bills, whenever such transactions appear to be disproportionate or large.

(xi) Proper periodical returns may be prescribed so that the Branch Managers report such co-acceptance commitments entered into by them to the Controlling Offices.

(xii) Such returns should also reveal the position of bills that have become overdue, and which the bank had to meet under the co-acceptance obligation. This will enable the Controlling Offices to monitor such co-acceptances furnished by the branches and take suitable action in time, in difficult cases.

(xiii) Co-acceptances in respect of bills for Rs.10,000/- and above should be signed by two officials jointly, deviation being allowed only in exceptional cases, e.g. nonavailability of two officials at a branch.

(xiv) Before discounting/ purchasing bills co-accepted by other banks for Rs. 2 lakh and above from a single party, the bank should obtain written confirmation of the concerned Controlling (Regional/ Divisional/ Zonal) Office of the accepting bank and a record of the same should be kept.

(xv) When the value of the total bills discounted/ purchased (which have been coaccepted

by other banks) exceeds Rs. 20 lakh for a single borrower/ group of
borrowers, prior approval of the Head

Letter of credit problems steps

Srinivas Kante:

For Assessing LC Limit we have to take care of following thing .

1.what will be annual purchases.
2.Wht is EOQ-economic order quantity which is calculated by source of supply,means of transport and any discount.
3.Lead time- the time taken in recving the goods after LC opened
4.Transit time if any
5.Usance time- the time to make the payment at any future date accepted by buyer.
Nw he we calculate we hv to convert annual purchases in to months
Then decide whether LC is DA or DP
Da Lc- the LC for which payment is made by the buyer at any future date after its acceptance by him .this is also called usance LC
dP Lc- LC for which the payment is made on production of documents no further time is given.this is also called sight Lc
So It's clear if we talk about dP Lc- we don't count usance time while calcuting total time/LC cycle so it will be Lead time+transit time
If talk Da Lc- it will be Lead time+transit time +usance time
Hw LC limit is calculated on that basis
Monthly purchases*total timing
Total timing will depend on what LC is opened whether do or da
We assume that
-annual consumption of material to b purchased under LC ....C RS.
-Lead time ...L(months)
-transit time...T(months)
-usance period....U(minths/)

Purchase cycle=L+t+u ie.P(months)
LC limit=P*C/12
Why C/12 bcz C is annual purchasing we hv to convert it in months basis while calculating LC limit

MODULE - D : OTHER CREDITS
Export Finance : Pre-Shipment Finance-Export Packing Credit in Rupees,
Running Account Facility, Pre shipment credit to specific sectors - Sub Suppliers,
Construction Contractors, Export credit to Processors / exporters-Agri Export
Zones, Export Credit Insurance Whole Turnover Packing Credit, Pre-Shipment
Credit in Foreign Currency (PCFC), Running Account Facility in all currencies,
Deemed Exports, Diamond Dollar Account Scheme, Post Shipment Rupee Export
Finance, Purchase / Discount of Export Bills, Negotiation of Export Bills, Export

on Consignment basis, Advance against Duty Draw Back Entitlements, ECGC Whole Turnover Post-Shipment Guarantee Scheme, Interest Rate of Rupee

Export Credit, ECNOS, Rupee Export Credit Interest Rate Subvention, Post-Shipment Finance in Foreign Currency, Gold Card Scheme for Exporters, Crystalisation of Export Bills.

Priority Sector Lending / Government Sponsored Schemes : Different Categories of Priority Sector borrowers, Agriculture (Direct & Indirect) Finance, MSME Finance (Direct & Indirect), Micro Credit, Government Sponsored Schemes, Swarnajayanti Gram Swarozgar Yojana (SGSY), Swarna Jayanti Shahari Rozgar Yojana (SJSRY), Self Employment Scheme for Rehabilitation of Manual Scavengers (SRMS), Swarna Jayanti Shahari Rozgar Yojana, Education Loans, Housing Finance, Weaker Sections, Export Credit, Differential Rate of Interest Scheme, Priority Sector Targets. Retail Loans : Characteristic of Retail Loans, Advantages of Retail Loans, Retail Banking Vs Corporate Banking, Various Retail Banking Products, Model Retail Banking Products - Home Loans, Vehicle Loan, Personal Loan, Pensioner Loan Scheme, Property Loan, Holiday Loan Scheme, Gold Loan Scheme, Education Loan, etc., Guidelines on CERSAI registration

Export Finance

Export Finance : Funds advanced by a lending institution (such as an exportimport bank or trade development bank) against confirmed orders from qualified foreign buyers to enable the exporter to make and supply ordered goods. Usually, the exporter arranges a commitment from the buyer to make the payment directly to the lender. Upon receipt of payment the lender deducts the loan amount plus interest and other charges and forwards the balance to the exporter.

RBI and DGFT::

RBI controls Foreign Exchange and DGFT (Directorate General of Foreign Trade) controls Foreign Trade. Exim Policy as framed in accordance with FEMA is implemented by DGFT. DGFT functions under direct control of Ministry of Commerce and Industry. It regulates Imports and Exports through EXIM Policy.
On the other hand, RBI keeps Forex Reserves, Finances Export trade and Regulates exchange control. Receipts and Payments of Forex are also handled by RBI.

IEC - Importer Exporter Code::
One has to apply for IEC to become eligible for Imports and Exports. DGFT allots IEC to Exporters and Importers in accordance with RBI guidelines and FEMA regulations. EXIM Policy is also considered before allotting IEC.
Export
Declaration
Form
All exports (physically or otherwise) shall be declared in the following Form.
1. GR form--- meant for exports made otherwise than by post.
2. PP Form---meant for exports by post parcel.
3. Softex form---meant for export of software.
4. SDF (Statutory Declaration Form)----replaced GR form in order to submit declaration electronically.
SDF is submitted in duplicate with Custom Commissioned who puts its stamp and hands over the same to exporter marked "Exchange Control Copy" for submission thereof to AD.
Exemptions
• Up to USD 25000 (value) – Goods or services as declared by the exporter.
• Trade Samples, Personal effects and Central Govt. goods.
• Gift items having value up to Rs. 5.00 lac.
• Goods with value not exceeding USD 1000 value to Myanmar.
• Goods imported free of cost for re-export.
• Goods sent for testing.
ADs may consider waiver for export of goods free of cost for export promotion up to 2% of average annual exports of previous 3 years subject to ceiling of Rs. 5.00 lac. The limit is Rs. 10.00 lac for Status Holder Exporters.

Prescribed Time limits::

The time norms for export trade are as under:
• Submission of documents with "Exchange Control Copy" to AD within 21 days from date of shipment.
• Time period for realization of Export proceeds is has been reduced to 9M for all types of exports including exports to SEZ (Special economic zones), SHE(Status Holder Exporters) and 100%EOUs.
Previously, the time period was 12Months for SEZs and SHEs.
• For, Exports to Warehouse established outside India, as soon as it is realized and in any case within fifteen months from the date of shipment of goods
• After expiry of time limit, extension is sought by Exporter on ETX Form. The AD can extend the period by 6M.
However, reporting will be made to RBI on XOS Form on half yearly basis

in respect of all overdue bills which remained outstanding for more than prescribed period or the bills which are overdue

Direct Dispatch
of Shipping
Documents::

AD banks may handle direct dispatch of shipping documents provided export proceeds are up to USD 1 Million and the exporter is regular customer of at least 6 months.

Advance Payments::

Exporters may receive advance payments from their overseas importers provided:
• Shipment is made within 1 year from receipt of advance.
• Rate of interest payable should not exceed LIBOR+100 bps.
• Documents are routed through AD from which advance was routed.

Prescribed
Method of
payment and
Reduction in
export proceeds

Exporter will receive payment though any of the following mode:
• Bank Drafts, TC, Currency, FCNR/NRE deposits, International Credit Card. But the proceeds can be in Indian Rupees from Nepal and Bhutan.
• Export proceeds from ACU countries can be settled in ACU/EURO or ACU/Dollar. A separate Dollar/Euro account is maintained which is denominated as ACU Dollar or ACU EURO.

ACU – Asian Clearing Union was formed in Tehran, Iran in 1974 and it comprises of following 9 countries as members.
India, Bangladesh, Bhutan, Myanmar, Iran, Pak, Srilanka, Nepal and Maldives.

Exporters may be allowed to reduce the export proceeds with the following:
• Reduction in Invoice value on account of discount for pre-payment of Usance bills (maximum 25%)
• Agency commission on exports.
• Claims against exports.
• Write off the unrecoverable export dues up to maximum limit of 10% of export value.

The proceeds of exports can be got deposited by exporter in any of the following account:
1. Overseas Foreign Currency account.
2. Diamond Dollar account.
3. EEFC (Exchange Earners Foreign Currency account)

DDA _ diamond Dollar accounts

Diamond Dollar account can be opened by traders dealing in Rough and Polished diamond or Diamond studded Jewellary with the following conditions:
1. With track record of 2 years.
2. Average Export turnover of 3 crores or above during preceding 3 licensing years.

DDA account can be opened by the exporter for transacting business in Foreign Exchange. An exporter can have maximum 5 Diamond Dollar

accounts.
EEFC Exchange Earners Foreign Currency accounts can be opened by exporters. 100% export proceeds can be credited in the account which does not earn interest but this amount is repatriable outside India for imports (Current Account transactions).

Pre-shipment
Finance or
Packing Credit::

Packing credit has the following features:
1. Calculation of FOB value of order/LC amount or Domestic cost of production (whichever is lower).
2. IEC allotted by DGFT.
3. Exporter should not be on the “Caution List” of RBI.
4. He should not be under “Specific Approval list” of ECGC.
5. There must be valid Export order or LC.
6. Account should be KYC compliant.
Liquidation of Pre-shipment credit
• Out of proceeds of the bill.
• Out of negotiation of export documents.
• Out of balances held in EEFC account
• Out of proceeds of Post Shipment credit.
Concessional rate of interest is allowed on Packing Credit up to 270 days. Previously, the period was 180 days. Running facility can also be allowed to good customers.

Post Shipment
Finance::

Post shipment finance is made available to exporters on the following conditions:
• IEC accompanied by prescribed declaration on GR/PP/Softex/SDF form must be submitted.
• Documents must be submitted by exporter within 21 days of shipment.
• Payment must be made in approved manner within 6 months.
• Normal Transit Period is 25 days.
• The margin is NIL normally. But in any case, it should not exceed 10% if LC is there otherwise it can be up to 25%.
Types of Post Shipment Finance:
• Export Bills Purchased for sights bills and Discounting for Usance bills.
• Export bills negotiation.
Discrepancies of Documents
Late Shipment, LC expired, Late presentation of shipping documents, Bill of Lading not signed properly, Incomplete Bill of Lading, Clause Bill of Lading , Short Bill of Lading or Inadequate Insurance.
Advance against Un-drawn Balance
Undrawn balance is the amount less received from Importers. Bank can finance up to 10% undrawn amount up to maximum period of 90 days.
Advance against Duty Drawback
Duty drawback is the support by Government by way of refund of Excise/Custom duty in case the domestic cost of the product is higher than the Price charged from the importer. This is done to boost exports despite international competition. Bank can make loan to exporter against Duty

Drawback up to maximum period of 90 days.
GATS Credit can be afforded to exporters of all the 161 services covered under GATS "General Agreement on Trade in Services". The provisions applicable to export of goods apply mutatis mutandis to export of services.

Crystallization of Overdue Bills

Consequent upon non-realization, Conversion of Foreign Exchange liability into Rupees is called crystallization. It is done on 30th day from notional due date at prevailing TT selling rate or Original Bill Buying Rate (Whichever is higher).

DA Bills

Notional due date is calculated in DA Bill by adding normal period of transit i.e. 25 days in the Usance period. 30th day is taken from notional due date.

DP Bills

30th day after Normal Transit Period
If 30th day happens to be holiday or Saturday, liability will be crystallized on the following working day.
Policy has been liberalized and crystallization period will be decided by individual banks.

Export of services

Credit can be provided to exporters of all 161 tradable services covered under GATS (General Agreement on Trade in services) where payment for such services is received in Forex. The provisions applicable to export of goods apply to export of services.

Gold Card Scheme

All exporters in Small and Medium Sector with good track record are eligible to avail Gold Card Scheme. The conditions are :
1. Account should be classified as Standard assets for the last 3 years.
2. Limit is sanctioned for 3 years and thereafter automatic renewal.
3. There is provision of 20% Standby limit.
4. Packing Credit is allowed in Foreign currency.
5. Concessional rate is allowed for 90 days initially which can be extended for 360 days.
6. Bank may waive collateral and provide exemption from ECGC Guarantee schemes.

7.Factoring and Forfaiting

Factoring is financing and collection of Receivables. The client sells Receivables at discount to Factor in order to raise finance for Working Capital. It may be with or without recourse. Factor finances about 80% and balance of 20% is paid after collection from the borrower. Bill should carry LR/RR. Maximum Debt period permitted is 150 days inclusive of grace period of 60 days. Debts are assigned in favour of Factor. There are 2 factors in International Factoring. One is Export Factor and the other is Import Factor. Importer pays to Import factor who remits the same to Export Factor.
Forfaiting is Finance of Export Receivables to exporter by the Forfaitor. It is also called discounting of Trade Receivablessuch as drafts drawn under LC, B/E or PN.It is always No Recourse Basis (i.e. without recourse to exporter). Forfaitor after sending documents to Exporters" Bank makes

100% payment to exporter after deducting applicable discount. Maximum
period of Advance is 180 days.

Priority Sector – RBI Guidelines

The need for commercial banks to improve Priority Sector advances was emphasized since 1968 with special focus on Agriculture and Small Scale industries. Initially there was no specific target fixed in respect of priority sector lending but in the year 1974 banks were advised to raise the share of these sectors to 1/3rd of their aggregate advances by March 1979. Subsequently, on the basis of the recommendations of the Working Group on the Modalities of Implementation of Priority Sector Lending and the Twenty Point Economic Programme by Banks under the chairmanship of Dr. K. S. Krishna swamy, all commercial banks were advised to achieve the target of priority sector lending at 40% of aggregate bank advances with specified sub-targets for lending to agriculture and weaker sections. The Internal Working Group of the RBI headed by Shri C. S. Murthy and the Shri Y.H.Malegam committee constituted to study issues and concerns in the Micro Finance institutions (MFI) sector, inter alia, had recommended review of the guidelines on priority sector lending. Subsequently, RBI has setup a Committee headed by Shri M V Nair to re-examine the existing classification and suggest revised guidelines with regard to Priority Sector lending classification and related issues. Subsequently, an Internal Working Group was set up by RBI in July 2014 to revisit the existing priority sector lending guideline and accordingly, revised guidelines are issued on 23.04.2015 which is as under:
1. Agriculture: The present distinction between direct and indirect agriculture is dispensed with. The lending to agriculture has been defined which includes Farm sector, Agriculture infrastructure and Ancillary activities. List of eligible activities under each category are furnished here under:
i) Farm Credit: Loans to individual farmers, including SHGs/JLGs directly engaged in agriculture and allied activities such as dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture. The credit facilities to the above segments covers crop loans as well as term loans. Loans to farmers up to `50 lakh against pledge/hypothecation of agriculture produce for a period not exceeding 12 months. It also covers loans to corporate farmers, farmers' producer organizations, partnership firms and co-operatives of farmers.
ii) Agriculture infrastructure: Loans for construction of storage facilities (warehouses, market yards and silos) including cold storage units irrespective of their location. Soil conservation, watershed development programs, plant tissue culture, agri-biotechnology, seed production, production of bio-pesticides, biofertilizer and vermi composting are also cover under this category. To consider under priority, the aggregate sanction limit per borrower should not exceed `100 lakhs from the banking system.
iii) Ancillary activities: It covers, loans for setting up of Agri-clinics, Agri Business Centres, Food and Agro processing units (not exceeding `100 crore per borrower), loans to PACS, FSS, MFIs for on-lending to agriculture sector, and loans to cooperative societies of farmers up to `500 lakh for disposing of the produce of members. Outstanding deposits under RIDF and other eligible funds with NABARD on account of priority sector shortfall is considered as part of agriculture lending.
2. Micro, Small and Medium Enterprises: Manufacturing Enterprises are those engaged in manufacturing or production of goods. These are defined in terms of investment in Plant & Machinery. Loans extended to Medium Manufacturing Enterprises shall be classified as Priority Sector advances. Similarly, Service

Enterprises are the enterprises engaged in providing or rendering of services. These are defined in terms of investment in Equipment. The modified definitions of MSM Enterprises are as under:

No Category Investment in Plant & Machinery / Equipment
Manufacturing Service
1 Micro Enterprise Up to `25 lakhs Up to `10 lakhs
2 Small Enterprise `25 to `500 lakhs `10 to 200 lakhs
3 Medium Enterprise `500 to `1000 lakhs `200 to 500 lakhs
Bank loans to Micro, Small and Medium enterprises, for both manufacturing and service sectors are eligible to be classified under the priority sector. However, bank loans up to `500 lakh per unit to Micro and Small enterprises and `1000 lakh to Medium enterprises engaged in providing or rendering services are covered under priority sector advances. All loans sanctioned to units in the Khadi and Village Industries (KVI) sector, irrespective of their size of operations, location and amount of original investment in plant & machinery. Such advances will be eligible for consideration under the sub-target of 7% / 7.5% prescribed for Micro enterprises under priority sector.
3. Housing Loans: Loans to individuals up to `28 lakh in metropolitan centres (with population of ten lakh and above) and loans up to `20 lakh in other centres for purchase/construction of a dwelling unit per family provided the overall cost of the dwelling unit in the metropolitan centre and at other centres should not exceed `35 lakh and `25 lakh respectively. However, housing loans to banks' own employees will be excluded. As housing loans which are backed by long term bonds are exempted from ANBC, banks should either include such housing loans to individuals up to `28 lakh in metropolitan centres and `20 lakh in other centres under priority sector or take benefit of exemption from ANBC, but not both. Further, housing loans to the following are also treated as priority sector:
_ Loans for repairs to damaged dwelling units of families up to `5 lakh in metropolitan centres and up to `2 lakh in other centres.
_ Bank loans to any governmental agency for construction of dwelling units or for slum clearance and rehabilitation of slum dwellers subject to a ceiling of `10 lakh per dwelling unit.
_ Loans sanctioned for housing projects exclusively for the purpose of construction of houses only to economically weaker sections and low income groups, the total cost of which does not exceed `10 lakh per dwelling unit, will qualify for priority sector status. However, the family income of the borrower should not exceed `2 lakh per annum irrespective of location.
_ Loans to Housing Finance Companies (HFC), for on-lending for the purpose of purchase/construction/reconstruction of individual dwelling units or for slum clearance and rehabilitation of slum dwellers, subject to an aggregate loan limit of `10 lakh per borrower, provided the all inclusive interest rate (Interest rate, processing fee and service charges). However, this segment should not exceed five percent of the individual bank's total priority sector, on an ongoing basis. The maturity of bank loans should be co-terminus with average maturity of loans extended by HFCs. Banks should maintain necessary borrower-wise details of the underlying portfolio.
_ Outstanding deposits with NHB on account of priority sector shortfall.
_ Bank loans up to a limit of `5 crore per borrower for building social infrastructure for activities namely schools, health care facilities, drinking water facilities and sanitation facilities in Tier II to Tier VI centres.
4. Education Loans: Loans to individuals for education purposes including vocational courses up to `10 lakh in India and `20 lakh for abroad studies irrespective of the sanctioned amount will be considered as eligible for priority

sector.

5. Social Infrastructure: Bank loans up to a limit of `5 crore per borrower for building social infrastructure for activities namely schools, health care facilities, drinking water facilities and sanitation facilities in Tier II to Tier VI centres.
6. Renewable Energy: Bank loans up to a limit of `15 crore to borrowers for purposes like solar based power generators, biomass based power generators, wind mills, micro-hydel plants and for non-conventional energy based public utilities viz. street lighting systems, and remote village electrification. For individual households, the loan limit will be `10 lakh per borrower.
7. Weaker Sections: Priority sector loans to the following borrowers will be considered under weaker sections category:
No Category
1. Small and Marginal Farmers
2. Artisans, village and cottage industries where individual credit limits do not exceed `1 lakh
3.
Beneficiaries under Government Sponsored Schemes such as National Rural Livelihoods Mission (NRLM), National Urban Livelihood Mission (NULM) and Self Employment Scheme for Rehabilitation of Manual Scavengers (SRMS)
4. Scheduled Castes and Scheduled Tribes
5. Beneficiaries of Differential Rate of Interest (DRI) scheme
6. Self Help Groups
7. Distressed farmers indebted to non-institutional lenders
8. Distressed persons other than farmers, with loan amount not exceeding `1 lakh per borrower to prepay their debt to non-institutional lenders
9. Individual women beneficiaries up to `1 lakh per borrower
10. Persons with disabilities
11.
Overdrafts up to `5000/- under Pradhan Mantri Jan Dhan Yojana(PMJDY) accounts, provided the borrowers' household annual income does not exceed `100,000/- for rural areas and `1,60,000/- for non-rural areas
12. Minority communities as may be notified by Government of India from time to time
8. Investments by banks in securitised assets, representing loans to various categories of priority sector, except 'others' category, are eligible for classification under respective categories of priority sector.
9. Transfer of Assets through Direct Assignment/Outright purchases by banks representing loans under various categories of priority sector, except the 'others' category, will be eligible for classification under respective categories of priority sector.
10. Bank credit to MFIs extended for on-lending to individuals and also to members of SHGs / JLGs will be eligible for categorisation as priority sector advance under respective categories viz., Agriculture, Micro, Small and Medium Enterprises, and 'Others', as indirect finance, provided not less than 85 percent of total assets of MFI (other than cash, balances with banks and financial institutions, government securities and money market instruments) are in the nature of "qualifying assets". In addition, aggregate amount of loan, extended for income generating activity, should be not less than 50 percent of the total loans given by MFIs. "Qualifying asset" shall mean a loan disbursed by MFI, which satisfies the following criteria:
_ The household annual income of the borrower in rural areas does not exceed `1 lakh while for non-rural areas it should not exceed `1.60 lakh.

_ Loan does not exceed `60,000/- in the first cycle and `1 lakh in the subsequent cycles. Tenure of loan is not less than 24 months when loan amount exceeds `15000/- with right to borrower of prepayment without penalty.
_ Total indebtedness of the borrower does not exceed `1 lakh.
_ The margin cap should not exceed 10 percent for MFIs having loan portfolio exceeding `100 crore and 12 percent for others. With effect from April 1, 2014, interest rate on individual loans will be the average Base Rate of five largest commercial banks by assets multiplied by 2.75 per annum or cost of funds plus margin cap, whichever is less.
The banks should obtain from MFI, at the end of each quarter, a Chartered Accountant's Certificate stating, inter-alia, that the criteria on qualifying assets, the aggregate amount of loan, extended for income generation activity, and pricing guidelines are followed.
Factoring - Reserve Bank has included factoring transactions under priority sector lending with an aim to increase cash flow to small and medium enterprises. Factoring transactions on 'with recourse' basis shall be eligible for priority sector classification. Factoring is a type of financial transaction and debtor finance in which a business sells its invoices to a third party, called a factor, at a discount. TReDS is an exchange-based trading platform to facilitate financing of bills raised by such small entities to corporate and other buyers, including government departments and PSUs, by way of discounting. Factoring through TReDS shall also be eligible for classification under priority sector upon operationalisation of the platform.
Differential Rate of Interest Scheme (DRI): The target stipulated for lending under DRI scheme is 1% of previous year total advances of the Bank. The existing loan limit is increased from `6500/- to `15000/- and the housing loan limit is also increased from `5000/- to `20000/-. The borrower's family income eligibility criteria is revised to `18000/- & `24000/- p.a. for Rural & Semi-Urban/Urban areas respectively. The interest rate on DRI loans is 4% p.a. simple interest at half-yearly rests. At least two third of DRI advances should be granted through rural/semi-urban branches. 40% of DRI advances should go to SC/ST. 2/3rd of total DRI lending is to be routed through Rural and Semi Urban branches. Branches can assist the handicapped/disabled persons for acquiring aids, appliances and equipment needed especially by students for pursuing studies and vocational training – example Braille Typewriters for blind etc.
Classification of Farmers
Category Irrigated Land Holding Un-irrigated Land Holding
Marginal 1.25 Acres Or 2.5 Acres
Small 2.50 Acres Or 5.0 Acres
Others Above 2.50 Acres Or Above 5 Acres
Credit flow to SC/ST
Scheme Reservation / Relaxation
DRI 40% of Advances. Land holding criteria is not applicable
SGSY 50% of the families assisted
SJSRY Credit to be extended to the extent of their strength in the local
PMEGP p2o2p.5u0la%ti oonf Advances. Age relaxation – 10 Years

Adjusted Net Bank Credit (ANBC): This concept is applicable to Scheduled Commercial banks, Urban Cooperative Banks and Small Finance Banks. Hitherto, Priority Sector Lending (PSL) being a percentage of total credit which was not getting truly reflected for various reasons and hence the, the concept of ANBC has been introduced. The spirit of the concept is to calculate the total credit as on close of business of preceding year in a non-discriminatory way so that the banks are neither unduly benefitted nor adversely penalized. The ANBC is arrived at in a judicious manner by reducing the quantum of total credit whenever banks did not part with their own funds and by increasing the same by the quantum of credit which should have formed part of the credit but had gone to other avenues. The computation of ANBC = Total credit minus Bills discounted with RBI and other approved financial institutions plus Bonds/Debentures in Non-SLR categories under HTM category + other investments eligible to be treated as PSL + outstanding deposits under RIDF and other eligible funds with NABARD, NHB, SIDBI and Mudra Limited on account of priority sector shortfall + outstanding PSLCs

Credit Equivalent Amount of Off-Balance Sheet Exposure (CEOBE): Some banks business models allow them to focus less on credit and more on Off-balance sheet items such as Letter of Credit, Bank Guarantees, Derivatives, etc. In such cases, PSL, if calculated on ANBC would be less as off-balance sheet items do not form part of credit. Hence, PSL in such cases will be computed as a percentage of CEOBE so that the quantum of PSL does not become casuality

Priority Sector – Targets & Sub-targets

Category	Domestic commercial banks and Foreign Banks with 20 branches and above
Priority Sector	40 per cent of Adjusted Net Bank Credit (ANBC) or Credit Equivalent amount of Off-Balance Sheet Exposure (CEOBE), whichever is higher.
Agriculture	18 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher. Within the 18%, a target of 8% of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher is prescribed for Small and Marginal farmers, to be achieved in a phased manner i.e. 7% by March 2016 and 8% by March 2017.
Micro enterprises	7.5% of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher to be achieved in a phased manner by March 2017.
Export credit	Incremental export credit over corresponding date of the preceding year, up to 2 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher, effective from April 1, 2015 subject to a sanctioned limit of ₹25 crore per borrower to units having turnover of up to ₹100 crore.
Weaker sections	10 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.
Differential Rate of Interest Scheme	1 per cent of total advances outstanding as at the end of the previous year. It should be ensured that not less than 40 per cent of the total advances granted under DRI scheme go to SC/ST. At least two third of DRI advances should be granted through rural and semi-urban branches.

ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher. The additional priority sector lending target of 2% has to be achieved every year from 2016-17 and reach 40% by 2019-20. To ensure continuous flow of credit to priority sector, there will be more frequent monitoring of priority sector lending compliance of banks on 'quarterly' basis instead of annual basis as of now.

Scheduled Commercial Banks having any shortfall in lending to priority sector shall

be allocated amounts for contribution to RIDF established with NABARD and other

Funds with NABARD/NHB/SIDBI, as decided by the Reserve Bank from time to time. Non-achievement of priority sector targets and sub-targets will be taken into account while granting regulatory clearances/approvals for various purposes.

Priority Sector Lending Certificates (PSLC): Presently, Banks which are short fall in Priority Sector (PS) lending are investing in Rural Infrastructure Development Fund (RIDF) of NABARD. However, the yield on such investments is low. To obviate the above situation, RBI introduced PSLC. The banks who have PS advances more than the stipulated norm, may issue PSLCs. The banks who contribute to these certificates can show the amounts subscribed against their PS lending. At the same time, the bank which has issued the certificate will reduce the amount from their PS advances. However, there will be no transfer of credit risk on the underlying assets. The transactions can be done through the CBS portal "e-Kuber" maintained by RBI. The standard lot size is `25 lakh and multiples thereof and the validity period is 31st March every year. This is credit positive for banks without expertise in making priority sector loans because it allows them to focus on their strengths and purchase credits from banks with expertise in making such loans, instead of diverting their own resources towards meeting PS lending targets.

Prime Minister Employment Generation Programme (PMEGP): Prime Minister's Employment Generation Programme (PMEGP) by merging the two schemes that were in operation till 31.03.2008 namely Prime Minister's Rojgar Yojana (PMRY) and Rural Employment Generation Programme (REGP) for generation of employment opportunities through establishment of micro enterprises in rural as well as urban areas. The Scheme will be implemented by Khadi and Village Industries Commission (KVIC) and the details are as under:

Category	Project Cost		
	Borrower contribution	Subsidy	
		Urban	Rural
General	10%	15%	25%
Special (SC/ ST/OBC/Minorities/Women/ Ex-servicemen / Physically handicapped/ NER / Hill and Border areas etc.)	05%	25%	35%

business/service sector is `25 lakh & `10 lakh respectively. The balance amount, excluding Margin Money/subsidy, will be provided by Banks as term loan.

Any individual above 18 years of age is eligible for the loan. Self Help Groups (including those belonging to BPL provided that they have not availed benefits under any other Scheme) are also eligible for assistance under PMEGP. Institutions registered under Societies Registration Act 1860; Production Co-operative Societies, and Charitable Trusts. However, existing Units (PMRY / REGP or any other scheme of Central / State Government) and the units that have already availed Government Subsidy (including units registered & certified khadi institutions who have availed subsidy from central/state government) are not eligible.There will be no income ceiling for assistance for projects under PMEGP. For setting up of project costing above `10 lakhs in the manufacturing sector and above `5 lakhs in the business/service sector, the beneficiaries should possess at least VIII standard pass educational qualification. Assistance is available only for new projects under the PMEGP. To claim Margin Money (Subsidy), the borrower is required to submit caste/community certificate or relevant document issued by the competent authority. In case of institutions, a certified copy of the bye-laws is required. Project cost will include Capital Expenditure and one cycle of Working Capital. Cost of the land should not be included in the Project cost. Projects costing more than `5 lakh, which do not require working capital, need clearance from controlling office

PMEGP is applicable to all new viable micro enterprises, including Village Industries projects except activities indicated in the negative list of Village Industries. Existing/old units are not eligible. Only one person from one family is eligible for obtaining financial assistance for setting up of projects under PMEGP. The 'family' includes self & spouse. No collateral security will be insisted upon for projects involving loan upto `10 lakhs in respect of the projects cleared by the Task Force. After issuance of the sanction letter by the financing branch, the beneficiary must have to undergo EDP training (at least 2 weeks) for the purpose of release of funds. The margin money (subsidy) is to be kept in Term Deposit for three years at branch level in the name of the beneficiary/Institution. No interest will be paid on the TDR and no interest will be charged on loan to the corresponding amount. Repayment schedule may range between 3 to 7 years after an initial moratorium as may be prescribed by the concerned bank/financial institution. Corporation Bank is acting as Nodal bank in implementation of PMEGP scheme in the country.
Swarnajayanti Gram Swarojgar Yojana (SGSY): It is a Scheme which is a restructure of the erstwhile schemes like IRDP, TRYSEM, DOWCRA, SITRA, GKY & MWS etc., with the objective to bring the assisted poor rural families above poverty line. The scheme aims at establishing a large number of micro enterprises in the rural area. The identification of the borrowers will be done by Grama Sabha. Productive and viable activities under Agriculture & ISB are eligible under this scheme with 50% coverage by SC/ST, 40% coverage by women and 3% to Physically Handicapped borrowers. The size of the loan under the scheme would depend on the nature of the project. The loans under the scheme would be composite loan comprising of Term Loan and Working Capital. Subsidy admissible is @ 30% or maximum `7500/- (For SC/ST- 50% or maximum `10000) & for groups – 50% or maximum `1.25 lac (no ceiling for minor irrigation projects). For all individual loans exceeding one lakh and group loans exceeding `10 lakh, suitable margin money/other collateral security in the form of insurance policy; marketable security/deeds of other property etc. may be obtained. The repayment period – minimum of 5 years and branches should ensure that repayment not to exceed 50% of incremental income. In the event of unfortunate/untimely death of the borrower, LIC make payment of `6000/- for natural death and `12000/- for accidental death to the legal heirs of the borrower. (Cir no. 189 Ref 28/3 dated 2.8.2012)
Self Employment scheme for rehabilitation of Manual Scavengers (SRMS):
The objective of the National Scheme for Liberation and Rehabilitation of Scavengers and their dependents is to liberate them from their existing hereditary and obnoxious occupation of manually removing night soil and filth and to provide for and engage them in alternative and dignified occupations. The Scheme would cover primarily all scavengers belonging to Scheduled Castes community. Scavengers belonging to other communities would also be covered. The scheme covers rural and urban areas and the identification will be done by Ministry of Social Welfare & National SC/ST financial development corporation. The beneficiaries are eligible for term loan up to ` 15 lakh and Micro finance up to `25000/- is allowed without any margin. The loans sanctioned under this scheme are eligible for subsidy @ 50% for the projects where the unit cost is up to ` 2 lakh and `1 lakh + 33.30% of project cost between `2 to 5 lakh; `2 lakh + 25% of project cost between 5 to 10 lakh and `3.25 lakh for projects above `10 lakh. The moratorium period for repayment of loan is maximum of 2 years. The beneficiaries are eligible for cash assistance of `40000/- payable in monthly installments of `7000/- after the identification of manual scavenger. Government provides training to the beneficiaries and pays `3000/- per month as stipend during training period. Repayment period of the loan is 5 years for the projects costing up to `5 lakh and 7 years for projects above `5 lakh. Rate of Interest – For loans up to `25000 @ 4% for women; others 5%. For loans above

`25000/-, the interest rate is @ 6% p.a.

Deendayal Antyodaya Yojana - National Urban Livelihood Mission (DAY – NULM): The GOI restructured the existing SJSRY and launched the NULM in the year 2013 in all district headquarters and all the cities with population of 1 lakh or more. The Self Employment Program (SEP) is one of the components of NULM which will focus on providing financial assistance through a provision of interest subsidy on loans to support establishment of individual & group enterprises and SHGs of urban poor. With a view to improving the livelihood of opportunities for the poor in urban areas, GOI has enhanced the scope of NULM and renamed as "Deendayal Antyodaya Yojana - National Urban Livelihood Mission (DAY – NULM)" and the salient features are as under:

No	Criteria	Individual Enterprises	Group Enterprises
1	Identification	Urban Local Body through (ULB) Task force consisting Municipal Commissioner, Lead District Manager, City Project Officer, Representative from DIC, Banks and City level federation.	
2	Eligibility	Urban poor (unemployed / under employed) living below the poverty line, in any city/town. Minimum **18 years** at the time of applying for Bank Loan. Residing in the town for at least three years. No minimum and maximum educational qualification.	The group should have minimum 5 members (minimum 18 years) with minimum 70% members from urban poor families. More than one person from the same family should not be included in the same group. No minimum and maximum educational qualification.
3	Nature of Activities	Manufacturing, servicing and petty business having considerable local demand.	Manufacturing, servicing and petty business having considerable local demand.
4	Project Cost	₹2 lakh.	₹10 lakh.
5	Facility	Term Loan or Working Capital or Composite Loan.	Term Loan or Working Capital or Composite Loan.
6	Margin Money	No margin money up to 50000/- and for loans beyond fifty thousand 5% of the project cost.	No margin money up to 50000/- and for loans beyond fifty thousand maximum 10% of the project cost.
7	Interest	Prevailing interest rate. Interest subsidy will be given (over and above 7%) only in case of timely repayment of loan.	Prevailing interest rate. Interest subsidy will be given (over and above 7%) only in case of timely repayment of loan.
8	Collateral	No collateral is required. Loans should be covered under CGTMSE.	No collateral is required. Loans should be covered under CGTMSE.
9	Repayment	5 to 7 years after initial moratorium of 6 to 18 months as decided by Bank.	5 to 7 years after initial moratorium of 6 to 18 months as decided by Bank.
10	Others	Where the activity requires some special skills, appropriate training must be provided to the beneficiaries by the Nodal agency before extending financial support.	

Swarna Jayanti Shahari Rojgar Yojana (SJSRY): The objective of the scheme is to address Urban poverty alleviation, the scheme seeks to provide gainful selfemployment to the urban poor (living below the urban poverty line) either unemployed or under employed, through setting up of self-employment ventures or provision of wage employment. The scheme has components such as Urban self Employment Programme (USEP), Urban Women Self-help Programme (UWSP), Skill Training for Employment promotion amongst Urban Poor (STEP-UP), Urban Wage

The defaulter to any nationalized bank / financial institution / cooperative bank is not eligible to avail loan under SJSRY. The loans granted under this scheme should be treated as advances under priority sector. The scheme is meant for Urban Poor who are under below poverty line and aims to cover 30% Women & 3% physically handicapped and SC & ST borrowers as per proportion to their population. Urban Self Employment Programme (USEP) – Operational details in regard to Self-Employment Individual through setting up of Micro-Enterprises

Urban Women Self-Help Programme (UWSP) – Operational details in regard to self-employment (group) through setting up of Micro-Enterprises

1	Identification	Survey by ULB
2	Eligibility	Urban poor women living below the poverty line, in any city/town with preference performing urban women SHGs. Minimum number of women in a group is **five**. 18 years at the time of the group applying for Bank Loan. No minimum and maximum educational qualification.
3	Activity	Any group activity/enterprise development for income generation by the urban poor women
4	Subsidy	Subsidy would be provided at the rate of 35% of the project cost subject to a ceiling of ₹3 lakh or ₹60,000/- per beneficiary.
5	Margin Money	5% of the project cost
6	Interest	Interest applicable to priority sector.
7	Collateral	No collateral is required.
8	Repayment	Repayment schedule ranges from 3 to 7 years after initial moratorium of 6 to 18 months as decided by Bank.

STEP-UP, UWEP & UDCN – Inputs under the scheme would be delivered both through the medium of community structures to be set up along with Urban Local Bodies (ULBs) like Community Development Society-CDS/ town-Urban Poverty Alleviation-UPA Cell.

Rajiv Gruha Kalpa Scheme is meant for Economically Weaker section segment in Urban areas. The borrowers income should be minimum `2,000/- per month and maximum `36000/- per annum. The unit cost `75,000/- and the borrower is required to bring 10% margin and the maximum Bank loan is `67,500 per house. 10% increase in unit cost is permitted. Site will be allotted by Govt. of A.P. at free of cost. Interest Rate 8% fixed.

Valmiki Ambedkar Awas Yojana (VAMBAY): Housing Finance Scheme was launched in Andhra Pradesh on 01.11.2002 with an objective to provide shelter or upgrade the existing shelter for people below the poverty line and EWS in urban slums. The ultimate objective of the Scheme is to have "Slum Less Cities". The funding pattern is 50% Government, 40% bank Loan and 10% Borrower Margin. These loans attract interest @ 10% p.a. tripartite agreement between Beneficiary Bank & APSHCL.

Interest Subsidy Scheme for Housing the Urban Poor (ISHUP) is introduced by Government of India with an objective to enable the Economic Weaker Sections (EWS) and Lower Income Group (LIG) segments in the urban areas to construct or purchase houses by providing an interest subsidy of 5% on loan amount of maximum `1 lakh. EWS and LIG are defined as households having an average monthly income up to `5,000 and `5,001 to `10,000 respectively. The borrowers under the scheme must have a plot of land for the construction or have identified a purchasable house. The preference under the scheme should be given to SC/ST/Minorities/Women/persons with disabilities in accordance with their population in the total population of the area as per 2001 census. The scheme will provide a subsidized loan for 15-20 years for a maximum amount of `1 lakh for EWS individual

CERSAI:

Central Registry of Securitisation Asset Reconstruction and Security Interest of India is a Government of India Company licensed under section 8 of the Companies Act, 2013 with Govt. of India having a shareholding of 51% by the Central Government and select Public Sector Banks and the National Housing Bank also being shareholders of the Company.

The object of the company is to maintain and operate a Registration System for the purpose of registration of transactions of securitisation, asset reconstruction of financial assets and creation of security interest over property, as contemplated under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). CERSAI is providing the platform for filing registrations of transactions of securitisation, asset reconstruction and security interest by the banks and financial institutions. At present the portal provides facility to file security interest in immovables created through all types of mortgages and in units under constructions besides filing of Security Interests in movables, intangibles and factoring transactions is also available on the portal.

More than a statutory obligation CERSAI is a risk mitigation tool for the Banks / Housing Finance companies, FIs and public at large to prevent multiple financing against the same property.

Online search is available to public to enable them to search and inspect the records maintained by the Registry on payment of fees prescribed under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Central Registry) Rules, 2011. The search can be made on the basis of both Asset Details as well as on the basis of Debtor's details.

Total time available for registration is 30 days and another 30 days with additional fee

MODULE - E : MONITORING, SUPERVISION & FOLLOW UP AND MANAGEMENT OF IMPAIRED ASSETS

Documentation : Meaning, Importance, Types of documents, Requisites of documentation, Selection of documents, Stamping of different documents, Mode and time of Stamping, Remedy for un-stamped / under-stamped documents, Documents of which registration is compulsory, Time limit of registration, Consequence of non-registration, Execution, Mode of Execution by different executants, Period of Limitation, Law of Limitation to Guarantor, Extension of period of limitation, Enforcement of documents, Death of Borrower / Guarantor.

Types of Charges : Purpose, Various types of charges, Types of Security, Mode of charge, Lien, Negative Lien, Set Off, Assignment, Pledge, Right of Banker as a Pledgee, Duties as a Pledgee, Mode of Charges, Hypothecation, Mortgage - different types of mortgages, Difference between Simple and Equitable Mortgage.

Credit Monitoring, Supervision & Follow Up : Credit Monitoring - Meaning, Monitoring Goals, Process of Monitoring, Different Monitoring Tools, Check-list for Monitoring, Monitoring by using various statements, QIS Formats / guidelines, Supervision & Follow Up.

Management of Impaired Assets : Introduction, Credit Monitoring, NPA why & how?, NPA Management Policy, Definition of Sick Unit, Non-Performing Assets (NPA), Income Recognition Policy, Assets Classification, Guidelines on Asset Classification, Projects under implementation, Project Loans under Infrastructure and Non-infrastructure Sectors, Projects under Commercial Real Estate Sector, Income Recognition, Take out Finance, Provisioning Norms for NPA, Provisioning Coverage Ratio (PCR), Options available to banks in Stressed Assets, Prudential Guidelines on Restructuring, Eligibility criteria for restructuring, Asset Classification Norms for Restructured Assets, Mahapatra Committee Recommendations, Revised Prudential Guidelines on Restructuring of Advances, General Provision on Restructured Standard

Accounts, Up-gradation of Restructured Accounts, Rehabilitation, Viability Period, Viability Parameters, Incentives for Quick implementation of Restructuring Package, Corporate Debt Restructuring (CDR) Mechanism, CDR Structure & Operations, New RBI Framework for Distressed Assets, Willful Defaulters, Penal Measures, Compromise, Legal Action, Civil litigation, Pre and Post - filing precautions, Type of Decrees, Modes of Execution of Decree, Lok Adalats, Debt Recovery Tribunal, SARFAESI, Write Off. Fair Practices : Applicability, Practices to be adopted, Loan Processing,Assessment, Disbursement, Administration, Recall / Repayment of Loan, Grievance Redress Mechanisms.

Stamp Duty

'Stamp duty' means a tax payable on certain legal documents specified by statute; the duty may be fixed or ad valorem meaning that the tax paid as a stamp duty may be a fixed amount or an amount which varies based on the value of the products, services or property on which it is levied. It is basically a kind of tax paid on any transaction based on exchange of documents or execution of instruments.

Stamp Duty & Registry

What is the difference between a document and an instrument?

A document is the record of the conditions agreed upon by the parties involved in a transaction in a proper format. A document whose stamp duty has been paid or more simply, a stamped document is considered an authentic and legal document. It gets evidentiary value and can be admitted as evidence in Courts under the provisions of the Indian Stamp Act, 1899. The Indian Stamp Act, 1899 is a fiscal statute dealing with tax on transaction.

Instrument is a document by which a right or liability is created, transferred, extended, limited, extinguished or recorded.

Coming to the subject of stamps used on these documents, in India, two types of stamps are used:

Impressed stamp

Adhesive stamp

Impressed stamps can be:

1.

1. Labels affixed and impressed by proper officer,

1.

2. Stamps embossed or engraved on stamp paper, and

3. Impressions by franking machines generally done by the bank by depositing the necessary amount of stamp duty with the banks.

Adhesive stamps can be:

Adhesive stamps are labels which can be conveniently stuck on the instruments. Adhesive stamps can be further categorised into two categories: postal and non-postal stamps. Postal stamps are used only for transaction with the post office and related function whereas a non-postal stamp can be a court fee stamp, revenue stamp, notarial stamp, special adhesive stamp, foreign bill stamp, brokers' note, insurance policy stamp or a share transfer stamp.

The most important aspect of the stamp duty is the calculation of the stamp duty. But before the procedure of calculation itself, some basics need to be cleared.

On what kind of documents is a stamp duty levied on?

Stamp Duty, in India, is generally levied on transfer of property, shares, debentures, bill of exchange, conveyance deed, hire purchase, promissory note and movable and immovable assets. It is also used for partnership deed, gift deed, lease agreement, rent agreement, increase in authorized capital, agreement of sale, buying a house, bank guarantee, commercial property, home loan, loan agreement, mortgage, and service apartment. In real estate transaction that involves buying, selling, renting, and leasing of a residential or commercial property, stamp duty of required value are paid before signing it as the documents are not producible in a Court unless properly stamped.

Stamp Duty Calculator:

Usually it is easy enough to calculate the stamp duty payable as per the rates provided in the Indian Stamp Act or the State Stamp Act and pay accordingly. But in complex cases, the person paying the duty may not be able to ascertain the correct stamp duty and may for help apply for the opinion of the Collector of Stamps.

First step to calculate the Stamp duty is to identify which category the document or instrument falls under. There are three categories of transaction for the purpose of stamp duty calculation:

Under the *first category,* the stamp duty remains fixed no matter what value is mentioned in the document or instrument. Examples of such instruments are Administration Bond, Affidavit, Adoption Deed, Appointment in Execution of Power, Divorce, Apprenticeship Deed, Award, Article of Clerkship, Cancellation Deed, Duplicate, Charter Party, Copy of Extracts, Indemnity Bond, Power of Attorney, etc.

Under the *second category*, Stamp duty charges are dependent upon the value mentioned in the document. Such documents are Mortgage Deed, Lease Agreement, Title Deeds, Security Bond, Hypothecation Deed, Article of Association, etc.

Under the *third category,* the Stamp duty depend either on the value mentioned in the document or on the true market value, whichever is higher. Instruments like Conveyance, Agreement for sale, Gift exchange, Partnership Deed, Development Agreement, Transfer of Immovable Property, Trust Deed, Partition, and so on.

Stamp duty for property transactions:

Calculation of Stamp Duty Rates for property transactions:

The stamp duty rate varies from one kind of transaction and on the location of the transaction. Every state in India follows a separate stamp duty rate structure. Usually the duty levied is based on the current market value of the concerned property. The rates are determined at the beginning of every year and made public through the stamp duty ready reckon. The concept of e-stamping has now been introduced by the government which is able to come up with a more accurate value of duty for immovable property. Various popular parameters are taken into account by the e-stamping procedure to calculate the rates of stamp duty in a particular region such as debt and mortgage, distance from conveniences, approach roads, etc.

Revenue Stamp:

It is a tax of Re. 1 in the form of revenue stamp, which should be affixed on receipt for any money or other property, the amount or value of which exceeds Rs. 5000.

Rate of stamp duty:

Stamp duty on non-residential properties whether in a co-operative society or not is at a rate of 5% of the market value. Stamp duty on residential flats in a housing society and building covered under Article 25(d) of Schedule of the Bombay Stamp Act, 1958 attracts concessional rates depending upon its market value as follows:

i. for up to Rs. 1,00,000 stamp duty is nil,

ii. between Rs. 1,00,001 to Rs, 2,50,000 it is 0.5% of the value,

iii. between Rs. 2,50,001 to Rs. 5,00,000 Stamp duty is Rs. 1,250 +3% of the value above Rs. 2,50,000

iv. Above Rs. 5,00,000 it is Rs. 8,750 + 5% of the value above Rs. 5,00,000.

Mode and time of Stamping:
a. Revenue Stamps
b. Special Adhesive Stamps
c. Impressed Stamps
d. Embossed Stamps
e. Bill of Exchange Stamps
f. E – Stamping

Revenue Stamps are affixed on Demand Promissory Notes, Receipts, Balance Confirmation Letters and Acknowledgements of Debt and security. Special Adhesive Stamps are used on prescribed documents. The stamps carry inscription such as Insurance, Notarial, Share Transfer, etc. Some State enactments stipulate Balance Confirmation Letters and Acknowledgements of Debt and security shall be stamped with Special Adhesive Stamps. In such states Special Adhesive Stamps are being used instead of revenue stamps.

Adhesive stamps can be used in lieu of stamp papers, but the stamp has to be cancelled by proper officers appointed under the stamp rules. In some states like Kerala, Managers and Agents of Scheduled Commercial Banks are included within the meaning of _Proper Officer'. In such states use of adhesive stamps in lieu of Non

Judicial Stamp papers is valid.
Remedy for un-stamped / under-stamped documents
Documents which are not duly stamped are inadmissible in evidence. Law provides avenues for rectification by paying the duty and penalty.
If a document is not duly stamped, the same cannot be rectified by mere annexing the stamp paper of the deficit value. In cases of document which was not duly stamped by accident, shall be produced before the Collector of Stamps. After proving that the omission was by mistake or accident, the position can be rectified by paying the deficit.
In such cases, the document must be presented to the
Collector of Stamps within a period of one year from the date of execution.
In case, the period of one year is expired or the omission was not due to any accident or mistake, the rectification could be done only by paying the deficitduty and penalty in

court when they are produced before the Court in support of the claim.

In certain states, Stamp Act has provisions to inspect documents and impound insufficiently stamped documents during the course of such inspection. In other states, insufficiently stamped documents could be impounded by the Stamp Authority upon production of such documents. For a document to be treated as properly stamped, the stamp of proper description and value should be used.
Documents of which registration is compulsory:
1. Agreement between bank and the customer. If equitable mortgage is done, then also intimation is to be given to the sub-registrar office within 30 days of execution
2. Agreement between customer and any of his parties for property purchase or sale
3. Registration of Partnership: A partnership firm is registered with registrar of firms. Though, it is not necessary that the firm be registered yet registration is ,preferred because an unregistered firm can not sue others in its own name for recovery of its dues while others can sue it in its name. Therefore, while granting loans banks prefer that the firm should be registered one.
Time limit of registration:

Registration Of Documents

Once you pay the stamp duty, the document has to be registered under the Indian Registration Act with a sub-registrar. This registrar should be of the jurisdiction where the property is situated if the transaction involves property purchase.
The basic purpose of registration is to record the execution of the document. Only when you register the document, it becomes legal and the ownership, if any, is transferred to the right owner.

Registration Fee

The registration fee is a fee that is over and above the stamp duty. This fee varies from state to state.
Maximum Time Limit:
Documents that have to be mandatorily registered, should be presented within four months from the date of their execution, along with the requisite fee. In case the time limit has expired, you can make an application to the sub-registrar for condonation of the delay, within the next four months and the registrar may agree to register such documents, on payment of a fine that may be up to ten times the original registration fee. The registration fee for property documents is 1% of the value of the property,

subject to a maximum of Rs 30,000.

Consequence of non-registration:

Failure to register the purchase agreement of a property, could put you at a huge risk.
Any document that is mandatorily required to be registered but is not registered, cannot

be admitted as evidence in any court of law.

Execution
Mode of Execution by different executants:
Period of Limitation:

A Demand Promissory Note Three years from the date of DP Note.
A Bill of exchange payable at sight or upon presentation Three years when the bill is presented
An Usance Bill of exchange Three years from the due date
Money payable for money lent Three years from the loan was made.
A guarantee
Three years from the date of invocation of the
guarantee
A mortgage – enforcement of payment of money
Twelve years from the date the money sued
becomes due
A mortgage – foreclosure
Twelve years from the money secured by the
mortgage becomes
due
A mortgage – possession of Immovable property
Thirty years when the mortgagee becomes

entitled to possession

Charges – Pledge/Hypothecation/Mortgage

Banks do business with depositors' funds. The Banks have to honor their commitment to return the deposits whenever demanded by the depositors. The primary source of funds for repayment is the business itself; hence banks take considerable care to evaluate the profitability and sustainability of the business financed by them. Despite all care and due diligence some of the businesses could fail. The cause of failure may be changes in the external environment or mismanagement. Banks have to ensure that even if the business fails, their funds are recoverable by invoking the "Security" offered by the borrowers. Security is an asset like land, building and machinery, stocks (raw materials / finished goods), receivables and other securities which are charged to the bank. Charge is the legal right given by the borrower to the bank to take possession of dispose of the security in the event of default. The types of charges are:

Pledge is a charge where the borrower hands over possession of asset to the bank. For example loans against gold jewellery, warehouse receipts, key loan etc. The relationship between borrower and the bank is "Pledger" and "Pledgee". Under this, the ownership of the goods remains with the borrower but the possession of the goods is in the hands of the bank. The bank enjoys Right of Sale in case the loan is not repaid and the bank can sell the pledged goods after giving adequate notice of sale to the borrower. It is the responsibility of the bank to take as much care of the goods pledged as a man of ordinary prudence would under similar circumstances. When the loan is fully paid, it is the responsibility of the bank to handover the possession of the goods back to the borrower.

Hypothecation – Normally banks lend funds to the borrowers to acquire raw material / assets to undertake their business activities and these assets continues to be in the possession of the borrower. It is as if the borrower holds the asset on behalf of the Bank. Hypothecation gives the Bank right to take possession and sell the asset, in case of default. However, bank need to initiate action either under SARFEASI or Court/DRT to take possession of the asset.

Pledge Vs Hypothecation – Thus, while under pledge the ownership remains with the borrower but the possession passes on to the bank, under hypothecation, both ownership and possession remains with the borrower. While under pledge the bank can sell the asset without going to court, under hypothecation it can be done only through the legal process. Hypothecation creates "floating charge" on assets created out of bank funds. Though hypothecation is the most prevalent form of charge for bank finance, it is inferior to pledge. To protect their assets, banks need to inspect the hypothecated assets periodically.

Mortgage – While movable assets can be pledged or hypothecated, immovable assets (land and buildings) can only be mortgaged. It is similar to hypothecation – both ownership and possession remain with the borrower (mortgagor) and the bank (mortgagee) gets the right to take possession and sell the mortgaged property by of SARFEASI or legal action. During the subsistence of the mortgage, the borrower can't sell the mortgaged property without the consent of the bank.

Simple Mortgage: A simple mortgage does not involve giving the possession of the mortgagor's property to the mortgagee. The mortgagee deposits the title deeds of the asset to the mortgagor and it is also called "Equitable Mortgage". It is under mutual agreement that in case of non-payment by the mortgagee to the mortgagor within the specified time, the mortgagee can cause the mortgaged property to be sold in accordance with law and have the sale proceeds adjusted towards the payment of the mortgage money.

Mortgage by Conditional Sale: This type of mortgage entails the apparent sale of property by the mortgagor to the mortgagee on a conditional basis, that on default by mortgagor, the sale shall become absolute and complete. If the mortgagor repays his loan, the sale shall become null and void

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Usufructuary Mortgage: It is a mortgage, by an express or implied term gives possession to the lender and gives him rights to accrue the rents or income coming from that property as repayment for interest and mortgage money till the time repayment is complete. There is no time limit for payment of the mortgage money.

English Mortgage: The mortgagor transfers the mortgaged property to the mortgagee in entirety. However there is a condition that on complete repayment of the repayment money, he will re-transfer the property back to himself.

Anomalous Mortgage: A mortgage that does not fall under the purview of any of the mortgage types is called an anomalous mortgage.

Conditions attached with mortgage: While mortgaging property, only legal rights are transferred to the mortgagee but not the possession. An instrument of mortgage deed is mandatory. On sale of a mortgaged property, the mortgage flows along with the property.

Assignment of Debt – While tangible assets are pledged or hypothecated or mortgaged, "actionable claims" are charged to a lender by executing a deed of assignment. It covers debts, receivables, subsidy or duty drawback receivable from Government, amount receivable under Insurance Policy etc. The person who assigns the debt is called the assignor and the person in whose favor the debt is assigned is called assignee. It is similar to hypothecation of a movable asset. The ownership and possession, in terms of the right to recover the debt, remain with the borrower.

There are two types of assignments viz., Legal assignment and equitable assignment. Legal assignment is done by the assignor executing a deed of assignment. For example, granting loan against LIC policy. Under equitable assignment, the assignor executes an irrevocable power of attorney in favor of the bank to collect payment. Advances against Supply Bills falls under this category.

Lien – It means the right to hold another's property till his debt is repaid. Section 171 of the Indian Contract Act 1872 confers the right of general lien on bankers. In the absence of any specific document or charge, Banks can exercise the right of lien on any asset of the borrower which has come into their possession. Thus, banker's line is considered as an implied pledge. Bank can recover the dues by selling the asset only after giving the notice to the owner.

Negative Lien – It is an undertaking by the borrower not to create any charge on his assets without the consent of the bank. It does not confer any right on the bank.

Credit Monitoring, Supervision & Follow Up :

Credit monitoring can be defined as a supervision of a loan account, on an ongoing basis, keeping a continuous vigil / watch over the functioning of borrower's unit, to confirm that the account conform to the various assumptions made at the time of sanction or last renewal.

Following points to be taken care of while loan monitoring:

Symptoms of sickness, weakness and deterioration of asset quality must be recognized well in time and acted upon promptly through effective monitoring/ alertness to capture the early warning signal.

There should not be excessive reliance on securities in preference to viability and cash flow.

There should not be excessive lending to certain borrowers/ group accounts.

At the time of sanction of loans, there should not be over valuation of securities.

The charges on securities should be properly created.

Obsolete stocks should be monitored.

Stock statements should be submitted in time by the borrower.

Annual Financial statements should be submitted in time by the borrower.

All the covenants stipulated while sanctioning the loan should be adhered to.

The interest and instalments are paid as per the agreed schedule.

Credit Monitoring – Meaning: Credit monitoring is the process of periodically reviewing your credit reports for accuracy and changes that could be indicative of fraudulent activity. It is the tacking of an individual's credit structure, for any changes or suspicious activities. A credit monitoring service is will show an individual's credit report provide them with new information regarding new credit inquiries, accounts etc. The individual also can ensure if this information is actually genuine. Credit Monitoring can also be used by individuals to keep a check on their credit score, as well as keep track of them, giving them the option to be well of their credit history before applying for loans and mortgages. The process of monitoring takes many steps to ensure negligent loans in parameters of the credit policy followed when it comes to delinquency. The credit management section will ensure the collection of the loans.,

Monitoring Goals:

1. Impressing upon the borrower the seriousness of his loan commitment
2. Staying abreast of changes in the local environment (neighborhood) ι
3. Observing any lapses in good management practices ι
4. Watching for signs of any misuse of loan proceeds ι
5. Noting any changes in the behavior of the borrower towards the loan officer
6. Collecting important data relevant to the financial health of the business

Process of Monitoring:

Monitoring of loans and advances is one of the major tasks of any bank and this task can be effectively decentralised to the regional/zonal authorities to have an effective control and supervision. This involves maintenance of a large database at ZO/RO of branches, covering all accounts and details of borrowers. This information helps ROs/ZOs to make decisions to plan various budgetary provisions and policies.

This involves review of implementation on a continuous basis

1. A comprehensive management information system and credit information system is important for an effective loan monitoring
2. MIS is required to be reviewed and updated regularly
3. Transparent policy at transaction level is essential which must lay guidelines relating to procedures, risk taking
4. MIS should reflect future data requirements.

Different Monitoring Tools :

1. Decentralization /Delegation of powers: The Branches along with Regional heads approval should be able to take faster decisions
2. Appraisal at regular intervals: Credit appraisal should be carried on for all the

existing accounts. The periodicity of the appraisal should depend on the risk rating of the account

3. Rating of large loans: The loans above 5 crores should be rated by external agencies and actions should be taken as per the ratings

On ongoing basis branches shouldmonitor the following points:

STOCK STATEMENT A stock statement is a valuable return submitted by borrower periodically confirming that these stock are hypothecated to the bank and are free from all types of encumbrance. Both manufacturing as well as trading units have to submit stock statement.

i) Bankers have to discuss about the submission of stock statement with the borrower during sanction seriously without fail. ii) Scrutiny of stock statement is done seriously and regularly. iii) Give training to borrower if needed. iv) Provide training to credit officer / newly appointed BMs. v) If there is any warning signal, starts remedial action vi) Stock statement format should be modified

BOOK DEBT STATEMENT Book Debt Statement is one of the important statement submitted by the borrower should ensure the following

a) We have to discuss about the submission of book debt statement with the borrower during sanction, seriously without fail. b) We may tell them for penal interest due to non submission / late submission of statement. c) Scrutiny of book debt Statement must be done with utmost care by BM or Credit in charge. d) Provide training to our field functionaries and borrower also if needed. e) Locate any warning signal and take immediate remedial action.

MONTHLY SELECT OPERATIONAL DATA (MSOD) In some bank there is a provision of submitting monthly selective operational data . Monthly select operational data is to be submitted by borrowers enjoying aggregate working capital credit limit of Rs 10.00 lakh and above or amt fixed by concerning bank. MSOD statement gives key performance figures of a unit on a monthly basis . These figures of a unit on a monthly basis include sales, stock, receivables, short term borrowings and gross profit. These data give an idea about the performance of a unit and bankers can compare the performance with the annual projections accepted at the time of sanction or renewal of the working capital.

a) Periodicity may be changed monthly to quarterly . b) Make a part of term and condition of sanction. c) Training to borrower how to submit this statement. d) Training to bankers for its scrutiny. e) Penal interest provision to be made on non submission.

INSPECTION OF SECURITIES

All banks stipulate a condition in the sanction advice that —the bank shall have the right to examine at all times during the currency of advance the company's books of account and to have the assets changed to the bank(whether it is prime or collateral) inspected at the periodical intervals either through its own officer or outside agencies. Inspection is an important part of monitoring. It is very very effective monitoring tool and has to be used properly. Securities can be primary or collateral. The important items to be inspected are:- Fixed Assets: Land & Building, Plant & Machinery, Vehicles. Current Assets: Inventories under hypothecation or under pledge, Book debt and receivables. Important points to be kept in mind during inspection of different types of securities. a) Is it an agricultural land or industrial or residential land ? b) Is the property owned or lease hold ? c) Examine the extent of the land, location details like survey no , Khata no, boundary… d) Is it a land locked plot? e) Is there a free accessibility to the land? f) Ownership of the land to be verified.. g) Chain of the document of title to be ascertain. h) Types of construction of the building , whether it is a as per approved plan from local body or not. i) Confirm that bank's name board is prominently displayed in the building / factory and business premises. j) Whether project implementation is as per implementation schedule or not. k) The machinery installed is of the same quality and specifications as per the invoice projection given at the time of sanction. l) Whether Godown is suitable for the goods stored in. m) Arrangements for protection from natural calamities. n) Capacity of the godown vis-à-vis the declared stock. o) How the stock are stored ? e.g. in Tin, in bags, in drum etc p) Whether there is adequate moving space in between the rows to facilitate easy verification of stocks. q) Is there any stocks lying with outside agencies entrusted for job works. r) Detail of paid or unpaid stock. s) Movement of stock and goods lying with shipping agency. t) Any change in the line of business. u) Whether book debt, stock register ,sales register, purchased register, dispatch register, receivable register, insurance register, invoice register, latest tax paid register are maintained.

QUARTERLY PERFORMANCE REPORT (QPR) This return was recommended by the Tandon Committee (1974) and later endorsed by Chore Committee (1979).All borrower enjoying fund based working capital limit of Rs 1 Cr and above from the banking system are required to provide the information in the prescribed form as a part of financial discipline and monitoring of the working capital limits

a) Timely submission of QPR is very very essential for monitoring of big account. b) It must be mentioned in terms & conditions c) Not only mentioned in terms & condition, but also through discussion on it with borrower during sanction of loan account. d) Highlight penal interest provision with borrower. e) Give quality time for its scrutiny by our monitoring officer not take it as a formality or only for file purpose. f) One copy may be demanded by RO monitoring officer from branch. g) Abnormal variation in fund flow statement must be discussed with borrower. h) Half yearly fund flow to be submitted without fail and on time.

Check-list for Monitoring: (This is a check list for a specific branch. Go through the same)

1 The account is frequently overdrawn

2 The account is continuously overdrawn

3 The account is overdrawn and the branches have not taken sufficient steps to regularise the accounts promptly

4The balance outstanding have exceeded the drawing power

5 Balance confirmation and acknowledgment of debt not obtained

6 The stock, book–debts statements not received regularly/ promptly

7 The FFI/ financial statements/audited statements/ FFR 1 & 2/ other operational data, etc, not received regularly/ promptly

8 The stock, book–debts statements, etc, not scrutinised and no suitable action is taken

9 The FFI/ financial statements/ audited statements/ FFR 1 & 2/ other operational data, etc, not received regularly/ promptly/ not scrutinised and no suitable action is taken

10 Non–moving stock is not deducted to arrive at the drawing power

11 The age–wise break–up of debtors is not found on record. The borrowers are allowed to draw money on entire outstanding debt, which must rather be for the recent debts as prescribed for particular industries and as per margin prescribed in the sanction letter

12 Wide discrepancies observed in the stock statements and stock figures in the annual audited financial statements
13 No penal interest has been charged for delay in submission of various statements as per the terms of agreement depending upon the type of loan/ credit availed by the borrower
14 Many branches have not adhered to the prescribed frequency of physical verification of securities given against loans & advances
15 Drawing power limits are not revised as per market value of shares for advances against security of shares
16 End–use of funds not ensured/not known funds utilised for purpose other than for which granted
17 The projections submitted by the borrower stay far beyond the actual performance. Further, no explanation for the same is taken from the borrower
18 Major sale proceeds of the borrower not routed through the Bank
19 Audited statements of non–corporate borrowers having limit beyond Rs.10 lakh not received
20 Renewal proposals of advances not received on time and in many cases the limits are not renewed
21 Application of wrong rate of interest, processing charges, commission, other charges, etc. resulting in income leakage/ excess booking of interest of the Bank
22 Insurance cover for stock/property is inadequate/not on record/ not renewed/ not endorsed in favour of the Bank
23 Inspection/physical verification of security charged, not been carried out
24 Expired bills/foreign currency sight bills which are outstanding, have not been crystallized
25 EBW statements on write–off of overdue export bills of ECM not found on record
26 Confirmation as to genuineness of export transactions not obtained from Bank's foreign offices/ correspondents/customs department
27 Import credit, bill of entry evidencing import of goods not found
28 Documents are not obtained for bills discounted under Letter of Credit
29 Advances, which are eligible for whole turnover packing credit guarantee cover of ECGC, are not brought under its cover
30 Though government guaranteed accounts are irregular since long, the issue of invocation of guarantee does not seem to have been considered
31 Prescribed margins not maintained as per sanctions
32 Allocated limits, full terms of sanctions, stock statements, inspection reports, margin, etc. not available at monitoring branches
33 For allocated limits, inordinate delays were noticed in responding to transfer by the allocator branch
34 Regular meetings not held with other consortium members to review the performance of borrowers and to assess the current state of affairs/ not been held as per norms
35 Individual members of the consortium are not advised about the quarterly operating limits/ D.P. allocated to each one of them

Non Performing Assets/Prudential Norms

A strong banking sector is important for flourishing economy. The failure of the banking sector may have an adverse impact on other sectors. High level of Non

Performing Assets (NPA) suggests low credit quality and warrants high provisioning, which has direct bearing on profitability and net-worth of banks and value of shareholders. The increased incidence of NPA is one of the major concerns of Indian Banks in the recent years. An asset is classified as NPA, if due in the form of principal and interest are not paid by the borrower for a period of 90 days. If any advance or credit facility granted by banks to a borrower becomes non-performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exists certain advances / credit facilities having performing status.

Category Treated as NPA if:

Term Loan Interest and/or installment of principal remain overdue for a period of more than 90 days

Overdraft/
Cash Credit
(OD/CC)
accounts

1) The account remains out of order i.e., if the liability exceed limit/DP continuously for 90 days. If liability is within limit/DP, but there are no credits continuously for 90 days or credits are not enough to cover interest debited during the same period.
2) Drawings are allowed on DP calculated on stock statement older than three months continuously for a period of 90 days
3) Regular/adhoc credit limits have not been reviewed/renewed within 180 days from due date/date of adhoc sanction.

Agricultural
Loans

A Loan is granted for short duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for two crop seasons. A loan granted for long duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for one crop season. "Long duration" crops would be crops with crop season longer than one year and crops which are not "long duration" crops would be treated as "short duration" crops. The crop season for each crop, which means the period up to harvesting of the crops raised would be determined by the SLBC in each state. In respect of agricultural loans which are not linked to harvesting season, term loans given to non agriculturists, identifications of NPAs would be done on the same basis as non–agricultural advances i.e. 90 days delinquency norm.

Bills
Purchased /
Discounted

Bill remains overdue for a period of more than 90 days.

Other a/cs Any amount to be received remains overdue > 90 days.

Potential NPA (PNPA): are those accounts showing overdues and irregularities persist beyond 30 days. These are also known as Border line Performing Assets.

Date of NPA: It is the date on which the overdues or the irregularities cross 90 days or the date on which the account comes under Income Recognition norms.

Overdue: Any amount due to the bank under any credit facility is 'overdue' if it not paid on the due date fixed by the bank.

Net NPA=Gross NPA – (provisions held towards NPAs + Balances in Interest Sundry Suspense A/c + part payments received in suit filed accounts and kept in Sundry Suspense.+ claims received from ECGC/CGC and kept in Sundry Suspense a/c).

Income recognition: The policy of income recognition has to be objective and based on the record of recovery. Income from nonperforming assets (NPA) is not
recognized on accrual basis but is booked as income only when it is actually

and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.

Reversal of Income: If an account becomes NPA for first time during the year the unrealized interest that was taken to P&L account on accrual basis pertaining to the current year as well as pertaining to the preceding year, if any, shall also be reversed. This will apply to Government guaranteed accounts also.

Valuation of Security for provisioning purposes: In cases of NPAs with balance of Rs.5 crore and above stock audit at annual intervals by external agencies and collaterals such as immovable properties charged in favour of the bank should be got valued once in two years by approved valuers by the Board.

Asset classification: Banks are required to classify non-performing assets further into the following three categories based on the period for which the asset has remained nonperforming and the reliability of the dues:

Substandard Assets: A substandard asset would be one, which has remained NPA for a period less than or equal to 12 months. It indicates credit weakness and scope for loss if deficiencies are not corrected.

Doubtful Assets: An asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months.

Loss Assets: A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. It is considered as uncollectible and it is not warranted to continue as bankable asset since there is little scope for salvage or recovery value.

Multiple Limits/Branches: Facilities granted by a bank to a borrower will have to be treated as NPA (except bills discounted under LC) if any one facility of the borrower becomes NPA. Uniform lowest classification shall be accorded to all facilities. In case of credit facilities for a borrower at more than branch, the principal branch shall decide the NPA status.

Advances under consortium arrangements: Asset classification of accounts under consortium should be based on the record of recovery of the individual member banks.

Accounts where there is erosion in the value of security: Where there are potential threats for recovery on account of erosion in the value of security or nonavailability of security, asset should be straightaway classified as doubtful or loss asset as appropriate.

Advances against Term Deposits, NSCs, KVPs, IVPs and LIC policies need not be treated as NPAs. Advances against gold ornaments, government securities and all other securities are not covered by this exemption.

Loans with moratorium for payment of interest: In the case of bank finance given for industrial projects or for agricultural plantations etc. where moratorium is available for payment of interest, payment of interest becomes 'due' only after the moratorium or gestation period is over.

Agricultural Advances: In cases of conversion or reschedule of short term
production loan as a relief measure, the term loan as well as fresh short-term loan

may be treated as current dues and need not be classified as NPA.

overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. However, interest can be recognized only on recovery basis not on accrual basis. State Government guaranteed advances would attract asset classification and provisioning norms if interest and/or principal or any other amount due to the bank remains overdue for more than 90 days.
Availability of security/Net worth of borrower/Guarantor: The availability of security or net worth of borrower/ guarantor should not be taken into account for the purpose of treating an advance as NPA or otherwise, as income recognition is based on record of recovery.
Post-shipment Supplier's Credit: To the extent Export Credit Guaranteed amount is received from the EXIM Bank, the advance may not be treated as a nonperforming asset for asset classification and provisioning purposes.
Ever greening: Rescheduling of a loan without assessing the viability of the activity for the purpose of avoiding an account becoming NPA.

Asset Classification	Period as NPA	Current provisioning (%)	Revised accelerated provisioning (%)
Sub- standard (secured)	Up to 6 months	15	No change
	6 months to 1 year	15	25
Sub-standard (unsecured ab-initio)	Up to 6 months	25 (other than infrastructure loans)	25
		20 (infrastructure loans)	
	6 months to 1 year	25 (other than infrastructure loans)	40
		20 (infrastructure loans)	
Doubtful I	2nd year	25 (secured portion)	40 (secured portion)
		100 (unsecured portion)	100 (unsecured portion)
Doubtful II	3rd & 4th year	40 (secured portion)	100 for both secured and unsecured portions
		100 (unsecured portion)	
Doubtful III	5th year onwards	100	100

SMA Sub-categories	Basis for classification
SMA-0	Principal or interest payment not overdue for more than 30 days but account showing signs of incipient stress (Please see Appendix to Part C)
SMA-1	Principal or interest payment overdue between 31-60 days
SMA-2	Principal or interest payment overdue between 61-90 days

Advances covered by ECGC guarantee

In the case of advances classified as doubtful and guaranteed by ECGC, provision should be made only for the balance in excess of the amount guaranteed by the Corporation. Further, while arriving at the provision required to be made for doubtful assets, realisable value of the securities should first be deducted from the outstanding balance in respect of the amount guaranteed by the Corporation and then provision made as illustrated hereunder:

Example

Outstanding Balance	Rs. 4 lakhs
ECGC Cover	50 percent
Period for which the advance has remained doubtful	More than 2 years remained doubtful (say as on March 31, 2014)
Value of security held	Rs. 1.50 lakhs

Provision required to be made

Outstanding balance	Rs. 4.00 lakhs
Less: Value of security held	Rs. 1.50 lakhs
Unrealised balance	Rs. 2.50 lakhs
Less: ECGC Cover (50% of unrealisable balance)	Rs. 1.25 lakhs
Net unsecured balance	Rs. 1.25 lakhs
Provision for unsecured portion of advance	Rs. 1.25 lakhs (@ 100 percent of unsecured portion)
Provision for secured portion of advance (as on March 31, 2012)	Rs.0.60 lakhs (@ 40 per cent of the secured portion)
Total provision to be made	Rs.1.85 lakhs (as on March 31, 2014)

Advance covered by guarantees of Credit Guarantee Fund Trust For Micro And Small Enterprises (CGTMSE) or Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH)

In case the advance covered by CGTMSE or CRGFTLIH guarantee becomes nonperforming, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing assets. An illustrative example is given below:

Example

Outstanding Balance	Rs. 10 lakhs
CGTMSE/CRGFTLIH Cover	75% of the amount outstanding or 75% of the unsecured amount or Rs.37.50 lakh, whichever is the least
Period for which the advance has remained doubtful	More than 2 years remained doubtful (say as on March 31, 2014)
Value of security held	Rs. 1.50 lakhs

Provision required to be made

Balance outstanding	Rs.10.00 lakh
Less: Value of security	Rs. 1.50 lakh
Unsecured amount	Rs. 8.50 lakh
Less: CGTMSE/CRGFTLIH cover (75%)	Rs. 6.38 lakh
Net unsecured and uncovered portion:	Rs. 2.12 lakh
Provision for Secured portion @ 40% of Rs.1.50 lakh	Rs.0.60 lakh
Provision for Unsecured & uncovered portion @ 100% of Rs.2.12 lakh	Rs.2.12 lakh
Total provision required	Rs.2.72 lakh

Asset classification of accounts under consortium should be based on the record of recovery of the individual member banks

A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons.

A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season

The credit facilities backed by guarantee of the Central Government though overdue may be treated as NPA only when the Government repudiates its guarantee when invoked.

A credit card account will be treated as non-performing asset if the minimum amount due, as mentioned in the statement, is not paid fully within 90 days from the next statement date. The gap between two statements should not be more than a month

Provisioning Coverage Ratio

i. Provisioning Coverage Ratio (PCR) is essentially the ratio of provisioning to gross non-performing assets and indicates the extent of funds a bank has kept aside to cover loan losses

Corrective Action Plan (CAP) by JLF

27.1 The JLF may explore various options to resolve the stress in the account. The intention is not to encourage a particular resolution option, e.g. restructuring or recovery, but to arrive at an early and feasible solution to preserve the economic value of the underlying assets as well as the lenders' loans. The options under Corrective Action Plan (CAP) by the JLF would generally include

a)Rectification - Obtaining a specific commitment from the borrower to regularise the account so that the account comes out of SMA status or does not slip into the NPA category.

b)Restructuring - Consider the possibility of restructuring the account if it is prima facie viable and the borrower is not a wilful defaulter, i.e., there is no diversion of funds, fraud or malfeasance,

c)Recovery - Once the first two options at (a) and (b) above are seen as not feasible, due recovery process may be resorted to. The JLF may decide the best recovery process to be followed,

ECGC

Risks in International Trade

Foreign trade risk may be defined as Uncertainty or Unplanned events with financial consequences resulting into loss. Types of Risks are as under:

1. Buyers" Risk: Non-Acceptance or non-payment
2. Sellers" Risk: Non- shipping or Shipping of poor quality goods or delay.
3. Shipping Risk: Mishandling, Goods siphoned off, Strike by potters or wrong delivery.
4. Other Risks:
- Credit Risk
- Legal Risk
- Country Risk
- Operational Risk
- Exchange Risk
5. Country Risk

Provision of risk is made if Exposure to one country is 1% or more of total assets. ECGC has the list of Country Risk Ratings which can be referred to by the Banks and the banks can make their own country risk policy.

Risk Classification of Countries

Export Credit and Guarantee Corporation provides guarantee cover for risks which can be availed by the banks after making payment of Premium.
ECGC adopts 7 fold classification covering 204 countries. The list is updated and published on quarterly basis. The latest classification is as under:
1. Insignificant Risks A1
2. Low Risk A2
3. Moderately Low Risk B1
4. Moderate Risk B2
5. Moderately High Risk C1
6. High Risk C2
7. Very High Risk D

Besides above, 20 countries have been placed in "**Restricted Cover Group-1"** where revolving limits are approved by ECGC and these are valid for 1 year.
The other 13 countries are placed in **"Restricted Cover Group-2"** where specific approval is given on case to case basis by ECGC

ECGC _ Export Credit and Guarantee Corporation

ECGC was established in 1964. Export Credit and Guarantee Corporation provides guarantee cover for risks which can be availed by the banks after making payment of Premium. Its activities are governed by **IRDA.**
The functions of ECGC are 3 fold:
1. It rates the different countries.
2. It issues Insurance Policies.
3. It guarantees proceeds of Exports.

Types of Policies:

1. Standard Policies

It provides cover for exporters for short term exports. These cover **Commercial and Political Risks**. The different types of Policies are:
- Shipment (Comprehensive Risk) Policy – to cover commercial and political risks from date of shipment. **Default of 4 months.**
- Shipment (Political Risks) Policy.
- Contracts (Comprehensive Risk) Policy for both commercial and Political risks.
- Contracts (Political Risks) Policy

2. Small Exporters' policy

A small exporter is defined whose anticipated total export **turnover** for the period of 12 M is **not more than 50 lac**. The policy is issued to cover shipments 24 M ahead.
The policy provides cover against Commercial risks and Political risks covering insolvency of the buyer , failure of the borrower to make payment due within 2 months from due date, borrower"s failure to accept the goods due to no fault of exporter.

3. Specific Shipment Policy

Commercial risks – Failure to pay within 4M. It covers short term credit not exceeding 180 days.

4. Exports Specific Buyer Policy

Commercial risks – Failure to pay within 4M and Political Risks
The other Policies are Exports (specific buyers" Policy), Buyers" Exposure Policy, Export Turnover Policy (exporters who pay minimum 10 lac premium to ECGC are eligible) and Consignment export Policy.

Financial Guarantees

ECGC issues following types of Guarantees for the benefit of Exporters:

Packing Credit Insurance

ECIB (WT-PC) – Exporters Credit Insurance for Banks (whole Turnover Packing Credit)
This policy is issued to banks to guarantee export risks:
- For all exporters
- Minimum 25 accounts should be there.
- Minimum assured premium is Rs. 5.00 lac.
- Period of cover is 12M.
- The claim is payable if there is default of 4 Months.
- Premium for fresh covers is 8 paisa per month and for others is 6-9.5 paisa percent per month. It is calculated on average outstanding.
- Percentage of cover ranges from 50-75%
- If due date of export proceeds is extended beyond 360 days, approval of ECGC is required.
- Claim is to be filed within 6M of report of default to ECGC.

ECIB – PC – for individual exporters. The advance should be categorized as Standard Asset. The period of coverage is 12M and %age of cover is 66-2/3 %. The premium is 12 paisa% per month on highest outstanding.
- Monthly declaration by banks before 10th.
- Approval of Corporation beyond 360 days PC.
- Report of default within 4M from due date.
- Filing of claim within 6M of the report.

ECIB –(WT- PS) – Whole Turnover Post Shipment Credit Policy
- It is a common policy for all exporters.
- Advances against export bills are covered.
- Premium is 5-9 paisa % per month.
- Cover is usually 60-75%.
- If the cover is taken by exporter individually, the cover increases to 75-90%.

Export Finance Guarantee

When banks make advance to exporters against export incentives receivables like Duty Drawback etc. The cover available is 75% and the premium ranges from 7 paisa onwards.

Exchange Fluctuation Risk Cover Scheme

The cover is available for payment schedule over 12 months up to maximum period of 15 years. Cover is available for payments specified in USD, GBP, EURO, JPY, SWF, AUD and it can be extended for other convertible currencies.
The contract cover provided a franchise of 2% Loss or gain within range of 2% of reference rate will go to the account of the exporter. If the loss exceeds 2% , the ECGC will make good the portion of loss in excess of 2% but not exceeding 35%.

The other guarantees are:
- Export Performance Guarantee
- Export Finance (Overseas Lending) Guarantee.

Transfer guarantee – cover to the confirming bank in India.

Maturity

Factoring

ECGC provides full-fledged Factoring Insurance services. It facilitates purchase of account receivables. It provides up to 90% finance against approved transactions. It follows up collection of sales proceeds. Exporters of good track record and dealing on DA terms having unexpected bulk orders are eligible to apply.

Common

Guidelines

Notice of Default

Notice of default must be served within a period of 4 months from due date or 1 month from date of recall.

Lodging of Claim

The claim should be filed with ECGC within maximum period of 6 months from date of lodging of Default Notice.

Lok Adalats:

INTRODUCTION

o Lok adalat is similar to a civil court can be organised by the State Authority, the District Authority, The Supreme Court Legal Service Committee or High Court Legal Services Committee at such intervals and places as deemed appropriate.

o Lok Adalts are created under Legal Services Authority Act 1987

JURISDICTION AND TYPES OF CASE

o A lok Adalt has jurisdiction to determine and arrive at a compromise or settlement between the parties to compromise or settlement between the parties to the dispute. It deals with the cases where

o The parties to the dispute agree to refer the issue to parties to Lok Adalt

o One of the parties approaches the Lok Adalt and Lok Adalt is satisfied that there are chances of settlement. In such case , the Adalt issues notices to the other party

o In the opinion of the Lok Adalt, the cognizance of the dispute can be taken.

CASES THAT CANNOT BE TAKEN UP

o The offences, which are compoundable under any Law, cannot be brought within the purview of the Lok Adalt. This implies that the Lok Adalt has no authority of its own, to pass judgements.

AWARDS OF LOK ADALT

o Their awards are in the form of consent decrees

o No appeal lies against such awards which is binding on all parties

PROCEDURE AND POWERS

o Civil Procedure Code is applicable which means the Lok Adalt can send summons, take evidence on oath, initiative ex-party proceedings and determine court procedures.

WHERE COMPROMISE IS NOT REACHED

o The case shall be returned back to the court from which the references was received for continuing with the case, there.

RBI GUIDELINES ON LOK ADALTS

o To make increasing use of the forum of Lok Adalts to settle banking disputes involving smaller amounts, RBI during April 2001 advised bank and financial institutions to follow the following guidelines for implementation:

AMOUNT

o Cases involving an amount up to Rs. 20 lakh may be referred to Lok Adalats

BORROWERS

o All NPA accounts, both suit filed and non-suit filed which are in ―doubtful‖ and ―loss‖ category. NO cut off date is suggested since Lok Adalat is an on-going process.

SETTLEMENT FORMULA

o It would be flexible with following essential parameters

o A decree should be sought from the Lok Adalat for the principal amount and interest claimed in the suit and after full payments of decree amount, a discharge certificate should be issued by the bank/financial institutions.

o Repayment period to be within 1-3 years

o The negotiated agreement should contain a default clause. If borrower does not pay due amount regularly, within the repayment period, entire debt will fall due for payments and bank may initiate legal proceedings

o The representing Offices should have sufficient powers to accept the comparises worked out within bank policy framework and should respond pro-actively to the suggestion of the Presiding Officer of the Lok Adalat.

DRT LOK ADALTS

o Banks can take up matters where outstanding exceed the ceiling of Rs. 20 lac, with Lok Adalats organised by the Debt Recovery Tribunals / Debt Recovery Appellate Tribunals.

SUPREME COURT SUGGESTION

o Supreme Court has suggested that personal loan cases up to Rs. 10 lac should preferably settled through Lok Adalts.

ORGANISATIONAL ARRANGEMENTS

The individual banks and financial institutions should be more pro-active and should take the responsibility of organising Lok Adalts. The institutions should get in touch with State/ District/ Taluk level Legal Services authorities for organising Lok Adalats. The banks should report the progressing to RBI at quarterly intervals within one month from the quarters ending MARCH, June, September and December. RBI monitors the progress made by the institutions in effecting recovery under the scheme

Debt Recovery Tribunal:

Debt Recovery Tribunals were established to facilitate the debt recovery involving banks and other financial institutions with their customers. DRTs were set up after the passing

of Recovery of Debts due to Banks and Financial Institutions Act (RDBBFI), 1993. Appeals against orders passed by DRTs lie before Debts Recovery Appellate Tribunal (DRAT). DRTs can take cases from banks for disputed loans above Rs 10 Lakhs. At present, there are 33 DRTs and 5 DRATs functioning at various parts of the country. In 2014, the government has created six new DRTs to speed up loan related dispute settlement.
Imp points:
1. DRTs are Special types of courts for effecting recovery of dues of banks and financial institutions.
2. DRTs are established under the Recovery of Debts due to banks and financial institutions Act 1993

2. The Act is not applicable to J&K.
3. 4. DRT is headed by a Presiding Officer. He is assisted by a Recovery Officer and one
4. Registrar.
5. 5. Type of Cases: Cases involving recoverable dues-of banks and Fls of Rs 10 lacs and
6. above only are filed with DRTs. Such cases can not be filed in the normal civil courts.
7. 6. Once the case is decided in favour of the bank or FI, the DRT issues a Recovery
8. Certificate. Recovery Officer who has powers such as attachment etc. helps in recovery
9. of dues through execution of the decree passed by DRT.
10. 7. Appeal against the order of the RecoveryOfficer can bemade to DRT within 30 days
11. of passing the order.
12. 8. Any appeal against the judgement of DRT can be preferred with Debt Recovery
13. Appellate Tribunal_ The head of DRAT is called Chairperson. The appeal is made
14. within 45 days of the date of receipt of the order. If borrower wants to appeal, 75% of
15. the judgment amount is required to be deposited which can be waived or reduced by
16. the Chairperson of the DRAT even to nil.
17. 9. Fee: for filing case with DRT- up to Rs 10 lac : Rs 12,000; For each additional Rs **1**
18. lac or part
19. thereof it is Rs 1000. Maximum amount of fees is Rs 1,50,000,
20. For filing appeal with DRAT- Where the amount of debt is less than Rs 10 lakh- Rs
21. 12,000; For debts due between Rs 10 lakh to less than Rs 30 lakh- Rs 20,000;
22. For debts of Rs 30 lakh andmore—Rs 30,000
23. 10. For being appointed as DRT, a person should qualify to be District Judge and for
24. being appointed as DRAT, the person should qualify to be a Judge of the High Court.
25. SARFAESI:

The **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002** (also known as the **SARFAESI Act**) is an Indian law. It allows banks and other financial institution to auction residential or commercial properties to recover loans. The first asset reconstruction company (ARC) of India, ARCIL, was set up under this act
Under this act secured creditors (banks or financial institutions) have many right for enforcement of security interest under section 13 of SARFAESI Act, 2002. If borrower of financial assistance makes any default in repayment of loan or any installment and his account is classified as Non performing Asset by secured creditor,then secured creditor may require before expiry of period of limitation by written notice to the borrower for repayment of due in full within 60 days by clearly stating amount due and intention for enforcement. Where he does not discharge dues in full within 60 days, THEN WITHOUT INTERVENTION OF ANY COURT OR TRIBUNAL Secured creditor may take possession (including sale,lease,assignment) of secured asset, or takeover management of business of borrower or appoint manager for secured asset or without taking any of these action may also proceed against guarantor or sell the pledged asset, if any.

Mardia Chemicals Ltd. v. ICICI Bank

In *Mardia Chemicals Ltd. v. ICICI Bank*, on 8 April 2004, the Supreme Court of India declared the Sarfaesi Act to be constitutionally valid. The Court said that a borrower may appeal against the lender in the debt recovery tribunal, without having to deposit 75% of the amount of the debt. If the tribunal does not stay the order, the lender may sell the assets.

After this law passed, on 27 November 2002, ICICI Bank took possession of Mardia Chemical plant in Vatva, Ahmedabad district, Gujarat. ICICI Bank was owed Rs 300 crore, in all it owed Rs.1,450 crore to 20 lenders.

Credit Management MCQS

1. As per RBI guidelines, the turnover method of assessment should be applied for working capital limits of up to Rs in case of SSI units.
(a) One Crore (b) Two Crore (c) Five Crore (d) Ten Crore
2. Interest rates, regulated by RBI, are applicable for credit limits up to Rs. ______ lakh
(a) One (b) Two (c) Five (d) Ten *(e) None of these
3. The total priority sector target for foreign banks, operating in India, with less than 20 branches is% of ANBC or credit equivalent of Off Balance Sheet Exposure whichever is higher.
(a) 20% *(b) 32% (c) 40% (d) 18%
4. Net working capital meas which of the following?
(a) Total current assets minus bank finance
(b) Total current assets minus credit from suppliers
*(c) Total current assets minus total current liabilities
(d) Short term sources brought in by promoters
5. Which of the following statements is not true for efficient inventory management?
(a) It results in reduction in inventory
(b) It reduces the working capital requirements of the enterprise. *(c)
It reduces the NWC available with the enterprise.

(d) It increases the Inventory Turnover Ratio if the level of sales remains the same.
6. Which of the following is not a source for meeting working capital requirements?
(a) Suppliers Credit (b) Bank Finance (c) Other current liabilities *(d) Advance payment to suppliers
7. Which of the following is a liquidity ratio?
*(a) Quick Ratio (b) TOLITNW (c) DSCR (d) DER
8. Which of the following is not correct regarding Current Ratio?
(a) For same level of current assets, increase in NWC results in increased current ratio.
(b) The current ratio can be less than one
*(c) The current ratio can be negative.
(d) Current ratio is an indicator of liquidity.
9. The commercial paper can be issued by which of the following?
*(a) Corporates (b) Corporates and partnership firms (c) Any Business Entity (d) None
10.Which of the following is not correct regarding forfeiting?

(a) It is a form of working capital finance
(b) It is used in export finance
*(c) It is with recourse to the drawer of the bill.
(d) Under this financier discounts the bills drawn on buyer.
11.Which of the following is correct regarding Letters of Credit?
(a) These are opened by a bank for export sales by the client
(b) These are opened by a bank for local sales by the client.
(c) Letters of Credit do not carry much risk for the opening bank.
*(d) Letters of Credit are opened by a bank for purchase of goods by' the client.
12.Under Turnover method of assessment, the limit is sanctioned at per Cent of the projected turnover.
(a) 25 *(b) 20 (c) 30 (d) 35
13. Cash Budget Method of assessment is more suitable for those business enterprises which have
(a) uniform level of operations (b) High level of operations
(c) Low level of operations *(d) Seasonal Operations
14.A DPG is issued by the bank for__________ , by its client
(a) Sale of goods (b) Purchase of goods
(c) Sale of capital goods *(d) Purchase of capital goods
15.Which of the following statements is not true for an infrastructure project?
(a) It has long gestation period
*(b) It reduces the risk for the lender as his funds get assure deployment for a long time.
(c) The debt equity ratio is normally high for an infrastructure project.
(d) The implementation period is usually long
16.Which of the following is not a source of funds for meeting the cost of purchase of fixed assets by an enterprise?
(a) Credit by supplier of assets (b) Internal accruals (c) Debentures *(d) DPG
17.Which of the following is a ratio indicative of the repayment capacity of a borrower?
(a) Quick ratio (b) TOLJTNW *(c) DSCR (d) DER
18.Which of the following is not correct regarding term loans by the banks?
(a) Asset liability matching is an important consideration in term financing
(b) Instalment•of term loan, payable within one year is considered as current liablility
(c) Repayment of a term loan can be in equated monthly
instalments. *(d) Current ratio is the most important ratio in appraisal of a
term loan 19. Project loans can be given by the bank to
(a) Only corporate (b) Only corporate and partnership firms
(c) Only corporate, partnership firms and societies *(d) Any business entity
20.Which of the following is not correct regarding infrastructure project by the
banks?
(a) Banks are allowed to funds promoters' equity in certain circumstances
(b) Exposure norms are relaxed by RBI
*(c) Asset liability mismatch has been permitted by RBI

(d) MFG provides liquidity support to banks
21. Which of the following statements is not correct for project appraisal?
(a) Examination of technical feasibility is carried out
(b) The contribution of promoters forms a part of economic appraisal
(c) Promoters' background is part of the management appraisal
*(d) Capacity of promoters to arrange for additional funds, in case of contingencies, forms a part of economic appraisal
22.Which of the following is not a purpose of credit monitoring
(a) To ensure end use of the funds by the borrower
(b) To detect any deterioration in the security charged to the bank
(c) *To comply with the guidelines of the RBI
(d) To ascertain that the business continues to run on the projected lines
23.Which of the following is not a tool available to the bank for credit monitoring?
(a) *Sending regular reminders to the borrower
(b) Periodic visits to the business place for inspection
(c) Analysis of financial statements
(d) Examine conduct of borrower's account
24.Which of the following is not a method of detecting wrong mention of inventory in a stock statement?
(a) Stock audit
(b) Inspection of stocks
(c) *Analysis of financial statements
(d) Cross-check from the balance sheet figure
25.Which of the following is not a method of detecting wrong mention of receivables in statement submitted by the borrower?
(a) *Analysis of financial statements
(b) Cross check from the balance sheet figure
(c) Receivables audit
(d) Inspection of books of account
26.Which of the following is not a danger sign about the direction of business of the borrower?
(a) Devolvement of LCs, invocation of Bank Guarantees
(b) Demand for higher limit
(c) Delays in submission of stock/receivables statements
(d) *Return of cheques/bills
27.Which of the following is not an unsatisfactory sign in conduct of the account of the borrower?
(a) Delay in payment of interest/instalments,
(b) Routing of transacrions with some other bank
(c) Frequent over drawings
(d) *High turnover
28.Which of the following is not the purpose of credit audit?
(a) Improvement in the quality of credit portfolio
(b) Review sanction process and compliance status of large loans
(c) Feedback on regulatory compliance
(d) *Stock inspection
29. Purpose of appointing bank's nominee on company's board of borrowing company is:
(a) *To keep a tab on the important decisions of the board
(b) To be a part of the management
(c) To guide the company for better working
(d) To safeguard the securities charged to the bank 30.Which of the following is not a risk mentioned in the Basel II Accord
(a) Operational risk (b) Market risk *(C) Default risk (d) Credit risk
31.Which of the following is not a credit risk?
(a) Unwillingness of a customer to meet his commitment relating to a financial transaction with the bank.

(b) Inability of the customer to reimburse the bank in case of invocation of a guarantee or devolvement of an L.C.
(c) Inability of a customer to meet his commitment relating to a financial transaction with the bank.
(d) *Loss to the bank due to fraud.
32.Which of the following is an external factor affecting credit risk
(a) *Government policies
(b) Faulty loan and repayment structuring
(c) Overexposure (concentration) of credit to a particular segment
(d) Lack of an efficient recovery machinery
33.Which of the following is not an internal factor affecting credit risk
(a) Excessive lending to cyclical industries
(b) Low quality of credit appraisal and monitoring
(c) Deficiencies in the loan policy of the bank
(d) *Protectionist policies of other countries.
34.Which of the following is not a macro level action for mitigation of credit risk/
(a) Periodically reviews of the exposure norms for single and group borrowers
(b) *Improving appraisal standards of credit proposals
(c) Frequent reviews of norms and fixing internal limits for aggregate commitments to specific sectors of the industry/business
(d) Periodic review of total credit portfolio based on quality parameters
35.Which of the following is not a micro level action for mitigation of credit risk?
(a) Improving sanctioning and delivering process
(b) Obtention of collateral security
(c) Monitoring and review of individual proposals/categories of proposals
(d) *Periodical reviews of the exposure limits for business/industry segment
36.Which of the following statements is not true regarding credit derivative products?
(a) These are used to hedge credit risk to the bank
(b) The protection buyer is the lending bank
(c) The protection seller can be another bank or any other organization
(d) *The credit asset is transferred in case of derivatives
37.Credit rating is a system of
(a) *Measuring risk
(b) Mitigating risk
(c) Migrating risk
(d) Credit appraisal
38.Internal rating means:
(a) Rating the project
(b) Rating the promoters
(c) Rating the risk for internal use.
(d) *None of the above
.39.For external credit rating, banks depend on
(a) *Rating agencies
(b) Experienced staff of the bank
(c) Banking consultants
(d) None of the above
40.Which of the following is not an approach for assessment of credit risks, laid down under Basel II Accord?
(a) Standardised approach
(b) Foundation Internal Rating Based (IRBO approach
(c) Advanced Internal Rating Based (IRB) approach
(d) *Simplified Internal Rating Based (IRB) approach
41.Which of the following statements is true regarding Standardised approach?
(a) *It has already been adopted by all the banks
(b) It has been adopted only foreign banks operating in India.

(c) It has been adopted by the foreign banks operating in India and some of the Indian banks
(d) It has to be adopted by the all the banks by March 2010
42.RB1 has suggested which of the following earliest date of making application by banks to RBI regarding implementation of the advanced approaches (Foundation as well as Advanced IRB)?
(a) *1, April 2012
(b) 1, April 2013
(c) 1, April 2014
(d) 1, April 2015
43.The aim of a rehabilitation programme is:
(a) *To make the operations of the enterprise viable again
(b) To help in employment generation
(c) To comply with RBI guidelines
(d) To increase bank's-advances
44. Banks enter into compromise with borrowers in case of default, because:
(a) Recovery through legal action is time consuming
(b) Adequate security is not available
(c) Realisation or security may be difficult3 (d)- *All the above

1. ˜Credit Rating Agencies in India are regulated by: RBI
2. ˜CRISIL stands for: Credit Rating Information Services of India Ltd.
3. ˜Deferred Payment Guarantee is : Guarantee issued
when payment by applicant of guarantee is to be made in installments over a period of time.
4. ˜If Break Even Point is high, it can be construed that the margin of safety is ____: Low.
5. ˜Long Term uses – 12; total Assets – 30; Long Term source 16; What is net working capital : 4
6. ˜On which one of the following assets, depreciation is applied on Straight line method: Computers.
7. ˜Projected Turnover is Rs.400 lacs, margin by promoter is Rs. 20 lacs. What is maximum bank finance as per Annual Projected Turnover method: 80 lakhs.
8. ˜Rohit was a loanee of the branch and news has come that he has expired. On enquiry, it was observed that he left some assets. Upto what extent the legal heirs are liable to the Bank? Legal heirs are liable for the liabilities upto the assets inherited by them.
9. ˜The appraisal of Deferred Payment Guarantee is same as that of a) Demand Loan b) OD c) Term Loan d) CC : Term Loan.
10. A cash credit account will be treated as NPA if the CC limit is not renewed within ___days from the due date of renewal: 180 days.
11. A director of a bank wants to raise loan of Rs 10 lakh from his bank against Life Insurance Policy with surrender value of more than Rs 15 lakh. What will be done?: Bank can sanction.
12. A firm is allowed a limit of Rs.1.40 lac at 30% margin. It wants to avail the limit fully. How much will be the value of security : Rs.2 lac
13. A guarantee issued for a series of transactions is called: Continuing guarantee
14. A lady who has taken a demand loan against FD come to the branch and wants to add name of her minor son, as joint a/c holder. What you will do?: Name can be added only after adjustment of the loan.
15. A letter of credit which is issued on request of the beneficiary in favour of his supplier: Back to Back LC
16. A loan is given by the bank on hypothecation of stock to Mr. A. Bank receives seizure order from State Govt. What should bank do?: Bank will first adjust its dues and surplus if any wilt be shared with the Govt.
17. A loan was sanctioned against a vacant land. Subsequently a house was constructed at the site. What security is available now to the bank? : Both
18. A minor was given loan. On attaining majority he acknowledges having taken loan and promises to pay. Whether the loan can be recovered? : He can not ratify the contract. Hence recovery not possible.
19. A negotiating bank and issuing bank are allowed days each for scrutiny of documents drawn under Letter of credit to ensure that documents are as per LC: 5 banking days each.
20. Age limit staff housing loan: 70 years;

21. An L/C is expiring on 10.05.2008. A commotion takes place in the area and bank could not open. Under these circumstances can the LC be negotiated?: The L/C can not be negotiated because expiry date of LC can not be extended if banks are closed for reasons beyond their control.
22. As per internal policy of certain banks, the net worth of a firm does not include: a. Paid up capital b. Free Reserve c. Share Premium d. Equity received from Foreign Investor : Revaluation Reserves
23. Authorised capital is Rs.10 lac. Paid up capital Rs.6 lac. The loss of previous year is Rs.1 lac. Loss in current year is Rs3 _ lac. The tangible net worth is : Rs.2 lac
24. Authorised capital= 10 lac, paid-up capital = 60%, loss during current year = 50000, loss last year = 2 lacs, what is the tangible net worth of the company? : 3.5 lac
25. Bailment of goods by a person to another person, to secure a loan is called : Pledge
26. Balance outstanding in a CC limit is Rs.9 lakh. Value of stock is Rs.5 lakhs. It is in doubtfUl for more than two years as on 31 March 2012. What is the amount of provision to be made on 31-03-2013?: Rs.9 lakhs (100% of liability as account is doubtful for more than 3 years)
27. Balance Sheet of a firm indicates which of the following – Balance Sheet indicates what a firm owes and what a firm owns as on a particular date.
28. Bank limit for working capital based on turn over method: 20% of the projected sales turnover accepted by Banks
29. Banks are required to declare their financial results quarterly as per provisions of : SEBI
30. Banks are required to maintain -a margin of ___ for issuing Guarantee favouring stock exchange on behalf of share Brokers.
31. Banks are required to obtain audited financial papers from non corporate borrowers for granting working capital limit of: Rs.25 lakh &above
32. Banks provide term loans and deferred payment guarantee to finance capital assets like plant and machinery. What is the difference between these two: Outlay of funds.
33. Benchmark Current Ratio under turn over method is: 1.25
34. Break Even Point: No profit no loss. (TR-TC=Zero)
35. Calculate Debt Equity ratio – Debenture – Rs 200, capital 50; reserves – 80; P& L account credit balance – Rs 20: 4: 3 (200 divided by 150).
36. Calculate Net working capital– Total assets 1000; Long Term liabilities 400; Fixed assets, Intangible assets and Non current assets (i.e. long term uses) Rs 350; What is net working capital : 400- 350= Rs 50
37. Calculate Tangible Net Worth: Land and building: 200 Lacs; Capital:80000 intangible asset:15000: 65,000
38. CALCULATION OF INTEREST IN LOAN ACCOUNT: MONTHLY
39. CARE stands for : Credit Analysis & Research Ltd
40. Cash Budget method is used for sanctioning working capital limits to : Seasonal Industries
41. CC limit Rs 4 lacs. Stock 6 lacs. Margin 25% . What is drawing power? : NOTIONAL - 4.5 lacs, BUT ACTUAL Rs. 4 LAC.
42. Central Registry of Securitization Asset Reconstruction and Security Interest of India (CERSAI) is a government company licensed under Section 25 of the Companies Act, has been incorporated to operate and maintain the Central Registry under the provisions of _____: SARFAESI Act 2002.
43. CIBIL is the agency that provides information to the member banks on (i) Credit Rating (ii) Information on credit History: Information on Credit History of borrowers
44. Contribution means : profit + fixed cost
45. Current Assets 600, Long Term sources - 600, Total Assests1000, what is NWC and Current Ratio: CR 1.5 : 1; NWC = 200 .
46. Current Liabilities are those liabilities which are to be paid: within one Year
47. Current Ratio = 2:1, Net working Capital=60000, What is the Current Liability of the firm? : 60000
48. Current ratio indicates: Liquidity of the firm (ability of a firm to pay current liabilities in time)
49. Current Ratio is 1.33:1, Current Assets is 100, what will be the amount of Current Liability: 75 lakhs
50. Debt Equity Ratio indicates: Long term solvency or capital structure of the firm.
51. Debt Securitization refers to: Conversion of receivables into debt instruments.
52. Debt Service coverage ratio is used for: Sanction of Term Loans

53. Deferred Payment guarantee is: Financial Guarantee
54. Deferred payment guarantee issued by a bank is a : Contingent Liability.
55. Difference between Long Term Source and Long Term Use is called: Net Working capital.
56. DSCR indicates: Ability of firm to repay term loan instalments
57. DSCR is for evaluating: Term Loan repayment-surplus generating capacity.
58. Duty of confirming bank: Only to verify the genuineness of L/C.
59. Equitable Mortgage is created by deposit of title deeds with bank at – (a) any where in India; (b) state capital; (c) only at Mumbai, Chennai or Kolkatta; (d) Any place notified by state government for this purpose: Correct answer is (d).
60. Excess of current liability over current assets means the firm may face difficulties in meeting its financial obligations in short term.
61. Expand CRILC: Central Repository of Information on large credits.
62. Expand IRR : Internal Rate of Return
63. Finance for construction of road and port is classified as: Infrastructure Finance.
64. For ascertaining that a firm will be able to generate sufficient profit to repay instalments of term loan, which ratio is computed?: Debt Service Coverage Ratio
65. For assessing Fund Based Working Capital limit for MSME upto _______Turnover method is followed under Nayak committee: Rs.5 crore.
66. For classification of assets in consortium accounts, which of the following is to be considered?: In consortium accounts, each bank will classify the account as per its record of recovery.
67. For Takeover of accounts from other Banks, the account copies of all the borrower accounts with the present bankers / financial institution shall be obtained at least for the last ______: 12 months.
68. Formation of consortium, when essential : When bank touches its exposure ceiling
69. Full form of DSCR: Debt Service coverage ratio;
70. Gold is pledged with bank as security for a Bank Guarantee by a borrower. Bank Guarantee stands expired. Whether a temporary overdraft availed by the borrower which is overdue can be got adjusted by selling the Gold held as security for issue of guarantee: Yes, because Bankers lien is a general lien and is an implied pledge. Further, the Gold was deposited in the ordinary course of business.
71. Green field project is related to : setting up new projects
72. Guarantee issued by a bank in favour of Custom department that party will fulfill export obligation for availing exemption from custom duty regarding tax. Such guarantee is called: Financial Guarantee
73. Guarantee issued by a bank which is still outstanding is shown in the Balance Sheet as: Contingent Liability.
74. Guarantors Liability: Recall the a/c and cause demand against the borrower and guarantor. Balance in guarantor's SB a/c cannot be appropriated directly.
75. Holiday period given for repayment of installements in a loan is termed as: Moratorium period
76. How DSCR is calculated?: (Profitafter tax + Depreciation + Interest on Term Loan) divided by (Annual instalment of term loan+ interest on term loan)
77. How much additional risk weight has been provided on restructured loans?: 25%
78. Hypothecation can be converted to pledge by: taking possession with the consent of the borrower.
79. Hypothecation described under SARFEASI Act.
80. If a businessman start a business with a Capital investment of Rs.3,00,000/- and withdraw Rs.25,000/- later. If Net Profit is Rs.1,20,000/- and income tax paid thereon is Rs.30,000/-, what is the position of capital account (net worth) at the end of the year – 395000; 365000; 360000; nil: Rs.3,65,000/-
81. If a LC contains a clause "about" regarding the amount and quantity of goods, how much tolerance is permitted?: 10%
82. If current ratio is 2:1, net working capital is Rs 20,000, current asset will be: Rs 40,000
83. If debtors are Rs 4 lac, annual sale is 60 lac, what is the Debt collection period: 0.8 months
84. If Debtors velocity ratio increases, it means debt collection period has increased or sales have decreased.
85. If documents are to be presented in about July month: these can be presented within 5 days before or 5 days after.
86. If in a Guarantee issued is silent, what will be the limitation period: 3 yrs and in case of Govt

guarantee it is 30 years.
87. If in a LC words around is written with date then variation of is allowed in the period: +/- 5 calendar days
88. If limit is 3 lacs, margin is 25% what should be stock to avail full limit?: Rs4 lac
89. If on a letter of credit it is not mentioned whether it is revocable or irrevocable, then as UCPDC 600, it will be treated as : Irrevocable LC
90. If on a Letter of Credit, date is mentioned as "end of the month", then as per UCPDC 600, it will mean: 21st to last day of the month.
91. If stock statement is not submitted for 3 months from its due date and DP is allowed on the basis of old stock report, then the account will be considered NPA after:90 days
92. If the projected sale of a-small (manufacturing) enterprise is Rs 80 lakh, margin available with the borrower is Rs 4 lakh, then as per turnover method, working capital limit will be: Rs 16 lakh.
93. If working capital limit to a borrower is Rs 10 crore and above, then as per RBI guidelines, the loan component should be at least: as per bank's discretion.(earlier it used to be 80%).
94. In a company, the registration of charges is required for: a)loan against FD b)lien on Govt Securities c) assignment of Book Debts d) lien on Shares : Book Debts
95. In A current account OD of Rs. 12000 is made. The FDR has become due later on if the right of appropriation can be used. The borrower has objected that he never requested for overdraft, hence payment can not be appropriated. The customer is right.
96. In a letter of credit, it is written that documents can be negotiated about 30th June. In this case, the documents can be negotiated: Before or after 5 clays of 30th June.
97. In case of a loan under consortium, each bank can have Maximum working capital limit of Rs-No rule in this regard. Rules of consortium to be framed by members of consortium.
98. In case of loan given by more than one bank under a consortium, how the asset classification is done by various banks?: Each bank will classify the account based on its record of recovery.
99. In case of revaluation of fixed assets, what percentage of revaluation reserve will be added to Tier II capital of the bank?: 45%
100. In Letter Of Credit jmporter is called: Opener of Letter of Credit
101. In project finance, Debt Equity Ratio requirement for other than Infrastructure finance is: 2:1
102. In respect of a project report, the feasibility which is given least importance by the preparers of the report, but very important for a banker is : a) Commercial b) Technical c) economic d) financial Ans: C
103. In the Balance Sheet of a bank, Contingent Liabilities are shown as: footnote to the Balance Sheet.
104. In the case of advance to a limited company for purchase of vehicle, the charge is registered with Regional Transport Authority in addition to registration of charge with. Registrar of Companies. Why this is done?:So that borrower can not sell the vehicle without intimation to the bank
105. Interest rate on advances is related to – Bank rate; Base Rate; PLR: MCLR Rate
106. Limit sanctioned Rs 5 lac; Stock Rs 6 lac; Margin 25%; What will be Drawing power: Rs 4.5 lac
107. Loan Delivery System is not applicable to: a) Loan to Soft ware industry b) export credit: export credit
108. Loan Delivery System suggested by Rashid Mani Committee is applicable on borrowers with working capital limits of: Rs 10 crore and above
109. Loan is in the name of A&B. Both have signed documents. A signs the Balance Confirmation but B does not. In this case limitation will extend against: both
110. Lorry Receipts issued by Transport Operators approved by IBA are preferred. The reason is the Transport Operators will take care of: Carriers Risk.
111. Stand by LC is just like : Financial guarantee (A guarantee of payment issued by a bank on behalf of a client that is used as "payment of last resort" should the client fail to fulfill a contractual commitment with a third party. Standby letters of credit are created as a sign of good faith in business transactions, and are proof of a buyer's credit quality and repayment abilities)
112. Standard Score under CIBIL: 300 to 900
113. Stock Audit is required in respect of loans of : Rs.1.00 crore & above
114. Subordinate Debt is shown as part of in the Balance Sheet of a bank: Other Liabilities and Provisions

115. Tangible Net Worth (TNW) is calculated as: Total paid up capital + Reserves – Intangible Assets.
116. The appraisal of deferred payment guarantee is similar to term loan: The difference is outlay of funds.
117. THE APPRAISAL OF DEFERRED PAYMENT GUARANTEE IS SIMILAR TO: TERM LOAN
118. The Audited Balance sheet for the latest financial year is to be obtained within ______ to finalise credit rating and re-fix interest accordingly: 6 months.
119. The Bank did not disclose all material facts regarding loan to the guarantor while obtaining guarantee. Can guarantor escape liability?: Guarantor cannot escape from his liability as it is not necessary to disclose all the materials facts with regards to the loan.
120. The Borrower has to bring funds as his contribution for loan from: Long term Sources
121. The charge on stocks is created by: Hypothecation (also by pledge or lien)
122. The concept of Base Rate is not applicable in the case of: Loan against Bank's own deposit
123. The limitations of financial statements are : only quantitative not qualitative.
124. The long term liability to tangible net worth ratio implies : Long term solvency of the firm .
125. The main distinction between Hypothecation and Pledge is on accountof : Possession
126. The Meaning of Debtor Velocity Ratio is: Cycle of Debt Collection Period
127. The procedure used for ascertaining Customers Credit worth is called: Credit Rating
128. Time Limit for registration of equitable mortgage with CERSAI: 30 days from date of deposit of title deeds. (Normally 30days and then delay can be condoned up to 30days on payment of penalty).
129. To improve Current Ratio of 2:1, what has to be done? a) Recover cash from Receivables b) Cash sales c) Decrease the Bills payables.
130. Total Indebtedness Ratio is represented by: Total outside liabilities divided by Tangible Net Worth
131. What is "pari passu" means: Sharing in the ratio of outstanding.
132. What is a Break even point-The level of sales at which a firm does not earn any profit and does not incur any loss.
133. What is cash loss : net loss before depreciation (Net loss minus depreciation)
134. What is Deffered Payment Guarantee?: Guarantee issued when payment by applicant of guarantee is to be made in instalments over a period of time.
135. What is Mortgage? Transfer of interest in specific immovable property to secure an existing or future debt.
136. What is nature of Banker's Lien?: It is implied pledge because Banker can dispose-off the goods after giving notice to the borrower.
137. What is Pari Passu charge?: In case of consortium advance sale proceeds of security will be shared among banks in proportion to their outstanding.
138. What is Real Rate of Interest?: Prevailing interest rate minus inflation rate
139. What is the meaning of Group in Exposure Norms: Commonality of management & Effective Control
140. What is the relationship between bank and customers in case of overdraft?: Creditor and Debtor
141. What is the risk weight for Personal Loans? 125%
142. What is the risk weight for Unrated companies?: 100%
143. What is the type of liability for the bank on account of issue of Bank Guarantee?: Contingent Liability
144. What type of bank gaurentee bank gives when a customer purchases a machine on instalment basis?: Deferred Payment guarantee.
145. What type of Guarantee is Deffered Payment Guarantee: Financial Guarantee
146. What type of liability is represented by Bank Guarantee?: Contingent Liability and shown as a footnote in the Balance Sheet.
147. What will be the tangible net worth if total assets are Rs 35 crore; total outside liability Rs 30 crore; intangible assets Rs 3 crore: Rs 2 crore
148. What will happen in case of negative working capital limit: Current Liabilities are more than Current Assets
149. Which is not a Credit Rating Agency – CRISIL, CARE, SMERA, ICRA, CIBIL: CIBIL
150. Which is not found in operating expenses statement of P&L statement - Salaries, Rent, Power: Power
151. Which is not included in Contingent liability – Bank Guarantee; Letter of Credit; Forward Contract; Bills Payable: Bills payable
152. Which of the following is a contingent liability – deposits, borrowings, capital, guarantee: Bank Guarantee

153. Which of the following is a Credit Information company – CIBIL, FIMDA, AMFI, CRISIL: CRISIL
154. Which of the following is part of the Solvency Ratios: debt equity ratio.
155. Which of the following represent Debt Service Coverage Ratio: (Net Profit after tax + Depreciation + Interest on Term loan) divided by (Annual instalment of term loan + interest on term loan)
156. Which of the items will not be an asset in banks bal sheet: Advances/Fixed Asset / Deposits : Deposits
157. Which one of following is credit information company?: Equifax
158. Which system replaced Benchmark Prime Lending rate in banks: Base Rate
159. While arriving Drawing Power for financing against book debts, only Book Debts _____and below are to be taken in to consideration. (other than MSME advances): 90 days
160. While doing Project Appraisal, sensitivity analysis is useful for: Viability and sustainability of project.
161. While financing for TL, Bank should look for the ability of the firm to generate the income to service the debt
162. While granting loans to a partnership, banks generally insist that the firm should be registered whereas registration of a partnership firm is optional. What is the reason for the same?: An unregistered firm can not sue its debtors for recovery of its dues whereas other can sue the firm for recovery of their dues
163. While undertaking technical appraisal, the following is not considered: cost of production and sales (it is used for economic viability).
164. Who is bound to file particulars of charge with the Registrar of Companies under MCA 21, when a company creates charge of somebody on its movable or immovable property except by way of pledge?: officials of the company.
165. Why banks do not grant loan to a minor?: A minor is not competent to contract Therefore, loan given to a minor can not be recovered.
166. Why banks ensure that charge created on any asset of the company should be registered with ROC within stipulated period?: If charge is not registered, bank will become unsecured creditor.
167. Why banks prefer financing of bills?: because the advance is self liquidating
168. Why fund flow statement is taken from the borrower?: To know sources from where funds have been raised and how funds have been utilized and to know changes in net working capital position.
169. Why loan against Partly Paid Shares are not preferred by banks?: Because partly paid shares represent contingent liability. In case company makes demand and the borrower does not pay the amount then the bank will have to pay the amount otherwise share may be forfeited. Moreover it is prohibited by RBI
170. Working capital requirement of a firm is required to be met through : Short term sources and surplus

Certified credit professionals exam review::

One Member review:

> Regarding paper.. One qstn was der frm factoring.. Pari passu charge, 1 qstn frm bfeak evn point.. No need to study fund flow nd cash flow as der was no qstn frm dat part.. Lc calculation with eoq given 5 marks numerical, payback, arr, npv, irr 5 mark numerical, mpbf, turnover tandon committee 5 mark numericals.. Export case study.. Priorty sector classfication case study.. Ratios numerical 3-4 marks like inventory turnover given find cost of goods sold. Mse service sector enterprise max loan.. Nd medium sector service sector max loan.. Numericals der were 20-30 marks.. Read btwn lines to build concept.. As 4 option were given nd u hv to find out which one is wrng.. 30-40 qstn were lyk dat..

Questns on NPV,IRR (to be read very minutely from the book)payback period ,project Viability ,RATIOS like Interest coverage ratio, Gross profit ,DER ratios,priority sector lending,pari passu charge,CP in detail confusing questions,LC limit ,frequency,No of LCs ,time period, Working capital 1st nd second method lending case studies, Forex PCFC , green clause LC ,education loan,minor,companies,partenership Kimbersley process ,credit rating agencies , Sarfaesi,Cersai ,registration of charges,BEP,Balancesheet , MSMED act 2006 and very minute topics from the book .Concepts to be cleared as options are confusing.

2nd member review .....Today it was my first attempt for CCP exam and by God's grace passed the exam. Thanks to this group for valuable information and guidance. In my opinion Paper was tough. Reading Taxman only is not enough. Concepts must be clear as der r full of case studies and numericals throughout the paper based on LC , IRAC norms, treatment of stressed assets,BG, BEP, WC requirement assessment under different methods, Project appraisal and Prisec case studies and documentation. I din face much questions on retail credit, fund flow cash flow and ratio analysis. All the best to CCP aspirants and who r not I will advice dem dat dis exam is worth a try.

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Treds 5 questions came
5 questions irr npv
Ratio tnw
Interest coverage ratio
Debt equity ratio
IBC 3 questions
Restructuring of msme 4 questions
Payback method 1 mark
SMA0
Loan disbursement in msme 25000 to 5 lakhs
No of days
Resolution of stressed assets
Factoring forfeiting 5 questions
Ic4 questions
Calculation with eoq
Frequency of LC opening
No of LC to be opened
Break even point 1 question
Which given under option is not source of working capital
A manager give a housing mortgage loan to Mr.a for rs.54 lakhs without getting title deed .now account becomes npa . How will you recover?

Commercial paper min max days

Current ratio 1 mark theory
100000 in rural and 160000 in urban

5000 od loanin janthan account SB ac
Housing loan 75 % max LTV

Cersai created under
Equitable mortgage
In mortgage itself 3 questions separately
How to check loan applicant
How to check trade receivable are correctly mentioned by borrower

5 questions in insolvency and bankruptcy

1. Cersai us established under

a Indian Contract Act.

b Transfer of property Act.

c Sarfaesi Act.

d Insolvency act

2. Bank get the right of title to good:

a Hypothecation

b Pledge

c Lien

d Assignment

3. 1 mark question from BEP, Interest Coverage Ratio, Quick Ratio.

4. Two Case studies on IRR, NPV, Project evaluation, etc.

5. MSME theoretical case regarding Revitalization of Asset, case study of 5 marks

6. Insolvency Preceedings Act case study of 5 marks.

7. NCLT case study of 5 marks.

8. Many questions from Business Maths. No case study from financial statement.

9. More than 80 questions were theoretical only few numericals were asked.

10. Only two or three questions from working capital

Certified credit professionals Today 25.08.2018 exam Recollected
1.computation related all type to working capital methods

2.ratio analysis
3. irr
4.LC
5.project finance
6.BEP
7. IRAC norms.
Read minutely as theory questions were tough. Read book thoroughly. Practice the calculation related questions
8.Case Study Questions (5Q) were from Capital Budgeting Techniques,
9. Working capital Assessment techniques, 10.LOC
11.BG
12.Export Credit
13.CP
14. Ratios
15. Then individual questions (1 - 2Q) from Credit rating agencies,
16.CIC
17.CERSEAI
18.PSL
19.BEP
20.Types of borrowers,
21.DDA
22.ANBC
23.Omnibus LC, etc.
24. Numerical 5 questions each from followingLC Assessment with EOQ
25.MPBF
26. NPV
27. IRR
28.EPC
29.Preshipment
30.Dollar account.
31.case studies on CP
32.and 2 more theory based case studies
33.Payback method
34.Running account facility
35.Gold card scheme
CCP Questions
36..8 Marks Numericals from Turnover and 37..1st and 2nd method of lending.
38..5 Marks Numericals from NPV and IRR.
39..5 marks questions from BG (not Numericals)
40..10 marks Numericals from Balance Sheet.
41.One question based on:

Under Section 16 of the MSMED Act, delayed
payment to supplier units, attracts compound interest with monthly rests at three times of the bank rate notified by the Reserve Bank.

42.One question was from which date minor will be liable towards firm after attending majority.. declaration date, attending majority date or after 6 month .. answer?
43.Numerical part -NPV , IRR ,COST BENEFIT , TIME VALUE OF MONEY , BREAK EVEN , LC LIMIT
CASE STUDIES- BANK GUARANTEE, EXPORT CREDIT , PRIORITY SECTOR , GOLD CARD SCHEME , DIAMOND DOLLAR ACCOUNT
MOSTLY QUESTIONS WERE FROM EXPORT CREDIT ABOUT 10 - 15 MARKS AND NUMERICAL ATLEAST 10 MARKS

certified credit professionals recollected

Treds 5 questions came
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IBC 3 questions
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Recollected questions for Physical class room Training:

Recollected questions from exit test of training program
1. Limit for Settlement through lok adalat : Ans. 20 lakhs
2. LTV for housing loan of Rs.75 lacs?
3. Time limit for handling of objection raised by borrower under SARFAESI? Ans. 15 days.
4. Under Turnover method calculation is on basis of gross or net sales? Ans. Gross sales
5. What is the ideal CR under MPBF method 2? Ans. 1.17
6. Whether passage time is included in education loan for abroad studies ? Ans. Yes.
7. Which method of MPBF is customer friendly? Ans. Method 1
8. Cash margin for LC, where should be classified in B/S? Ans. Current assets.
9. What is the eligibility criteria for interest subvention under PC?
10. Eligibility criteria for KCC loan?
11. NPA between 31 to 60 days classified under which category of SMA?
12. Calculation of inventory is given in which form of financial statements, form I, II, III or IV?
13. Crop loan margin
14.Bank guarantee period 10 yrs
15. Foreign trade policy period 2015-2020
16.Balance sheet snapshot shows
17.KCC loan period
18.back to back LC
19.CMA reports
20. NCLT
21. DRT
22. SARFASAI
23.large exposure norms

****BEST OF LUCK ****

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clarify any doubt colleagues should cross-check the facts, laws and contents of this publication with original Govt. / RBI / Manuals/Circulars/Notifications/Memo/Spl Comm. of our bank.