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CREDIT MANAGEMENT

SCHOOL OF SOCIAL SCIENCES

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SCHEME OF LESSONS

BLOCK I

LENDING PROCEDURES AND FORMS

Indian banking after the post – nationalization period has interested a rapid change in its organization, concept and goals in response to the changes in the social, political and economic environment.

Banks have been financing all productive endeavors with particular attention to the credit needs of the weaker sections. Indirectly, they contribute huge amount every year to the public borrowing programme, which helps the government finance planned development activities.

Unit : 1 Bank credit and Principles of lending

Bank credit means bank loans and advances. The major part of a bank's income is earning from interest and discount on the funds so lent. The business of lending, the nevertheless, is not without certain inherent risk. The national credit council had indicated three sectors – agriculture, small-scale industries and exports as deserving priority treatment in the matter of bank credit.

Unit 2 : Secured Advances – Types of securities

The advances are mainly for the working capital needs of business and industrial concerns. While granting advances against such security, a banker has to take into certain considerations.

Unit 3 : Guarantees

Contracts of guarantee are special significance in the business of banking as a means to ensure safety of funds best to the customers. A guarantee is, in fact, the personal security of the third person, who must command the confidence of the banker.

Unit 4 : Mortgage

A mortgage is a charge created by offering immovable property like land and buildings as security for a loan. From the point view of transfer of title to the mortgaged property, mortgages can divided into two categories, viz., legal mortgage and equitable mortgage. In case of legal mortgage the mortgager transfers legal title to the mortgaged property in favour of the mortgagee by deed.

Unit 5 : Forms of Credit /lending

In India, the category of loans, cash credits and advances account for the bulk of bank credit. Security of funds lent is not sought exclusively in the tangible assets of the borrower but also in his technical competence managerial ability, honesty and integrity.

Unit : 6 Various Committees and their recommendations for Bank credit

With the growth of industrialisation, the commercial banks preferred to lend against the security of stocks through pledge or hypothecation, meeting the working capital needs of the industries. Different committees were recommending certain norms to RBI. Norms for inventory and receivables, cash credit and bank credit to small-scale industries.

Unit 1

BANK CREDIT AND PRINCIPLES OF LENDING

STRUCTURE

OVERVIEW

Bank credit commonly known as loans, is made by the bank to industrialists, executives, traders and others. The major portion of a bank's fund is employed by way of loans and advances, which is the most profitable employment of its funds. The major part of a bank's income is earned from interest and discount on the funds so lent. The business of lending, nevertheless, is not without certain inherent risk.

LEARNING OBJECTIVES

After reading this unit, you should be able to know the following

- bank credit and to check the credit worthiness of Borrowers
- the principles of Bank lending
- process of the loan application form

1.1 MEANING OF BANK CREDIT

Bank credit really refers to bank loans and advances. Banks have the power to expand or contract demand deposit and they exercise the power through granting more or less loans and advances. Now, this power of commercial bank to expand deposits through expanding their loans and advances is known as credit creation.

At one time, there was a needless controversy regarding the ability of commercial banks to create credit. Some writers meant by bank credit bank loans and investments and, therefore, maintained that a bank could never lend more than the amount, which the depositors had entrusted with it. Suppose that a person deposited Rs.1,000 with a bank, the latter could lend up to Rs.1,000 and not more. In fact, it should be lend far less, since it had to maintain a small margin of cash reserves against the withdrawal of money by the depositors. In any case, the bank could not lend more than Rs.1,000 and, therefore, it was concluded that banks could not create credit.

It is true that a bank cannot lend more than what it has. But it is equally true that what is lend out by a bank comes back to the bank by way of new depositors, which may again be lent out, and so on deposit becoming the basis for a loan or investment, which again returning to the bank as fresh deposit becomes the basis for the new loan, and so on. Commercial banks, therefore, are able to multiply loans and investments and thus multiply deposits. A small volume of cash is the basis for multiplication of deposits through multiplication of loans and advances ("loans create deposits"). It is in a sense that banks create credit. Credit creation can be defined as the expansion of bank deposits through the process of more loans and advances and investments.

1.2 CREDIT WORTHINESS OF BORROWERS

The business of sanctioning unsecured advances is comparatively more risky and needs special care and attention on the part of the bankers. In the absence of a charge over any special asset, the safety of the advance depends upon the honesty and integrity of the borrower as much as upon the worth of his tangible assets. The banker has, therefore, to make proper enquiries not only about the borrower's capacity to pay but also about his willingness to pay the amount. However, such enquiry is also necessary in case of a secured advance but its urgency is greater in case of an unsecured advance for obvious reason.

The creditworthiness of a person means that he deserves a certain amount of credit, which may safely be granted to him. Such creditworthiness is judged by the banker based on his (i) character, (ii) capacity, and (iii) capital.

1.2.1 CHARACTER

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

1.2.2 CAPACITY

The success of an enterprise largely depends upon the ability, competence and experience of the entrepreneur. If the borrower possesses necessary technical skill, managerial ability and experience to run a particular industry or trade, success of such unit may be taken for granted (barring some unforeseen circumstances) and the banker will consider him a deserving case for granting an advance. The significance of this factor is now growing, as the banks are willing to grant unsecured loans to technicians and competent persons based on soundness of their business projects, irrespective of their own capital.

1.2.3 CAPITAL

The importance attached by the bankers to the adequacy of capital of the borrower is not without significance. Banks are the depositories of the public money and lend the borrowed money. The bankers, therefore, do not lend money to an entrepreneur without adequate funds of his own. In case of failure of the business enterprise, the bankers will be able to realise his money if the borrowerrs own capital is sufficient.

Though all the above-mentioned factors are important and taken into account by the banker at the time of assessing the creditworthiness of a borrower, their relative importance differs from banker to banker and from borrower to borrower. The consideration of security is now undergoing a change. Greater emphasis is being laid on the ability and competence of the borrower and the soundness of his project. However, persons of doubtful integrity and without good character are not granted unsecured advances. Further, credit worthiness is a relative term. A person may be considered, based on the above, creditworthy for a certain amount only and not more.

1.3 PRINCIPLES OF BANK LENDING

Lending of funds to the constituents, mainly traders, business and industrial enterprises, constitutes the main business of a banking company. The major portion of a bank's funds is employed by way of loans and advances, which is the most profitable employment of its funds. The major part of a bank's income is earned from interest and discount on the funds so lent. The business of lending, nevertheless, is not without certain inherent risks. Largely depending on the borrowed funds, a banker cannot afford to take undue risks in lending. While lending his funds, a banker, therefore, follows a very cautious policy and conducts his business based on the well-known principles of sound lending in order to minimize the risk.

1.4 PRINCIPLES OF SOUND LENDING

There are three cardinal principles of bank lending that have been followed by the commercial banks since long. These are the principles of safety, liquidity and profitability. Nationalized banks in India, like others, do follow these principles in the employment of their funds. These banks are also required, under Section 8 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 in the discharge of their functions, to be guided by such directions about matters of policy involving public interest as the Central Government give. The Central Government and the Reserve Bank have during the last decade or so issued a number of directions in this regard, highlighting the social purpose, which they have to sub serve. The traditional principles of bank lending have, therefore, been followed with certain modifications. The concept of security has undergone a radical change and profitability has been subordinated to social purpose in respect of certain types of lending.

1.4.1 SAFETY

As the bank lends the funds entrusted to it by the depositors, the first and foremost principles of lending is to ensure safety of the funds lent. By safety is meant that the borrower is in a position to repay the loan, along with interest, according to the terms of the loan contract. The repayment of the loan depends upon the borrower's (i) capacity to pay, and (ii) willingness to pay. The former depends upon his tangible assets and the success of his business; if he is successful in his efforts, he earns profits and can repay the loan the promptly. Otherwise, the loan is recovered out of the sale proceeds of his tangible assets. The willingness to pay depends upon the honesty and character of the borrower. The banker should, therefore, take utmost care in ensuring that the enterprise or business for which a loan is sought is a sound one and the borrower is capable of carrying it out successfully. He should be a person of integrity, good character and reputation. In addition to the above, the banker generally relies on the security of tangible assets owned by the borrower to ensure the safety of his funds.

1.4.2 LIQUIDITY

Banks are essentially intermediaries for short-term funds. Therefore, they funds for short periods and mainly for working capital purposes. The loans are, therefore, largely re-payable on demand. The banker must ensure that borrower is able to repay the loan on demand or within a short period. This depends upon the nature of assets owned by the borrower and pledged to the banker. For example, goods and commodities are easily marketable while fixed assets like land and buildings and specialized types of plants and equipments can be liquidated after a time interval. Thus, the banker regards liquidity as important as the safety of the funds and grants loans on the security of assets, which are easily marketable without much loss.

1.4.3 PROFITABILITY

Commercial banks are profit-earning institutions; the nationalized banks are no exception to this. They must employ their funds profitably so as to earn sufficient income out of which to pay interest to the depositors, salaries to the staff and to meet various other establishments expense and distribute dividends to the shareholders (the Government in case of nationalized banks). The rates of interest charged by banks primarily depend on the directive issued by the Reserve Bank. The variations in the rates of interest charged from different customers depend upon the degree of risk involved in lending to them. A customer with high reputation is charging a lower rate of interest as compared to an ordinary customer. The sound principle of lending is not to sacrifice safety or liquidity for the sake of higher profitability. That is to say, that the bank should not grant advances to unsound parties with doubtful repaying capacity, even if they are ready to pay a very high rate of interest. Such advances ultimately prove to be irrecoverable to the detriment of the interest of the banks and its depositors.

1.4.4 THE PURPOSE OF THE LOAN

While lending his funds, the banker enquires of the borrower the purposes for which he seeks the loan. Banks do not grant loans for each purpose – they ensure the safety and liquidity of their funds granting loans for productive purposes only, viz., for meeting working capital needs of a business enterprise. Loans are not advanced for speculative and unproductive purposes like social functions and ceremonies or for pleasure trips or for the repayment of a prior loan. Loans for capital expenditure for establishing business are of long-term nature and the banks grant such term loans also. After nationalization of major banks loans for initial expenditure to start small trades, businesses, industries, etc., are also given by the banks.

1.4.5 THE PRINCIPLE OF DIVERSIFICATION OF RISKS

This is also a cardinal principle of sound lending. A prudent banker always tries to select the borrower very carefully and takes tangible assets as security to safeguard his interests. Tangible assets are no doubt valuable and the banker feels safe while granting advances on the security of such assets, yet some risk is always involved therein. An industry or trade face depression- is conditions and the price of the goods and commodities may sharply fall. Natural calamities like floods and earthquakes, and political disturbance in certain parts of the country may rain even a prosperous business. To safeguard his interest against such unforeseen contingencies, the banker follows the principle of diversification of risks based on the famous maxim do not keep all the eggs in one basket. It means that the bankers should not grant advances to a few big firms only or to concentrate them in a few industries or in a few cities or regions of the country only. The advances, on the other hand, should be over a reasonably wide area, distributed amongst a good number of customers belonging to different trades and industries. The banker thus diversifies the risk involved in lending. So that if a few big customers meet misfortune, or certain trades or industries are affected adversely, the overall position of the bank will not be in jeopardy.

1.5 APPRAISAL OF THE LOAN

Once the bankers received the application, he allotted a serial number and enters in the 'Loan Application Received Register.' The register has different column for recording the following particulars:

- ⇨ Serial number.
- ⇨ Date of receipt of the application form.
- ⇨ Name of the application.
- ⇨ Amount of loan.
- ⇨ Nature of the loan applied for (agriculture, SSI, small business etc.).
- ⇨ The manner of disposing of the application.

The loan application form is the base for the banker to decide whether to sanction a loan or not. The bank manager or his field staff will thoroughly scrutinize the application form and the relevant documents. This process is known as "Appraisal of the Loan." Normally the manager will also have an interview with the borrower. The following information will ascertained by the bank manager.

1.5.1 PARTICULARS OF THE BORROWER

The manager learns, from the application the details of the borrower, like the name, address, his ability, integrity and experience, his establishment, the nature of his business, his reputation in the market etc.

1.5.2 PURPOSE OF THE LOAN

The purpose of the loan is very important. The banker rarely lends money for unproductive purposes. In case of a new business, he may ascertain whether the money will be used for long-term capital outlay, i.e., for the purchase of plant and machinery. If so, he take adequate care as the bank primarily lends for short-term purposes. The banker takes extra care if the loan applied for is for the redemption of previous loan/loans. Normally commercial banks do not grant credit for such purposes.

1.5.3 SECURITY

The banker looks at the security offered by the borrower and finds out whether it can easily sold in the market without any loss of time and value. He verifies the validity of the title to such security or securities. He may examine carefully whether he can have adequate 'Margin' in such securities. The difference between the market value of the securities and the amount lent against them is known as 'Margin'. In case there are sureties for the borrower, the details of such sureties and reference will be verified.

Although banks insist upon securities, they do not completely rely upon securities. If the banker feels that the project/proposal is unsatisfactory, he will decline the proposal without any hesitation even if the securities are too good. Security is taken as the last resort for the bank to get back the money by realising the security because:

i. The customer may suffer in venturing into such unrealistic project. Further damage is done to him by selling his securities at odd times at low process.

ii. The banker, as expected, may not be able to realise the securities in certain cases; legal hurdles may arise;

iii. Realising such securities is time – consuming and expensive, in certain cases, the value of such securities may fall.

iv. If the bank resorts to sale of such securities, there is adverse publicity against the bank, affecting its reputation.

v. Finally yet importantly, there is disharmony between the banker and the borrower.

1.5.4 AMOUNT OF LOAN

The banker examines the relationship between the amount required by the borrower for his project and the amount asked in the application. He verifies, using certain techniques, whether the amount is adequate to take up the proposed project. There is a misconception among the borrowers that the bank will normally grant lesser amount than requested. Therefore, there is tendency to inflate the figures in the project proposal. The main concern for the bank manager is to determine the right quantum of loan required for the project. If the bank grants more, the customer may spend it lavishly and waste it. Nevertheless, at the same time, if it is inadequate, the manger may have to lend more subsequently to protect the previous lending. If he refused to grant additional sum, the project may fail and the customer may not be able to pay back the loan. Consequently, the bank will suffer.

The banker carefully ascertains the amount of loan, allowing provision for emergencies. In case, the bank feels that he cannot agree for the requested amount, he may ask the necessary amendments. The banker himself need not contribute the entire investment. He may insist on the borrowers contributed.

CHECK YOUR PROGRESS

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1. Bank loans and advances are called as ____________
2. Credit worthiness is judged by the banker______, ________ and ________
3. Safety is meant that the borrower is in a position to ___________.
4. The bank manager will thoroughly scrutinize the application form with relevant document is called as ______________.
5. _________ means expansion of bank deposits through more loans and advances.

LET US SUM UP

For an outsider, bank lending may appear to be simple affair. However, lending of funds is not that easy as one imagines. With the rapid industrialization and development of various sectors of the economy, the banker's task is to choose the right type of borrower. The banker selects such borrowers and an art of the banker. The banker selects such borrowers and arranges for making such advances, keeping in mind the principles of lending, particularly if it is a long-term credit.

The first stage for a borrower to avail of a bank loan is to get the prescribed application form from the respective branch from where he intends to obtain a loan. The next step is to fill the application. The application should be complete in all respects. All the necessary documents in support of the claims made in the application form are also attached with the application and submitted at the bank.

GLOSSARY

Bank Credit : refers to loans and advances.

Credit Worthiness : means that the person who deserves a certain amount of credit.

Lending : of funds means, loans and advances to the traders, business and enterprises.

Credit Appraisal : means the bank manager will thoroughly scrutinize the application form and relevant documents.

Loan Application form : is the base for the banker to decide whether to sanction a loan or not.

ANSWERS TO CHECK YOUR PROGRESS

1. Bank credit
2. Character, Capacity, Capital
3. Repay the loan along with interest
4. Appraisal of the loan
5. Credit creation

MODEL QUESTIONS

1. What is Bank Credit?
2. How does a banker evaluate the proposal given by a client?
3. What are the General Principles of Bank Lending?
4. What do you mean by "Credit Appraisal"? What are the Procedures for appraisals of credit proposals by commercial bank?
5. What is bank lending?

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Unit 2

SECURED ADVANCES – TYPES OF SECURITIES

STRUCTURE

OVERVIEW

Generally, bank advances money against securities. The securities provided by the customers give protection and safety to the lending banker. In spite of these, the banker is liable to suffer losses due to his ignorance, negligence or carelessness. Therefore, the banker should observe some basic principles, while granting advances against securities.

LEARNING OBJECTIVES

After reading this unit, you should able to

- the General Principles of Secured Advances
- various types of securities against which a banker grants advances
- the precautions to be taken by a banker in making advances against different securities.

2.1 GENERAL PRINCIPLES OF SECURED ADVANCES

2.1.1 ADEQUACY OF MARGIN

Margin means the difference between the market value of the security and the amount of the advance granted against it. The banker should always keep adequate margin because the market value of the security may come down and the amount due from the customer may increase gradually due to interest accruals. Hence, the banker should require a very high margin.

2.1.2 MARKETABILITY OF SECURITIES

If the customer defaults in making payment, the banker should dispose of the security without lose of time and money. Therefore, the banker should be very cautious in accepting assets, which are easily marketable. In short, liquidity of the security should, therefore be the prime consideration of the banker.

2.1.3 DOCUMENTATION

Apart from the .securities being offered by the borrower, it is desirable to get the documents signed by the borrower. These documents contain all the terms and conditions on which the banker sanctions a loan and hence misunderstanding at a later stage can be avoided.

2.1.4 REALISATION OF THE ADVANCES

If the borrower defaults in making payment, the banker may realize his debt by disposing of the security offered. If the banker is not able to recover his full dues from the security, he shall file a suit for its recovery within a period of three years from the date of the sanction of loan.

2.2 ADVANCES AGAINST GOODS

Banks grant loans against .goods as security. Such goods are classified in India into four main heads, viz.

(i) Food articles, (ii) Industrial raw materials, (iii) Plantation products and (iv) Manufactured articles and minerals.

These advances are mainly for the working capital needs of business and industrial concerns. While granting advances against such security, a banker has to take into consideration the following:

i. Safety: Goods are tangible assets and provide better security than the unsecured advances. Bat it is not practically possible for the banker to vouch the correctness of the contents of each bag, or container of goods stored in a godown. Further, there is a risk of deterioration in the quality of the goods and the goods may not be durable. Therefore, the banker, in order to protect himself against such risks, should not lend money against goods for a long period. Therefore, goods are suitable securities for advances for a shorter period only.

ii. Price Stability: Wide variation in prices of certain goods take place due to changes in demand and tastes of the people. Therefore, bankers should be reluctant to accept such commodities as security for loans. Banks should accept only those goods, the prices of which are stable over a long period.

iii. Easy Marketability: Bankers should accept goods as securities, which have regular and ready market.

iv. Shorter Duration of Advances: As most of goods decay or deteriorate in quality over a period time, bankers should lend against them for shorter periods only.

PRECAUTIONS T0 BE TAKEN BY THE BANKER

Loans advanced against goods are not free from certain risks. Therefore, a banker should be very careful in accepting them as security and take the following precautions:

1. The banker has to take into consideration the honesty and trustworthy of the customer. In addition, the customer must possess business talent and experience, otherwise even an honest and reliable customer without competence, and practical experience is not free from risk.
2. Before accepting any commodity as security, the banker must see the nature of the demand for such goods. The banker should accept those

goods, which are necessaries of life and are regularly consumed by large number of customers.

3. In order to maintain sufficient margin, the banker should know thoroughly the conditions and customs of the trades of the goods offered as security.
4. The banker should also take delivery of the goods before the loan is granted.
5. The banker should estimate the value of the goods very carefully.
6. Necessary care should be taken to see that the goods pledged are properly stored.
7. The banker must see that the goods are duly and adequately insured against fire, theft, etc.
8. Suppose the borrower is allowed to repay the loan in parts, the banker should ensure that good released are in proportion to the amount of repayment of loan.

2.3 ADVANCES AGAINST DOCUMENTS OF TITLE OF GOODS

The documents of title to goods are bill of lading, Dock warrants, warehouse keeper's certificate, railway receipts and delivery orders. These documents of title to goods represent actual possession of goods. The person who possesses such documents can transfer the goods to any person by endorsement or delivery or by both. The transferee is entitled to take delivery of the goods in his own right. However, the advances against documents of title to goods are subject to certain risks and the banker should, therefore take the following precautions:

Precautions to be Taken by the Banker

1. In order to avoid the risks of *fraud* and dishonesty of borrowers, the banker should select trust worthy and reliable borrowers in case of such advances.
2. Care should be taken to see that the documents are genuine and are not forged ones.
3. Obtain complete set of documents from the borrowers.

4. The banker should see that the goods are insured against fire, theft, etc.
5. A memorandum of charge duly signed by the borrower should be obtained authorising the banker to sell the goods, if the borrower defaults in making payment.
6. It is essential to see that the person (transporter, warehouse keeper, etc.,) issuing such documents of title to goods are a reliable person.

2.4 ADVANCES AGAINST STOCK EXCHANGE SECURITIES

Stock exchange securities are those, which are regularly purchased and sold in the stock exchange. The securities traded on the floor of stock exchange are :

i. Securities issued by the central and state governments,
ii. Securities issued by semi-Government authorities like port trust, electricity Boards, etc., and
iii. Shares and debentures issued by the companies. Banks advancing loans against these securities, have certain advantages. They are: 1. Reliability 2. Liquidity 3. Price stability 4. Transferability 5. Easy valuation 6. Yield income 7. Quick release of security.

Risks in Advancing Against Stock Exchange Securities

The following are the demerits of stock exchange securities:

1. Forfeiture of securities in the case of partly paid shares.
2. They are not negotiable instruments and hence, the transferee cannot get a better title than the transferor has.
3. Wide fluctuations in prices of the securities make them less liquid sometimes.
4. It is very difficult to distinguish between a genuine share certificate and a forged one.

Precautions to be Taken by the Banker

1. ***Choice of Securities :*** A bank cannot advance money blindly against every share offered as security. Not all the shares may be worth accepting. Hence, the banker, after careful study of the financial position of companies, prepares a list of securities against which advances may be made. This list should be revised often. This type of exercise

will reduce the risk of making advance on undesirable stock exchange securities.

2. ***Valuation of Securities:*** Securities cannot, generally be taken at their face value and at the same time, a bank should not rely completely on the stock exchange quotations. It should study the economic conditions of the country and the industry concerned.
3. ***Adequate Margin:*** As the prices of some securities fluctuate widely, the bank should keep adequate margin while lending against such securities.
4. ***Preference of Debentures and Preference Shares:*** A bank should prefer preference shares and debentures to equity shares because the fluctuations of these are very small.
5. ***Partly paid Shares:*** A bank should not take the unnecessary risk of advancing against partly paid shares. This is to avoid the partly paid shares being forfeited on non- payment of calls. However, if the customer is credit worthy, the bank may consider advancing after getting an undertaking that the calls will be paid.
6. ***Transfer of Securities:*** The bank's charge over the shares will be complete only when the shares are transferred in its name in the books of the company or the bank may get an equitable charge i.e., the bank should take delivery of the shares along with a blank transfer deed duly signed by the customer
7. ***Notice to Company:*** Whenever a bank makes an advance against such securities. It should give a notice to the concerned company about the fact that it has got interest in such shares.

2.5 ADVANCES AGAINST LIFE INSURANCE POLICIES

In India, the Life Insurance Corporation of India itself comes forward to make advances because of life policies. However, in case, the borrower wants to make loans from a bank, the borrower should file a "deed of assignment" to the bank along the with the actual policy and give undertaking to the bank for the repayment of principal and interest.

Merits of Life Policies as Security

1. The surrender value of the policy can be easily ascertained from the L.I.C.
2. The policy can be legally assigned in favour of the bank by duly registering the same with the L.I.C.
3. The value of the policy is increased over a period.
4. Even in the event of the borrower becoming insolvent, the bank gets full claim over the policy.
5. In the case of non-payment of loan by the borrower, the bank can surrender the policy and get cash easily.

Precautions to be taken by the banker

1. The bank should verify whether the policy holder has an insurable interest in the life of the assured.
2. The banker should see that the age of the assured has been duly admitted.
3. The bank should prefer an endowment policy rather than a whole life policy.
4. The bank should ensure that the policy is free of any encumbrance.
5. The bank should see that premium is paid regularly.
6. The bank should get the policy assigned in favour of the bank.
7. The bank should maintain sufficient margin while granting advances on the surrender value of the life policy.

2.6 ADVANCES AGAINST REAL ESTATE

Real estates are immovable properties like land, building factory, premises, etc. Banks do not prefer to advance money against the security of real estate because of many risks and disadvantages.

Difficulties Associated With Real Estates

There are certain drawbacks in accepting real estates as collateral securities. It is very difficult to ascertain the title to the property. It is also not readily disposable. Valuation of property is another important problem for the bank. The banker should get legal opinion about the property, which is expensive. Further, many restrictive laws govern the immovable properties.

Precautions to be taken by the banker

When a banker decides to grant advances against such security, it should take the following precautions:

1. ***Title Verification:*** The bank should ascertain through legal experts whether the property offered as security has a clear title. Property should be free from any other charge or encumbrance
2. ***Lease-Hold Property:*** If the property is a leasehold property, the bank should examine the terms of lease and unexpired portion of the lease.
3. ***Valuation:*** Proper valuation of the property should be done with the help of approved valuers.
4. ***Adequate Margin:*** A bank should keep adequate margin i.e., it should not advance more than 50% to 60% of the value of the property in order to avoid loss due to fall in the value of the property.
5. ***Legal Mortgage:*** Even if it is expensive, the bank should obtain a legal mortgage of the property, duly registered.
6. ***Insurance:*** The bank should see that the building or factory, etc., is insured against fire and other calamities and the policy should be assigned in favour of the bank.

2.7 ADVANCES AGAINST FIXED DEPOSIT RECEIPTS

Banks advance loans against the security of fixed deposit ,eceipts (FDR). *As* the fixed deposits are repayable only after the expiry of the fixed date, a depositor may borrow money against the F.D. receipt. Loan is granted by keeping some I margin against the face value of the receipt.

Precautions to be taken by the banker

1. Loans against Fixed Deposit Receipt (FDR) should be granted only to' those

   Persons in whose name the deposit stands.
2. The bank should not grant a loan on the FDR issued by another bank as the issuing bank might have charge over such deposits.
3. The bank should get back the FDR duly discharged by the depositor.
4. If the FDR is in the joint names of two or more persons and the loan is desired by

any one of them, the bank should get the signatures of all of them to discharge it.

5. If the FDR is in favour of a minor, no loan should be granted against such receipt.
6. If the fixed deposit receipt has matured and by the time the loan is not repaid, the bank should adjust the amount of loan including the interest and refund the surplus, if any, to the party concerned.

2.8 ADVANCES AGAINST BOOK DEBTS

Book debts are actionable claims, which can be assigned to other person as provided in the Transfer of property Act, 1882. Banks also grant advances against book debts of their customers. However, advances against such book debts involve many risks/because in case of default by debtors, the bank has to perform the role of a debt collector.

Precautions to be taken by the banker

1. The Bank should get legal assignment of book debts in its favour by the customer.
2. The bank should inform the debtors of the customer about the assignment by a written notice.
3. If there are joint debtors, the bank should give notice to all of them to bind them.
4. Advances against book debts should be granted only to highly trustworthy customers.
5. The bank should have sufficient margin to cover the non-recovery portion of the debts.

2.9 ADVANCES AGAINST SUPPLY BILLS

Supply bills are those bills, which are prepared by persons who supply goods, articles or materials to the Government or semi-Government bodies, etc., and by contractors who undertake the Government contract work. Under this, the amount becomes due from the Government. Such supply bills can be assigned to the banker for securing loans. Granting loans against the security of supply bills involves many risks.

i. The payment of supply bills by the Government may be delayed for a long time.

ii. Bills may not be passed for full payment and

iii. The person concerned may set off the payment against any payment due to the Government.

Precautions to be taken by the banker

1. Only honest and trustworthy customers should be granted loans against supply bills
2. The banker should examine the terms and conditions of the contract entered into between the supplier and the Government.
3. The banker should obtain irrevocable power of attorney to receive the amount of the bill directly.
4. Supply bills have to be verified by the banker along with the inspection report, delivery note, Railway receipts, etc.
5. The banker should advance against supply bills keeping a margin of 10% to 25%.
6. If the supply bills are returned unpaid or less amount is paid, the banker should ask the supplier to regularise his account.

CHECK YOUR PROGRESS

1. The Banker is liable to suffer losses due to his______________
2. General Principles of secured advances are_____________
3. The borrower wants to make loans from a bank; the borrower should file a_________________ to the bank along with the actual policy.
4. Book debits are actionable claims which can be assigned to other person as provided in the__________
5. The advantages of securities are___________

LET US SUM UP

The security furnished by the customer provides as element of protection and safety to the lending banker, he is liable to suffer losses due to his ignorance, negligence or carelessness; here we discussed the nature of various types of securities offered to the banker and the necessary precautions to be taken by the Banker.

GLOSSARY

Secured Advances : provided by the customers give protection and safety to the lending banker.

Goods : are tangible assets and provide better security than the unsecured advances.

Stock Exchange Securities : are those that are regularly purchased and sold in the stock exchange.

Real Estates : are immovable properties like land, building, factory, premises, etc.

Fixed Deposit Receipts : are repayable only after the expiry of the fixed date; a depositor may borrow money against the F.D. receipt.

Book Debts : are actionable claims, which can be assigned to other person

Supply Bills : are those bills, which are prepared by persons who supply goods, articles or materials to the Government or semi-government bodies, etc, and by contractors who undertake the Government contract work.

ANSWERS TO CHECK YOUR PROGRESS

1. Ignorance, negligence or carelessness
2. Adequacy of Margin, Marketability of securities, Documentation, Realization of the Advances
3. Deed of Assignment
4. Transfer of property Act 1882
5. Reliability, liquidity, Price Stability, Easy valuation etc.

MODEL QUESTIONS

1. What the general principles that is to be observed while granting advances against securities?
2. Mention the precautions that should be taken by the banker while advancing loans against document of title to goods.
3. What precautions should be taken by the banker while advancing against stock exchange securities?
4. What are the merits of life policies as security?

5. Explain the various types of securities against which a banker grants advances.
6. Describe in detail the various formalities to be observed and the precautions to be taken by a bank while making advances against immovable property.
7. What are supply bills? Describe the procedure, documentation and precautions relating to advance against supply bills.

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Unit 3

GUARANTEES

STRUCTURE

OVERVIEW

Contracts of guarantee are special significance in the business of banking as a means to ensure safety of funds best to the customers. The safety of such founds is primarily ensured by security a charge over the tangible assets owned by the borrower and / or by the personal security of the latter. But in care the borrower is unable to provide the security of tangible assets or the value of the latter. Falls below the amount of the loan and the borrowers personal security is not considered sufficient, an additional security is sought by the banker in the form of a 'guarantee' given by a third person. A guarantee is, in fact, the personal security of the third person, who must command the confidence of the banker.

LEARNING OBJECTIVES

After reading this lesson, you should clearly known

- Contract of Guarantee
- Contract of Indemnity
- Essential features of Contract of Guarantee
- Liability of Surety
- Rights of Surety

3.1 MEANING AND DEFINITION OF GUARANTEE

Ordinarily, advances given by a banker must properly secure. But in exceptional cases, advances may be given on the personal security of the borrower provided the banker has complete confidence in the integrity and honesty of the customer. If the banker considers that the borrower's personal security is not sufficient, an additional security is required by the banker in the form of a "guarantee" given by a third party. A guarantee is, therefore, the personal security of the third party whom the banker has got confidence. In recent years, the importance of giving guarantee as a security for loans has greatly increased.

Section 126 of the Indian Contract Act, 1872 defines a contract of guarantee as "a contract to perform the promise or discharge the liability of a third person in case of his default". The person who gives the guarantee is called the surety or the guarantor. The person in respect of whose default the guarantee is given is called the principal debtor and the person to whom the guarantee is given is called the creditor. Hence, It is clear that contract of guarantee is a secondary contract, the principal contract being between the creditor and the principal debtor themselves. Therefore, the existence of a principal contract is essential for entering into a contract of guarantee.

3.2 CONTRACT OF INDEMNITY

Another contract, which appears similar to the contract of guarantee, is the contract of indemnity. Section 124 of the Indian Contract Act, 1872 defines the contract of indemnity as "a contract by which one party promises to save the other from loss caused to him by the conduct of any other person". The person who makes such a promise is called the 'indemnifier' and the other person is called the beneficiary'. For example, if the consignee of goods has lost the lorry receipt, he may take delivery of the goods from the transport company by furnishing an indemnity bond, thereby promising to reimburse the transport company any loss that may be caused to it by giving delivery of the goods without the lorry receipt.

3.3 DISTINCTION BETWEEN A CONTRACT OF GUARANTEE AND A CONTRACT OF INDEMNITY

Though both the contract seems to be alike, they differ in many respects:

1. In the case of a contract of guarantee, there are three parties, viz., the surety or guarantor, the principal debtor and the creditor. However, in the case of contract of indemnity, there are only two parties, viz., the promiser or the indemnifier and the party to be indemnified or insured.
2. In the case of guarantee, the liability of the surety to the creditor is secondary, the primary liability being that of the principal debtor. But in the contract of indemnity the liability of the indemnifier to the indemnified is primary and independent.
3. In a contract of guarantee, there are three contracts. One between the principal debtor and the creditor, the second between the creditor and the surety and the third between the surety and the principal debtor. However, in the contract of indemnity, there is only one contract i.e., between the indemnifier and the indemnified.
4. In the contract of guarantee, there is usually an existing debt, the performance of which is guaranteed by the surety. But in the contract of indemnity, the liability of the indemnifier arises only on the happening of a contingency.
5. In the guarantee, it is necessary that the surety should give the guarantee at the request of the debtor. But in the indemnity, it is not necessary for the indemnifier to act at the request of the indemnified.
6. The guarantor possesses certain rights, which are not available to the indemnifier. For example, the surety has the right of subrogation i.e., he can recover the amount paid by him from the principal debtor. The indemnifier cannot claim such reimbursement from anybody else.

3.4 ESSENTIAL FEATURES OF A CONTRACT OF GUARANTEE

1. A contract of guarantee may be either oral or written. Invariably bankers insist to have a written contract of guarantee as in England, where a guarantee must be in writing.
2. The contract of guarantee requires the concurrence of all the three parties concerned to the contract of guarantee.
3. Under certain special circumstances, a contract of guarantee is implied. For example, the endorser of a bill of exchange is liable to pay, as a surety, the amount of the bill of exchange to the payee in case the acceptor of the bill defaults to fulfill his promise.
4. A contract of guarantee, like any other valid contract, must have consideration. Here consideration received by the principal debtor is sufficient for the surety and it is not necessary that it must necessarily result in some benefit to the surety himself.

3.5 LIABILITY OF THE SURETY

3.5.1 NATURE AND EXTENT OF LIABILITY

It is co-extensive. According to Section 128 of the Indian Contract Act "the liability of the surety is co extensive with that of the principal debtor unless otherwise provided by the contract". This means that the quantum of liability of a surety is the same as that of the principal debtor, unless there is a contract to the contrary. That is, the liability of the surety can neither be more nor less than that of the principal debtor, though by a special contract, it may be made less than that of the principal debtor, but never greater.

3.5.2 LIMITATIONS OF SURETY'S LIABILITY

Though the liability of the surety is co-extensive with that of the principal- debtor, he may limit his liability.

3.5.3 THE TIME LIABILITY ARISES

The liability of the surety arises as soon as the principal debtor makes a default. The creditor is not bound to proceed first against the principal debtor before recovering the amount from the surety. In other words, the creditor can sue the surety without suing the principal debtor. In the Bank of Bihar Limited Vs Damodar Prasad and Another, the Supreme Court held that the liability of the surety is immediate and cannot be deferred.

3.5.4 LIABILITY OF CO-SURETIES

If there is more than one person guaranteeing a debt, all of them is called co-sureties and are .able to the principal debtor. If one of the sureties paid the entire amount to the creditor, he is entitled to claim contribution from his co-sureties.

3.6 RIGHTS OF SURETY

3.6.1 RIGHT OF SUBROGATION

When the principal debtor defaults to pay the creditor and the surety pays, the surety steps into the shoes of the creditor and acquires all right of the creditor against the principal debtor (Section 140 of Indian Contract Act, 1872). Thus, the surety is entitled to the benefit of every security .which the creditor has against the principal debtor provided such security was in existence at the time of the contract of guarantee.

3.6.2 RIGHT TO INDEMNIFY BY THE PRINCIPAL DEBTOR

According to Section 145 of the Indian Contract Act, 1872, in every contract of guarantee, there is an implied promise by the principal debtor to indemnify the surety and the surety is entitled to recover from the principal debtor all payments properly made. After the surety makes payment under the contract of guarantee, he becomes a simple creditor of the principal debtor and can recover the amount with interest. If he sustains any damage beyond the amount paid, he can also recover that damage.

3.6.3 RIGHT TO REVOKE CONTINUING GUARANTEE

The surety has the right to revoke at any time a continuing guarantee by giving notice of such revocation to the creditor. This right is available only for future transactions, but he remains liable in respect of the transactions, which have already taken place.

3.7 OBLIGATIONS OF CREDITOR (BANKER) TOWARDS SURETY

The banker as the creditor of the customer (principal debtor) has certain obligations towards Ute surety under contract of guarantee.

1. The banker as creditor should not change the original terms of the contract, without taking consent of the surety. If he does so without the

consent of the surety, the surety is discharge from his obligation as regards the transactions undertaken subsequent to the date of such change.

2. The banker as creditor should not release the principal debtor nor do any things of which may discharge the principal debtor. If he does so, the surety is discharge from his liability.

3. The creditor should not give any extension of time to the debtor, unless the same is providing in the contract of guarantee. If the time is extending, it is possible that in the meantime the debtor will die or become insolvent with the effect that the surety may not be able to recover the amount from the debtor.

4. It is the duty, on the part of the creditor to every act, which is necessary to protect the rights of the surety.

CHECK YOUR PROGRESS

1. Contract of guarantee may be either_______or________
2. One party promises to save the other from loss is called ___________
3. The principle Contract being between the________and the_________
4. A guarantee which extends to a series of promises or transaction is called a ________
5. The surety may revoke a continuing guarantee as to ________only.

LET US SUM UP

In recent years, significance of guarantee as a security for loans granted has greatly increased. Since the introduction of social control on banks and especially after the nationalization of major banks, greater attention is being paid towards augmenting bank advances for small and neglected borrowers who are unable to provide sufficient tangible assets as security.

The surety may however, undertake liability for less then the amount of debt of the principal debtor by specifying the same in the contract of guarantee.

GLOSSARY

A Guarantee : is the personal security of the third party whom the banker has confidence.

Contract of Indemnity : by which one party promises to save the other from loss caused to him by the contact of any other person.

Guarantor : is a person who gives the guarantee

Creditor : is the person to whom the guarantee is given.

Indemnifier : is the person who makes a promise and the other person is called the **beneficiary.**

ANSWERS TO CHECK YOUR PROGRESS

1. Oral or written
2. Indemnifier
3. Creditor and the principal debtor
4. Continuing guarantee
5. Future transactions

MODEL QUESTIONS

1. Explain and distinction between a Guarantee and an Indemnity which of there is a better security for a lending banker?
2. What is meant by 'continuing guarantee'?
3. State the precautions of a banker should take in granting loans against guarantees?
4. What are the rights and liabilities of the surely and the banker in a contract of guarantee?
5. The surety's liability is co-existence with that of the principal debtor – discuss?
6. Differentiate between Bank Guarantee and Letter of Credit?

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Unit 4

MORTGAGES

STRUCTURE

OVERVIEW

A cardinal principle of sound banking is to ensure safety of funds lent by a banker to his customers. A banker lends his funds to persons of means, engaged in some business, trade, industry or in any profession or vocation. When a customer offers immovable property like land and building as security for a loan, charge thereon is created by means of mortgage. The present lesson deals with the legal provisions leganding mode of creating charge over the tangible assets and the rights and obligations of the mortgager and mortgagee.

LEARNING OBJECTIVES

After reading this lesson, you should be able to:

- Define Mortgage
- Different types of mortgage
- Mortgager and Mortgagee's rights and duties

4.1 DEFINITION AND MEANING OF MORTGAGE

A mortgage is a charge created by offering immovable property like land and buildings as security for a loan. Section 58 of the Transfer of property Act 1882 defines mortgage as "the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability". The person who transfers the interest in property is called a mortgager and the person who gets the interest in property is known as the mortgagee.

4.2 MAIN FEATURES OF A MORTGAGE

1. A mortgage can be affected only in case of immovable property.
2. A mortgage is the transfer of some interest in the specific immovable property. However, the right of ownership in the property is not transferred to the mortgage. The property cannot be sold without the consent of the mortgagee.
3. The actual possession of the property need not always be transferred to the mortgagee.
4. When the payments due along with interest are completely paid by the mortgager, he gets back all his interest and rights in the property mortgaged.
5. If there are more than one co-owners of a property, every co-owner has the right to mortgage his share of property.
6. The object of mortgage must be to secure a loan or to ensure the performance of promise, which results in monetary obligation.

4.3 TYPES OF MORTGAGES

Section 58 of the Transfer of property Act, 1881 approves the following forms of mortgages.

4.3.1 SIMPLE MORTGAGE

A simple mortgage is one in which a person mortgaging the property binds himself personally to pay the mortgage money. Under this, the possession of the property is not delivered to the mortgagee. But if he fails to pay as per the contract, the mortgagee shall have the right to cause the mortgaged property to be sold to recover the amount due from the mortgager. For this, the mortgagee should seek the intervention of the court for selling the mortgaged property.

4.3.2 MORTGAGE BY CONDITIONAL SALE

Under this form of mortgage, the mortgager ostensibly sells the mortgaged property with any one of the following conditions.

1. The sale shall become absolute if the mortgager fails to pay the mortgage amount on a certain date.
2. The sale shall become void if the mortgager pays the mortgage amount.
3. The buyer shall transfer the property to the seller if the letter makes payment on a certain date.

4.3.3 USUFRUCTUARY MORTGAGE

The mortgager gives possession of the property or binds him, expressly or implicitly, to give such possession to the mortgagee in this mortgage. In simple words, in this type of mortgage, the mortgagee is authorizing to retain possession of the property and to receive income arising there from the liability of the mortgager is gradually reduce.

4.3.4 ENGLISH MORTGAGE

In the case of English mortgage, the mortgager binds himself to repay the mortgage money on a certain date and transfer the mortgaged property absolutely to the mortgagee on the condition that the mortgagee will retransfer the same to the mortgager upon the payments of mortgage money.

4.3.5 MORTGAGE BY DEPOSIT OF TITLE DEEDS / EQUITABLE MORTGAGE

Where a person delivers to the creditors' documents of title to immovable property with intention to create a security thereon, the transactions are called a mortgage by deposit of title deeds or equitable mortgage. However, this type of mortgage can be created in India only in cities like Kolkatta, Chennai and Mumbai or any other town, which the State Government concerned, may specify in this behalf.

4.3.6 ANOMALOUS MORTGAGE

This is a type of mortgage, which does not come under any of the above mentioned mortgages. In this case, the terms and conditions agreed to between the mortgager and the mortgagee do not strictly confirm to those specified under section 58 of the Act. Nevertheless, the rights and liabilities of parties are determined by the terms of contract as stated in the mortgage deed.

From the point view of transfer of titled to the mortgaged property, mortgages can be divided into two categories, viz., legal mortgage and equitable mortgage. In case of legal mortgage the mortgager transfers legal title to the mortgaged property in favour of the mortgagee by deed. This is created by registering the mortgage deed. In case equitable mortgage, the mortgager does not transfer the legal title of the property in favour of the mortgagee, but deposits the title deeds of the mortgaged property with the mortgagee.

4.4 THE DIFFERENCE BETWEEN THE LEGAL MORTGAGE AND EQUITABLE MORTGAGE

Legal Mortgage	Equitable Mortgage
Created by registering the mortgage deed.	Created by merely depositing the title deeds of the property.
As it is subject to stamp duty, it is costly.	As no registration is required, it is cheap.
As registration is compulsory, reputation of the mortgager may be affected.	As there is no registration, it does. not affect the reputation of the mortgager.
The mortgagee can sell the property without going to the court.	Cannot sell the property without going tothe court.

Legal Mortgage	Equitable Mortgage
Legal interest in the property is transferred in favour of the mortgagee.	Legal interest in the property is not transferred.
It involves lot of time and trouble.	Does not involve much time and trouble.

4.5 RIGHTS TO MORTGAGER

1. The mortgager can redeem the property mortgaged at any time he likes.
2. He has the right to inspect the property.
3. Right to make any additions or improvements on the mortgaged property.

4.6 RIGHTS OF THE MORTGAGEE

1. **Right to Foreclosure of Sale:** The mortgagee has a right to obtain from the court a decree for selling the property at any time after the mortgage money has become due to him. This is called a suit for foreclosure.
2. **Right to Sue for Mortgage Money:** The mortgagee has a right for the mortgage money in the following cases.
   a. Where the mortgager binds himself to pay the money, or
   b. Where the mortgaged property is partly or wholly destroyed and the security is not sufficient, or
   c. Where the mortgagee is deprived of the whole or part of the mortgaged property as a consequence of wrongful act of the mortgager, or
   d. Where the mortgager fails to deliver possession of the mortgaged property in favour of the mortgagee.
3. **Right of Sale without Intervention of Court:** The mortgagee has the power to sell the property without the intervention of the court in the following cases.
   i. Where the mortgage is an English mortgage, and

ii. Where it is expressly provided in the mortgage deed and the mortgagee is the Government or the whole or part of the mortgaged property is situated in the towns of Kolkatta, Chennai and Mumbai or in any town, which the state Government may specify in the behalf.

4. **Right to Accession to the Mortgaged Property.** The mortgagee is empowered to hold for the purpose of security any accession to the mortgaged property, provided contract to the contrary does not exist.
5. If the mortgaged property is a leased and the mortgager obtains a renewal of lease, the mortgagee is entitled to the new lease.
6. The mortgagee has the right to recover the money spent by him on the mortgaged property from the mortgager.

CHECK YOUR PROGRESS

1. The person who transfers the interest in property is called a ________
2. The person who gets the interest in property in known as ___________
3. ____________ is one in which a person mortgaging the property binds himself personally to pay the mortgage money
4. Mortgager has the right to inspect the__________________
5. The mortgagee has the right to recover the ________ spent by him on the mortgaged property from the mortgager.

LET US SUM UP

Secured advances are those advances, which provide absolute safety to the banker by means of a charge created on the tangible assets of the borrower in favour of the banker. In such condition, the banker gets certain rights in the tangible assets over which a charge is created. One of the creating charges is mortgage.

GLOSSARY

Mortgage is a charge created by offering immovable property like land and buildings as security for a loan.

Simple Mortgage is one in which a person mortgaging the property binds himself personally to pay the mortgage money.

Mortgage by conditional Sale is the mortgager ost4ensibly sells the mortgaged property.

Usfructuary mortgage in which the mortgager gives possession of the property or binds himself, expressly or implicitly, to give such possession to the mortgagee.

English Mortgage means the mortgage binds him to repay the mortgage money on a certain date and transfer the mortgaged property absolutely to the mortgagee on the condition.

Mortgage by deposit of the deeds refers where a person delivers to the creditors documents of title to immovable property with intention to create a security thereon.

Anomalous mortgage means the terms and conditions agreed to between the mortgager and the mortgagee do not strictly confirm to those specified.

Mortgager is a person who transfers the interest in property.

Mortgagee is the person who gets the interest in property.

ANSWERS TO CHECK YOUR PROGRESS

1. Mortgager
2. Mortgagee
3. Simple Mortgage
4. Property
5. Money

MODEL QUESTIONS

1. Discuss the characteristics of mortgage.
2. Explain the different types of Mortgages.
3. Explain the legal and equitable mortgage by distinguishing them clearly.
4. Discuss the rights of mortgager and Mortgagee.

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Unit 5

FORMS OF CREDIT / LENDING

STRUCTURE

OVERVIEW

The terms and conditions, the rights and privileges of the borrower and the banker differ in each case. In India, the category of loans, cash credits and advances account for the bulk of bank credit. This lesson describes the existing practices in relation to loans, cash credits and overdrafts in India.

LEARNING OBJECTIVES

After reading this lesson, you should understand the following:

- details about Cash Credit System
- the procedures of an overdraft facilities
- advantages and Disadvantages of loan system
- requirement of the borrower demands for loan / credit

5.1 CASH CREDIT

Under this system, the banker permits his customer to borrow money up to particular limit against the security of tangible assets or guarantees. The customer withdraws cash from this account as and when he needs funds and deposits any amount of money, which he finds surplus with him. The cash credit account is thus an active and running account to which deposits and withdrawals may be made frequently. The bank will charge interest only on the actual amount withdrawn by the customer. Cash credit is the main methods of lending by banks in India and accounts for about 70% of the total bank credit. In recent years, banks have started charging a minimum interest of one percent on the amount unused.

Cash credit is the main method of lending by banks in India and accounts for about 70 per cent of the total bank credit. Under the systems, the banker specifies a limit, called the cash credit limit, for each customer, up to which the customer is permitted to borrower against the security of tangible assets or guarantees. The customer withdraws from his cash credit account as and when he needs the funds and deposits an amount of money which he funds surplus with him on any day. The cash credit account is thus an active and running account to which deposits and withdrawals may be affected frequently. The customer is required to provide tangible assets as security to cover the amount borrowed from the banker. The borrower is charged interest on the actual amount utilised by him and for the period of actual utilisation only. Other features of cash credit arrangements are as follows:

1. The banker fixed the cash credit limit after taking into account several features of the working of the borrowing concern such as production, sales, inventory levels, past. Utilisation of such limits, etc. The banker is thus inclined to relate the limits to the security offered by their customers.
2. The advances sanctioned under the cash arrangement are technically repayable on demand and there is no specific date of repayment, but in practice, they roll over a period. Cash accruals arising from the sales are adjusted in a cash credit account from time to time but it is found that on a larger number of accounts no credit balance emerges or debit balance fully wiped out over a period of years as the withdrawals are in excess of receipts.

3. Under the cash credit arrangement, a banker keeps adequate cash balance to meet the demand of his customers as and when it arises. However, the customer is charged interest only on the actual amount utilised by him. To neutralise the loss of interest on the idle funds kept by the banks within the credit limits sanctioned, a commitment charge on the unutilized limits may be charge by the banks.

5.1.1 ADVANTAGES OF CASH CREDIT SYSTEM

1. ***Flexibility :*** The borrowers need not keep surplus idle funds with themselves; they can re-cycle the funds quite efficiently and can minimise interest charges by depositing all cash accruals in the bank account and thus keeping the drawls at the minimum required level. The system thus ensures lesser cost of funds to the borrowers and better turnover of funds for the banks.
2. ***Operative convenience :*** Bank has to maintain one account for all the transactions of customer. The repetitive documentation can be avoided.

5.1.2 WEAKNESS OF CASH CREDIT SYSTEM

1. ***Flexion of Credit Limits :*** The cash credit limits are prescribed once in a year. Hence, it gives rise to the practice of fixing larger limits than is required for most part of the year. The borrowers misutilise the unutilised gap I in times of credit restraint.
2. ***Bank's inability to verify the end of funds :*** Under this system, the stress is one security aspect. Hence, there is no conscious effort on the part of banks to verify the end use of funds. Funds are diverted, without bankers' knowledge, to unapproved purposes.
3. ***Lack of proper management of funds:*** Under this system, the level of advances in a bank is determined not by how much the bank can lend at a particular time but by the borrower's decision to borrow at that time. The system therefore, does not encourage proper management of funds by banks.

5.2 OVERDRAFT

When the banker permits a current account holder to draw more than what stands to his credit, such an advance is called an overdraft. This arrangement of overdraft facility may be extended to the current account holders either on giving some collateral security or on the personal security of the borrower. The customer may withdraw as and when he needs funds and repays it by means of deposits. Interest is charged on the exact amount overdrawn and for the exact period of its actual utilization. Overdraft is not granted as regularly as cash credit. It is granted only occasionally and for shorter periods. Overdraft system is more or less akin to cash credit system. When the banker to draw more than what stands to his credit such an advance is called and overdraft permit a current account holder. The banker may take some collateral security or may grant such advance on the personal security of the borrower. The customer is permitted to withdraw the amount as and when he needs it and to repay it by means of deposit in his account as and when it is feasible for him. Interest is charged on the exact amount overdrawn by the customer and for the period of its actual utilisation.

5.3 LOANS

Sanctioning of a specified lump sum amount by the banker to a customer is called a loan. Once a loan is sanctioned and transferred to the customer's current account the customer is required to pay interest on the full amount irrespective of the fact that the amount of is used or not. A loan once repaid in full or in part cannot be withdrawn again by the borrower unless the banker sanctions a fresh loan. This is the aspect, which differentiates it from the cash credit.

The commercial banks mainly provide short-term loans for meeting the working capital requirements of trade and industry. However, during recent times, particularly after the nationalization of commercial banks, an innovation has taken place and the banks have now come forward to grant medium and long-term loan to industries. These loans are called term loans.

5.3.1 ADVANTAGES OF LOAN SYSTEM

1. ***Financial Discipline on the Borrower :*** As the time of repayment of the loan or its installments is fixed in advance, this system ensures a greater degree of self-discipline on the borrower as compared to the cash credit system.

2. ***Periodic Review of Loan Account :*** Whenever any loan is granted or its renewed is sanctioned, the banker gets opportunities of automatically review the loan account. Unsatisfactory loan accounts may be discontinued at the discretion of the banker.
3. ***Profitability :*** The system is comparatively simple; Interest accrues to the bank on the entire amount lent to a customer.

5.3.2 DRAWBACKS OF LOAN SYSTEM

1. Ever time a loan is required, it to be negotiated with the banker. To avoid it, borrowers may borrow in excess of their exact requirements to provide for any contingency.
2. Banks have no control over the use of funds borrowed by the customer. However, banks insist on hypothecation of the asset/vehicle purchased with loan amount.
3. However, the loans are for fixed periods, but in practice they roll over, i.e., they are renewed frequently.
4. Loan documentation is more comprehensive as compared to cash credit system.

Loans are granted for short, medium or long periods. Short-term loans are usually granted to meet the working capital needs of the borrower. Medium-term loan repayable over a period ranging from 1 year to 5 years, are granted for the purchase of durable goods like tractors and vehicles, equipments for professionals and other tools etc. Long-term loans, generally called 'term loans'. Are extended by banks, and other term lending institutions for meeting the requirements of capital investment in industry or agriculture. When a loan is granted both for buying equipments and for working capital purposes, especially in case of small borrowers, it is called a Composite Loan. Banks also provide on a limited scale 'consumption loans' to meet the medical and educational expense and expenses relating to marriages and other religious ceremonies.

5.4 THE DEMAND FOR CREDIT

The expansion or contraction of credit largely depends on the demand for bank credit by borrowers. This in turn depends upon:

i. The level of production both agriculture and industrial.

ii. The level of inventories held by business and industrial houses.

ii. The price level of goods and commodities in the country.

iv. The procurement policy of Food Corporation of India as other State agencies.

5.5 CONSORTIUM ADVANCES

Commercial banks in India have started granting credit on a consortium basis not only to public food procurement agencies but also to various public and private sector companies. This practice, also known as Participation Financing, or Joint Financing, is adopted in case of big borrowers, whose credit needs are met by two or more banks jointly in proportion to their capacities. There are two specific reasons for financing on participation basis: First, the resource of banks does not permit large advances, particularly in view of the credit control measures adopted by the Reserve Bank; and second, the banks are able to diversify their risks by participating in big advances. Each bank bears a part of the risk involved in a large advance.

Banks have in recent years adopted the concept of consortium advances not only in case of working capital financing but in term lending also. In the letter case, bank s participates in term loans with the term lending institutions also and is benefited by the technical and other expertise of these institutions. The credit needs of public food procurement and distribution agencies such as the Food Corporation of India, State Governments, Civil Supplies Corporations and Co-operative Marketing Federations have met by 36 banks comprising the public sector banks and the major private sector Indian banks. Joint financing or consortium lending is to be distinguished from multiple banking. In the letter case, a borrower borrows from a number of banks under separate agreements and securities are charged to them separately. Nevertheless, in case of a joint finance, an advance is given to the same party against a common security with remains charged to all the banks for the total advance. Usually in the case of a consortium advance, one of the banks acts as a consortium leader and takes leading part in the processing of the loan proposal, its documentation, recovery, etc. The participating banks enter into an agreement setting out the terms and conditions of such participation arrangement.

The Reserve Banking made following suggestions in August 1974 to the banks for sanctioning advances to large borrowers.

1. Large credit limits by a bank to any single borrower in the private or public sector (including Electricity Boards) in excess of 1.5 per cent of its deposits should normally be extended on a participation basis. This norm is not being adopted with flexibility and exceptions could be made in reasonable circumstances.
2. Whether it is decided to finance a borrower on consortium basis the arrangement should normally take care of the entire financial requirements of the borrower.
3. The food credit consortium arrangement should be forget between the banks themselves and the total business of the Food Corporation should be shared between the participating banks.
4. The case of sick unit, a reliable assessment as to the possibility of revival/rehabilitation should be taken up by the banks already lending to the sick mills. Banks should then proceed to find the financial requirements for revival along with the specialised agencies like the industrial Reconstruction Bank of India.
5. In case where the working capital requirements of borrower are financed by a number of banks without consortium arrangement a proper procedure for coordination among the financing banks should be evolved by
   - ⇨ Periodical exchange of essential information.
   - ⇨ Review of borrower's position through periodical inter institutional meetings, and
   - ⇨ Joint review of credit requirements of the borrower at the time of renewal/extension of credit limits or when the borrower's performance shows signs of deterioration.
   - ⇨ In 1978 Reserve Bank issued further guideline to be followed by banks in lending for working capital under consortium arrangement (i) The formation of consortium was made obligatory where the aggregate credit limits sanctioned by several banks to a single party amounted to Rs.5 crores or more (ii) The share of each

participating bank in the consortium was not to be less than 10 per cent of the total working capital limits sanctioned to the borrowers. (iii) The number of banks should not normally exceed five, except in case of very large credit limits. (iv)The terms and conditions of the advance were to be finalised by the consortium committee and were to be uniform for all the member banks. (v)All the consortium members were required to be sufficiently involved in the follow-up and supervision of the use of credit.

The scheme of participation Certificates, introduced in 1970 is a scheme to even out liquidity amongst the banks and certain other financial institutions. A Participation Certificate is an instrument through which a banker. Which has granted credit to its borrowers, thus the scheme facilitates inter-bank flow of funds for short periods, and reduce recourse to the Reserve Bank. These Certificates can be issued on terms and conditions prescribed by the Reserve Bank. These terms are as follows:

1. Participation arrangement may be entered into by a bank with any other commercial bank, the life Insurance Corporation of India, the Unit Trust of India, the General Insurance Corporation of India, the Industrial Credit and Investment Corporation of India, Export Credit Guarantee Corporation Limited and other institutions approved by the Reserve Bank from time to time. These Certificates are issued by banks against the working capital advances granted by them (such as cash credit, secured overdrafts and advances against book debts). The advantages are earmarked in favour of the holder of the certificate and it is noted on the certificates.
2. The period of maturity of these certificates should be less than thirty days and not more than 189 days.
3. The maximum rate of interest to be offered by the bank to the participating insurance is 10%.
4. The restrictions regarding maturity and rate of interest are not applicable in respect of certificates issued by a commercial banks to another commercial bank, irrespective of whether the latter was authorized to issue participation certifications or not.

5. Premature payment of certificate may be allowed, provided the period of maturity is thereby not reduced to below 30 days.

The Reserve Bank has approved 39 banks under the scheme to issue participation Certificates the Participation Certificate scheme was envisage as a means of evening out liquidity imbalance with the financial system. It was intended to provide Temporary Avenue of investment for short-term floating funds. However, banks found these certificates convenient for investing sizable amounts on a continuing basis by renewing the maturity certificates. The cost of raising funds through these certificates to the banks issuing such certificates was lower than that of raising fund from the call money market.

CHECK YOUR PROGRESS

1. _______ are usually granter to meet the working capital needs of the borrowers
2. Cash credit system banks prescribe the___________
3. _____________ facility is available to current account holder
4. Composite loan is granted for ___________
5. Consortium advances is otherwise called as___________

LET US SUM UP

Significant changes have taken place in the concept of security observed by the bankers in their attitude towards the hither weaker and regulated sections of society during the last decade. Security of funds lent is not sought exclusively in the tangible assets of the borrower but also in his technical competence managerial ability, honesty and integrity. In this lesson, we discussed about the main styles of credit system of financing prevalent in our country.

GLOSSARY

Cash credit means the banker specifies the limit.

Overdraft means the banker permits the current account holder to draw more than what stands to his credit.

Loans refer to sanctioning of a specified lump sum amount by the banker to a customer.

Demand for credit means expansion of credit largely depends on the borrowers.

Term loans mean long-term loans.

Composite loan means a loan is granted both for buying equipments and for working capital purposes, specially in case of small borrowers.

A participation certificate is an instrument through which a banker has granted credit to its borrowers.

ANSWERS TO CHECK YOUR PROGRESS

1. Short – Term Loans
2. Cash Credit limits
3. Overdraft
4. Small borrowers
5. Participation financing or Joint financing

MODEL QUESTIONS

1. What is Cash credit system and state the advantages and disadvantages of the system.
2. Explain about overdraft and their procedures.
3. Discuss the merits and demerits of loan system.
4. What is demand for credit?
5. What is consortium advances and explain?
6. Explain about participation certificate.

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Unit 6

VARIOUS COMMITTEES AND THEIR RECOMMENDATIONS FOR BANK CREDIT

STRUCTURE

OVERVIEW

In the early years when the security concept was strictly followed, the commercial banks insisted upon lending money based on agricultural produce. Slowly there was a shift from farmer to the trader. With the growth of industrialisation, the commercial banks preferred to lend against the security of stocks through pledge or hypothecation, meeting the working capital needs of the industries. With the advent of planning for development, it was felt that the security cum-guarantee system of lending was inadequate and had little social content and needed complete revamping as funds were not available for the priority sector.

The National Credit Council Study Group (NCC Study Group) was not in favour of the lending policies adopted by the commercial banks and recommended that the banking system turn to financing of industry based on a total study of the borrower's operations rather than on security consideration alone. Since nationalisation of major commercial banks, there has been a shift from security orientation to 'investment/purpose' orientation.

Traditionally banks have been meeting the working capital need of the industries by sanctioning overdrafts or cash credits against the pledge or hypothecation of inventories. The industries should meet part of the working Capital requirement either from their owned or long-term borrowing. Nevertheless, unfortunately, they seem to be depending entirely on the commercial banks. In many cases, funds borrowed from commercial banks are found to have been misused by building up inventories for speculative purposes, depriving a large number of genuine borrowers. Since the availability of funds are limited, its is felt that it must be allocated in such way that it yields the best possible return to the bank and the society in general and to the borrower in particular.

LEARNING OBJECTIVES

After reading this unit, you should understand,

- tandon Committee Norms
- chore Committee Norms
- nayak Committee Recommendations

6.1 TANDON COMMITTEE

In order to establish a link between output and credit needs in industries, the Reserve Bank of India appointed a Study Group in 1974 in under the chairmanship of Mr.P.Tandon. The Study Group submitted two interim reports regarding norms for inventory, approach to lending and style of credit and information system. Some of the important recommendations of the study are as follows:

Norms for Inventory and Receivables

The commercial banks are lending against chargeable current assets such as raw materials and stores, work-in-progress, finished goods, receivable and spare. An industrial unit is expected to hold only a reasonable level of these current assets. The committee suggested for the maximum level of inventory for 15 major industries to support planned operations in the ensuing year, mainly based on the length of the operating cycle for each industry. The operating cycle commences from the time of purchase of raw materials and ends with the receipt of cash from the debtor to whom the finished products have been sold on credit. The committee made it clear that the bank funds should not be used for building up excessive inventories. The norms proposed represent the maximum level for holding inventories and receivables in each industry, If however, a borrower has managed with less inventory in the past, he is expected to do so. As regards spares, only a general guideline has been spelt out. The norms have been expressed in units of months. Norms need not be absolute. It may be slightly deviated in the light of the changing circumstances, like power cuts, strikes, transport delays, bottlenecks, non-availability of shipping space or disruptions in sales and other unavoidable interruption in the process of production.

The new policy has been designed to enforce finished discipline on borrowers since they have to plane their credit requirements. This enables the banks to estimate and plan their portfolio. The new policy is applicable to all industrial borrowers including the small–scale industries; obtaining credit facilities exceeding Rs.10lakhs are covered. The Reserve Bank of India has issued directions to all commercial banks with deposits of RS.50 crores and above for implementing the new inventory norms. In case the existing borrowers have already exceeded the limit, it has been suggested that such inventories should be reduced in a phased manner. The industries may have to pay a higher interest rate if they happen to continue to hold excess inventories. Even in the case of such industries not covered by the present norms, the banks wicks have to a general supervision.

6.2 NORMS OF TANDON COMMITTEE REPORT OF THE STUDY GROUP TO FRAME THE GUIDELINES FOR FOLLOW UP OF BANK CREDIT (1975)

6.2.1 TASKS OF TANDON COMMITTEE

1. What constitute working capital requirement of industry which bank should finance and what are the end use of credit?

2. How is the Quantum of Bank-Advance to be determined?
3. Can norms be evolved for built- up of current assets and for debt-equity ratio to ensure minimal deposit on bank finance?
4. Can the current manner and style of lending be improved?
5. Can an adequate planning assessment and information system be evolved to ensure a disciplined flow of credit to meet genuine production needs and the proper supervision?

6.2.2 EVALUATION OF PRESENT SYSTEM

1. In the early years, bank lending in India was mostly directed to financing of movement of agricultural produce from the grower to the trader. The task of financing foreign trade being handled mostly by foreign banks. Advances were sanctioned against the security of stocks pledged or hypothecated to the banks.
2. With the Growth of Industrialisation, the same system of bank lending continued with minor changes and the banker saw his functions as meeting also the industry's need for short-term funds. Working capital finances was made available ostensibly for acquisition of current assets and as the advantages were made available in cash credit system, repayable on demand.
3. With the Advent of Planning for Economic Development and a growth awareness of the role of bank credit in the economy, it was felt that the prevailing commercial bank lending system had little social content and that it aided concentration of economic power.
4. The security cum guarantee system of lending was found inadequate also with the termination of the managing agency system. The entry of new entrepreneur into the industry with technical knowledge but lacking financial backing and managerial background also called for a new approach to lending by banks.
5. The purpose and direction of commercial banks lending in the country was questioned by the National Credit Council's study Group No.2 (NCC Study Group). The NCC Study Group recommended inter alia that the banking system should turn to financing of industry because of a total study of the borrower's operations rather than on security

considerations alone. Nationalisation of major commercial banks in 1960 raised expectations of new sense of direction in bank lending.

6.2.3 RECOMMENDATIONS OF TANDON COMMITTEE NORMS FOR INVENTORY AND RECEIVABLES

1. Norms have been suggested for 15 major industries taking into account inter alia company finance studies made by the Reserve Bank process period in the different industries, discussion with the industrial experts and feedback received on the interim report. The norms proposed represent the maximum levels for holding inventory and receivable in each industry. If however a borrower has managed with less in the past, he continues to do so.

   Norms cannot absolute or rigid thus deviation from norms may be visualized under the following circumstances:

   ⇨ Power cuts strikes ad other unavoidable interruption in the process of production.

   ⇨ Transport delays and bottlenecks.

   ⇨ Accumulation of finished goods due to non-availability of shipping space for exports.

   ⇨ Build up of stocks of finished goods such as machinery due to failure on the part of purchasers.

   ⇨ Need to cover full or substantial requirements of raw materials for specific expenditure contracts of short duration.

2. Norms should apply to all industrial borrower including small- scale industries.

   All credit limits whether enhancement has to seek for therein or not, should be considered in the light of the norms and where the levels of inventory and receivables are excessive. They should be reduced bringing down also the dues to the bank and/ or other creditors.

   The maximum permissible level of bank borrowing could be worked out in 3 ways:

   i. The borrower will have to contribute a minimum of 2.5% of the working capital gap from Long-term Funds, i.e., Owned Funds and Term Borrowings. This will give a minimum current ratio of 1:1.

ii. The Borrower will have to contribute a minimum of 2.5% of total Carom Long-term Funds Current ratio of at least 3:1.

iii. The borrowers will have to contribute a minimum of entire core Current Assets and minimum of 2.5% of the balance Current Assets.

3. The classification of Current Assets and Current Liabilities for computing the Permissible level of banks finance should be as per the usually accepted approach of bankers.

4. In future while financing a new project, the term lending institutions may provide for margins because of the recommended proposals and the bank, which is to finance the working capital and margin requirements.

5. Apart from loan and cash credit, a part of the total credit requirement within the over-all eligibility could be provided by the way of bill limits to finance seller's receivables. It is desirable that as far as possible, receivables should be financed by way of bills rather than cash credit against book debits.

6. The proposed system of lending and the style of credit may be extended to all borrowers having credit limit in excess of Rs.10lacs from the banking system.

7. The recommendations regarding inventory/receivables norms and mechanics of lending are to be viewed as package. It is an integrated scheme and the borrower is expected to subject himself to the entire discipline envisaged.

8. Stock statements will continue to be submitted but they need to be improving. The basis of valuations in the stock statements and the Balance Sheets should be uniform.

9. Management competence is an important factor in the efficiency of operations reflected in profitability and working capital and financial management

10. For the purpose of better control, there should be a system of borrower classification in each bank. Only feasible manner in which the banker can satisfy himself concerning end-use of funds would be to ensure,

by calling for appropriate operational date and figures relating to financial position at periodical intervals.

11. While financing, trade banks should keep in view inter alia the extent of owned funds of the borrower in relation to the credit limits granted, the annual turn over.
12. In the case of consortium advances or where a borrower is financed by more than one bank the concerned banks should evolve a procedure to ensure a uniform handling of the account in conformity will the inventory and receivable norms and the financial discipline suggested.
13. The Indian Bank Association has important role to play in a study of the environment and particularly the impact of regulations and enactments on the working of banks.
14. Instead of every bank, attempting to make detailed studies of all the major industries it should be beneficial of some selected banks concentrate on one or two industries each for which they may best fitted to study.
15. Inventory/receivables norms should be given effected to immediately, while action should be initiated to implement the new approach to lending within the bound schedule.
16. Steps should be taken simultaneously to introduce the suggested information system for all industrial borrowers with limits aggregating Rs.1 crore.
17. Bank should conduct training session for the operating officials.
18. The National Institute of Bank Management should organize special courses and The Banker's Training College or training the banker is operating officials.
19. Seminar may be convened in the Bankers Training College where operating officials can find solutions to any operational problems.

Follow up and supervision of bank credit and ensuring that borrowers take effective action to improve their financial strength is a continuous exercise. However, its prime contribution will be to take forward the of the study group to a continuing function of a dialogue with industry and banks to see the suggested system runs smoothly.

6.3 CHORE COMMITTEE NORMS

All the commercial banks in India meet the working capital requirements of the industry through overdrafts, cash credit and discounting commercial bills of exchanges. Of these methods, the most prominent method is the Cash Credit Method.

6.3.1 CASH CREDIT

The cash credit facility is similar to the overdraft arrangement. It is the most popular method of bank finance for working capital in India. Under the cash credit facility, a borrower is allowed to withdraw funds from the bank up to the sanctioned credit limit. He is not required to borrow the entire sanctioned credit at once; rather he can draw periodically to the extract of his requirements and repay by depositing surplus funds in his cash credit account. There is no commitment charge. Therefore, interest is payable on the amount of actually utilised by the borrower. Cash credit limits are sanctioned against the security of current assets. Though funds borrowed are repayable on demand, banks usually do not recall such advances unless they are compelled by adverse circumstances. Cash credit is most flexible arrangement from the borrower's point of view. Cash credit provides for the fixation of credit ceiling to individual borrowers because of maximum requirement of credit. This leads to a sizeable unutilised credit leading to a substantial gap between the sanctioned limits of cash credit and the extent of their utilisation.

The Reserve Bank of India appointed a committee in March 1979, under the Chairmanship of Mr.K.B.Chore to minimise the problem of cash credit. The main objective of the committee is review the cash credit system in the recent years and to suggest modifications in the existing system for greater credit discipline. The Committee's task was to look was into the operations of the cash credit system and to find out alternative ways of controlling the flow of banking credit to industry, particularly medium and large-scale industry.

The committee made a number of recommendations and prescribed new discipline and norms for cash credits after modifying the Tandon Committee norms. The RBI accepted the recommendations of the Chore Committee with certain modifications. The salient features of the main recommendations are as follows.

The Chore Committee examined the various forms of lending – overdraft, cash credit, discounting bills of exchanges and loans and advances. After analyzing the merits and demerits of each system, its was found that each system has its own merits and demerits but no system was superior to the other. It was also found that there a credit gap. However, the Committee could not find any evidence to show that the gap was so misused. It was pointed out that the unused gap in the public sector units was much more than in the private sector.

It was clearly pointed out that it would be difficult to replace the cash credit system totally by any other system. Therefore, the periodical review of credit limits and streaming the system were recommended. An annual review of all borrowers' accounts exceeding Rs.10 lakhs as working capital was suggested.

6.3.2 OTHER IMPORTANT RECOMMENDATIONS

Although there is no objection in continuing the three methods of lending, it would be good to follow loans and discontinuing of bills methods rather than cash credit system.

1. The advantages of the existing system of extending credit by a combination of three types of lending, namely, cash credit loan and overdraft should be retained. At the same time, it is necessary to give some directional changes to ensure that wherever possible the use of cash credit would be supplemented by loan and bills.
2. Bifurcation of cash credit limit into a demand loan portion and a fluctuating cash credit component has not found acceptance either on the parts of the bank or borrowers. Such bifurcation may not serve the purpose of better credit planning by narrowing the gap between sanctioned limits and the extent of utilisation thereof.
3. In order to ensure that borrowers do enhance their contribution to working capital and to improve their current ratio, it is necessary to place them under the second method of lending recommended by the Tandon Committee, which would give a minimum current ratio of 1.33:1. The excess borrowing should be segregated and treated as a working capital term loan, which should be made repayable in installments.

4. While assessing the credit repayments, the banks should appraise and fix Separate limits for the 'normal non-peak level' as also for the peak level credit requirements 'indicating also the periods during which the separate limits would be utilised by the borrower. This procedure would be extending to all borrowers having working capital limits of Rs.10 lakhs and above.

5. If any adhoc or temporary accommodation is required in excess of the sanctioned limit to meet unforeseen contingencies, the additional finance should give, where necessary, through a separate demand loan account or a separate non-operative cash credit account. There should be a stiff penalty for such demand loan on non-operative cash credit position at least 2% above the normal rate, unless the Reserve Bank exempts such penalty. This is to discourage the borrower from approaching banks frequently for ad hoc or temporary limits in excess of sanctioned limit.

6. The borrower should be asked to give his quarterly requirements of funds before the commencement of the quarter on the basis if his budget, the actual requirement being within the sanctioned limit for the particular peak level/non-peak level periods.

7. Request for relaxation of inventory norms and for ad hoc increases in limits should subjected by to close security and agreed to only in exceptional circumstances.

8. The banks should advice their own checklist in the light of the instruction issued by the Reserve Bank for the security if data at the operational level.

9. Delay on the part of banks in sanctioning credit limits could reduce in case where the borrowers co-operate in giving the necessary information about their performance and future projections in time.

10. As one of the reason for the slow growth of the bill system is the stamp duty on such bills and difficulty obtaining the required documentations of stamps. These questions may have to take up with the State Government.

11. Bank should review the system of financing book debts through cash credit and insist on the conversion of such cash credit limits into bill limits.
12. To encourage the bill system of financing and facilitate call money operations, an autonomous financial institution on the lines of the discount house in the United States may be set up.
13. Banks should give particular attention to monitor the key branches and critical accounts.
14. The communication channels, systems and procedures within the banking system should tone up to ensure that minimum time is taken for collection of instruments.
15. Although banks usually object to their borrowers dealing with other banks without their consent, some of the borrowers still maintain current accounts and arrange bill facilities with other banks, which initiate the credit discipline. The Reserve Bank issues suitable instructions in this behalf.
16. The need for reducing the over dependence of the medium and large borrowers both in the private public sectors – on bank finance for their production or trading purposes is recognized. The net surplus cash generation of an established industrial unit should utilised partly at least for reducing borrowing for working capital purposes.
17. The borrower would be required to submit the branch to the controlling office would send his budget requirements in triplicate and a copy each immediately and Head office for record. The penalty would be applicable only in respect of parties enjoying credit limits of Rs.10 lakhs and above, subject to certain exemptions.
18. The non-submission of the returns in time is partly due to certain features in the forms themselves. To get over this difficulty, simplified forms had been proposed. As the quarterly information system is part and parcel of the revised style of lending under the cash credit system, if the borrower does not submit the return with the prescribed time, he should be penalised by charging the whole outstanding in the account at a penal rate of interest of one percent per annum more than the contracted rate for the advance from the due date of the return till the date of its actual submission.

19. A stage has come to enforce the use of drawee bills in the lending system by making it compulsory for banks to extend at least 50per cent of the cash credit limit against raw materials to manufacturing units whether in the public or private sector by way of drawee bills. To start with, this discipline should be confined to borrowers having aggregate working capital limits of Rs.50 lakhs and above from the banking system.
20. Banks should insist on the public sector undertaking or large borrowers maintain 'control accounts' in their books to give precise date regarding their dues to the small units and furnished such data in their quarterly information system. Thus would enable the banks to take suitable measures for ensuring payments of the dues to small units by a definite period by stipulating, if necessary, that a portion of limits for bills acceptance (drawee bills) should be utilised only for drawee bills of small –scale units.
21. No conclusive data are available to establish the degree of correlation between production and quantum of credit at the industry level. As this issue is obviously of great concern to the monetary authorities, the Reserve Bank may undertake a detailed scientific study in this regard.
22. Credit control measures, to be effective, will have to be immediately communicated to the operational level and follow up. There should be a 'cell' attached to the Chairman's office at the central office of each bank to attend to such matters. The central office of banks should take a second look at the credit budget as soon as changes in credit policy are announce by the Reserve Bank, revise the plan of action in the light of the new policy, and communicate the corrective measures to the operational levels as quickly as possible.

6.4 NAYAK COMMITTEE RECOMMENDATIONS

In 1992, the Committee to examine the adequate of Institutional credit to the small-scale industries sector and related aspects' under the chairmanship of Shri.P.R.Nayak submitted its report to RBI. The committee has made major recommendation regarding sanctioning and following of credit to SSI sector.

As per the committee report, SSI sector has received a level of working capital, which was only 0.1% of its output. The village industries and the smaller tiny industries among the sector got working capital finance to the extent of only about 2.7% of their output.

At present norms for inventory and receivables are applicable to all units enjoying aggregate fund –based working capital credit limit of Rs. 10lakhs and above form the banking system. As per the new norms, the first method of lending (under lending norms) will not apply to all those industries under this sector which one enjoying aggregate fund- based working capital credit limits ranging from Rs.10 lakhs to Rs. 50 lakhs. Instead, such units may provide working capital limits computed based on a minimum of 20% of their projected annual turnover for new as well as existing units.

The banks may satisfy themselves about the reasonableness of the projected annual turnover because of annual statements and other related documented to ensure the realistic growth density of year. The Small-scale Industries (SSI) units should also bring in 5% of their annual turnover as margin money.

In other words, 25% of the output value should be computed as working capital requirement of which 4/5 should be provided by the banking sector, and the balance 1/5 should represent borrower's contribution towards margin for the working capital. In case where output exceeds the projections or where the initial assessment of working capital is found inadequate, the competent authority as should consider suitable enhancement in the working capital limits and when this is deemed necessary.

However, for other SSI units having aggregate fund-based working capital limits of above Rs.50lakhs would, continue to be government by the existing guidelines on lending norms, method of lending etc.

As part of the rehabilitation package, the interest on Working Capital Term loan (WCTL) has been modified as under:

The rate of interest applicable may be 1.5 to 3.0% points below the prevailing fixed rate/minimum lending rate, whenever applicable, but not more than the lowest lending rate for tiny decentralised sector units and not more than 5 % points below the minimum lending rate in the case of advances of over Rs.2 lakhs (i.e., the highest lending rate) for the other SSI units.

CHECK YOUR PROGRESS

1. Nayak Committee recommendations report submitted to RBI in the year __________
2. The main objective of the chore committee is to review the _______
3. Tandon Committee norms___________ and ______________
4. The RBI approach a chore committee in_______________
5. The guidelines on bank credit is submitted by______________

LET US SUM UP

Different committees are recommended certain norms to RBI. All commercial banks in India meet the working Capital requirements of the industry through overdrafts, cash credits and discounting commercial bills of exchange. Norms for inventory and receivables, cash credit and bank credit to small-scale industries.

GLOSSARY

Tandon Committee Group submitted two interim reports regarding norms for inventory, approach to lending and style of credit and information system.

Inventory and Receivables are lending against chargeable current assets such as raw materials and stores, work-in-progress, finished goods, receivable and spare by the commercial bank. An industrial unit is expecting to hold only a reasonable level of these current assets.

Chore Committee has appointed a committee in March 1979, under the Chairmanship of Mr.K.B.Chore to minimise the problem of cash credit by Reserve Bank of India.

The **Cash credit** facility, a borrower is allowed to withdraw funds from the bank up to the sanctioned credit limit. He is not required to borrow the entire sanctioned credit at once; rather he can draw periodically to the extract of his requirements and repay by depositing surplus funds in his cash credit account.

Nayak Committee is to examine the adequate of Institutional credit to the small-scale industries sector and related aspects' in 1992.

ANSWER TO CHECK YOUR PROGRESS

1. 1992
2. Cash Credit System
3. Inventory, Approach to lending, style of credit and information system
4. March, 1979
5. Tandon Committee

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BLOCK II

CREDIT TO SPECIAL TYPES OF CUSTOMERS

A banking institution solicits deposits of money from the members of the public. An account in a bank for this purpose may be opened by any person who is legally capable of entering into a valid contract, and applies to the banker in the proper manner, i.e., he follows the procedure laid down by the banker and accepts the terms and conditions stipulated by the banker.

Unit : 7 Lending to special types of customers

This unit deals with the precautions to be ensured by the Banker while opening an account of several customers like Minor, Lunatics, Drunkards and Illiterate Person etc. The banker, however, possesses the right to reject an application for opening an account, if he is not satisfied with the identity of the applicant.

Unit 7

LENDING TO SPECIAL TYPES OF CUSTOMERS

STRUCTURE

OVERVIEW

The primary function of a commercial bank is to attract deposits of money from the public. The bank does this by opening accounts. An account in a bank can be opened by any person who (1) is legally capable of entering into a valid contract and (2) applies to the banker in proper manner i.e., he follows the procedure laid down by the banker and accepts the terms and conditions stipulated by the latter. Under the provisions of the Indian contract Act 1872, certain persons like minor, insolvent, lunatic and drunkards are incompetent to enter into valid contracts. So they cannot open and operate the account with the bank. Some persons like trustee, agent and executor have only limited power to enter into contract. The bank must take necessary precautions in dealing with such persons in order to safeguard its interests. Institutions like clubs, societies, colleges, etc., partnership firms and joint stock companies open account with the banker. The bank should take special care and precautions while dealing with such special types of customers. The present lesson discusses the legal position of the special cases of a bank's customers and the necessary precautions that a banker should take while dealing with them.

LEARNING OBJECTIVES

After reading this lesson, you should understand the following:

- Precautions to ensure by the Banker while opening an account to the special types of customers like individuals, partnership firm, joint stock companies etc.

7.1 INDIVIDUALS

7.1.1 MINOR

A person who has not completed 18 years of age is a minor. However, in case, a guardian is appointed by a court or the property of the minor is put under the charge of a court of wards, the person will attain majority only on completion of 21st year of his age.

Under section 11 of the Indian contract Act, 1872, a minor is not capable of entering into valid contract and a contract entered into by a minor is voidable. A banker should therefore, be very careful in dealing with a minor and should take the following precautions.

1. A banker can very well open a savings bank account and not a current account in the name of a minor in any of the following ways
   a. In the name of the minor himself
   b. In the joint name of the minor and his/her guardian; and
   c. In the name of the guardian.

In case of (a) and (b) above, it is essential that the minor must have attained the age of 14 years and he can read or write English, Hindi or a regional language.

2. The bank should record the date of birth of the minor as given by the minor as given by the minor or guardian. On attaining majority, the account of the minor in the name of the guardian should be closed and the balance should be either given to minor (Now major) or credited to a new account in his own name.
3. If the guardian dies before the minor attaining majority, the balance should be paid to the minor on attaining majority or to a person appointed by a competent court as the guardian of the property of the minor.
4. In case the minor dies, the balance in the account is permitted to be withdrawn by the guardian.
5. No risk is involved if an account is opened in the name of the minor so long as the minor does not overdraw the account.
6. If an advance is granted to a minor on the guarantee of a third party such advance cannot be recovered from the guarantor also because the contract of guarantee is invalid on the ground that the contract between the creditor and the principal debtor (minor) itself is a void contract.
7. A minor may draw, endorse or negotiable a cheque or a bill but he cannot be held liable on such cheque or bill.

7.1.2 LUNATICS

Lunatic is a person of an unsound mind and hence he is incompetent to enter into a valid contract under the Indian contract Act 1872,since a lunatic does not understand what is right and what is wrong, and hence a contract entered into by him is void.

1. If a lunatic applies to the bank for opening an account, the bank should refuse to open an account for him.
2. When a person who has an account with the bank has become insane or lunatic, the bank should suspend the operation of his account as soon as it receives the notice. The bank is however, entitled to debit

the account of the lunatic customer in respect of all cheques honored by the bank before getting the notice.

3. While suspending the operation of the account of any customers on the ground of lunacy, the bank must have sufficient proof (doctor's certificate or a court notice) of his lunacy.

7.1.3 DRUNKARDS

A drunkard is a person who is under the influence of alcoholic drinks or drugs and stands on the same footing as a lunatic. An agreement made during drunkenness is void. The bank should not honour cheques of a person who has written and issued them under the influence of liquor. However, it is very difficult to judge whether the person is so intoxicated that he is not capable of understanding the implications of issuing the cheque. When a customer presents his own cheque when he is drunk, the bank should not make immediate payment. Therefore, it is better and safer that the bank should insist upon such a customer getting a witness (who is not drunk) to countersign before making any payment against the cheque.

7.1.4 ILLITERATE PERSON

Illiterate persons cannot sign their names but affix their thumb impression. In such cases, the bank may permit the opening of a savings bank account or fixed deposit account by an illiterate person by taking thumb impression instead of his signature. The bank should also insist on a copy of the photograph affixed on the account from withdrawals from this account will be allowed only if he comes personally to the bank and puts his thumb impression in the presence of some responsible officer of the bank.

7.1.5 MARRIED WOMAN

A married woman enjoys the same contractual right as a man or a single woman. So a bank can open an account in the name of a married woman. The bank should be careful in granting any loan or overdraft to a married woman, because in case of default, her husband cannot be made liable. The bank can recover such loans only from the property of the married woman. However, the husband would be made liable in the following cases:-

a. When his wife acts as an agent of her husband, and

b. When his wife is compelled to overdraw her account to meet the necessaries and for household purposes.

In France, consent of husband is necessary for opening an account by a married woman.

7.1.6 PARDANASHIN WOMAN

A pardanashin woman observes complete seclusion in accordance with the custom of her own community. She does not deal with the people other than the members of her own family. Therefore, a contract free from all defects. The banker should, therefore, take due precaution in opening an account in the name of such woman. Usually the banker refuses to open an account in her name, as the identity of such woman cannot be ascertained.

7.1.7 INSOLVENT

A banker should not open an account of a person who is an undischarged insolvent. This is because he is subject to a number of disabilities. Suppose a customer who was solvent at time of opening the account, but subsequently becomes insolvent, the bank must stop the operation of his account immediately after the receipt of notice of such an insolvency petition being filed in the court. When the customer is declared insolvent, the bank should act according to the directions given by the official assignee.

7.2 PARTNERSHIP FIRM

Partnership is formed on account or agreement between the partners and with the sole aim of earning and sharing profits in a particular ratio. The partners carry joint and several liabilities and the partnership does not possess any legal entity. The banker should take the following precautions while dealing with a partnership firm:

1. The specimen signatures of partners who are empowered to operate the accounts should be taken along with the application form duly completed.
2. A copy of the partnership deed or agreement should be obtained to know the capital of the partners, borrowing powers of partners, etc.
3. A written mandate has to be obtained with regard to the operation of accounts, overdrawing, etc.

4. The banker should see that no amount is transferred from partnership accounts to the personal accounts of the partners.

7.3 JOINT STOCK COMPANIES

Modern businesses are generally organized as joint stock companies. They are artificial persons created by law to achieve certain objectives. A joint stock company has a separate legal existence. Its life is not affected by incoming outgoing of members. It has no physical existence. It has no mind or a body of its own. It acts through the board of Directors. It can purchase and sell properties in its own name. It has got a separate legal entity free its members who constitute it.

The banker should satisfy about the following while opening an account in the name of a company.

1. ***Examination of Documents:*** The banker should thoroughly and carefully examine the documents such as memorandum of Association, Articles of Association, and Certificate of incorporation and certificate of commencement of business to know its constitution, powers and objectives, rules and regulations, etc. Copies of all these documents must be obtained while opening an account in the name of a joint stock company.
2. ***Copy of Board's Resolution:*** A copy of the resolution passed at the meeting of the board of Directors appointing the company's bankers should be obtained along with application form duly completed. In addition, the specimen signatures of persons who are empowered to operate the account on behalf of the company should be obtained.
3. ***A Written Mandate:*** A written mandate should be obtained authorizing the bank allowing overdrawing the account and giving security the bank.
4. ***Registration of charges:*** Whenever a company borrows, it has to give certain assets by way of security and if the bank accepts them, as security, then it should be property recorded in the books of the company and should be duly registered with the registrar of joint stock companies with in 30 days of its creation. Otherwise, it shall be void against the creditor of the company.

5. ***Director's Personal Accounts:*** If the banker of a company also has personal accounts of the directors of the company, the bank should be careful whenever there is a transfer of money from company's accounts to the personal accounts of the directors. That is, the banker should verify himself about the genuineness of such transfers.

7.4 JOINT ACCOUNTS

When two or more persons open an account jointly, it is called joint account. The banker should take the following precautions in dealing with a joint account.

1. All the persons who have joined to open a joint account must sign the account opening form to open a joint account.
2. The bank should ask for clear instruction in writing as to who will operate the account. Suppose no clear instruction is given, the bank should honour cheques only when all the joint account holders sign the cheques.
3. Any joint account holder including the one who is authorized to operate the account can stop payment of a cheque issued on a joint account.
4. The banker should also ask for a clear mandate as to allow overdraft facility for the joint account.
5. The authority to operate the account can be revoked by any of the persons giving such authority. It is automatically revoked if one of the joint account holders dies, becomes bankrupt or of unsound mind.
6. The banker should ask for clear instructions regarding the withdrawal of securities in the joint account.

7.5 TRUST

A trustee is a person in whom a confidence is reposed. The person who reposes the confidence is called the author of the trust. The person for whose benefit the trust is formed is called the beneficiary. A trust is usually formed by means of a document called the "Trust Deed". The bank can permit the opening of an account by trustee. But before doing so, the bank should take certain precautions.

1. The bank should thoroughly examine the trust deed to know the names of trustees, the power vested in them for administering the trust property and other terms and conditions.

2. In case of two or more trustees, the banker should ask for clear instructions regarding the person/persons who shall operate the account.
3. If one or more of the trustees died or retires the authority vested in the remaining trustees depends upon the provisions of the trust deed.
4. The insolvency of a trustee does not affect the trust property and the creditors of the insolvent trustee cannot recover their claims from the trust property.
5. The banker should take all precautions to safeguard the interests of the beneficiaries of a trust, failing which the banker shall be liable to compensate the latter for any fraud on the part of the trustee.
6. The trustees may borrow money from the banker and pledge or mortgage the trust property only if the trust deed specifically confers such power on them.

7.6 CLUBS, ASSOCIATIONS AND EDUCATIONAL INSTITUTIONS

These are all non-trading institutions interested in serving the community around. The banker should examine the Following.

1. ***Incorporation:*** These institutions may be registered or incorporated according to the Indian companies Act or the Co-operative societies Act or the Societies Registration Act. If it is not registered, the organization does not have legal existence and hence it will have no rights to contract with the outside parties.
2. ***Constitution:*** Every organization should have a constitution of its own in the name of byelaws or rules or Memorandum of Association and Articles of Association. These documents enable the banker to know exactly the rights and powers of the organization. This will help the banker to deal with such organization properly.
3. ***A copy of the resolution of managing committee:*** The banker should ask for the copy of the resolution passed at the meeting of the Managing committee or Board of Directors regarding the appointment of Banker with specific instruction for overdrawing and the persons authorized to operate the accounts.

4. ***An Application Form:*** An application form duly completed in all respects along with specimen signatures or the persons authorized to operate the account should be submitted for opening the account.
5. ***Transfer of Funds:*** The banker should be very careful to see that the funds of the organization are not transfer to the personal accounts or the persons authorized to operate the account.

7.7 JOINT HINDU FAMILY

A Joint Hindu Family also known as Hindu undivided family possesses ancestral properties and carries on the business. The ownership of the property passes to the members of the family as per the Hindu Law. Under their law, every male member of a family acquires an interest in the joint property by birth and he is called a coparcener. While dealing with the account of a joint Hindu Family, the banker should take the following legal precautions.

1. The family business and its assets are managed by the eldest male member of the family known as Karta. According to law, if a loan is granted to a joint Hindu Family, the banker has to get the documents executed by the Karta of the Family. However, it is always better if the banker gets the documents executed by all the adult male members.
2. The power of the Karta to borrow money on the security of the family property is subject to one limitation, i.e., the loan is taken for meeting the family needs and not for any speculative business.
3. The coparceners 'liability in case of loans granted to a joint Hindu Family is limited to the extent of their interest in the joint property.
4. If there is a minor coparcener in Hindu undivided family, his guardian must sign the documents on his behalf and once the minor attains majority, he should sign the documents.

7.8 EXECUTORS AND ADMINISTRATORS

Executors and administrators are persons who have appointed to conduct the affairs of persons after his death. The executor is appointed by the testator (person making a will) to execute his will after his death, but whereas an administrator is appointed by a court for the execution of a will, if the executor is not named in the Will. The duties of both the executor and the administrator are the same. The banker should take the following precautions while dealing with executors and administrator.

1. When the customer (who has made the Will) of a bank dies, the banker should stop payments from his account. The executor should be permitted to operate the account of the deceased after he has obtained a probate from the court. The administrator is authorized to do so after securing the letter of administration. The banker should examine these documents before the authorized persons are permitted to operate the account.
2. When two or more executor or administrators are appointed, they should open a joint account with the bank and operate the account. In such cases, the bank should obtain clear instructions regarding the operation of the account and the overdraft on behalf of the executor.
3. The banker should be very cautious in conducting the accounts of executor/administrators to avoid the misappropriation of the funds of the deceased. The banker should not permit transfer of funds from the estate account to the personal account of the executor.
4. On the death, insolvency, insanity or resignation of any of the executor or administrators the bank can honour the cheques issued by him and can continue to operate the account, unless otherwise provided in the Will.
5. The executor/administrator may pledge the property of the testator to obtain an overdraft from the banker. The executor may do so only if he is permitted by the Will.

Hence, the banker should examine the Will before granting any loan to the executor or administrator. When the bank sanctions a loan, all the executor or the administrators must jointly sign the loan document.

CHECK YOUR PROGRESS

1. A person who has not completed _____________ of age is a minor
2. The bank many permit the opening of a savings bank account or fixed deposit account by an illiterate person by taking _________ instead of his signature
3. Clubs, associations and educational institutions are all_____________ institutions interested in serving the community around

4. Partnership does not possess any_______________
5. A trust is usually formed by means of a document called the_______

LET US SUM UP

A banking institution solicits deposits of money from the members of the public. The banker, however, possesses the right to reject an application for opening an account, if he is not satisfied with the identity of the applicant. The banker should, therefore, take special care and precautions to ensure that the accounts of all types' customers are being conducted in accordance with the provisions of their respective charters.

GLOSSARY

Minor is a person who has not completed 18 years of age.

A partnership is form on account or agreement between the partners and with the sole aim of earning and sharing profits in a particular ratio.

Joint Stock Company has a separate legal existence. Modern business is generally organised as joint stock companies.

Lunatic is a person of an unsound mind and he is not competent to enter into a valid contract.

Drunkard is a person who is under the influence of alcoholic drinks or drugs and stands on the same footing as a lunatic.

Trustee is a person in whom a confidence is reposed.

Clubs & Association are all non-trading institutions interested in serving the community around.

Joint Hindu Family possesses ancestral properties and carries on the business.

ANSWER TO CHECK YOUR PROGRESS

1. 18 years
2. Thumb Impressions
3. Non – Trading Institutions
4. Legal
5. Trust deed

MODEL QUESTIONS

1. What precautions should a banker take in opening and conducting accounts in the names of minors and married women?
2. What styles should a banker take
   a. To open an account of partnership firm, and
   b. To chose the account of an undesirable customer
3. What precautions should a banker take while opening current accounts in the name of
   a. A Joint Stock Company
   b. A Pardenshin Lady
   c. Clubs

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BLOCK III

ADVANCES TO SMALL AND MEDIUM ENTERPRISES AND OTHER PRIORITY SECTORS

Small and medium enterprises (SMEs) are the growth engines of the Indian economy due to their ability to create job, foster entrepreneurship and to provide depth to the industrial based of the economy. Since the saving season is round the corner, Government wish to impress upon all the agencies concerned the urgent need to significant enhance the quantity and quality of credit flowing to the Agricultural sector.

Unit : 8 Business Loan

The banks were advice to formulate a comprehensive policy more liberal than the existing policies. Under the policy, banks were directed to achieve a minimum of 20% year on year growth in credit to the SME sector with an objective to double the flow of credit to SME sector within a period of 5 years. Public sector banks have shown a 26.44% year on year growth in credit to SMEs for the period ended September 30, 2006. This is much higher than the targeted 20% year on year growth in credit to this sector.

Unit : 9 Agricultural Advances

Governments are of the view that the full potential of Agriculture as a profitable activity must be realise at the earliest to benefit the farmers. Among the factors that will help in realizing this full potential are access to institutional credit to more farmers and appointment quantity and quality of agricultural credit.

Unit : 10 Agricultural loan – Infrastructural facilities

Advances to farmers for acquisition of jeeps, pick-up vans, mini-trucks etc., to be use for transport of agricultural inputs and farm products may reckoned as agricultural advances under the priority sector. Agri-clinic is envisaged to provide expert services and advice to farmers on cropping practices, technology dissemination crop protection from pests & diseases. Agri-business centers are envisaged providing input supply, farm equipment on hire and other services.

Unit : 11 Government sponsored advances

The purpose of bank nationalisation was to promote rapid growth in agriculture, small industries and exports, to encourage new entrepreneurs and to develop backward areas. After nationalisation, public sector banks have extended liberal credit facilities to the other priority sectors.

Unit 8

BUSINESS LOAN

STRUCTURE

OVERVIEW

Small and medium enterprises (SMEs) are the growth engines of the Indian economy due to their ability to create job, foster entrepreneurship and to provide depth to the industrial based of the economy. The policy package for stepping up credit to SMEs' was announced by RBI in August 2005, which has to be implemented by banks action taken thereon. Government of India and RBI attach great importance to the sector.

LEARNING OBJECTIVES

After reading this lesson, you should able to

- various measures to enhance banks lending to SME sector
- definitions of SME, Tiny Units, Small Scale Industries, Small Scale Service or Business enterprises and medium enterprises.
- processing and recovering procedures for SME sector

The banks were advice to formulate a comprehensive policy more liberal than the existing policies. Under the policy, banks were directed to achieve a minimum of 20% year on year growth in credit to the SME sector with an objective to double the flow of credit to SME sector within a period of 5 years. Accordingly, the guidelines were put up to our Board and approved by term. While large industries have access to various sources of finance, SME sector depends primarily on finance from banks.

8.1 RESERVE BANK OF INDIA HAS INITIATED VARIOUS MEASURES TO ENHANCE BANK'S LENDING TO SME SECTOR

As per SME, definition investment in plant & machinery up to Rs.1 crore and in select industries up to Rs.5 crores has been defined as SSI. Investment in plant & machinery above Rs.1 crore & Rs.5crore as the case may be and up to Rs.10crores has been defined as medium enterprise. Presently as per the latest definition under MSMED (Micro, Small and Medium Enterprises Development Act 2006) due recognition has been given to the service sector also. Investment ceiling up to Rs.25 lakhs in respect of manufacturing enterprises and Rs.10 lakhs in respects of service enterprises has been classified as Micro Enterprise. Investments above Rs.25 lakhs and up to Rs. 5 crores in respect of manufacturing enterprises and investments above Rs.10 lakhs and up to Rs.2crores in respect of service industry have been classified as Small industry. Investments above Rs.5 crores and up to Rs.10 crores in respect of manufacturing enterprises and investments above Rs.2 crores and up to Rs. 5 crores in respect of service enterprises have been classified as medium enterprises.

⇨ Composite loan limit single window for SSI enterprises is being enhanced from Rs. 50 lakhs to Rs 1 crore.

⇨ Banks can extend credit facilities to SSI units up to Rs.5 lakhs without collateral security.

⇨ Simplified debt restructuring mechanism for units in the SME sector has been implemented.

⇨ Cluster based approach for financing SME sector offers possibilities of reducing of transaction costs and mitigation or risks. About 149 clusters have been identified by SIDBI.

⇨ Banks are provided guarantee cover of 75% by CGTSI in respect of finance to SSI unit's up to a limit of Rs.25 lakhs sanctioned without collateral security or personal guarantee.

8.2 PUBLIC SECTOR BANKS UNDER SME SECTOR

Public sector banks have shown a 26.44% year on year growth in credit to SMEs for the period ended September 30, 2006. This is much higher than the targeted 20% year on year growth in credit to this sector. The cumulative SME credit outstanding for 27 public sector banks stood at Rs.1,61,038.64crores as on 30.09.06 against a level of Rs1,27,35,949 crores as on 30.09.05 (figures as per Business Line dated 10.11.2006)

8.3 SMALL AND MEDIUM ENTERPRISES POLICY GUIDELINES

Small and medium enterprises (SMEs) are the growth of the Indian economy due to their ability to create jobs, foster entrepreneurship, and to provide depth to the industrial based of the company.

Reserve Bank of India detailing "Policy package for stepping up Credit to Small and Medium Enterprises" advised Banks that Government of India announced certain measures in the parliament on August 10, 2005 for stepping up credit to Small and Medium Enterprises. Take these policy packages are required to be implemented by Banks and action there against.

Thus, Government of India and Reserve Bank of India attach great importance to this sector. They have announced a policy package for stepping up credit flow to SME sector. Banks were directed by GOI and RBI to formulate a comprehensive and liberal policy to achieve a minimum 20% year on year growth in credit to the SME sector with an objective to double the flow of credit to SME sector within a period of five years.

Accordingly, policy guidelines for enhancement of credit to SME sector was put up to our Board along with an action plans to implement the package, which has since been approved.

8.4 OPERATIONAL INSTRUCTIONS

The salient features of the policy guidelines on SME sectors are gives below.

DEFINITIONS

8.4.1 SMALL AND MEDIUM ENTERPRISES (SME)

The Internal group set up by RBI defines small and medium enterprises (SME) as units comparing small scale industries having investment in plant and machinery up to Rs.1 crore and medium enterprises having investment in plant & machinery in excess of the specified limit for SSI units and up to Rs.10crores. Thus, small and medium enterprises (SME) consider of tiny units, small scale industries, and medium enterprises.

8.4.2 TINY UNITS

Tiny units are small units in which investment in plant and machinery does not exceed rupees 25 lakhs irrespective of the location of the units.

8.4.3 SMALL SCALE INDUSTRIES (SSI)

Small-scale industrial units are those units engaged in the manufacture, processing or preservation of goods and whose investment in plant and machinery, excluding land and building (original cost), whether held on ownership terms or on lease or on hire purchase, does not exceed rupees one crore. These units would, inter alia, units engaged in mining or quarrying, service and repairing of machinery

The units should not be a subsidiary of, or owned or controlled by, any other industrial undertaking. Investment limit in plant and machinery up to Rs.5 crore is permitted in respect of small-scale units manufacturing specified items under hosiery, hand tools, drugs pharmaceuticals and stationery items & sports goods.

8.4.4 SMALL SCALE SERVICE / BUSINESS ENTERPRISES (SSSBE)

A small scale service / business enterprises (SSSBE) is a unit engaged in service or business which is industry related and has investment in fixed assets, excluding land and building, not exceeding Rs. 10 lakhs.

8.4.5 MEDIUM ENTERPRISES

Medium enterprises are those units having investment in plant & machinery in excess of the specified limit for SSI units (i.e. Rs. 1 crore / Rs. 5 crore) and up to Rs. 10crores. RBI/government has thus, now delinked medium industries from the present MLI and added it to SSI and termed them as small and medium enterprises beside advising banks to frame a policy to enhance credit to small & medium enterprises (SMEs).

8.5 ADVANCES GRADUATED AS DETAILED BELOW SHOULD BE INCLUDED UNDER SSI SECTOR

a. Loans for setting up to industrial estates.

b. All advances to khadi & village industries sector, irrespective of their size of operations, location and investment in plant and machinery will be covered under priority sector advances and will be eligible for consideration under the sub-target (60 percent) of the SSI segment within the priority sector.

c. Manufacture of common salt through any process including manual operation (involving solar evaporation) may be considered as an industrial activity and credit provided by banks to unit engaged in the manufacture of common salt, which satisfy the norms of SSI unit, may be classified under advances to SSI.

d. Units engaged in ship break/dismantling are composite ones which also undertake the processing of scrap thus obtained and hence entire activity can be covered under processing. Therefore, all small scale industrial units with original cost of plant and machinery not exceeding Rs.1 crore and engaged in ship breaking /dismantling activity may be considered as small scale industrial undertakings and bank advances to such units reckoned as priority sector advances.

e. Banking loans to bought leaf factories manufacturing tea are to be reckoned as priority sector lending to small-scale industry, provided the investment in plant and machinery (original cost) does not exceed the prescribed limits.

f. Water mills (Gharat) have been recognized as an industrial activity and will be eligible for registration as small-scale industry.

g. Good and Agro – based processing sector

The following items within the food and agro-based processing sector would be eligible for classification as priority sector lending by branches:

Advances granted to the following units satisfying the definition of SSI should be shown under advances to SSI.

- ⇨ Fruit and vegetable processing industry.
- ⇨ Food grain milling industry.
- ⇨ Dairy products
- ⇨ Processing of poultry and eggs, meant products.
- ⇨ Fish processing
- ⇨ Bread oilseeds, meals (edible) breakfast foods, confectionery (including cocoa processing and chocolate), malt extract protein isolate, high protein food, weaning food and extruded/ other ready to eat food products.
- ⇨ Aerated water/ soft drinks and other processed foods
- ⇨ Special packaging for food processing industries.
- ⇨ Technical assistance and advice to food processing industry.
- ⇨ Loans to industry to software industry with credit limit up to Rs. 1 crore from the banking industry to be included under SSI sector.

If the investment in plant & machinery, in all the above cases, exceeds the limit for SSI and is below Rs.10 crore, it can be classified under medium enterprises and will not qualify for priority sector lending.

a. Agencies involved in assisting the decentralised sector in the supply of inputs and marketing of outputs of artisans, village and cottage industries.

b. Government sponsored Corporations providing funds to the weaker sections in the priority sector.

c. Advances to handloom co-operatives.

d. Term finance/loans in the form of lines of credit made available to State industrial development corporation/ state financial corporation for financing SSIs.

e. Credit provided by banks to khadi and village industries commission (KVIC) under the scheme for provision of credit to KVIC by consortium of banks for lending of NBFCs or other intermediaries for on lending to the tiny sector.

f. All new loans granted by banks to NBFCs and other intermediaries for on lending to SSI sector with effect from November 11, 2003.

8.6 NORMS FOR SME ADVANCE

In order to ensure free flow of credit to SME sector, the following norms, right form the stage of submission of application to disbursement of the loans, should followed.

8.6.1 APPLICATION FORM

⇨ Simplified loans applications, as prescribed by RBI / Kapur committee, along with a checklist for borrowers, as well as for the bank have been provided.

⇨ Four different application forms are prescribed exclusively for SME advances and branches are to use these applications only.

8.6.2 APPLICATIONS RECEIVED REGISTER

A register should be maintained at branch level wherein the details regarding disposal of SME application viz., date of receipt date of sanction, date of disbursement and date of rejections with reasons therefore etc., should be recorded. The register should be made available to all inspecting officials. Rejection of applications for fresh limits/enhancement of existing limits should not be done without the approval of the next higher authority.

8.6.3 ASSESSMENT OF CREDIT FOR SME UNITS

a. Simplified procedures should be adopted for sanction of working capital limits based on 20% of the projected annual turnover to SME units requiring aggregate fund based working capital up to Rs. 7.5 crores.

b. For SME units requiring working capital limits over Rs.7.5 crore and upto Rs. 10 Crore, the maximum permissible bank finance (MPBF) method based on credit monitoring arrangement (CMA) data should be followed.

c. For SME units requiring working capital limits over Rs.10 crores, cash budget system of MPBF method, at the option of the borrower, should continue to be followed.

8.6.4 MARGIN

- For loans up to Rs.50,000/- to SME, no margin is required.
- For loans above Rs. 50,000/- margin should be obtained depending upon the scheme as per loan policy document and circulars issued form time to time.

8.6.5 SECURITY / OTHER FEATURES

a. No collateral security is required for SME advances up to Rs. 5 lakhs.

b. On cash-to-cash basis and on merits, no collateral security need be insisted for advances up to Rs.25 lakhs based on good record of accomplishment and financial position of the existing SME units subject to compliance of certain parameters.

c. All funds based credit facilities up to Rs.25 lakhs sanctioned to SSI units without collateral security and / or third party guarantee should be covered under credit guarantee fund scheme for small industries (CGFSI) administered by credit guarantee fund trust for small industries (CGTSI.)

d. Eligible borrowers [as mentioned under (b) above] should be give the option to provide acceptable collateral security, including third party guarantee, or take credit guarantee covered for small industries form CGTSI.

e. Complete loans up to Rs. 1 Crore should be granted to eligible SME units.

f. SSI advances are also granted under other scheme like technology up gradation fund scheme, national equity fund scheme, rural employment generation programme-margin money (REGP-MMS) under khadi & village industries commission (KVIC) laghu udhyami credit cards (LUCC).etc.

8.7 PRICING

Much significance is now attached to rating of SME borrowers for the taking of benefits accruing to borrowers like availability of adequate and quick finance at competitive interest rates etc. Hereafter

a. SME borrower accounts with credit limit of Rs.2 lakhs and up to Rs.1, crore will be rated by internal credit scoring model.

b. All the existing as well as new SME borrowers with credit limits of above Rs. 1. Crore should be rated with the help of CRISIL RAM rating module.

8.7.1 PRICING FOR NEW BORROWERS

In the case of sanction of credit facilities to new borrowers with credit facilities of above Rs.1crore, or proposals involving take over borrower accounts from other banks, the rating will be done by RAM module.

8.7.2 AVAILABILITY OF CREDIT TO ALL SEGMENTS

Advances to SSI sectors are categorized as priority sector advances. In order to ensuring that, credit is available to all segments of the SSI Sector.

1. 40% should be made available to units with investment in plant and machinery up to Rs.5 lakhs.
2. 20% to units with investment in plant and machinery between Rs.5 lakh and Rs.2.5 lakhs
3. 40% to units with investment in plant and machinery above Rs.25 lakhs

8.7.3 DELEGATION OF POWER TO BRANCH MANAGERS

For SME sectors in accordance with Kapur committee recommendations managers can grant ad-hoc facilities to the extent of 20% of the working capital limits sanctioned to SME borrowers.

8.7.4 PUBLICITY & COMPLIANCE

a. A copy of the charter for small & medium enterprises containing, interalia, the details of time frame for disposal of SME loan applications, and other features should be displayed on the notice board of bank branches.

b. Controlling office should review the position prevailing in the branches with regard to compliance of instructions prescribed for SME advances.

8.7.5 OTHER GUIDELINES

a. Self-set target (envisaging incremental growth rate of 20% on year-on year basis) for advances to SME sector will be fixed by central office, and advised to field functionaries from year to year.

b. The existing specialised SSI branches/Divisions are redesigned as SME finance branches/ divisions so that those SSI branches/divisions will extend finance to SME sector.

c. Towards increase in flow of credit to SME sector, monitoring and reviewing the policy, a separate cell called SME CELL under CSSD has been formed at central office.

d. Each of the rural and semi-urban branches is advised to finance at least on an average 5 new SMEs per year.

e. Wherever bank is the Lead bank of the direct, the Regional office should adopt at least once cluster.

f. Cluster based approach in extending finance to SME sectors; as per Ganguly committee recommendations should be adopted.

g. In order to effectively monitor the credit flow to SME sector, branched should submit the prescribed quarterly / half-yearly / annual statements related to advances to SME sector to regional office concerned. Regional offices, in turn, should consolidate the date obtained from branches and submit the returns to CSSD, central office periodically.

CHECK YOUR PROGRESS

1. Investment in Plant & Machinery up to ____________

2. Tiny Units in which investment in plant & machinery does not exceed_______

3. Kapur Committee have been prescribed___________
4. No collateral Security is required for SME advances up to_________

LET US SUM UP

Detailed policy guidelines have been issued to the branches with instructions to adopt pro-active approach for lending to SME sector. All commercial bank branches here been advised to ensure that out of the total credit to SSI. On merits, no collateral security is being insisted for advances up to Rs.25 lakhs. Simplified loan applications and specification frame for disposal applications were made. In total, simplified procedures are adopted for assessment of credit facilities.

GLOSSARY

Small and Medium Enterprises (SME) as units comparing small-scale industries having investment in plant and machinery up to Rs. 1 crore and medium enterprises having investment in plant & machinery in excess of the specified limit for SSI units and up to Rs. 10 crores.

Tiny Units are small units in which investment in plant and machinery does not exceed Rs. 25 lakhs irrespective of the location of the units.

Small Scale Industrial units (SSI) are those units engaged in the manufacture, processing or preservation of goods and whose investment in plant and machinery, excluding land and building does not exceed Rs. 1 Crore.

Small Scale Service or Business Enterprises is a unit engaged in service or business which is industry related and has investment in fixed assets, excluding land and building, not exceeding Rs. 10 lakhs.

Medium Enterprises are those units having investment in plant & machinery in excess of the specified limit for SSI units and up to Rs. 10 crores.

ANSWER TO CHECK YOUR PROGRESS

1. Rs.1 Crore
2. Rs.25 Lakhs
3. Simplified loan application form
4. Rs.5 Lakhs

MODEL QUESTIONS

1. Define SME.
2. Explain the RBI's various measures to enhance bank's lending to SME sector.
3. Explain the processing and recovering procedures for SME sector Advances.
4. Write a note on:
   a. Tiny Units
   b. SSI
   c. Medium Enterprises
5. What are the powers delegate to Bank branch managers for SME sector

BOOKS REFERENCES

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Unit 9

AGRICULTURAL ADVANCES

STRUCTURE

OVERVIEW

Governments are of the view that the full potential of Agriculture as a profitable activity must be realized at the earliest to benefit the farmers. Among the factors that will help in realizing this full potential are access to institutional credit to more farmers and appointment quantity and quality of agricultural credit. Environment here also noted with deep sadness the condition of farmers all over the country. Successive droughts here had driven a large member of farmers to description and in many cases, even to suicide. It is therefore, necessary to provide some debt relief to the farmers within the limits of financial prudence.

LEARNING OBJECTIVES

After reading this lesson, you should able to

- General norms applicable for agricultural advances
- Agricultural advances loan processing, sanctioning, monitoring and recovering procedures.

9.1 R.V. GUPTA COMMITTEE RECOMMENDATIONS

R.V. Gupta Committee submitted the recommendations to Reserve Bank of India during 1998 and some of the important decisions are as follows.

9.1.1 OBTAINING OF NO-DUE CERTIFICATE

Obtaining of no-due certificate should not insist as a matter of routine. No-due certificate has been dispensed with for all Government sponsored programmes as the loan application contains clause for eliciting particulars about any loan taken by the applicant. If branch still feels to verify the status of loan account with other banks, branches have to furnish the list of borrowers to be financed in duplicate to all the branches operating in their service area and get clearance within 15 days. If there is no response within 15 days, then it is constructed that the applicants have to no- due with other banks.

9.1.2 OTHER ADVANCES

Up to Rs.25,000/-	-	No due certificates from Co-operative banks alone
Above Rs.25,000/-	-	From all banks including Co-operative banks

9.1.3 DISBURSEMENT OF ADVANCES IN CASH

In respect of agricultural advances, the loan amount can be disbursed in cash as detailed below:

- Government sponsored programme – As per programme guidelines
- Short term agricultural advances – Entire limit can be disbursed in cash
- Medium term agricultural advances – Up to Rs. 10,000/- in cash

9.1.4 LIQUID SAVING MODULE

Liquid savings module has been built in as part of the crop loan disbursed as cash credit. The credit balance in CC account should be treated as short-term deposit. If the account balances in is credit balance for a minimum period of 15 days, then appropriate deposit rate for the days the account is in credit should be credited to the account automatically.

9.2 APPLICATION FORMS

9.2.1 SERVICE AREA APPLICATION

The service area approach has been introduced effective from 1 April 1998. As per this scheme, the entire villages all over the country have been allocated to all banks for the over all development banks have to finance priority sector advances only in the service areas. However, as per RBI relaxation, banks are now permitted to finance any village within the block, provided NOC is obtained from the concerned bank branch.

9.2.2 MONITORING THE IMPLEMENTATION OF THE PROGRAMME

State level - State level banker's committee (SLBC) in Tamil Nadu State

District level - District Consultative Committee (DCC)

Block level - Block level banker's Committee (BLBC) with lead District Manager as Chairperson conducted meeting quarterly.

9.2.3 PREPAYMENT PENALTY

No penalty for prepayment of loans. Where subsidy is involved, the subsidy will be made available on prorate basis, after the lock in period, if any under the scheme. Otherwise, the subsidy will be forfeited.

9.2.4 OUT OF POCKET EXPENSES (INCLUDING LEGAL CHARGES, VALUATION CHARGES ETC.)

All out of pocket expenses incurred by the bank for servicing the borrower account such as inspection pre-sanction and post sanction visits, recovery visits, insurance, valuation charges payable to approved valuers in respect of land, building, plant, machinery, vehicle notice etc., should be paid by the borrower.

9.2.5 MORTGAGE CHARGES

All priority sector advances are exempted from mortgage charge whether taken as prime or collateral security.

9.3 GESTATION AND REPAYMENT PERIOD

The time taken for the project to generate income is to be treated as gestation period and during the gestation period is no demand towards repayment of principal. Servicing of interest depends on other income, if any some of the projects with gestation period are:

a.	Poultry layers	- 6 months
b.	Calf rearing	- 30 months
c.	Sheep and goat	- 12 months
d.	New Well construction	- 23 months
e.	Coconut plantation	- 3-4 Years
f.	Rubber plantation	- 5 Years.

9.4 DISPOSAL OF APPLICATIONS

Reserve bank has fixed certain period for the disposal of applications under priority sector

Up to Rs.25,000/-	-	Within 15 Days
Above Rs. 25,000/- up to Rs.2 Lakhs	-	4weeks
For SSI up to Rs.25,000/-	-	Within two weeks provided it is complete in all respects and duly accompanied by a checklist.
Above Rs.25,000/-	-	Within four weeks provided it is complete in all respects and duly accompanied by a checklist.

9.5 INSURANCE

Insurance is optional for agricultural /OPS advances up to the limit of Rs.10000/ For limit above Rs.25000/- insurance is compulsory For all livestock, movable assets or for assets where insurance is warranted by law viz., Tractor, Motorcycle etc., insurance is compulsory irrespective of limit. Crops that are eligible under RKBY are to be insured.

Assets can also be insured with private insurance companies approved by IRDA to do non-life insurance business.

CHECK YOUR PROGRESS

1. ___________ has been built in as part of the crop loan disbursed as cash credit.
2. The service area approach has been introduced from___________
3. __________ is optional for Agriculture / OPS advances up to the limit of Rs.10,000/-
4. ___________ are exempted from mortgage charge whether taken as prime or collateral security.
5. The taken for the project to generate income is treated as _________.

LET US SUM UP

The economic environment are changing and lending institutions must view agriculture as a sector in which there are commercial opportunities for banks to lend and earn reasonable profits. Banks should not miss potential income opportunities in a dynamic sector of the economy. Failure to deliver adequate credit in a timely manner will be to the detrimented to the interest of both the banks and the large community of farmers. Since the saving season is round the corner, Government wish to impress upon all the agencies concerned the urgent need to significantly enhance the quantity and quality of credit flowing to the Agricultural sector.

GLOSSARY

Agricultural Credit will help in realizing this full potential are access to institutional credit to more farmers and appropriate quantity and quality of agricultural sector.

Farmers are engaged in the agricultural activities.

Mortgage Charges are collected in the form of prime or collateral security.

Out of pocket expenses incurred by the bank for servicing the borrower account such as inspection presanction and post sanction visits, recovery visits, insurance, valuation the borrower should pay charges etc.

Gestation period means the time taken for the project to generate income.

Service area Application means the entire villages all over the country have been allocated to all banks for the over all department.

Liquid saving module means the account balance in is credit balance for a minimum period of 15 days and then appropriate deposit rate for the days the account is in credit should credited to the account automatically.

ANSWER TO THE CHECK YOUR PROGRESS

1. Liquid Saving Module
2. 1st April 1989
3. Insurance
4. All priority sector advances
5. Gestation period

MODEL QUESTIONS

1. Explain the R.V. Gupta Committee recommendations regarding to agricultural advances.
2. Discuss the Credit Appraisal for Agriculture.
3. What are out of pocket expenses?
4. Write a note on Liquid saving module.

BOOKS REFERENCES

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Unit 10

AGRICULTURAL LOAN – INFRASTRUCTURAL FACILITIES

STRUCTURE

10.4.4 Margin

10.4.5 Security

10.4.6 Valuation

10.4.7 Quantum of loan

10.4.8 Other points

10.5 Advances to farmers for acquisition of trucks, jeeps, pick-up vans, mini trucks etc.

10.5.1 Eligibility

10.5.2 Quantum of loan

10.5.3 Margin

10.5.4 Interest rate

10.5.5 Security

10.5.6 Repayment

10.6 Minor irrigation is an important scheme to this helps increased production and bringing areas under cultivation

10.6.1 Purpose

10.6.2 Eligibility

10.6.3 Technical feasibility

10.6.4 Unit cost (Quantum of loan)

10.6.5 Margin

10.6.6 Interest

10.6.7 Disbursements

10.7 Selection of pump set

10.7.1 Supervision and follow-up

10.7.2 Objectives

10.7.3 Agri-clinics

10.7.4 Agri- business centers

10.7.5 Eligibility

10.7.6 Project activities

10.7.7 Project cost & coverage

10.7.8 Security

10.7.9 Repayment

10.7.10 Selection of borrowers

Let us sum up

Glossary

Answers to check your progress

Model Questions

Books References

OVERVIEW

To provide insurance coverage and financial support to the farmers in the event of failure of crop as a result of Nature calamities, pest and diseases and also to encourage the farmers to adopt progressive framing practices like high value inputs and higher technology in Agriculture, Government if India has decided to introduce " RASHTRIYA KRISHI BIMA YOJANA" from Rabi 1999-2000 season and accordingly the existing comprehensive crop insurance scheme (CCIS) stands withdrawn with effect from Rabi 1999- 2000 season.

LEARNING OBJECTIVES

After reading the lesson, you should able to know the following

- Know about Rashtriya Krishi Bima Yojana Scheme.
- Advances for agnation of Trucks, Jeeps, Pick-Vans, Mini Trucks etc.,
- Irrigation helps increased production and areas under cultivation

10.1 SALIENT FEATURE OF THE SCHEME

10.1.1 CROPS COVERED

The crops in the following broad groups are covered.

- Food crops (Cereals, Millets and Pulses), Oil seeds, Sugarcane, Cotton and potato.
- Other annual Commercial /Horticultural Crops will be covered I due course subject to availability of past yield data.

10.1.2 STATES AND AREA TO BE COVERED

The scheme extends to all States and Union Territories. The States/UTS opting for the scheme would be required to take up all the crops identified for coverage in a given year. The States /UTS once opting for the scheme have to continue for a minimum period of three years.

10.1.3 FARMERS TO BE COVERED

All farmers including sharecroppers, tenant farmers growing the notified crops in the notified areas are eligible for coverage:

a. Compulsory Basis : All farmers growing notified crops and availing seasonal agricultural operations loans from financial institutions (i.e. Loanee farmers)

b. Voluntary Basis : All other farmers growing notified crops that opt for the scheme (i.e., Non-Loanee farmers).

10.1.4 RISK COVERED AND EXCLUSIONS

- Comprehensive Risk Insurance will be provided to cover yield losses due to non- preventable risk.
- Natural fire and lighting, storm, Hailstorm, Cyclone, Typhoon, Tempest, Hurricane, Tornado etc.
- Flood, Inundation and land slide, Drought, Dry spells, pests/ Diseases etc.,
- Losses arising out of war and nuclear risks, malicious damage and other preventable risks shall be excluded.

10.1.5 SUM INSURED / LIMIT OF COVERAGE

The sum insured may extend to the value of the threshold yield of the insured farmer. He can insure his crop up to 150% of average yield of the crop on payment of extra insurance premium at concessional rates.

In case of Loanee farmers, the sum insured would be at least equal to the amount of crop loan and insurance charges shall be an additional to the scale of finance for obtaining loan.

Premium Rates (Refer GIC guidelines then & there)

SEASON	CROPS	PREMIUM RATE
Khariff	Bajra and Oilseeds	3.5% of sum insured or Actual rate whichever is less
	Other Crops (Cereals, Millets and Pulses)	2.5% of S.I or Actuarial rate whichever is less

RABI	Wheat	1.5% of S.I or Actuarial rate whichever is less
	Other Crops (Cereals, Millets and Pulses)	2% of S.I or Actuarial rate whichever is less
Khariff and RABI	Annual Commercial/ Annual Horticultural Crops	Actuarial Rates

10.1.6 PREMIUM SUBSIDY (REFER GIC GUIDELINES THEN & THERE)

30% of subsidy in premium is allowed in respect of small and marginal farmers to be shared equally by Government of India and State/UT Govt.

The definition of Small and Marginal Farmers would be as follows:

Small Farmer : One who owns a land holding of 2.5 acres of irrigated land or 5 acres of dry land.

Marginal Farmer : One who owns a land holding of 1.25 acres of irrigated land or 2.50acres of dry land.

10.1.7 AREA APPROACH AND UNIT OF INSURANCE

The scheme would operate based on "Area Approach "i.e. defined areas for each notified crops for widespread calamities and on an individual basis for localised calamities such as hailstorm, landslide, cyclone and flood. The defined area (i.e., unit area of insurance) may be Gram panchayat, Mandal, Phirka, Block, Taluka etc., to be decided by the States/UT Govt., and will be required to reach level of Gram Panchayat as the unit in a maximum period of three years. Individual based assessment in case of localised calamities to begin with would be implemented in limited areas on experimental basis, initially and shall be extended in light of operational experience gained.

10.1.8 SEASONALITY DISCIPLINE

The broad seasonality discipline followed for loanee farmers will be as under:

ACTIVITY	KHARIF	RABI
Loaning period	April - September	October-March
Cut-off data for receipt of Declarations	November	May
Cut-off date for receipt of yield data	January/ March	July/September

The broad cut-off dates for receipt of proposals in respect of non- loanee farmers will be as under

KHARIF	31st JULY
RABI	31st DECEMBER

10.2 LEVEL OF INDEMNITY AND THRESHOLD YIELD

Three levels of indemnity viz., 90% ,80% and 60% corresponding to low risk, medium risk and high risk areas shall be available for all crops (Cereals, Millets, Pulses and Oilseeds and annual commercial horticultural crops) based on co-efficient of variation (CV) in yield of past 10 Years data. However, the insured farmers' unit area may opt for higher level of indemnity on payment of additional premium based on actual basis.

The threshold yield or Guaranteed yield for a crop in a insurance unit shall b the moving average based on past three years average yield in case of rice and wheat and five years average yield in case of other crops multiplied by the level of indemnity.

10.2.1 NATURE OF COVERAGE AND INDEMNITY

If the actual yield (AY) per hectare of the insured crop for the defined area in the insured season, fall short of the specified threshold yield (TY) all the insure farmers growing that crop in the defined area are deemed to have suffered shortfall in their yield.

Indemnity shall be calculated as per the formula.

$$\frac{\text{Shortfall in Yield}}{\text{Threshold Yield}} \text{ X Sum insured}$$

Shortfall = Threshold yield –Actual yield for the defined area.

10.2.2 INDEMNITY IN CASE OF LOCALISED RISKS

Loss assessment and modified indemnity procedure in case of occurrence of localised perils, such as hailstorm, landslide, cyclone and flood where settlement of claims will be on individual basis shall be formulized by insurance agency in Co-ordination with State/ Union Territory Government.

10.2.3 PROCEDURE FOR APPROVED AND SETTLEMENT OF CLAIMS

Once the yield data is received from the state /UT Government, as per the prescribed cut-off dates, claims will be worked out and settled by insurance agency.

The claim cheques along with claim particular will be released to the individual nodal banks. The banks at the grass-root level, in turn, shall credit the account of individual farmers and display the particulars of beneficiaries on their notice board.

10.2.4 MANAGEMENT OF THE SCHEME AND MONITORING

- ⇨ In respect of loanee farmers, the bank shall play the same role as under CCIS.
- ⇨ In respect of non-loaners farmers, bank shall collect premium along with declarations and send it to insurance agency within the prescribed time limit.
- ⇨ Selection of the banks will be based on service area approach (SAA) of RBI or at the option of the banks. (Where Co-operative banks have good network)
- ⇨ The department of Agriculture, Agricultural Statistics, Directorate of Economics and Statistics, Department of Co-operation, Revenue Department of the State Government will be actively involved in smooth implementation of the scheme.

During each crop season, the agricultural situation will be closely monitored in implementing State/UT. The State /UT Department of Agriculture and District Administration shall set up a District level monitoring committee (DLMC) who will provide fortnightly reports of Agricultural Situations with details, of area sown, seasonal weather conditions pest incidence, stage of crop failure etc.,

10.2.5 BENEFITS EXPECTED FROM THE SCHEME

The scheme is expected to be a critical instrument of development in the field of crop production, providing financial support to the farmers in the event of crop failure.

Encourage farmers to adopt progressive farming practices and higher technology in agriculture. Help in maintaining flow of agricultural credit provide significant benefits not merely to the insured farmers, but to the entire community directly and indirectly through spill over multiplier effects in terms off marinating production and employment, generation off market fees taxes etc., and net accretion to economic growth.

10.3 TRACTOR ADVANCES

10.3.1 ELIGIBILITY

Land holding criteria	:	Up to 35 HP –Minimum 4 acres of perennially irrigated Land Above 35 HP-Minimum 6 acres of perennially Irrigated land
Economical Use	:	There should be scope to utilise the tractor at least for 1000 working hours per annum. It canbe 500 hours for own far use and 500 hours for custom hiring
Incremental Income	:	The farmer should derive not less than 50% incremental income (40% in case of northeastern states) by use of Tractor in his own farm.
Implements	:	A minimum of three implements are to be purchased along with tractor. A trailer can also be treated as one of the implements.
Second Tractor	:	For financing purchase of a second tractor to the same Beneficiary there should be a minimum gap of 3 years Since financing the earlier tractor and the loan should have been fully repaid.
Second Hand Tractor	:	Finance should not be made for purchase of second hand tractor.

10.3.2 ECONOMIC SIZE OF TRACTOR

It is preferable to purchase tractors with capacity up to 50 DBHP (Draw Bar Horse Power)

10.3.3 PRE-SANCTION INSPECTION

Pre-sanction inspection of the farm/residence should be made to ascertain / confirm about the details of the prospective borrower and the same should be recorded. In addition, the scope for economical utility of the tractor in the area should be assessed.

10.3.4 MARGIN

The loan amount is to be arrived at by deducting necessary margin (to be brought in by the farmer) on the amount of pro-forma invoice.

10.3.5 SECURITY

- ⇨ Hypothecation of tractor, implements and accessories
- ⇨ Mortgage of landed properties.

10.3.6 POST CREDIT SUPERVISION

- ⇨ The tractor /implements should be verified immediately after purchase.
- ⇨ It should be ensured that banks name as financier is written on the tractor/ trailer.
- ⇨ Periodical post sanction inspection should be conducted once in a quarter.

10.3.7 REPAYMENT

Nine Years Repayment schedule may be fixed as equated annual or half-yearly installment as per the cropping pattern of the farmer.

10.4 SCHEME FOR PURCHASE OF LAND FOR AGRICULTURAL PURPOSE

10.4.1 OBJECTIVES

1. To make the small and marginal holding economically viable
2. To make fallow lands and waste land under cultivation
3. To step up agricultural production and productivity.
4. To finance the share croppers/tenant farmers to purchase land to enable them to increase their income.

10.4.2 ELIGIBILITY

Small and margin farmers i.e. those who would own maximum of 5 acres of non irrigated land or 2.5 acres of irrigated land including purchase of land under the scheme. Share croppers/tenant farmers.

10.4.3 PURPOSE

To purchase, develop and cultivate agricultural as well as fallow and wastelands / purchase of land for establishment or diversifying into other allied activities.

10.4.4 MARGIN

As per general margin norms for agri advances

10.4.5 SECURITY

The land purchase out of the bank finance and mortgaged on favour of the bank will form the security for the loan

10.4.6 VALUATION

For fixing the quantum of finance, the price directed by the farmer may be cross checked with the last 5 years average registration value available with the Registrar/ Sub-Registrar of the area.

10.4.7 QUANTUM OF LOAN

Maximum Rs. 2 Lakhs only.

10.4.8 OTHER POINTS

- ⇨ Land should be preferably in one place and not fragmented
- ⇨ Land should be made to put into use immediately for cultivation /active self-help Groups are also eligible.
- ⇨ The loan should not be used for speculative purpose
- ⇨ Project cost includes cot of land stamp duty, registration charge and land development expenses.
- ⇨ During the period of loan, the land should not be sold.

10.5 ADVANCES TO FARMERS FOR ACQUISITION OF TRUCKS, JEEPS, PICK-UP VANS, MINI TRUCKS ETC.

Advances to farmers for acquisition of jeeps, pick-up vans, mini-trucks etc., to be used for transport of agricultural inputs and farm products may also be reckoned as agricultural advances under the priority sector.

10.5.1 ELIGIBILITY

1. The appliance should own a minimum of eight acres of irrigated land However, in respect of plantations; it should be at least 10 acres.
2. Even with the minimum land holding, it should also be ensured that the net surplus farm income is not less than Rs.50,000/- per annum, after meeting out all his farm expenses, including loan repayments. (Branch should work out this income take into account the applicant's cropping patter, loan repayment commitments, family expenses etc.)
3. The applicant should possess valid driving license. If driver is proposed to be engaged branch should verify the license of the driver.
4. The applicant's neighborhood should offer good scope for transport of inputs / produces like vegetables fruits/ flowers.(presence of sugar mills, regulated mark etc.. will offer ample scope for hiring out of the vehicle.)
5. The applicant is dealing with us (if our customers) should be satisfactory for other, they should not be defaulters to other banks / credit societies etc.
6. Applicant should possess valid permit for using the vehicle for transport of agricultural predicts .inputs from concerned authority.

10.5.2 QUANTUM OF LOAN

The loan shall be 75% of the cost of the vehicle. The total price of the vehicle may include essential accessories as body shall, stepney, tarpaulin, road tax, insurance, tool box, top hood etc.

10.5.3 MARGIN

As per general margin norms for agri advance

10.5.4 INTEREST RATE

The interest rate will be as applicable for term loans under agriculture depending on the quantum of loan.

10.5.5 SECURITY

1. Hypothecation of vehicle to be purchased and crops cultivated.
2. Mortgage of Immovable property worth at least the loan amount.

10.5.6 REPAYMENT

The repayment shall be with a period of 6 years in suitable installments (Monthly / Quarterly) depending on the cropping and income patterns. No holiday period.

10.6 MINOR IRRIGATION IS AN IMPORTANT SCHEME TO THIS HELPS INCREASED PRODUCTION AND BRINGING AREAS UNDER CULTIVATION

10.6.1. PURPOSE

The banks can consider the loan for the following purposes in respect of minor irrigation schemes by means of exploitation ground water resources:

- ⇨ Sinking of new well (open / tube well)
- ⇨ Deepening of existing open wells
- ⇨ Installation of electric motor and pump set / oil engine and pump set.
- ⇨ Providing stand by oil engine to meet the power cut.
- ⇨ Construction of pump room
- ⇨ Construction of staining well
- ⇨ Laying of pipelines
- ⇨ Sprinkler irrigation system
- ⇨ Drip irrigation system

10.6.2 ELIGIBILITY

- ⇨ The beneficiary should own an economic holding of 3 acres of land for electric motor/oil engine and pump set, 5 acres for sinking of new open well and 10 acres for tube well. However, relaxation of this norm on minimum land holding could be considered wherever it is established that the applications land holding is an economic unit and satisfies the norms of investment and repayment capacity.

- ⇨ He must be adopting or willing to adopt new techniques in agriculture.
- ⇨ He should not default to any financial institution including our bank in respect of any credit facilities availed by him.
- ⇨ The ground water norms and spacing norms (technical feasibility) should be satisfied.

10.6.3 TECHNICAL FEASIBILITY

1. Availability of ground water potential in the area is based on categorization of the area viz., Dark, Grey and white.
2. Number of additional wells without affecting the recharge rate if water to the existing wells.
3. Depth of the water table,
4. Minimum distance to be kept between the two wells (soaking norm) as prescribed by ground water directorate suitable of water for irrigation

The applications should duly fill in and accompanied by the following.

- ⇨ Copy of the village records duly signed by the village revenue officer with office seal in evidence of the ownership of the land
- ⇨ Certificate of village officer on the value of land offered as security.
- ⇨ No due certification from local Agricultural credit Co-operative societies/ land development bank / other banks.
- ⇨ Detailed estimated and plans for the construction work from a qualified Engineer.
- ⇨ Copy of the Proforma invoice from reputed dealers for the pump set with electric motor/oil engine and pipelines.
- ⇨ In the case of pump set with electric motor, feasibility certificate from the state electric board should be obtained.

10.6.4 UNIT COST (QUANTUM OF LOAN)

The unit cost approved by NABARD for standard size of wells and standard types of pump sets has to be followed. But it may very depending on the depth of water table, type of oil, size of well etc.,

10.6.5 MARGIN

As per general margin norms for agri advances.

10.6.6 SECURITY

As per general margin norms for agri advances.

10.6.7 INTEREST

Interest should be charged at rate fixed by RBI from time to time.

10.6.8 DISBURSEMENTS

The loan amount may disburse in three or four installments after verifying the progress of work before each disbursement. The borrower should commence the wok his margin money. The cost of pipes, cement, bricks, pump set accessories etc., shall be paid directly to the supplier. In the case of composite loans (well and pump set with electric motor), the loan component for the pump set should be released only after striking of water in the well. No advance payment for pump set should be made.

10.7 SELECTION OF PUMPSET

Branches should grant loan (or the pump sets with electric motor/oil engine) which are approved by state government.

10.7.1 SUPERVISION AND FOLLOW-UP

On completion of the work / installation of pump set, the farm should be inspected and completion report has to be prepared. It should be reported whether the entire project has been completed satisfactorily and as per the estimate. Thereafter periodical inspection at least once in a quarter in respect of pump sets and once in half year in respect of well, should be made to verify whether the irrigation facilities are made use of to the maximum extend and whether crops are raised successfully according to the cropping pattern proposed. The pump sets/oil engines have to be verified for satisfactory functioning. Metallic strip with the inscription "Hypothecated to ____bank" should be fixed on the machineries or the word should be painted.

With the diversification and modernization of agricultural practices, there is a need to augment support and extension service for agriculture. For this purpose a scheme for financing setting up of agri-clinic and agri-business centers by agricultural graduates has been formulated by NABARD after consulting Government of India, Ministry of Agriculture and banks. The scheme aims at suppiementing the existing extension net work to accelerate the processes of technology transfer to agriculture and providing supplementary sources of input supply and service, for which largely farmers presently depend upon State Departments. It provides employment opportunities to technically trained persons.

Refinance support from NABARD under automatic refinance facility is available for this scheme. Short fall in margin /down payment by the borrower due to genuine reason can be assisted under "Soft Loan Assistance Fund " of NABARD subject to a maximum of 50% of margin prescribed by banks without interest. The bank may charge service charge at 3%. The banks may use their discretion for selection of the borrowers/entrepreneurs and the actively depending in the potential of the area etc.

10.7.2 OBJECTIVES

- To supplement the efforts of Government Extension System.
- To make available supplementary sources of input supply and service to needy farmers.
- To provide gainful employment to agriculture graduates in new emerging areas in agricultural sector.

10.7.3 AGRI-CLINICS

Agri-clinics are envisaged to provide expert services and advice to farmers on cropping practices, technology dissemination crop protection from pests & diseases, market trends and prices of various crops in the markets and clinical services for animal health etc. would enhance productivity of crops /animals.

10.7.4 AGRI- BUSINESS CENTERS

Agri-business centers are envisaged to provide input supply, farm equipment on hire and other services. In order to enhance viability of the ventures, agriculture graduates may also take up in agriculture and allied areas along with the agri-clinics.

10.7.5 ELIGIBILITY

The scheme of open to agriculture graduates/graduates in subjects allied to agriculture like horticulture, animal husbandry forestry, dairy, veterinary, poultry farming, pisciculture and other allied activities.

10.7.6 PROJECT ACTIVITIES

- Soil & water quality cum inputs testing laboratories
- Pest Surveillance, Diagnostic and control service maintenance, repairs and custom hiring of agricultural implements and machinery including micro irrigation systems
- Agri – service carter including the three activities mentioned above Seed processing units
- Micro propagation through plant Tissue culture labs and hardening units.
- Setting up of sericulture units, production of bio-fertilizers, bio pesticides, bio-control agents.
- Setting up of apiaries (bee keeping and Honey & bee products processing units.
- Provision of extension consultancy services
- Facilitation and agency of agricultural insurance services
- Hatcheries and production of fish finger –lings for aqua culture
- Provision of livestock health cover, setting up veterinary dispensaries & service including frozen semen banks and liquid nitrogen supply
- Setting up of information technology kiosks in rural areas for access to various agriculture related portals
- Seed processing and testing units
- Value addition centers
- Setting up of cool chain from the farm level onwards, post Harvest Management centers for sorting, grading , standardization, storage and packaging
- Setting up of metallic /non –metallic storage structures
- Retail marketing outlets for processed agri-products.

10.7.7 PROJECT COST & COVERAGE

The project may take by agriculture graduates either individually or on joint/ group basis. The outer ceiling for the cost of project by individual would be Rs.10lakhs and for the group would be Rs. 50 lakhs. The drop may normally be of five, of which one could be a management graduate with qualification or experience in business development and management.

10.7.8 SECURITY

Up to Rs.5 lakhs loan	- Nil
Above Rs. 5 lakhs loan	- as per general norms

10.7.9 REPAYMENT

The period of loan will vary between 5 years to 10 years depending on the activity. The repayment period may include a grace period of maximum of 2 years.

10.7.10 SELECTION OF BORROWERS

The selection of borrowers and location of the projects may be done by the banks in consultation with agricultural universities / KVKs etc. in their area of operations, if necessary.

CHECK YOUR PROGRESS

1. Rashtriya Krishi Bima Yojana Scheme introduced by the Government of India in the year__________
2. Comprehensive Risk Insurance will be provided to cover yield losses due to____________
3. ____________ who owns a land holding of 2.5 acres of irrigated land or 5 acres of dry land.
4. Soft loan assistance fund of NABARD subject is a maximum of ____________ prescribed by banks without interest.
5. Agri-Business Centers are envisaged to provide ______________

LET US SUM UP

The bank should issue Kisan credit cards to farmers enabling them to readily purchase agricultural inputs like seeds, fertilizers, prescribe etc., accordingly NABARD prepared the model scheme and circulated the same among banks. To provide continuous cash credit facilities for meeting the expenditure of crop cultivation and for other expenditures like maintenance of machinery, implements, post harvest expenditures etc.

GLOSSARY

Small farmer is one who owns a land holding of 2.5 acres of irrigated land or 5 acres of dry land.

Marginal farmer is one who owns a land holding of 1.25 acres of irrigated land or 2.50 acres of dry land.

Unit area of insurance may be Gram panchayat, Mandal, Hobble, Circle, Phirka, Block, Taluk etc. to be decided by the State or Union territory Government.

Agri–Clinics are envisage to provide expert services and advice to farmers on cropping practices, technology dissemination, crop protection from pests & diseases, market trends and prices of various crops in the markets and clinical services for animal health etc. would enhance productivity of crops / animals.

Agri-business centers are envisaged to provide input supply, farm equipment on hire and other services.

The unit cost approved by NABARD for standard size of wells and standard types of pump sets has to follow. But it may very depending on the depth of water table, type of oil, size of well etc.,

Advances to farmers for acquisition of jeeps, pick-up vans, mini-trucks etc., to use for transport of agricultural inputs and farm products may also be reckoned as agricultural advances under the priority sector.

ANSWER TO CHECK YOUR PROGRESS

1. 1999 – 2000
2. Non-Preventable Risk
3. Small Former
4. 50% of Margin
5. Input Supply Farm equipment on hire and other services

MODEL QUESTIONS

1. Explain the details Rashtriya Krishi Bima Yojana Scheme.
2. Who are small farmer and Marginal farmer?
3. Write note about Tractor Advances.
4. What is the main aim of Agricultural advances for acquisition of land?
5. Explain about advances to farmers for acquisition of Trucks, Jeeps and Mini Trucks etc.
6. Write a note about Agri-Business and Agri-Centers.

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Unit 11

GOVERNMENT SPONSORED ADVANCES

STRUCTURE

OVERVIEW

The purpose of bank nationalisation was to promote rapid growth in agriculture, small industries and exports, to encourage new entrepreneurs and to develop backward areas. After nationalisation, public sector banks have been increasingly motivated towards helping various priority sectors in general and neglected sectors in particular. The expansion of credit to agriculture and small scale industries was a trend started after the introduction of social control of banks but which gained momentum after nationalization. In the matter of extending credit to small business, considerable progress has been made and bank have Introduced special schemes to assist the borrower of various categories and means. Most of the borrowers were formerly at the mercy of moneylenders and paying usurious rates of interest any thing up to 36 per cent or even more.

LEARNING OBJECTIVES

After reading this lesson, you should able to

- know about Government Sponsored priority Sector Advances.
- lead Bank Scheme.
- government Sponsored Loan to Weaker Section.

11.1 PRIORITY SECTOR ADVANCES

Tertiary sector under priority sector, popularly called as other priority sector (O.P.S), consists of business and services sector. The important advances under this sector are:

A. Business	B. Services
1. Small Business	1. Small Road & water transport operators (SRWTO)
2. Retail Trader	1. Professional & Self Employed (P& SE) 2. Education 3. Housing 4. Consumption

11.2 GENERAL GUIDELINES FOR OTHER PRIORITY SECTOR ADVANCES

11.2.1 SERVICES AREA APPROACH

The service area concept for priority sector advances has been introduced since 1.4.1989 under this concept branches have been allocated villages for the total development which are called service area villages and the other villages which are not allocated but can be extended with finance, provided if any they are within the block are called non- service area villages.

11.2.2 GESTATION PERIOD & REPAYMENT PROGRAMME

In respect of priority sector advances, the concept of gestation period is very important. It is the time taken for the project to generate income. During this gestation period when there is no income to the borrower, we should not demand repayment of principal and interest. In addition, the accrued interest should not be compounded during this period. However if the borrower has other source of income, then we can stipulate that the interest should be serviced.

11.3 INSURANCE

Wherever immovable assets are created, insurance is compulsory if the loan amount exceeds Rs.10,000 if movable assets are created it should be insured comprehensively irrespective of the loan amount.

11.4 SMALL BUSINESS

Small businesses are units engaged in rendering services other than professional services in which the original investment in plant & machinery is not exceeding Rs.20 Lakhs. The working capital facilities may be fixed depending upon the requirement for different activities and within the overall ceiling fixed.

11.5 RETAIL TRADER

Advances to traders both private as well as Cooperatives:

- For cooperatives – No limit is fixed.
- For private traders – For Essential commodities – No limit
- For non- essential commodities up to Rs. 10 Lakhs

11.6 SMALL ROAD AND WATER TRANSPORT OPERATORS (SRWTO)

Advances granted to transport operators owning not more than 10 vehicles including the one, which is to be financed. The Financial viability of the proposal is to be analyzed by working out the DSCR (Debt Service Coverage Ratio) which should be preferably more than 1.5 to 2:1.The invoice price may include accessories like tarpaulin, stepney tools kit etc. expenses relating to insurance, road tax, rout permit, full fuel tank etc. may be include. However, transportation charges are to be excluded. Necessary route permit should be obtained from RTO Comprehensive insurance for the vehicle with bank's clause to be obtained. Notice of Bank's hypothecation should be painted on the vehicle.

11.7 PROFESSIONAL & SELF EMPLOYED (P&SE)

Advances granted to professional qualified people to carry out their profession:

11.7.1 ADVANCES TO MEDICAL PRACTITIONERS

Rural and semi –urban areas	:	Up to Rs.15 Lakhs, inclusive of Rs.3 Lakhs Working capital
Other areas	:	Up to Rs. 10Lakhs, inclusive of Rs. 2Lakhs as working capital

For medical practitioners alone one vehicle either two-wheeler or four wheeler or ambulance is also permitted under priority sector.

11.7.2 ADVANCES TO OTHER PROFESSIONALS

Advances to other professionals like Lawyers, Chartered Accounts and Engineers can be considered up to a limit of Rs.10 Lakhs inclusive of Rs.2 Lakhs as working capital.

11.8 EDUCATION LOAN

1. General Educational loan scheme to paid category
2. Computer education in non-formal private institutions through select branches.

Purpose

This is a very compressive scheme and bank can finance for almost all-educational schemes both in India abroad. The list covers the following purposes.

A. **Inland studies**

- ➪ School education including plus two
- ➪ Graduation courses
- ➪ Professional courses including Engineering, Medical Agriculture, veterinary, Law Dental etc.,
- ➪ Course like ICWA, CA, CFA etc.
- ➪ Courses conducted by Management institutes like IIM, XLRI , NIFT
- ➪ Course offered in India by Reputed foreign universities.
- ➪ Other courses leading to Diploma /Degree approved by UGC/ AICTE/ICMR etc.,
- ➪ Computer certificate courses of reputed institutes with high job placement value.
- ➪ Courses offered by National institute and other reputed private institutions with prior approval from our regional office.

B. **Foreign Studies**

This scheme also provides in case of foreign studies.

C. **Job oriented professional / technical courses** offered by reputed universities at the graduation level.

D. MCA, MBA, MS etc offered by CIMA – London, CPA in USA etc.

Margin

Up to Rs. 4Lakhs –no margin

Above R.4lakhs – India study 5%, foreign study 15%

Eligible Expenditures

- ➪ Fees payable to school / college /hostel
- ➪ Examination /Library / Laboratory fee
- ➪ Purchase of books / requirements / instruments / uniforms
- ➪ Caution deposit building fund / refundable deposit supported by institution bills / receipts.
- ➪ Travel expenses, passage money or studies abroad.
- ➪ In case of self- financing colleges, without hostel facilities, reasonable rent can also be considered for private accommodation.

- ⇨ Purchase of computers essential for the course
- ⇨ In case of physically handicapped students tricycle motorized tri-wheeler is also permits.

Rate of Interest

The interest rate will be fixed at the time of availment of the loan and shall continue until closure of the loan as advised by Company from time to time.

Security

- ⇨ For loans up to Rs4 Lakhs: No security
- ⇨ For loans above Rs.4 Lakhs and above – Third party Guarantee
- ⇨ Collateral security of suitable value or Co-obligation of parents / guardian third party along with assignment of future income of the student.

Holiday Period

Normal duration of the course plus 12 months or 6 months after employment whichever is earlier. Where students are not able to complete the course, they are given additional two years.

Important guidelines under education loan

It can be granted to minors also. In that case documents to be executed by the parent for himself and on behalf of the minor. When the minor attains majority, an undertaking letter should be obtained. The loan amount should be needing base. While releasing the amount in stages branch should ensure that the student had cleared all subjects without any arrears in the earlier semester exam.

11.9 LEAD BANK SCHEME

With the nationalization of 14 banks, the government took the initiative for extending the banking system to rural areas and was looking for a scheme of rapid branch expansion. The national credit council study group under the leadership of Prof. D.R. Gadgil first conceived of the "area approach" for branch expansion. Nationalized banks were expected to adopt areas for increasing banking facilities to encourage local enterprise in agriculture and increase the productive efficiency of small industries. The committee of bankers appointed by the reserve bank of India in 1969 accepted the "area approach" and gave a practical shape to it under the title of "lead bank scheme". Towards the close of 1969 the Reserve Bank of India accepted the scheme and finalized a lead bank of India accepted the scheme and finalized a lead bank scheme for all the 559 districts in the country. Under the scheme the state bank of India and its subsidiaries, the 14 nationalised banks and 2 private sector banks were allotted the districts and were asked to play the "lead role". The allotment of districts to the various banks was based on such criteria as the size of the bank, the adequacy of its resources for handling the volume of work, contiguity of districts the regional orientation of banks, the desirability for each state to have more than one lead bank operating in the territory and to the extent possibility, for each bank to operate in more than one state. Thus under the scheme 26 banks have shared the responsibility for surveying and developing the banking potential of all the districts in the country.

11.9.1 OBJECTIVE OF THE SCHEME

The basic aim of the lead bank scheme is that individual banks should adopt particular districts for intensive development. Under the scheme, the lead banks were expected to act as leaders to bring about a coordination of co-operative banks, commercial banks and other financial institutions in their respective districts in the interests of district development. They were expected to make a quick survey of their lead districts so as to identity-unbanked centers where bank branches could be located and prepare a phased programme for branch expansion in the district. Because of the surveys, the lead banks are expected to estimate the deposit potential and the credit gaps so that steps could be taken to tap the deposit potential and fill the credit gaps.

The close involvement of the lead bank with a particular area will not only result in deposit mobilization but also in the expansion of finance to agriculture and small industries. Individual banks would make a detailed survey of the area of their operation and the potential in that area for economic growth and evolve schemes to accelerate their involvement in their respective areas. The following importance benefits were expected to flow from the scheme:

a. The whole country would be served by a well-knit system of commercial and co-operative banking;
b. Branch expansion, supervision and guidance would become effective:

c. A dynamic relationship between commercial banks, co-operative credit institutions and government authorities at the district level would evolve;

d. There would be a close integration of credit and banking business with other activities; and

e. Major battlement in the development of the district would be identified and the lead bank would induce the appropriate agencies to take remedial action.

11.9.2 AN APPRAISAL OF THE LEAD BANK SCHEME

The lead bank scheme did not have a proper start. From the very beginning, there was inadequate understanding, and even serious misunderstanding of the scope and objectives of the lead bank scheme. In an article in the reserve bank of India bulletin, we read: "There was much misunderstanding about the purpose of the surveys, not to mention the functions of the leadership in a district. In the minds of bankers, the lead bank scheme had obviously not taken a distinct operational shape." The banking commission came across two divergent views on the role of the lead bank scheme. One view was that the lead bank of a district conducted the district survey, identified places of banking potential and offered the list to all interested banks to open branches; the lead bank itself would open branches only in those places, which were not taken up by other banks. The second view was that the lead bank had the full responsibility to open branches in the district entrusted to it. This confusion as to the real meaning and content of the lead bank scheme naturally hampered the progress of the scheme in the initial years.

The criterion of contiguity of districts could not always be allowed in practice. Some regional banks were allotted districts and states where they had no foothold whatsoever- e.g. Canara bank, syndicate bank and union bank were allocated districts of U.P. and Hariyana. Many of the lead banks could not develop the "personal feel" for local problems and deposit potential. Other difficulties for regional banks which were allotted lead districts away from the base of their operations include: recruitment of new staff and posting of the existing staff in far-flung areas, lack of knowledge of the local language, difference in customers, aptitudes and attitudes etc. supervision control and guidance by the head office became difficult in such cases, therefore banks should not be allotted lead districts which are away from their principal area of operation.

The banking commission found that the lead banks were not properly equipped to conduct the techno-economic surveys of the districts allocated to them. Moreover, in the opinion of the commission, such surveys should be conducted by the state government as they are said to be useful from the point of view of comprehensive planning besides as the banking commission emphasized the functions of planning and that of banking were separate; it should be the responsibility of the state government and not lead bank to plan the development of a district.

The banking commission pointed out serious difficulties at the operational stage. The lead bank was expected to be a coordinating agency for commercial and co-operative banks, short term and long-term credit and financial institutions and the district authorities in the state. The commission pointed out that the lead bank had no authority over the other nor was it necessary for the other to approach the lead bank for any specific, purpose. Besides, in a far-off district, junior officer of a lead bank might be posted and they might find it difficult to get the necessary co-operation from officer of other banks if the latter happen to be seniors. These were real obstacles, which would hinder the emergence to the lead role of the lead banks.

Finally, the commission alerted a word of caution about the role of lead banks. Extension of banking facilities is an important part of the infrastructure needed for the development of an area in combination with other infrastructural facilities such as transport, communication, stage, processing and marketing facilities, etc. but then when such facilities are not adequately provided for in a district, the lead bank can have only a limited success.

11.9.3 PRESENT POSITION OF THE LEAD BANK SCHEME

By 1973-74, surveys were completed in 380 districts to be covered under the lead bank scheme. Some banks had carried out in-depth studies of limited areas within the districts and on the basis of such studies some development schemes had already been drawn up for specific action. A few banks had also undertaken the formulation of comprehensive credit plans for their lead districts on an experimental basis. The lead banks have also constituted district level consultative committees comprising representatives of scheduled commercial banks and other financial institutions operating in the district, state government officials, etc., to help in identifying bankable scheme to evolve methods for exchanging information about borrowers to lead to lend to priority sectors, etc.

The Reserve Bank of India constituted two study groups in august 1975 to review the working of the lead bank scheme in Maharashtra and Gujarat and to formulate appropriate guidelines for its effective working. The study groups recommended that the lead banks should prepare technologically feasible and economically viable schemes in the priority sectors, which could be completed in 3 to 5 years, and all financial institutions should collectively implement such schemes. The reserve bank set up a high power committee (HPC) in March 1979 to watch the overall progress of the lead bank scheme and to issue policy guidelines for the effective functioning of scheme.

On the advice given by the HPC, the lead banks have to formulate district credit plans (DCPs) for a uniform period of 3 years and also annual action plans(AAPs) in December in each year so that these plans would synchronies more or less with the 5-year plans of the government. The district credit plan is to be of a comprehensive nature and is to indicate credit targets for institutional credit agencies in the district on a block-wise, sector-wise, scheme-wise and bank-wise basis. in October 1980, the Integrated Rural Development Programme(IRDP) was extended to all the blocks in the country. Lead banks were advised to prepare banking plans, to allocate the responsibility of financing the identified beneficiaries for different activities among the participating banks and integrating the same with AAPs. The lead banks have also been given the responsibility to obtain complete details of village also been given responsibility to obtain complete details of village wise distribution of physical programmes, subsidy, credit needs, etc., from the district rural development agencies, incorporate the same in the AAPs and ensure that the specified branches of the participating banks accept the responsibility for processing and sanctioning applications of the identification beneficiaries from the villages allocated to them .

Programmes incorporate in the DCPs have not always been successfully implemented either because they were not tested for their feasibility or for want of adequate infrastructural support and forward and backward linkages.

A working group is now engaged in reviewing the working of the iead bank scheme in regard to the preparation and implementation of DCPs and to review the role of the lead banks so as to make them more effective.

Both the government and the RBI giving considerable importance's to the land scheme for extending the bank banking habit in every part of the country, in mobilizing of the savings of the people and in extending credit for rapid industrialization.

Advances to Priority Sectors

SBI like all other banks in the country has been making rapid progress in extending credit to the priority sectors and other weaker sections of the community.

Assistance to Weaker sections

Within the priority sectors, SBI has rendered special assistance to weaker sections. For the intensive coverage of weaker sections under agricultural lending in rural areas, SBI organize publicity drives in the form of audio visual programmed through publicity vans, meetings with villagers, distribution of pamphlets and broachers indicating benefits that can be derived by the borrowers and special shows in fairs and meals laying emphasis on the bank schemes.

11.10 EXPORT FINANCE

SBI renders promotional services to the exporting community such as obtaining status reports on overseas buyers, circulating tender notice in respect of projects abroad and providing information on overseas development having a bearing on the country's foreign trade. SBI is playing major role in attracting the funds of non-resident Indians by servicing their remittances and maintaining their accounts as well as furnishing valuable advice regarding investment facilities in the light of liberalization in the policies of the Government of India.

CHECK YOUR PROGRESS

1. Insurance is compulsory, when the loan of immovable assets exceeds to ____________
2. No security is required for educational loan up to __________

3. The aim of lead bank scheme is that____________
4. ____________ is the time taken for the project to generate income.
5. Other Priority Sector consists of ______________

LET US SUM UP

Public sector banks have extended liberal credit facilities to the priority sectors, viz., agriculture, small –scale industries, road and water transport operations, retail traders and small businessman, professionals and self employed persons. Banks could not increase their assistance to priority sectors mainly because of two constrains paucity of viable schemes and of trained staff at the decision making level.

GLOSSARY

Other Priority Sector consists of business and services sector.

Service Area approach means branches had allocated villages for the total development.

Gestation period is the time taken for the project to generate income and during the period when there is no income to the borrower; banker should not demand repayment of principal and interest.

Lead Bank Scheme is that individual banks should adopt particular districts for intensive development.

Small Business is units engaged in rendering services other than professional services in which the original investment in plant and machinery is not exceeding Rs. 20 lakhs.

Retail Trader like private and cooperative sector may enjoy the advances.

Professional and self – employed people may enjoy the advances granted to professional qualified people to carry out their profession.

Education Loan has launched for studies in India and abroad merging schemes like general educational loan scheme to paid category and computer education in non-formal private institutions through select branches.

ANSWER TO CHECK YOUR PROGRESS

1. Rs.10,000
2. Rs. 4 Lakhs
3. The individual banks should adopt particular districts for intensive development.
4. Gestation period
5. Business and services sector

MODEL QUESTIONS

1. Write a note about lead bank scheme.
2. Explain the guidelines provided for other priority sector advances.
3. Write about professional advances under priority sector
4. Write a detail note on:

   a. Appraisal of lead bank scheme

   b. Small road and water transport operators.

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BLOCK IV

FINANCIAL VIABILITY OF CREDIT PROPOSAL AND FIXING CREDIT LIMITS

Corporate sector includes Non-Government Public and Private Limited Companies, Co-operative non-credit societies, Co-operative banks and Private financial and investment companies. As the exposure is very large and long in project financing, if is essential that bankers should put in place proper mechanism for supervision and follow up. With the rapid industrialization and development of various sectors of the economy, the banker's task is to choose the right type of borrower. Since a banker deals with other people's money, he exercises at most caution and employees a number of modern tools of appraisal before sanctioning the loan to selected borrowers.

Unit : 12 Corporate Finance

Corporate finance deals with precedents, practices and policies based on expediency or experience, accident or anticipation. It discusses both fact and policy. It is concerned with fact, in so far as it describes the prevailing precedents and practices involved in financial administration and management; it deals with policy in so far as it succeeds in formulating -principles or rules of expediency which may be a guide to sound financial procedure.

Unit : 13 Project Finance – Supervision and follow-up

Project finance is to repay out of cash accruals generated over a period of time it is essential that, a project have to monitored, supervised and followed up on ongoing basis throughout the currency of the finance.

Unit 14 Procedure for appraisal of credit proposal and fixing credit limits

A banker may find the amount received from various deposit accounts would be inadequate to meet the innumerable proposals from the borrowers seeking financial help for various purposes. The selections of good borrower are an art. The bankers selects such borrowers and arranges for making such advances, keeping in mind the principles of lending, particularly if it is a long-term credit.

Unit 12

CORPORATE FINANCE

STRUCTURE

OVERVIEW

Corporate sector includes Non-Government Public and Private Limited Companies, Co-operative non-credit societies, Co-operative banks and Private financial and investment companies. Among there, the non-financial sub-sector of non-government public limited companies in undoubtedly the most important from the point of view of industrial investment. A new corporate enterprise may be started by means of capital raised externally but much of its subsequent development proceeds from self-financing. Savings generated within the corporate units and left in the form of retained earnings and amortization provisions constitute the main spring of their expansion.

LEARNING OBJECTIVES

After reading this lesson, you should be able to

- raising of Capital by Corporate enterprises
- definitions of Corporate Finance
- scope of Corporate Finance

- importance of Corporate Finance
- External Sources of funds raised by the Corporate Sector

12.1 MEANING OF FINANCE

Finance may define as that administrative area or set of administrative functions in an organization, which relate with the arrangement of cash and credit so that the organization may have the means to carry out its objective as satisfactorily as possible.

Finance has usually divided into categories according to the type of entity or organization served. The major classification of this nature is two-fold; public finance and business finance. The former is normally concerned with the ways of securing money for the conduct of government and the administration of public funds.

Business finance involves an analysis of the various means of securing money for private Business enterprises and the administration of this money by individuals, voluntary associations and co-operation.

Business finance may further be sub-divided into various categories: personal finance, partnership finance, and corporation or company finance. The financial operations carried on by a modern economic unit (known as Business Corporation) in contrast with earlier forms of business organization require a detailed and critical study. It is worth noting t hat principles of Business finance are just as applicable to the small firm as to the large.

A corporate enterprise may be defined as an organization sanctioned by government to carry on some specific and clearly defined under taking. It is considered as separate from its members; it is capable of expressing purposes and ideals of its own, of owning property, of contracting debts, of suing and being sued. It is for several reasons an effective agency for the raising of capital

i. The division of capital into small units in the form of shares or bonds makes it possible to attract funds from people of moderate means.
ii. The division of shares and debentures into small denominations makes it possible for the individuals to diversify their investments and thus reduce the risk to the minimum.

iii. The division of corporate securities into bonds and shares serves to attract funds from the people of different temperaments and of different economic positions.

iv. The easy transferability of bonds and shares, made possible by the development of organized stock exchanges, enables an individual to withdraw his investment at a1most a moment's notice.

v. The principle of limited liability facilitates the assembling of vast amounts of capital required.

vi. The large aggregation of capital provides an unusual competitive strength and stability, which in turn renders the securities attractive to the investing public.

The corporation is merely a way of doing things. It is a means whereby small and scattered savings are mobilized for producing and distributing goods on a large scale. To the extent that the corporation successfully performs this function, it will survive as an institution. Corporate undertaking is the economic pulse of the nation. Its birth, prosperity and demise generally reflect the economic progress of a country. Impersonal In form, it has wielded much economic, political and social power.

Corporations can be classified into two groups.

i. Public corporations, which are generally established under the social Acts of the legislature, for instance, the National Industrial Development Corporation, the Industrial Finance Corporation, the Damodar Valley Corporation, etc.; and

ii. Private corporations, which are engaged in commerce, industry and finance. In its broadest sense, corporation finance applies not only to industrial trading, enterprises but also to public utility concerns organized on corporate basls.

12.2 DEFINITION AND SCOPE OF CORPORATE FINANCE

Corporate finance or, broadly speaking, business finance can be defined as the activity concerned with the raising and administering of funds used in business. Since today business property is held mostly by the impersonal units' known as corporations or companies, the emphasis in the study of business finance is given on company or corporate finance and the matters of policy that are entailed in the financial management of these larger organizations. Besides, the greater complexity and the larger public interest in the affairs of corporate enterprises justify special attention to their financial problems.

Corporate finance deals with precedents, practices and policies based on expediency or experience, accident or anticipation. It discusses both fact and policy. It is concerned with fact, in so far as it describes the prevailing precedents and practices involved in financial administration and management; it deals with policy in so far as it succeeds in formulating -principles or rules of expediency which may be a guide to sound financial procedure.

"Corporate finance deals with the financial problems of corporate enterprises. These problems include the financial aspects of the promotional of new enterprises and their administration during early development, the accounting problems connected with the distinction between capital and income, the administrative questions created by growth and expansion; and finally, the financial adjustments required for the bolstering up or rehabilitation of a corporation which has come into financial difficulties."

It will thus be noted that corporate finance studies the financial operations carried on by a corporation from the time of its very inception to its growth and expansion. It analyses the financial implications involved in the promotion of corporate enterprises. It assists in scanning the financial plans of new and established business units. It examines the nature, extent and form of the capital required by corporations. It scrutinizes the practices and policies of administering corporate income. It looks into the propriety of dividend, depreciation and reserve policies adopted by various business companies. It studies the nature and importance of financial assistance rendered to business enterprises-by the different financial institutions such as issue houses, investment bankers, underwriting firms, banks, insurance companies, industrial banks, investment companies, holding companies, stock exchanges, development and financial corporations. Last but not the least; it examines the role of the state in regulating and controlling the financial practices and policies of corporations.

12.3 IMPORTANCE

The social and economic significance of corporation finance is accentuated by three factors: (i) organization of business on corporate basis and assumption of increasing public responsibilities as the corporation increases in size and influence, (ii) the wide distribution of corporate ownership, and (iii) the divorce between ownership and management

For business management the subject is of primary importance. It will remain so as long as it is necessary to obtain funds from private owners. Management owes direct responsibility to the body of share-, holders. The most important single test of managerial ability is to be found in the adequacy, regularity and growth of net return on the total investment involved. There has to be a deep consciousness, on the part of management, of handling other people's money. Business has to be carried on a unharmed basis, but this does not mean avoidance of reasonable and inevitable risks of business operations. Further, management owes a responsibility-though vague in character-to the public in general. The interest of the public lies in the continued life of business enterprises, and the same is adversely affected by their failure since employment position is likely to be disturbed.

The corporate form of business organization is chiefly responsible for the separation between ownership and management. Management is provided with a number of opportunities to manipulate the financial statements. Knowledge of the principles of corporation finance is likely to stand as a protector of shareholders and of other persons dealing with the corporation. Besides, as long as corporation securities occupy their present Position as investment instrument, knowledge of corporation finance will be a basis for any sound approach to the study of investment.

The financial side of business mechanism, with all the attendant problems of ownership, control and distribution of income, is of paramount importance to those who are in charge of the operation of our economic society. "Economists, sociologists and students of politics should all be familiar with the machinery of corporation finance if they are to be more than dilettante in their analysis of present-day social problems as they are affected by property, chiefly corporate property, which constitutes empire and social power in our current capitalistic regime.

Bearing in mind the role of the corporate sector in the economic development of our country under the five-year plans, we can appreciate the importance of the study of corporation finance. Finance being the Sine qua non of industrialization. It becomes incumbent on our part to take up systematic and critical study of corporation finance. It assists in the assessment of financial needs of industries-large or small-and indicates the internal and external resources for meeting them. It assesses the efficiency and effectiveness of our financial institutions in mobilizing individual and corporate savings

In analyzing trends in finances of the private cooperate sector; attention is concentrated here on non-government public limited companies, which constitute the most important segment of this sector.

In the case of external sources, the major constituents were net amount mobilized against issues of share capital and premium on shares, borrowings, and trade dues and other current liabilities.

12.4 FINANCING INVESTMENT

It would be useful to focus attention on certain important issues connected with financing of private corporate sector investment. The increasing reliance of the private, corporate sector on debentures in recent years, especially following liberalization terms and conditions of issue of debentures, shows a trend towards financial disintermediation, i.e. companies raising resources directly from savers via the capital market instead of from banks and other financial institutions. This trend is in line with what is happening in the industrialized countries of the West and in Japan.

Term-lending institutions have also been encouraging established houses and large groups to raise as much funds from the capital market as possible. IDBI is ready to provide bridge loan facilities in such cases so that the implementation of the projects does not get adversely affected pending rising of resources from the capital market.

12.5 DEBENTURES

Issuing debentures is an attractive way of raising funds from the capital market for purposes, of expansion, diversification and modernization as also for working capital purposes as it does not dilute the impingement's control over the company unlike in the case of equity shares. Besides, borrowing through debentures is advantageous since interest paid on debentures is tax-deductible for profit earning companies. However, for protecting the interests of debenture holders, companies are now required to create a Debenture Redemption Reserve (DRR) equivalent to 50 per cent of the amount of debenture issue before the debenture redemption commences.

The capital market buoyancy appears to have petered out. The primary and secondary capital markets are also sluggish for quite some time. The declining profitability of industries such as textiles, engineering, chemicals and cement, and the severe drought situation have affected investment climate and investors' psychology. Companies experiencing declining profitability and with high debt-equity ratios are likely to face debt-servicing problems. There are instances of companies having defaulted on payment of debenture interest on time. An active secondary market for debentures has not yet developed in the country and this has impaired the liquidity of this capital market instrument.

Some spokesmen of private corporate sector have complained about the 'crowding out' effect on equity and debenture issues from new saving instruments devised by the Government, especially the bonds allowed to be issued by public sector undertakings which offer 9 per cent (tax-free) and 13 per cent interest per annum. The major support to these bonds has, however, come from banks and financial institutions and not from public.

12.6 NEED FOR LARGER EQUITY SHARE

In view of the current unfavorable situation in the capital market, reliance of the private corporate sector on borrowings from banks and other financial institutions may be expect to increase. It is indeed difficult at this stage to predict when the capital market will revive. Until this happens, it is reasonable to expect a reversal of the trend from financial disintermediation to intermediation.

The private corporate sector's increasing reliance on external source c of funds would add further to interest burden and affect its profitability.

CHECK YOUR PROGRESS

1. Cooperation finance deals with the financial problems of ___________
2. The Major constituents of external sources of funds were __________, __________, ______________
3. The private corporate sectors increasing funds on external sources in the way of __________
4. Public finance means securing money for the conduct of government and the ____________

LET US SUM UP

It examines the defects in the relationship between industry and financial institutions, such as banks, insurance companies, investment companies, investment trusts, stock exchanges and financial corporations. Last but not the least, it determines the role to be played by the State in levying control on capital issues, imposing tax on corporate income and providing finance, directly or indirectly, to corporate enterprises in the private sector.

GLOSSARY

Finance may define as that administrative area or set of administrative functions in an organization, which relate with the arrangement of cash and credit so that the organization may have the means to carry out its objective as satisfactorily as possible.

Business finance involves an analysis of the various means of securing money for private Business enterprises and the administration of this money by individuals, voluntary associations and co-operation.

Corporate finance deals with precedents, practices and policies based on expediency or experience, accident or anticipation.

A corporate enterprise may define as an organization sanctioned by government to carry on some specific and clearly defined under taking.

Corporation is a means whereby small and scattered savings is mobilized for producing and distributing goods on a large scale.

Public corporations, which are generally, established under the social Acts of the legislature, for instance, the National Industrial Development Corporation, the Industrial Finance Corporation, the Damodar Valley Corporation, etc

Private corporations, which are engage in commerce, industry and finance. In its broadest sense, corporation finance applies not only to industrial trading, enterprises but also to public utility concerns organized on corporate basis.

External Sources, the major constituents were net amount mobilized against issues of share capital and premium on shares, borrowings, and trade dues and other current liabilities.

ANSWERS TO CHECK YOUR PROGRESS

1. Corporate Enterprises
2. Borrowings, Issues of Share Capital and Premium on Shares and other current liabilities
3. Increasing the internet burden
4. Administration of public funds

MODEL QUESTIONS

1. Define corporate finance.
2. Discuss the scope of corporate finance.
3. Explain the importance of corporate finance.
4. Why the corporate finance is essential and how they can raise their capital?
5. What are the external sources of corporate finance?

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Unit 13

PROJECT FINANCE - SUPERVISION AND FOLLOWUP

STRUCTURE

OVERVIEW

Project finance is assuming a lot of importance for bankers. RBI has progressively relaxed the guidelines for project finance. As per current policy guidelines, bankers can, on their own, (without mandatory involvement of financial institution) extend term finance without any monetary ceiling subject to individual bank prudential exposure limits. A successful project-lending programme is one where the lender is able to recover his advance fully from the income generated by the assisted project.

LEARNING OBJECTIVES

After reading this lesson, you should able to know about

- Project finance and its scope
- Project finance follow up measures
- Supervision of project finance

13.1 MEANING AND SCOPE OF PROJECT FINANCE

A successful project-lending programme is one where the lender is able to recover his advance fully from the income generated by the assisted project. Project finance (term loan/DPG/co-acceptance) is to be repaid out of cash accruals generated over a period of time it is essential that, a project is monitored, supervised and followed up on ongoing basis throughout the currency of the finance. The scope of post sanction follow up extends beyond merely ensuring the observance by the borrower of the terms and conditions governing the advance. It involves performance evaluation of the borrowing unit to ensure that the projected sales and profit/cash generation is achieved and the loan is repaid as scheduled.

13.2 FOLLOW UP MEASURES

The post sanction follow up can be divided broadly into two categories.

1. Follow up during implementation stage, and
2. Follow up after commencement of commercial production.

13.2.1 FOLLOW UP DURING THE IMPLEMENTATION STAGE

A. OBJECTIVES

The main objectives of follow up at this stage are to ensure that the borrower mobilizes the means of financing tied up for the project as per schedule and according to the requirements of the implementation of the project. To ensure that all the funds so raised are utilized for the approved purposes without any part thereof being wasted or diverted for any other purpose. To ensure that the physical progress of the project is in accordance with the project implementation schedule facilitating completion of the project in time without giving rise to any over run and to ensure that in case any overrun arises for unavoidable reasons beyond the control of the borrowing unit, the promoters bring in their proportionate contribution to finance the overrun, the balance being provided by term lenders by granting term loans in the same ratio in which the original term loan requirements were shared by them (this contingency will arise where promoters are unable to meet the entire overrun cost from their resources).

B. PROCEDURES FOR FOLLOW UP

Follow up at implementation stage begins as soon as sanction of the bank's term loan is communicate to the borrowers. The following procedures are followed for monitoring and follow up of project implementation.

1. OBSERVATION OF PERIODICAL PROGRESS REPORTS

When the project is in implementation stage term lenders are interested in seeing that the implementation is carried out according to the time schedule envisaged earlier and in accordance with cost estimates. Term loans are released in stages depending upon the progress in implementation. It has to ensure that, amount disbursed are utilized for the purpose for which it has been sanctioned and requisite margin is maintained all through the project implementation. The periodicity of the progress report submission can vary depending upon the size of the project. In large projects, the periodicity is generally quarterly. However, in case of projects where gestation period is small or where close monitoring is desired for any reason then the periodicity can be monthly.

The following aspects must be carefully examined.

- ⇨ Position regarding obtention of consents from government and other statutory authorities e.g. pollution control board.
- ⇨ Position regarding acquisition of land development of site.
- ⇨ Progress made in construction of factory and other buildings.
- ⇨ Position regarding placement of orders for plant &machinery and other equipment and their delivery schedules.
- ⇨ Position regarding installation of plant, machinery and other equipment.
- ⇨ Positions regarding availment of technical know how, engineering service where applicable.
- ⇨ Position regarding training of technical and operating staff.
- ⇨ Position regarding completion of formalities for disbursement of term loans and public issue, if envisaged.
- ⇨ Progress regarding mobilization of means of finance tied up for the project viz. promoters' contribution, public issue of share capital, and loans from financial institutions/banks.

- ⇨ Progress regarding receipt of central/state subsidy if any; in case any delay is anticipated, alternative arrangement made to meet the gap in means of finance.
- ⇨ Position regarding the capital expenditure already incurred/to be incurred under various heads and the sources from which they were/ will be met.
- ⇨ Position regarding overrun if any in the cost of the project and the progress made in the mobilization of means of financing tied up therefore.
- ⇨ Position relating to contingencies, pre-operative expanses, availability of margin money for working capital. The progress report will also serve as the basis for disbursement of term loan and verification of end use of funds released.

For effective monitoring of the implementation of industrial projects involving term loans and deferred payment guarantees from the bank and to have proper and effective follow up, our bank has introduced a system of reporting. Submission of this newly designed form will facilitate.

Tracking the progress in implementation of the project so as to determine cost overrun and on time over run if any identification of the problems if any, faced by the promoters during the different stages of the project implementation. Preparation of timely solutions/midcourse corrections so that the projects are not derailed at any point of time.

Once the project is completed and commercial production commences it is enough if branches send the last two pages of the format duly filled in.

2. PERIODICAL SITE INSPECTION

Periodical visit and inspection of assisted concerns is one of the major tools used by the lenders to monitor the progress. The frequency and intensity of these inspections depend on the magnitude of investment in the project, the state of implementation, the track record of promoters, the reliability of management, the past performance and specific circumstances/situation prevailing. The visit could be categorized into pre-disbursement visit to make 'on the spot assessment' of location, infrastructure facilities available/created, physical progress of implementation of the project and establish the need for disbursal requested for periodic inspection during construction/implementation period to monitor physical progress of the project.

3. OBSERVATION OF AUDITED ANNUAL FINANCIAL STATEMENT WHERE THE PROJECT IMPLEMENTATION SPANS OVER MORE THAN ONE ACCOUNTING YEAR

The annual audited statement must carefully study to ascertain capital expenditure incurred on the project and the means of finance. The figures could be compared with information shown in the progress reports. The comments of auditors must be gone through in particular.

Recognizing that unduly long time overrun in a project adversely affects its viability and the asset quality is deteriorated, RBI felt that there was a need to evolve an objective and definite time frame for completion of projects to ensure that the loan assets relating to projects under implementation were appropriately classified and asset quality correctly reflected for this purpose RBI has given the norms for classifying the assets, which involve time overrun into 3 categories as under.

CATEGORY 1: projects where financial closure had been achieved and formally documented.

CATEGORY 2: projects sanctioned before 1997 with original project cost of Rs.100 crores or more where financial closure was not formally documented.

CATEGORY 3: projects sanctioned before 1997 with original projects have less than Rs100 crores where financial closure was not formally documented.

In all three cases, in case of time overrun beyond a period of 2 years of assessing the date of commencement of commercial production, the asset has to be classified as sub-standard regardless of the record of recovery and provided for. As regards projects to be financed in future i.e. from MAY 2002, the date of completion of the project shall be clearly spelt out at the time of financial closure. In such cases, if the date of commencement of commercial production extends beyond a period of 6 months after the date of completion of the project as originally envisaged at the time of financial closure of the project, the account should be treated as sub-standard asset. Given the above situation, it is imperative that monitoring of the projects financed assumes grater importance, as large funds are lent and influence profitability and capital adequacy requirement if they are monitored properly.

13.2.2 FOLLOW UP AFTER COMMENCEMENT OF COMMERCIAL PRODUCTION

A. OBJECTIVES

The main objectives of follow up after commencement of commercial production are to ensure that the assets created are utilize for production/ approved purposes and well maintained. To monitor an ongoing basis the performance and operating results by comparing the actual with original estimates and analyzing the reasons for major variance. The borrowing unit's financial strength to initiate corrective measure because of the early warning signals perceived in the course of such monitoring to avert incidence of incipient sickness. To ensure the recovery of installment of the principal and interest as per scheduled repayment programme.

B. MEASURES

The above objectives are achieve by obtention of periodical follow up/ performance reports containing information on capacity utilization, actual production/sales and cost of production, profitability, sources and uses of funds. The actual are compared with estimated figures for the relevant quarter/half year. It is essential to ensure that the projected level of profitability/internal cash generation is achieved, as otherwise the repayment of term loan/servicing of term loan will be in jeopardy.

1. PERIODICAL UNIT INSPECTION

Inspection of assisted unit must carry out periodically until term loan was fully liquidated. The main objective behind the periodical inspection in respect of term loans is to ensure that the unit is maintaining normal operations as per projected utilization of capacity. All the fixed assets are put into effective use; in case any fixed asset in idle whether the position is explained and acceptable. All the fixed assets charged to the bank are intact, well maintained and put into optimum use to achieve desired level of profitability. There is no dilution of security coverage available to the lenders. During the unit inspection, the visiting official should keep his eyes and ears wide open to pick up any warning signals that may have impact on recovery of loan and/or affect security charged to the lender. He should also make use of the occasion to peruse the records at random and discuss with the management and also operating staff to ascertain progress of the business, problems, if any faced and corrective measures/ proposed course of action, plans.

2. OBTENTION OF ANNUAL AUDITED FINANCIAL STATEMENTS

Obtention of annual audited financial statements to study the performance and financial position of assisted units. Figures should be studied not only in absolute terms but also in relative terms by working out key ratios to assess the profitability, liquidity and solvency. Balance sheets can also be used to make inter-unit, comparison of the industry. Whenever desired, shareholders meetings also can be attended by representative of the lending institution.

CHECK YOUR PROGRESS

1. Post sanction follow up are classified into _________ and _________.
2. Term loans are measured in stages depending up on the __________.
3. The periodicity of small project can be _________.
4. ___________ and ____________ of assisted concerns is one of the major tools used by the lenders to monitor the progress.
5. The time of financial close of the project, the account should be treated as ___________

LET US SUM UP

As the exposure is very large and long in project financing, if is absolutely essential that bankers should put in place proper mechanism for supervision and follow up encompassing various aspects discussed earlier, so that, bankers can take full advantage of emerging opportunities, avoiding the pitfalls.

GLOSSARY

Project finance is a successful project-lending programme is one where the lender is able to recover his advance fully from the income generated by the assisted project.

Follow up measures involves performance evaluation of the borrowing unit to ensure that the projected sales and profit/cash generation is achieved and the loan is repaid as scheduled.

Follow up during implementation stage are to ensure that the borrower mobilizes the means of financing tied up for the project as per schedule and according to the requirements of the implementation of the project

Follow up after commencement of commercial production is to ensure that the assets created are utilize for production/approved purposes and well maintained.

Periodical visit and site inspection of assisted concerns is one of the major tools used by the lenders to monitor the progress.

ANSWER TO CHECK YOUR PROGRESS

1. Follow up during implementation stage and follow up after commencement of commercial production.
2. Progress in implementation.
3. Monthly
4. Periodical visit, inspection
5. Substandard asset

MODEL QUESTIONS

1. What is project finance and explain its scope?
2. What are the procedures adopted by the bank in to case of project finance?
3. Explain follow up measures after commencement of commercial production.
4. Discuss the supervision of project finance.
5. What are the objectives of follow up during the implementation stage?

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Unit 14

PROCEDURE FOR APPRAISAL OF CREDIT PROPOSAL AND FIXING CREDIT LIMITS

STRUCTURE

OVERVIEW

For an outsider, bank lending may appear to be a simply affair. However, lending of funds is not that easy as one imagines. A banker is guided by various considerations. Primarily, a banker may find the amount received from various deposit accounts would be inadequate to meet the innumerable proposals from the borrowers seeking financial help for various purposes. With the rapid industrialization and development of various sectors of the economy, the banker's task is to choose the right type of borrower. Since a banker deals with other people's money, he exercises at most caution and employees a number of modern tools of appraisal before sanctioning the loan to selected borrowers.

The selections of good borrower are an art. The bankers selects such borrowers and arranges for making such advances, keeping in mind the principles of lending, particularly if it is a long-term credit

LEARNING OBJECTIVES

After reading this lesson, you should be clearly understand

- different forms of advances.
- processing of loan application form.
- appraisal of the borrower done by the banker.
- credit appraisal.
- financial feasibility of the project.
- technical feasibility of the project.
- feasibility of the borrower.

14.1 DIFFERENT FORMS OF ADVANCES

Usually advances are made by way of

a. Overdrafts,

b. Cash credit,

c. Discounting bills of exchange and

d. Loans and advances.

Overdraft is a temporary financial accommodation usually available to businessperson to meet their urgent needs. Cash credit is mostly a secured credit. Only the bank manager often sanctions a small limit. While overdraft is granted on personal or just current accounts, cash credits are sanctioned for the benefit of industrialists, businesspersons and other. The borrowers may prefer to cash credit as they have the liberty to draw in installments as and when required by them, but may have to pay interest only on the amount actually outstanding. The banks also purchase and discount commercial bills to finance genuine trade transaction and movement of goods. Bills are to be supported by documents of title to goods such as invoice, railway receipts, lorry receipts, bills of landing etc. The bankers based on certain movable or immovable securities may grant loans.

14.2 PROCESSING OF LOAN APPLICATION FORM

Whatever the type of advances they make the banks adopt certain procedure. The first step for a borrower to avail of a bank loan is to get the prescribed application form from the respective branch from where he intends to obtain a loan. Different forms of applications are available for different categories of loans. The RBI has also given direction to the commercial banks that they should lend 40% of their advances to the priority sectors, such as agriculture, small-scale industries, small borrowers etc. The borrowers obtain the necessary application for a bank loan. The application form is available free of cost.

The next step is to fill in the application. Many banks make the necessary application available to their customers in the local language also. The application calls for the entire range of details and information necessary for ensuring sanction and safe return of money Lent. The application should be complete in all respects. All the necessary documents in support of the claims made in the application form are attached with the application and submitted at the bank.

Once the banker receives the application, he allots a serial number and enters in the 'Loans Application Received Register'. The register has different columns for recording the following particulars:

I. Serial number

II. Date of receipt of the application form

III. Name of the applicant.

IV. Amount of loan.

V. Nature of the loan applied for agriculture, SSI, small business etc.

VI. The manner of disposing of the application.

14.3 APPRAISAL OF THE BORROWER

The loan application form is the base for the bankers to decide whether to sanction a loan or not. The bank manager or his field staff will thoroughly scrutinize the application form and the relevant documents. This process is known as "Appraisal of the borrower". The bank manager will ascertain the following information.

14.3.1 PARTICULARS OF THE BORROWER

The manager learns, from the application the details of the borrower, like the name, address, his ability, integrity and experience, his establishment, the nature of this business his reputation in the market etc.

14.3.2 PURPOSE OF THE LOAN

The purpose of the loans is very important. The banker rarely lends money for unproductive purposes. In case of a new business, he may ascertain whether the money will be used for long-term capital outlay, i.e., for the purchase of plant and machinery. If so, he takes adequate care as the bank primarily lends for short-term purposes. The banker takes extra care if the loan applied for is for the redemption of previous loan/loans. Normally commercial banks do not grant credit for such purposes.

14.3.3 SECURITY

The banker looks at the security offered by the borrower and finds out whether it can be easily sold in the market any loss of time and value. He verifies the validity of the title to such security or securities. He may examine carefully whether he can have adequate 'Margin', in such securities. The difference between the market value of securities and the amount lent against them is known as 'Margin'. In case there are sureties for the borrower, the details of such sureties and reference will be verified.

Although the banks insist upon securities, they do not completely rely upon securities. If the banker feels that, the project/proposal is unsatisfactory; he will decline the proposal without any hesitation even if the securities are too good. Security is taken as the last resort for the bank to get back the money by realizing the security because:

i. The customer may suffer in venturing into such unrealistic project Further damage is done to him by selling his securities at odd times at low prices.

ii. The banker, as expected, may not be able to realize the securities in certain cases; legal hurdles may arise;

iii. Realizing such securities is time-consuming and expensive, in certain cases; the value of such securities may fall.

iv. If the bank resorts to sale of such securities, there may be adverse publicity against the bank, affecting its reputation.

v. Finally yet importantly, there is disharmony between the banker and the borrower.

14.3.4 AMOUNT OF LOAN

The banker examines the relationship between the amount required by the borrower for his project and the amount asked for in the application. He verifies, using certain techniques, whether the amount is adequate to take up the proposed project. There is a misconception among the borrowers that the bank will normally grant lesser amount than requested. Therefore, there is a tendency to inflate the figures in the project proposal. The main concern for the bank manager is to determine the right quantum of loan required for the project. If the bank grants more, the customer may spend it lavishly and waste it. However, at the same time, if it is inadequate, the manager may have to lend more subsequently to protect the previous lending. If he refuses to grant additional sum, the project may fail and the customer may not be able to pay back the loan. The banker carefully ascertains the amount of loan, allowing provision for emergencies. In case, the bank feels that he cannot agree for the requested amount, he may ask the necessary amendments. The banker himself need not contribute the entire investment. He may insist on the borrower's contribution.

A borrower may approach a bank for three types of loan.

- Short-term loan;
- Medium-term loan; and
- Long-term loan

14.4 SHORT-TERM CREDIT

Traditionally banks provide short-term credit only. The period of loan normally ranges between 3-6 months. Short-term loans are required by traders and manufacturing units to build up their inventory. The short-term finance depends upon the working capital cycle of the business. Short-term credit is also needed to meet operational expenses and long-term credit needs of the customers. It is a temporary financial accommodation during the period between the time of purchase of raw materials and the time of sale of finished goods. For example, a cracker-manufacturing unit may have to build up its inventory from the month of April. However, in November, just before Deepavali, he may sell his stock and pay back the loan. Short-term finance may affected through cash credit against pledge, hypothecation of stock, book debts or supply bills. In the case of certain credit sales, banks may also resort to discounting such commercial bills.

14.5 MEDIUM-TERM CREDIT

Banks, in certain special cases, grant medium-term loans to the borrowers. The period of loan normally ranges between 1-2years. Such medium-term loans are required to expand their business, renovation etc. In business where the working capital cycle is longer, the medium-term loans are granted to meet their working capital need also.

14.6 LONG-TERM CREDIT

The commercial banks hesitate to grant long-term credit, as they cannot afford to lock up their funds in long-term ventures. The banks may in certain exceptional cases; resort to long-term credit, ranging between 2-7years. Long-term finance is required to acquire fixed assets like plant and machinery, land and buildings etc. They also lend for renovation or modification, etc. Banks may lend individually or in consortium with other banks or financial institutions.

Whatever the type of loans is short-term, medium-term or long-term loan, the banker adopts an overall credit appraisal procedure which covers certain common areas of probe in addition to the special attention toward the specific category of credit.

14.7 CREDIT APPRAISAL

Credit appraisal is a technique by which a banker estimates the soundness of a credit proposal by careful analysis. Credit appraisal lends to finding out the quantum of credit required for a borrower and the safety of such credit. In the recent years, the banks and financial institutions have developed certain sophisticated techniques for ascertaining credit limits and to decide whether it would be worthwhile to accept such proposals.

Traditionally commercial banks are lending short-term credit needs, meeting the working capital gap. There is a close relationship between the success cares in selecting the right proposal and looks for various particulars like sales, cost of sales, expected profit, general and administrative expenses, tax factor, indirect incomes etc. The banker may also ask for current liabilities. The banker may ascertain the maximum permissible bank finance for the working capital as per the tendon committee report, towards fluctuating demand credit, fixed loan, discounting bills etc. Appraisal of loan application is the starting point for fixing credit limit for the borrowers. The banker evaluates the proposal taking into account the following:

14.7.1 APPROVAL

The banker examines whether the respective bodies have approved the proposed project submitted. In the case of a company, there should be provision for such a project as per the memorandum of association and articles of association. In addition to this, the directors' approval is necessary. The banker may satisfy himself as to whether the project has the legal sanction in terms of the required licenses, approvals, and clearances from the appropriate authorities or government.

14.7.2 TECHNICAL FEASIBILITY

A new project submitted with the banker for consideration of financial assistance requires a thorough scrutiny. One of the important considerations affecting the feasibility of the project is the type of technology proposed to be employed by the borrower. The banker ascertains if necessary, with the help of the experts in the field, as to whether the technology is the latest or outdated, capital-intensive or labour-intensive etc. He also examines the borrower's capability in case of changes in the product or shift in consumer preference. The experts may also give the their approval after considering the availability of raw materials, labour, fuel, power, water, transport, market technology etc. Location of the project is another important factor for the success of the project. In case of manufacturing unit, proper location may be related to adequate supply of raw materials, availability of power, water, labor and other infrastructure facilities.

14.7.3 FINANCIAL FEASIBILITY

The nationalization of commercial banks in 1969 has a tremendous impact on the lending policies of the commercial banks. The security-oriented approach has been relegated to the background. Instead, the trust is more on purpose and performance. Due to these changes in the policies, the bankers assess the project on the above lines, by examining the financial statement and analyzing the balance sheets. The bankers evaluate the project by using certain important techniques of financial evaluation for lending decisions, viz., ratio analysis, break-even analysis, cash flow and fund flow analysis.

Ratio Analysis : Ratio refers to the numerical or quantitative relationship between two items/variables. It is an invaluable aid to management in the analysis of the data. Although there are many ratios for evaluation of a firm, a banker may use only a few ratios related to his needs. The banker is to judge not only the profitability of the firm but also the cash flow in the firm, as the repaying capacity of a borrowing concern is not influenced by profit alone. Some of the ratios widely used by the bank at the time of project appraisal are as follows:

$$\textbf{Current Ratio} = \frac{\text{Current Assets}}{\text{Current liabilities}}$$

Current ratio states the relationship between current assets and current liabilities. It is an index of the firm's financial stability. Current assets are cash and other assets, which could be converted into, cash in the near future. Current assets comprises of cash, bank, short-term investments, bills receivable, book-debts, inventories etc. Similarly, current liabilities are those, which are to be spelled in the near future, viz., creditors, bills payable, income tax, overdrafts etc.

An ideal current ratio is said to be 2:1. A high current ratio is an assurance that the firm will have adequate funds to meet current obligations. However, one of the limitations is that current ratio fails to indicate the rate of liquidity of individual components. For example, a large inventory does not mean cash. In credit analysis, a banker will not be satisfied with the mathematically good current ratio. What is required more is the qualitative aspect of the composition of the current assets.

$$\textbf{Liquid Ratio} = \frac{\text{Liquid Assets}}{\text{Liquid Liabilities}}$$

Liquid ratio is a rigorous test for ascertaining the liquid character in the firm. It examines the relationship between the liquid assets and liquid liabilities. This can be worked out only if the current assets are classified into liquid asset and deferred assets. Similarly, the current liabilities may be classified as liquid liabilities and deferred payments. This classification can be effected by establishing a simple rule that all assets and liabilities are liquid if they are expected to be realized or paid within a month. The components of liquid assets are cash, bank, debtors, bills receivable, immediate marketable securities etc.

$$\textbf{Net profit Ratio} = \frac{\text{Net Profit}}{\text{Sales}} \times 100$$

Net profit ratio is the relationship between net profit and sales. It indicates the profitability of the business.

$$\textbf{Debt-Equity Ratio} = \frac{\text{Long-term Debt}}{\text{Shareholders' equity}}$$

This ratio shows the relationship between borrowed funds and owner's capital. This ratio is used for measuring the long-term financial solvency of a firm. The debt refers to the long-term debt alone and equity may include both ordinary and preference capital but excludes past accumulated losses. It is the ratio of the amount invested by outsiders with that of the amount contributed by owners (including preference shareholders).

Since the equity shareholders do not have the voting rights, a doubt has often been expressed as to whether preference capital should be taken into account while computing shareholders' equity. The exact treatment may depend on the purpose for which the ratio is used. If the banker intends to calculate the financial solvency of the firm, preference capital should be included. On the other hand, if the debt-equity ratio is calculated for computation of earnings per share, it need not be taken into account.

$$\textbf{Capital/Asset Ratio} = \frac{\text{Fixed Assets}}{\text{Capital Funds}}$$

This ratio states the relationship between the fixed assets and paid-up capital plus reserves. Fixed assets are taken at its depreciated book value. This ratio may indicate as to whether the long-term funds have been effectively utilized. It may also indicate as to whether the long-term funds have been effectively utilized. It may also indicate as to whether the long-term funds have been invested in long-term assets. If any firm has done so, it may land itself sooner or later into financial constrains to meet its immediate obligations. The current ratio, in such concerns, may not be satisfactory.

$$\textbf{Cash-flow Ratio} = \frac{\text{Operating profit + Depreciation}}{\text{Net Sales}}$$

This ratio enables a banker to Asses the cash generating capacity of the firm as well as the extent to which the funds are derived. Some firms may have a good net profit ratio. Nevertheless, their cash flow ratio may be poor.

Break-even Analysis : Break-even analysis is an analytical technique for studying the relationship between cost, volume and profit. It is a device used to determine the usefulness of the profit planning. As the banker is interested in getting back his money, he went to make sure when the surplus is likely to be received by this unit. He may like to find the break-even point of sales volume at which the total revenue is equal to the total costs. The break-even point is computed as follows:

$$\textbf{Break-even Point} = \frac{\text{Fixed Cost}}{\text{Contribution per unit}}$$

Contribution = Selling Price - Variable Cost (per unit)

The break-even point gives the answer wherein the firm does not make either profit or loss when it manufactures/sells a particular number of units. This analysis is very important for the banker as the repayment of the term loans is generally scheduled to begin after the break-even.

Apart from the analysis of the data, the facts given in the project proposal are carefully examined and verified. The banker also checks the calculations shown in the project report. The banker also examines the feasibility report given by the technical experts. The experts may give their comments after considering the availability of raw materials, labor, fuel, water, transport, market, technology etc.

Cash Flow and Fund Flow Analysis : Cash flow and fund flow analysis are important analytical tools for a banker for evaluating the employment of funds. Cash flow may be of two types - Actual cash flows and National cash flows. Actual cash flow refers to the actual movement of cash in or out of the business whereas the national cash flow may refer to the increase or decrease in the current assets. The cash flow estimates are prepared to indicate the inflow and outflow of funds year by year of the concern covering the entire period of term advance. These estimates would help the banker to schedule the repayment of loan over a period, making provisions allowances favoring the borrower. Cash flow and funds flow technique help banker to find out wherefrom the funds would come and how such funds would be applied. Once the fund flow and cash flow statements are favorable, it enables the banker to decide the case easily to the advantage of the borrower.

Return on Investment : The very first information that a banker seeks in a project report is the return on investment. He may compare this with the cost of capital. He may think of further appraisal of the project only if the return on investment is more than the cost of capital. There are four methods to evaluate the return on cost of capital.

a. Payback Period Method.

b. Average rate of return.

c. Net present value method.

d. Internal rate of return.

a. **Payback period method :** Payback period method is a technique by which the banker finds out the number of years required to recover the original cash outlay invested in a project. The following formula can be adopted:

$$\textbf{Pay-back period method} = \frac{\text{Cash outlay}}{\text{Annual cash inflow}}$$

One of the limitations of this method is that it does not consider the flow of funds after the payback period. However, it is a useful technique for a banker who lends funds to the borrower.

b. **Average rate of return (ARR) :** Average rate of return is a method to determine the average annual profit during the lifetime of the project. It is normally expressed in percentage. The following formula is adopted:

$$\text{ARR} = \frac{\text{Annual Average Profit}}{\text{Initial Investment}} \text{ X } 100$$

c. **Net Present Value Method (NPV) :** Net present value method is the classic method of evaluating the investment proposals. It is one of the discount cash flow techniques, recognizing the time value of money. Under this method, the future costs and revenues are discounted by a required rate of return in order to compare the present value of future benefits with the present value of investments. If the present value of future benefits exceeds the present value of investments, the banker will accept the project. Otherwise, he may out rightly reject it.

d. **Internal Rate of Return (IRR) :** Internal rate of return is a technique by which the banker matches the present value of future benefits with the present value of the project and finds out the IRR. He may compare the internal rate of return with the expected rate. If the IRR is satisfactory, he may proceed further in evaluating the project.

14.7.4 COMMERCIAL FEASIBILITY

Commercial feasibility involves the study of the product in relation to its current and future demands, market share, fluctuations in demand for the product due to changes in consumer preferences or technology etc. Normally increase in production may lead to reduction in the cost per unit. However, exceeding a particular limit, it need not be true. The products manufactured by the firm should be sold in the market to enable the producer to move along the operating cycle, as the inventory is not cash. The capacity to repay the loans is dependent on the sales revenue of the project.

14.7.5 MANAGERIAL COMPETENCE

The banker also examines the organizational and managerial capabilities of the applicant. Managerial ability is the most essential factor considered by both commercial bankers and development banks in sanctioning the application. Sometimes the project may be technically sound, economically, commercially, and financially profitable. However, if it cannot be managed properly, it cannot be considered as a worthwhile project. Hence, the banker gives more weightage for managerial competence of the applicant.

Moreover, the applicant may be over enthusiastic in his ideas. However, he might have undermined certain realities. The banker takes into account the controllable factors and non-controllable factors. The controllable factors are the inputs, viz., money, materials, machines, methods, etc. they are to be scientifically designed and combined. It is very difficult to predict the non-controllable factors like change of government policy, competitors' behavior, legal restrictions, political changes etc. all these factors are carefully visualized in advance before granting loans.

14.7.6 SOCIO-ECONOMIC VIABILITY

The banker and the financial institutions evaluate the project based on the socio-economic viability. It is an assessment to know whether such project, as a whole, brings any social benefit to the nation to fulfill the national objectives. Some of the socio-economies benefits to the nation are employment generation, removal of regional imbalances, minimization of inequalities in the distribution of income and wealth, development of import substitution, export-orientation, development of agriculture and other priority sectors, enlistment of weaker sections of the society etc. The banker may consider a lower rate of interest, low margin, longer repayment schedule etc., for certain types of projects. For instance 4% per annum is changed towards the deferential interest rates (DIR) loans.

The banker, having thoroughly examined the application, may accept or reject the proposal or may also suggest to the borrower the necessary modification in the project. Ones he is convinced about the project, he hold an interview with the prospective borrower-customer to discuss about the project, interest rates, repayment schedule etc. In certain cases, the banker may visit the location of the plant to study details before making the commitment.

During the interview, the banker will discuss with the customer in detail about various aspects of his project proposal, particularly the amount of loan required, the borrower's contribution, security, repayment schedule, type of credit, interest rate etc.

In the case of working capital requirement, it is to be noted that the peak level of borrowing coincides with the peak level of production and credit sales. Taking into account all the above factors working capital limits may be fixed as follows:

Working capital financed = working capital requirements - (credit available from suppliers + cash + borrower's fresh contribution).

CHECK YOUR PROGRESS

1. Loans may be granted by the bankers on the basis of certain __________
2. As per RBI direction, commercial bank should lend __________ to priority sectors.
3. A borrower may approach a bank for ______________
4. Credit appraisal lends to finding out _____________
5. Current ratio is an index of the firm's ____________

LET US SUM UP

In the case of long-term loans, the banker should not undertake any risk and block his capital. Credit limit, in such cases, should be fixed taking into account the total cost of project, promoter's contribution, other sources of funds, working capital requirements, cash flow, debt-equity ratio etc. The bank normally experts the borrower to prove adequate stake in the cost of the project to ensure his continued interest and care of the project. The owner's contribution should be in the form of risk- capital and the bank provides the balance.

GLOSSARY

Overdraft is a temporary financial accommodation usually available to businessperson to meet their urgent needs.

Cash credits as they have the liberty to draw in installments as and when required by them, but may have to pay interest only on the amount actually outstanding.

'Margin' is the difference between the market value of securities and the amount lent against them.

Short – term credit for the period of loan normally ranges between 3-6 months and required by traders and manufacturing units to build up their inventory.

Credit Appraisal lends to finding out the quantum of credit required for a borrower and the safety of such credit.

Financial feasibility means the bankers evaluate the project by using certain important techniques of financial evaluation for lending decisions, viz., ratio analysis, break-even analysis, cash flow and fund flow analysis.

Technical feasibility means the consideration of the project is the types of technology propose to employ by the borrower.

Ratio refers to the numerical or quantitative relationship between two items/ variables.

Break even point gives the answer wherein the firm does not make either profit or loss when it manufactures/sells a particular number of units.

Cash flow analysis estimates are prepared to indicate the inflow and outflow of funds year by year of the concern covering the entire period of term advance.

Commercial feasibility involves the study of the product in relation to its current and future demands, market share, fluctuations in demand for the product due to changes in consumer preferences or technology etc.

Socio–economic viability is an assessment to know whether such project, as a whole, brings any social benefit to the nation to fulfill the national objectives.

Payback period method is a technique by which the banker finds out the number of years required to recover the original cash outlay invested in a project.

ANSWER TO CHECK YOUR PROGRESS

1. Movable or immovable securities
2. 40% of their advances.
3. Short term, medium term and long – term loans.
4. Quantum of credit required for a borrower and the safety of such credit.
5. Financial stability

MODEL QUESTIONS

1. Explain the different forms of advances.
2. What are the procedures for loan application form?
3. What is credit appraisal?
4. Explain the financial feasibility of the project.
5. What are the managerial competences of the project?
6. How to fix the credit limits for the borrower by the banker?

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BLOCK V

NON-PERFORMING ASSETS & ASSET RECONSTRUCTION FUND

Bank credit is sanction for a definite purpose to be repaid within a specified date/period. As the repayment of the advances depend on the income generation from the activity, monitoring of the advances after release assumes greater importance of NPA of the bank does not show an abnormal increase.

Unit : 15 Non-Performing Assets

It is observed that the recovery of NPA during the last couple of years had been surpassed by the slippages resulting in our NPA portfolio swelling up, despite all our efforts in recovery of NPA Slippage management assumes greater significance in the present day's context and in future with stringent provisioning/capital adequacy requirements. We have to realize the implications of the effect of further slippage and tone up not only to arrest the same but also to upgrade the already slipped to position ourselves better and for this slippage management is crucial.

Unit : 16 Debt Recovery Tribunals

Debt recovery Tribunals has powers to order attachment, to appoint a receiver and to appoint a commissioner for preparation of inventory or for sale. Compromise should be undertaken when the borrower is not able to pay the dues as was originally contracted and the account has turned NPA and not a willful defaulter. Lok adalat is old and has its roots in panchayat Adalats.

Unit : 17 Asset Reconstruction Fund

Restructuring should attempted where, after an objective assessment of the viability and promoter's intention (and his stake), banks are convinced of a turnaround within a scheduled timeframe. In respect of very unviable units as decided by the banks/consortium of banks, it is better to facilitate winding up/selling of the unit early, to recover whatever is possible through legal means before the security position becomes worse. Debt restructuring can take several shapes and can happen under different circumstances.

Unit 15

NON - PERFORMING ASSETS

STRUCTURE

OVERVIEW

Bank credit is sanctioned for a definite purpose to be repaid within a specified date/period. As the repayment of the advances depend on the income generation from the activity, monitoring of the advances after release assumes greater importance. Needless to mention that we should concentrate equally on slippage management. So that the level of NPA of the bank does not show an abnormal increase. This is another area where we need to be more alert and prevent deterioration of assets by our prompt corrective action.

It is observe that the recovery of NPA during the last couple of years had been surpassed by the slippages resulting in our NPA portfolio swelling up, despite all our efforts in recovery of NPA. While sanction of good proposals will take care of the percentage of NPA, monitoring the same is a tool to arrest the slippages of assets into the danger zone of NPAs. When everything is appears to be so, we tend to loosen our grip particularly in the observance of the basics. No account turns into non-performing asset category overnight. The symptoms of deterioration in the health that are visible should not be lost sight of and necessary corrective action is to be initiated at the earliest.

LEARNING OBJECTIVES

After reading this lesson, your should understand to

- definition and meaning of NPA
- causes of NPA
- remedial Measures
- management of NPA's

15.1 DEFINITION OF NON-PERFORMING ASSETS

Assets are bifurcated as 'performing' and 'non – performing' assets. RBI has defined that an asset including a leased asset has to treat as Non – Performing when it ceases to generate income for the bank. Thus, an NPA was defined as a credit facility in respect of which interest and/or installment of principal has remained 'past due' for a specified period. This specified period was reduced in a phased manner from 4 quarters as at 31/3/1993 to 3 quarters as at 31/3/1994 and to 2 quarters as at 31/3/1995.Due to improvements in the banking system and awareness level to recover the dues, the past due concept of 30 days time from due date was removed with effect from 31/3/2001.

As stated earlier, with a view to moving towards international best practices and to ensure greater transparency RBI has issued the guidelines to all the commercial banks (excluding RRBs and LABs) to adopt 90 days overdue norms for identification of an asset as NPA from the year ending 31/3/2004. This is reduced from the 180 days overdue norms, which were hitherto the identification area.

Accordingly, the latest definition is where Interest and or installments remain overdue for more than 90 days in respect of a Term Loan. The account remains 'out of order' in respect of overdraft/cash credit.

15.2 CAUSES OF NPA'S

All the accounts displaying unsatisfactory features/early-warning signals are on the threshold of falling into NPA category, if the bank does not take cognizance of the same and initiate remedial action.

RBI guidelines on the preventing slippage mainly cover the following aspects:

1. Early recognition of the problem

2. Introduction of new asset category i.e. special mention accounts
3. Recourse to SARFAESI Act
4. Initiating legal action
5. Auditor's responsibility
6. Identifying the borrowers with genuine interest
7. Focusing on cash flows

Points 1 and 2 are of paramount importance since any slippage cats into the hard-earned profits.

The accounts though regular but are potential NPAs in the event of the following

i. Delay in submission of stock/financial/control statements
ii. Frequent development of letters of credit and non-payment within a reasonable period
iii. Frequent invocation of bank guarantees and non-payment within a reasonable period.
iv. Return of cheque/bills discounted
v. Non-payment of bills discounted or under collection.
vi. Non-compliance of terms and conditions of sanction
vii. Return of cheque issued by borrowers
viii. Development of DPG installment and the non-payment within a reasonable period.
ix. Poor financial performance in terms of declining sales and profit, cash losses, net loss and erosion of net worth etc.
x. Incomplete documentation relating to creation/registration of charges/ mortgages

15.3 REMEDIAL MEASURES

Bank will be able to address the issue of arresting slippages only when the banks strictly adhere in letter and spirit the various guidelines stipulated in the letters from corporate office. They should also ensure prompt and timely submission of the various statements giving the full information required so that correction steps could be taken in time.

As the name itself suggests, time statement is most importance source to the branch/controlling offices to focus their attention on those accounts that show the warning signals at the incipient stage itself.

a. Irregularity in payment of interest/repayment of installment
b. Frequent return of cheques/bills, even if the accounts may otherwise be regular
c. Non submission of financial statements and other statements including stock statements in time
d. Non fulfillment of Letter of Credit obligations
e. Letter of Guarantee invoked but not paid
f. Documents time barred
g. Non renewal of limits

15.4 MANAGEMENT OF NPA'S

RBI describes "special mention account" as an asset, which exhibits signs of sickness/irregularities. They are given the names as "WATCH" and "SPECIAL WATCH" category accounts in our bank. We have to place accounts in WATCH/ SPECIAL WATCH category when the following symptoms of sickness is seen.

a. non-payment of one quarterly interest/installment
b. Frequent requests for excess drawings over the limit
c. Frequent return of bills purchased/cheques sent for collection
d. Cheques issued are returned for financial reasons
e. Non-submission of stock statements

Thus, the account, which shows the irregularities/deficiencies are pointed out in potential NPA and items, mentioned under a) and b) above are treated under WATCH CATEGORY.

The system envisages that corrective action/necessary steps be taken by the branches for regularization such that these accounts do not slip into NPA category. The accounts with the following sickness are to be observing closely and reported to controlling office. Any irregularity such as frequent return of cheques/bills purchased/discounted, non-payment of Deferred Payment Guarantee installments, frequent devolvement of Letter of Credits, non-payment of Letter of Credits on invocation, poor financials, poor sales performance, cash loss, division of funds, incomplete documentation, imperfect formalities towards insurance/registration of charges/mortgages, non-compliance with terms and conditions.

15.5 CONTINUOUS SURVEILLANCE STATEMENTS

One of the best tools that are available to the branch to have a good slippage management is the continuous surveillance statement. Branches are free to adopt preparation of the same even for less than Rs 100 lakhs working capital facilities. Ultimately, it is only the monitoring system that are devise to see the health of the borrowers' accounts at the end of every month and to take corrective steps wherever necessary.

There is no dearth of monitoring tools available to the banker. Effective use of the same is what is required.

"Prevention is better than cure" is a saying.

"A stitch in time saves nine" is another.

CHECK YOUR PROGRESS

1. NPA means ____________
2. Bills outstanding ______beyond stipulated period is called supply bills.
3. Packing credit advances remaining outstanding beyond 30 days from the expiry of __________
4. Special mention account as an asset which exhibits signs of __________
5. Best technique of the bank branch to have a good slippage management is the___________

LET US SUM UP

Slippage management assumes greater significance in the present day's context and in future with stringent provisioning/capital adequacy requirements. We have to realize the implications of the effect of further slippage and tone up not only to arrest the same but also to upgrade the already slipped to position ourselves better and for this slippage management is crucial. Identification of the potential NPAs and taking immediate corrective actions is expected out of the branches such that the sickness at the incipient stage itself is identified and corrected.

GLOSSARY

NPA (Non-Performing Assets) was defined as a credit facility in respect of which interest and/or installment of principal has remained 'past due' for a specified period.

Special mention account means that an exhibits signs of sickness/ irregularities.

Watch and Special Watch category the account, which shows that the irregularities / deficiencies of potential NPA and items.

Continuous Surveillance Statements is one of tool that branches are free to adopt preparation of the same even for less than Rs. 100 lakhs working capital facilities

ANSWER TO CHECK YOUR PROGRESS

1. All the accounts displaying unsatisfactory features
2. 90 days
3. Letter of credit/firm order
4. Sickness / irregularities
5. Continuous surveillance statements

MODEL QUESTIONS

1. Define NPA. Explain the causes of NPA.
2. What are the remedial measures will be taken by the bank for NPA?
3. Explain the ERI statement.
4. How to manage the NPA by the bank?
5. What are the RBI guidelines for NPA?

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Unit 16

DEBT RECOVERY TRIBUNALS

STRUCTURE

OVERVIEW

As an attempt towards reducing the Non Performing Assets and thereby gain the multifaceted advantages viz.

1. Release of provision held
2. Redeployment of recovered funds.
3. Improving yield on advance

Several schemes were put in place framed both by RBI and by the bankers on their own, initially valid for a shorter duration and later on extended to enable the banker recover those hardcore NPAs where recovery was not possible under normal circumstances and to provide relief to those who were affected.

LEARNING OBJECTIVES

After reading this lesson, you should be able to

- DRT through compromise settlement
- recovery of NPA through Debt Recovery APPELLATE Tribunals
- recovery of NPA through Lok Adalat

16.1 GUIDELINES FOR RECOVERY OF NON-PERFORMING ASSETS (NPAS) THROUGH COMPROMISE SETTLEMENT

It is an attempt that provides a lot of relief to the affected person who has already suffered some loss or other in his business activity, which forced him not to keep up his commitments and honor the claims of the bank. This has proved to be one of the best avenues to the banks to reduce their NPA portfolio. Which divergent views are expressed about the ONE TIME/NEGOITATED SETTLEMENT SCHEMES, the fact remains that this has provided to be best possible way of recovery in the cases where recovery had otherwise proved to be difficult? With the expiry of one time settlement scheme advised by RBI, as of now there is only one scheme under OTS framed by the bank in existence.

16.1.1 BANK'S SCHEME

Bank scheme covers settlement of all NPA accounts including the accounts where suits are decreed/recovery certificate are issued. However, the scheme will not cover the cases of fraud, malfeasance and cases of willful default.

16.1.2 NPA'S WHICH ARE IN SUB-STANDARD CATEGORY

Book outstanding as on date of classification of the account as substandard PLUS amount of ECGC /DICGC claim credited, if any, prior to date of classification as substandard together with interest at 10% for the total amount till date of settlement PLUS subsequent debit of legal expanses/other costs along with interest from date of debit till date of settlement MINUS subsequent recoveries received together with countervailing interest and countervailing interest on ECGC/DICGC claim received, if it is credited to the amount before the date of classification as doubtful asset.

16.1.3 NPA'S WHICH ARE IN LOSS CATEGORY

Book outstanding as on date of classification of the account as loss asset PLUS amount of ECGS/DICGC claim credited if any prior to classification or loss asset PLUS subsequent debit of legal expenses/other costs MINUS subsequent recoveries received.

Our scheme envisages that the entire compromise amount should be paid within a period of 30 to 90 days from the date of communication. In deserving cases, however, deferred payment may be permitted upon one year by collecting interest prevailing at the date of settlement, in which event; at least 25% of the compromise amount has to be collected upfront payment.

16.1.4 DEVIATIONS TO THE SETTLEMENT FORMULA ARE FOLLOWS

The offer amount is less than the minimum amount prescribed. Borrowers are not able/agreeable to pay the minimum upfront payment of 25%. Borrowers are not able/agreeable to pay interest for deferred payment. Deferred payment period exceeds one year.

OTS proposals whether with deviation or not should be sanctioned by the same authority exercising the respective discretionary power. In case of criminal action against the borrower, the settlement proposal is to be sent to central office for consideration. For central office sanctioned loans, they are to be referred to central office only.

Visit of executives at the branches for on the spot sanction of OTS/OCS must be utilized as an opportunity to bring those chronic cases to the compromise table and early settlement. This executive can exercise the discretionary powers of the next layer of authority, present in the task force meeting and top official must sign the OTS proposal with recommendation.

16.2 RECOVERY OF NON-PERFORMING ASSETS THE DEBT RECOVERY TRIBUNAL (DRT)

Debt Recovery Tribunals are special quasi-judicial forms established under the provisions of Recovery of Debts due to Banks and Financial Institution Act, 1993 for speedy of loans. Debt Recovery Appellate Tribunals (DRATs) are the appellate bodies where all appeals arising out of the orders passed by DRTs are filed. A person in the rank of a district judge is the presiding officer of DRT. DRAT is presided over by a chairperson who is in the rank of high court judge. The pecuniary jurisdiction is Rs. 10 Lakhs and above. The tribunals will have territorial jurisdiction. Only banks and financial institutions can avail of the benefit from the tribunals. The law of limitation is applicable. The tribunals are mainly guided by the principles of natural justice.

There are 29 DRTs in INDIA at present and 5 DRATs. The DRATs are located in MUMBAI, DELHI, KOLKATTA, CHENNAI and ALLAHABAD.

As per the latest amendment to the Act which is effective from 17.01.2000, debt includes any liability which is assigned or is payable under any arbitration award or under a mortgage. DRAT can transfer, on application, any case from one tribunal to another. If another bank has a claim against the same person, then that bank can join the case before the final order is passed subject to separate fees. The tribunal has powers to order attachment, to appoint a receiver and to appoint a commissioner for preparation of inventory or for sale. The recovery officer is empowered to require the Debtor to declare on affidavit the particulars of his or its assets.

16.2.1 STEPS INVOLVED IN FILLING & PROSECUTING A SUIT BEFORE DRT

1. Filling of original application
2. Service of summons
3. Appearance of defendants.
4. Filing of reply statement by the defendants.
5. Filing of proof affidavit by the bank.

6. Filing of counter proof affidavit by the defendants.
7. Arguments by both sides.
8. Passing of final orders by DRT.

16.2.2 PROCEDURE FOR FILLING APPLICATION BEFORE DRT

Every application shall be accompanied by a paper book containing:

- A statement of the debts due from a respondent.
- All documents relied upon by the applicant.
- Details regarding payment of fees

Three applications should be submitted to DRT with adequate copies equivalent to the number of defendants.

16.2.3 PROCEDURE AT DRT

Registrar of DRT is responsible for the overall administration of the tribunal. The registrar gives OA (original application) number and issues summon after scrutinizing the application. If the defendant admits a part of the liability, the bank can request DRT for passing interim order for the admitted amount and pursue for the balance dues.

The presiding officer is responsible for ordering injunction or stay for appointment of a commissioner/receiver/for issuance of garnishee order or for passing orders for attachment before judgment.

Exparte: The presiding officer calls for the proof affidavit, and then issues recovery certificate.

Contested : The presiding officer calls for the proof affidavit, arranges for summary evidence, arguments and finally issues recovery certificate. The tribunals have to decide the claim within 6 months in any case. The appeal against the decision of DRT can be made within 45 days only to the Debts Recovery Appellate Tribunals (DRAT) by any party and will be decided with in 6 months. The borrower has to deposit 75% of claim if he prefers to file an appeal DRAT can waive this.

The DRAT's decision is conclusive.

The Recovery officer shall, on receipt of the recovery certificate, issue notice to certificate debtors, granting 15 days time for payment of the amount specified in the recovery certificate. If the defendant fails to pay the amount, recovery officer will proceed to recover the amount by any one or more of the modes, which are detailed below.

- Attachment and sale of movable /immovable property of the defendant

The recovery officer normally attaches the movables unless otherwise prohibited. In case of immovable property, recovery officer shall cause proclamation of the intended sale in the vernacular language, by giving details of the property and 30 days time.

- Arrest and detention of the defaulter
- Appointment of receiver

Appointment of receiver is a precondition to the attachment of business or building. Banks seeking satisfaction of recovery certificate should move an application before the recovery officer for appointment of receiver for the management of assets seized.

To sum up the DRT Act provides ample scope for a bank or financial institution to initiate action against borrowers with large overdue, in a systematic and fast manner.

16.3 RECOVERY OF NPA THROUGH LOK ADALAT

Lok Adalat is a process of administering justice. It is a voluntary process and works on the principle that both parties to the dispute are willing to sort out their disputes amicably. Through this mechanism, disputes can be settled in a simpler, quicker and cost-effective way.

The Lok Adalat is not a new concept. It is quit old and has its roots in Panchayat Adalats. The system, however, has remained out of tune for long. The parliament by enacting the legal services authorities act, 1987, conferred legitimization and recognition to the system. Honorable chief justice of Supreme Court Shri. Ahmedi mooted the revival of the concept and carried forward by his successors.

Objective

Expeditious arrival of settlement through conciliation and thereby reduce litigation.

Objectives of legal services authorities act 1987

To provide free and competent legal aid to the weaker sections of the society, to organize Lok Adalats, and to effectively monitor them at all levels by constitution statutory legal service authorities on the recommendations of Justice P.N.Bhagwathi committee for implementing legal aid scheme for

- Quick disposal of suits pending in courts in summary way
- Arbitration and settlement between parties at lesser costs
- Legally constitute the authority.
- Take cognizance of any existing suit in the court.
- Adjustable fresh disputes which are not pending before the court.

Follow the principles of natural, equity for play and other legal principals for expedition's arrival of settlement through conciliation and without going to the courts.

16.3.1 CONSTITUTION

There are four layers

Central authority: The national legal service authority is the apex agency. The central government and this layer down policies and principles for making legal services available under the Act constitute this.

State authority: State legal services authority constituted by every state shall give effect to the policy and directions of the central authority. The state authority discharges its function in co-ordination with other governmental agencies, non- governmental voluntary social service institutions.

District legal services authority: The district authority performs such functions of such functions of the state authority in the district, as may be delegated by the state authority (viz.)

Coordination of the activities of the taluk legal service committee and other legal services in the district. Organizing Lok Adalats within the district at such intervals and places for exercising such jurisdiction and such areas as it taluk legal services committee.

Taluk legal services authority : The taluk legal service committee in turn performance such functions as assigned by the district authority and co-ordinates the activities of legal services in the taluk.

Organize lok adalats within the taluk at such intervals and places for exercising such jurisdiction for such areas, as it thinks fit.

16.3.2 JURISDICTION

Any matter, which is falling which the jurisdiction and any pending civil suit/all compoundable criminal offences.

16.3.3 FEES

There is no court fee even for fresh disputes referred to lok adalat.

16.4 LIMIT FOR SETTLEMENT OF NPA OF BANKS AND FINANCIAL INSTITUTION

The lok adalat can handle all cases of non-performing assets with dues up to Rs.20 Lakhs. DRT can arrange Lok Adalat for cases with dues of Rs.20 Lakhs and above already, which have been already referred to it.

16.4.1 CONSTITUTION

Every lok adalat shall consist of Serving or retired judicial officers. Other persons of the area as specified by the organizer.

16.4.2 THE LOK ADALAT PROCEDURE

The entire procedure and exercises for organizing the Lok Adalat can be completed in five stages, which are as given below.

STAGE 1 : The matter is to be discussed with the concerned district judge of the district with details of suit filed cases, proposed to be referred pending in various courts in concerned districts. All cases of NPA where suit has not so far been filed.

STAGE 2: After obtaining clearance from district judge a formal requested has to be made to him giving, full details in prescribed formats as the case may be.

STAGE 3: The date for the district judge fixes the date for the lok adalat is consultation with state legal services authority.

STAGE 4: Notice is to be prepared in prescribed format for each defendant. Defendants include borrowers and guarantors.

STAGE 5: The notices so prepared have to be signed by the secretary lok adalat cell and other judicial officers, subsequently dispatched to the defendants. One copy is retained for lok adalat record.

16.4.3 AWARD

Every award of the lok adalat shall be deemed a decree of a civil court. Every award by the lok adalat shall be final and binding on all the parties to dispute and no appeal shall lie to any court against the award.

16.4.4 REFUND OF COURT FEES

Where a compromise or settlement has been arrived at by a lok adalat in a case referred on it of pending suit under subsection 1) of section 20,the court fee paid in such case shall be refunded in the manner provided under court fee Act 1870.

16.4.5 POWERS OF LOK ADALAT

Lok adalat has requisite powers to specify its own procedure for the determination of any dispute coming before it.

16.4.6 ORGANISING LOK ADALAT

First of all we have to identify cases that can be taken to lok adalat, then take up the identified cases before lok adalat considering the willingness of the borrowers/guarantors etc.

16.4.7 HOW TO APPROACH LOK ADALAT

When a matter is pending in any court and there is some indication that the borrower intends to compromise the matter the borrower and the bank may make an application to the court indicating their inclination to compromise or to arrive at a settlement where upon the court will pass the necessary order to transfer the suit to lok adalat.

CHECK YOUR PROGRESS

1. Compromise amount should be paid within a period of ____________ from the date of communication.
2. DRT are established under the provisions of _______________
3. __________ DRTS and ____________ DRATS in India.

4. Four lagers are __________, _________, ____________, _____________
5. Every lok adalat consist of ___________________

LET US SUM UP

Debt recovery tribunal has powers to order attachment, to appoint a receiver and to appoint a commissioner for preparation of inventory or for sale. Compromise should be undertaken when the borrower is not able to pay the dues as was originally contracted and the account has turned NPA and not a willful defaulter. Lok adalat is old and has its roots in Panchayat adalats. Lok adalat main objective are expeditious arrival of settlement through conciliation and thereby reduce litigation.

GLOSSARY

Negotiated settlement schemes/ one time scheme the fact remains that this has provided to be best possible way of recovery in the cases where recovery had otherwise proved to be difficult. With the expiry of one time settlement scheme advised by RBI, as of now there is only one scheme under OTS framed by the bank in existence.

Sub-standard category means book outstanding as on date of classification of the account as substandard PLUS amount of ECGC /DICGC claim credited PLUS subsequent debit of legal expanses/other costs along with interest at 6% from date of debit till date of settlement MINUS subsequent recoveries rcccived

Loss category means book outstanding as on date of classification of the account as loss asset PLUS amount of ECGS/DICGC claim credited if any prior to classification or loss asset and subsequent debit of legal expenses/ other costs MINUS subsequent recoveries received.

Lok Adalat shall consist of Serving or retired judicial officers and other persons of the area as specified by the organizer

Central authority is the apex agency constituted by the central government and this layer down policies and principles for making legal services available under the Act.

State authority constituted by every state shall give effect to the policy and directions of the central authority.

Debt Recovery Tribunals are special quasi-judicial forms established under the provisions of Recovery of Debts due to Banks and Financial Institution Act, 1993 for speedy of loans.

ANSWERS TO CHECK YOUR PROGRESS

1. 30-90 days
2. Bankers and financial institution act, 1993.
3. 29 and 5.
4. Central authority, state authority, district legal services authority, taluk legal services authority
5. Serving or retired judicial officers

MODEL QUESTIONS

1. Explain the compromise settlement under DRT
2. How the non-performing assets to be recovered through DRT & DART?
3. Explain the procedures for recovery of NPA through lok adalat.
4. Explain the 4 layers of constitution under lok adalat.

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Unit 17

ASSET RECONSTRUCTION FUND

STRUCTURE

OVERVIEW

When once account starts showing the symptoms of sickness, the banker has to analyze the reason and initiate necessary action to enable the unit to turn around. As discussed in the previous revival may be done based on a techno-economic feasibility study. Restructuring should be attempted where, after an objective assessment of the viability and promoter's intention (and his stake), banks are convinced of a turnaround within a scheduled timeframe. In respect of very unviable units as decided by the banks/consortium of banks, it is better to facilitate winding up/selling of the unit early, to recover whatever is possible through legal means before the security position becomes worse.

LEARNING OBJECTIVES

After reading this lesson, you should able to

- asset restructuring for borrowing company
- debt reconstructing for an insolvent company
- corporate debt restructure mechanism
- restructure treatment of standard and sub – standard accounts

17.1 RESTRUCTURING / RESCHEDULEMENT / REPHRASING / RENEGOTIATION OF ACCOUNTS

Debt restructuring can take several shapes and can happen under different circumstances. Broadly, all these situations can be brought under the following three major heads. A healthy company would want to restructure its debt portfolio by substituting existing high cost debt with fresh low cost borrowings. A company without repaying capacity and liquidity problems would want to restructure its debt portfolio to reduce the cost of borrowing and improve working capital position. A company is insolvent would need a wholesale restructuring of its debt portfolio to rehabilitate it and make it solvent.

In today's scenario, because of the falling interest rates, many healthy corporate have initiated proceedings to restructure their existing high cost debt with fresh low cost borrowings.

However, the case of the second category of the accounts is different. The main drive for debt restructuring in such companies is their inability to adhere to the due dates for payment of interest and principal on their borrowings. Initially, the problems are more of a short-term nature and could be mistaken for a tight liquidity position. At this stage, the lenders do try to help by releasing adhoc sanctions or adhoc deferments. However, as time passes by and the situation worsens, the debt burden keeps mounting and the cash flow deficit widens. The loan account slips into NPA category and the working capital limits become irregular. It then becomes evident that the company is incurring cash losses and any further assistance from the lenders would amount to financing of loses. At this point, the lenders step into save the company from insolvency by restructuring its debt portfolio.

Following example amplifies the point.

* Company has the following details to offer as at the end of a financial year.

PARTICULARS	AMOUNT (IN LAKHS)
EQUITY SHARE CAPITAL	150
LONG TERM BORROWING(INCLUDING OD INT & OTHER CHARGES	550

BANK BORROWING FOR WC (OVERDRAWN BY Rs25 LAKHS)	225
RESERVES AND SURPLUS	125
EARNING BEFORE INTEREST AND TAX	78
INTEREST ON LONG TERM BORROWINGS	96
INTEREST ON BANK BORROWINGS	38
TAX RATE APPLICABLE	35%

The company is presently incurring cash losses and is not able to service its debt commitments. However, the company has the potential to improve its EBIT to at least Rs. 150 Lakhs immediately if it has sufficient working capital. In order to bring the company back into black and improve its working capital position, the management has negotiated for a debt restructuring with its lenders, the salient features of the package are as under:

- ⇨ Enhancing the working capital to Rs. 250 Lakhs.
- ⇨ Promoters are brining in fresh interest free loan of Rs. 100 Lakhs to beef up long-term resources of the company.
- ⇨ The long-term lenders are rescheduling Rs. 200 Lakhs to be repaid after a moratorium of 2 years and the rest of the loan of Rs. 350 Lakhs with a moratorium of 1 year with a revised installment schedule.
- ⇨ The interest on the long-term borrowing to be reduced to 15% and on the working capital to 16%.
- ⇨ Various factors have been taken into account before deciding on the package.

Comparative table for the impact of the debt restructuring on the company's financial is give below:

BEFORE RESTRUCTURING	**Rs. in Lakhs**	**Rs. in Lakhs**
EBIT		78
LESS : INTEREST ON LONG TERM BORROWING	96	
LESS : INTEREST ON BANK BORROWING	38	134

PROFIT BEFORE TAX		(56)
INTEREST COVER(TIMES)		0.58
DEBT EQUITY RATIO		2.00
INTEREST/EBIT (%)		172%
AFTER RESTRUCTURING		
EBIT		150
LESS : INTEREST ON LONG TERM		
BORROWINGS	82.50	
LESS : INTEREST ON BANK		
BORROWINGS	40.00	122.50
PROFIT BEFORE TAX		27.50
PROVISION FOR TAX @ 35%		09.63
PROFIT AFTER TAX		17.87
SHARE CAPITAL		150
UNSECURED LOANS		100
LONG TERM BORROWINGS		550
BANK BORROWINGS		250
INTEREST COVER(TIMES)		1.23
DEBT EQUITY RATIO		1.40
INTEREST / EBIT (%)		81.67%

After the restructuring, the company's cash flow would improve significantly due to the following reasons:

- The servicing of the long-term loans has been rescheduled with a revised repayment schedule that gives the company enough time to increase its earnings and to reduce the debt burden.
- The working capital limit has been enhanced by Rs. 50 Lakhs to regularize the overdrawn amount and provide Rs. 25 Lakhs additionally thereby increasing liquidity. The company is able to generate post-tax profit, which would improve over a period to add enough cash for servicing the loans.

⇨ The company has brought in Rs. 100 Lakhs as unsecured interest free loans that would only strengthen and augment cash flow.

17.2 DEBT RESTRUCTURING FOR AN INSOLVENT COMPANY

These companies by definition cannot service their debt obligation with the available assets, as capital employment is already shrunk due to operational losses suffered. Hence, restructuring exercise can be attempted only after the future viability is established beyond doubt. Rehabilitation package has to be drawn about proposing the sacrifices from the lenders and the equity shareholders. Additional funding requirements require to be estimated and a financing plan has to be drawn up. In these categories, debt restructuring becomes a part of the overall revival plan for the company.

Following example amplifies the point

HEALTH LTD has the following details to offer as at the end of the financial year

PARTICULARS	AMOUNT (IN LAKHS)
EQUITY SHARE CAPITAL	500
LONG TERM BORROWING (INCLUDING	
OD, INT& OTHER CHARGES)	1050
BANK BORROWING FOR WC	
(OVERDRAWN BY Rs 100LAKHS)	350
RESERVES AND SURPLUS	650
EARNINGS BEFORE INTEREST AND TAX	105
INTEREST ON LONG TERM BORROWINGS	183075
INTEREST ON BANK BORROWINGS	63
TAX RATE APPLICABLE	**35%**

The company has been incurring cash losses for the past 4 years due to which its capital is completely eroded. The company has been defaulting on long-term loans, which have piled up significantly. Working capital limits are irregular due to interest debits from time to time. Though the company is in operation, due to the hung debt burden, the company will soon put up for liquidation. A restructuring has been worked out as follows to keep the afloat and solvent.

There would a capital reduction to write off the existing capital completely against the accumulated losses to the extent of Rs. 500 Lakhs. There would be fresh capital contribution of Rs. 500 Lakhs, which would partly, used to write off the balance-accumulated losses to the extent of Rs. 150 Lakhs.

The long-term loan would be written down by 30% and would carry an interest rate of 12%. There would a moratorium of 18 months for repayment of the principal. The working capital; would be regularized to the present level of Rs. 350 Lakhs with reduced interest rate reduction for the past 4 years at 12.5%. This would release additional working capital to the company of around Rs. 75 Lakhs.

The company is looking at a revival business plan by cutting costs, diversifying portfolio and aggressive marketing strategy, as better recovery management. It hopes to make EBIT of Rs. 250 Lakhs on existing scale of business without the need for fresh capital investment in the medium term.

Comparative table for the impact of the debt restructuring on the company's financial is given below:-

BEFORE RESTRUCTURING	**Rs. Lakhs**	**Rs. Lakhs**
EBIT		105
LESS: INTEREST ON LONG TERM		
BORROWINGS	183.75	
LESS: INTEREST ON BANK		
BORROWINGS	63	246.75
PROFIT BEFORE TAX		141.75
INTEREST COVER(TIMES)		0.42
DEBT - EQUITY RATIO		NEGATIVE
INTEREST/EBIT (%)		235%
AFTER RESTRUCTURING		
EBIT		250
LESS - INTEREST ON LONG TERM		
BORROWINGS	88.20	

LESS - INTEREST ON BANK		
BORROWINGS	43.75	131.95
PROFIT BEFORE TAX		118.05
PROVOSION FOR TAX @ 35%		NIL
PROFIT AFTER TAX		118.05
SHARE CAPITAL		350
LONG TERM BORROWINGS		735
BANK BORROWINGS		350
INTEREST COVER(TIMES)		2.27
DEBT EQUITY RATIO		1.57
INTEREST/EBIT (%)		**43.98%**

The above example explains the need to reduce capital, write off existing debt, interest relief to some extent, and other concessions to make the company viable and financially solvent. Nevertheless, what is prime and utmost important is determining the

Viability of the unit before the exercise undertaken. It has to be assessed with reasonable certainty that given some financial breathing space the business has a potential to turn the company around.

Aspects towards the above are taken into account in rehabilitation of potentially viable units under the provisions of SICA act and also under CDR. Having said this, we should be aware of the accounting treatment from the point of income recognition, provisioning requirements and what effect it has on the bank, which are discussed hereunder.

RBI has already given the guidelines towards TREATMENT OF RESTRUCTURED ACCOUNTS for the purposes of asset classification, income recognition and provisioning requirements. The guidelines issued by RBI for restructuring were applicable for all industrial advances. However, RBI came out with their guidelines separately for accounts with outstanding of Rs. 20 Crores and above under CORPORATE DEBT RESTRUCTURES MECHANISM.

The guidelines have been issued with two prime objectives:

- ⇨ To help the industries tide over the liquidity problems arising out of economic slow down/recession, by going in for restructuring of their liabilities. To help the lending institutions to restructure their borrower accounts thus ensuring a predetermined rate of return throughout the repayment period with minimum provisioning requirements.
- ⇨ The restructuring exercise can be attempted either for STANDARD or SUBSTANDARD accounts. In the context of restructuring of the accounts, following are the stages when the same could be attempted.
- ⇨ Before commencement of commercial production.
- ⇨ After commencement of commercial production but before the asset has been classified as substandard.
- ⇨ After commencement of commercial production and after the asset has been classified as substandard.

17.3 RESTRUCTURING GUIDELINES

The following are the salient points of restructuring guidelines.

Only standard and sub standard assets are permitted to be restructured, where repayment of the dues is reasonably is assured. RBI's intention is to keep the doubtful and loss assets out of the restructuring mechanism as assurance of repayment is absent in such cases. (RBI has permitted the same in the case of CDR). As per RBI guidelines, rescheduling of interest element, rescheduling of installment of principal, sacrifice in respect of past interest dues by way of a write off at the time of restructuring would not cause down gradation of asset, subjective however, to compliance of the conditions set out therein.

These provisions would enable the lending institutions to undertaken restructuring of their borrower accounts depending upon on the merits of each case, thus avoiding large provision requirements the assets would have otherwise attracted due to down gradation of the asset consequent to restructuring. For the purpose of restructuring of the borrower accounts, the guidelines provided by RBI for income recognitions norms are enumerated hereunder:

17.3.1 TREATMENT OF RESTRUCTURING STANDARD ASSETS

Rescheduling of the installments of principal alone, at any of the stages i.e., before commencement of commercial production & after commencement of commercial production but been classified as SUBSTANDARD, would not cause a standard asset to be classified in the substandard category, provided the loan/credit facility is fully secured.

A scheduling of interest element at any of the stages i.e., before commencement of commercial production & after commencement of commercial production but before the asset has been classified as SUBSTANDARD, would not cause an asset to be downgraded to the substandard category. However, this is subjected to the condition either that the amount of sacrifice if any, in the element of interest, measured in present value terms, is written off or provided for to the extent of the sacrifice involved.

To know the quantum of sacrifice, the future interest dues, as per the original loan agreement in respect of the account should be discounted to the present value at a rate appropriate to the risk category of the borrower and compared with the present value of the dues expected to be received under the restructuring package, discounted on the above basis. The intension of RBI in stipulating such a requirement must be that the lending institutions ensure an effective and uniform return on the asset at the restructured interest rate throughout the repaying period. By making provision at the discounted value as previously mentioned for future interest, the yield on the asset is kept constant during the entire repayment period. RBI guidelines do not require for making provision for principal repayments at the discounted value. By this, RBI has ensured the time value of money.

17.3.2 TREATMENT OF RESTRUCTURING SUBSTANDARD ACCOUNTS

Rescheduling of the installment of principal alone, would render A SUBSTANDARD ASSET ELIGIBLE TO BE CONTINUED IN THE SUB STANDARD CATERGORY for the specified period, provided the loan/credit facility is fully secured.

A rescheduling of interest element would render a subsequent asset eligible to be continued to be classified in the substandard category for the specified period. However, this is subject to the condition either that the amount of sacrifice if any, in the element of interest, measured in present value terms, is written off or provided for to the extent of the sacrifice involved. Even in cases where the sacrifice is by way of write off the past interest dues, the asset should continue to be treated as sub standard.

To know the quantum of sacrifice, the future interest dues, as per the original loan agreement in respect of the account should be discounted to the present value at a rate appropriate to the risk category of the borrower and compared with the present value of the dues expected to be received under the restructuring package, discounted on the above basis.

CHECK YOUR PROGRESS

1. The restructuring exercise can be either for ________ or __________
2. The company has brought in __________ as unsecured interest free loans that would only strengthen and augmented cash flow.
3. The firm has the potential to improve its EBIT to at least __________ immediately it is has sufficient working capital.
4. The RBI stipulated to the lending institutions ensures that uniform return on the asset at the ________ throughout the repaying period.

LET US SUM UP

Asset Reconstruction Fund playing an important role in the credit management. RBI has already given guidelines towards treatment of restructured accounts for the purpose of asset classification, income recognition and provisioning requirements reconstruction exercise can be attempted either for standard or substandard accounts. A restructuring has been worked out to keep the afloat and solvent.

GLOSSARY

Adhoc sanctions means the main driver for debt restructuring in such companies is their inability to adhere to the due dates for payment of interest and principal on their borrowings.

Debt restructuring indicates a healthy company would want to restructure its debt portfolio by substituting existing high cost debt with fresh low cost borrowings.

Insolvent company means that the companies cannot service their debt obligation with the available assets, as capital employment has already shrunk due to operational losses suffered.

Sub standard asset is a rescheduling of interest element would render a subsequent asset eligible continued to be classified in the substandard category for the specified period.

Treatment of restructured accounts for the purposes of asset classification, income recognition and provisioning requirements.

ANSWERS TO THE CHECK YOUR PROGRESS

1. Standard accounts or Sub-Standard accounts
2. Rs. 100 Lakhs
3. Rs. 150 Lakhs
4. Restructured interest rate

MODEL QUESTIONS

1. Discuss the asset reconstruction fund.
2. Explain the Debt restructuring for an insolvent company.
3. What is debt restructure mechanism?
4. Explain the RBI guidelines towards standard and sub-standard accounts.

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TAMILNADU OPEN UNIVERSITY

B.COM., Bank Management (BBM - 23)

CREDIT MANAGEMENT

Model Question Paper

Time: 3 Hrs **Max Marks: 75**

Part - A

Answer any THREE **(3 x 5 = 15)**

1. What are the advantages of Bank credit to borrowing Companies?
2. Write a brief note on “Guarantee”
3. What are the legal documents called for lending to an individual?
4. What are the special features of self-employed loan?
5. What are the functions of Debt Recovery Tribunals?

Part - B

Answer any FOUR **(4 x 15 = 60)**

6. Discuss the different types of credit in India.
7. What are the documents required for lending to partnership?
8. Explain the objectives of priority sector lending.
9. Explain the different types of agriculture loans.
10. What do you mean by Funds Flow statement? Draft a format of funds flow statement.
11. Discuss the causes of NPA.