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## **Dissection of Bank Credit Facilities and Remedies**

**Kritika Khurana**

Assistant Professor, Maitreyi College, University of Delhi, India

**Abstract:**

*The facilities given by banks such as loans and overdrafts are sanctioned for future use of the customers and accordingly projections are called from the customer and are accepted if no discrepancy is found in the paperwork and the bank finds the customer fit to repay the amount, while it should be thoroughly scrutinized in the light of monetary and economic cycles of the industry, growth of complementary and substitute products, new inventions in the field. The banks have to perform the Dissection of credit facilities extended to borrowers and have to analyze whether Fund Based and Non Fund Based facilities extended are properly assessed and need based facilities are extended to borrower. It is utmost necessary to ensure end use of facilities extended, whether used for the business purpose or diverted to other areas.*

**Keywords:** *Non-Performing Assets, RBI, commercial banks, fund based facilities, non-fund based facilities, term loan, overdraft, packing credit, bank facilities*

### **1. Introduction**

Every country has a Central Bank known as Banker's Bank or Government Bank to support the Government, to regulate and monitor the economy's financial system in appropriate manner and maintain foreign reserves to achieve the higher GDP and to regulate the inflation trend and money supply in the economy. The objective is achieved by announcing the monetary policy according to status and strength of Business Cycles and regulate monetary demand and supply by applying various tools to regulate commercial banks.

The RBI has permitted banks to have their own interest rates for Deposits as well as for Lending. Banks are further instructed to have the Base rate (according to their cost of funds including some profit) below which they should not Lend. Banks have to regulate their lending to various sectors i.e. priority, on-priority according to RBI norms. Banks are advised by RBI to KNOW THEIR CUSTOMER (KYC). KYC norms are for proper identification of Bank's customer i.e. they are having proper Identity and they don't belong to unethical group, names not appear in Defaulter List or terrorist group.

The primary function of Commercial Banks is to accept deposits and after compliance of CRR (Cash Reserve Ratio) and SLR (Statutory Liquidity Ratio) norms balance amount is lent to borrowers for Business purposes. Every Bank has a department of Assets Liability Management – ALM. It manages funds flows of the bank. The banks generate income by extending Fund based and Non fund Based facilities. In case account become stressed asset and become Non Performing Assets (NPA), Banks suffered loss of income on one side and provide provision out of income generated for NPA. Further Banks capital adequacy ratio is affected and Banks have to induct further capital for growth of business.

We have to perform the Dissection of credit facilities extended to borrowers and to analyse whether Fund Based and Non Fund Based facilities extended are properly analysed, assessed and need based facilities are extended to borrower. It is utmost necessary to ensure end use of facilities extended, whether used for the business purpose or diverted to other areas. If every activity of borrower is effectively performed than it is necessary to analyses that why sudden mortality occurred in the standard account. Borrower business operations might be effected by market trend or change in economic scenario and which may affect the health of the account and its daily operations will gradually be affected, but not sudden mortality of account will occur. It shows some deficiency in Banking system of assessing need of the customer or monitoring of account is not upto the mark.

The banks are following old traditional methods to extend credit facilities without changing the modalities of assessment and credit format on the one side and controls and monitoring are unable to stop the syphoning of funds by borrower by using loop holes of the system. The account become Non Productive asset and banks sink further to retain the account as standard by extending corporate loans or extend repayments periods to camouflage its classification, instead of treating immediately its sickness or to recall the account and take over its management by transferring shares in its name and hand over its management to effective professionals / competitors engaged in the industry.

- Banks Are Extending Fund Based and Non Fund Based Facilities According to Need of the Business and We Will Carry Dissection of Credit Facilities extended Corporates to Ensure Its Lacunas and Find out the Remedies to Improve upon the System of Lending and Its Follow Up, as under:

**Meaning of**

1. **FUND BASED FACILITIES:** All facilities extended in which Banks are out of funds for procuring capital assets or to supplement working needs of the borrower is Known as Fund based facilities the Banks extend the FUND BASED facilities in various forms (asunder):
  - a) **Term Loan:** The facility is for procuring fixed asset or otherwise and repayment period is more than 3 years according to repayment strength and asset procured is charged to the Bank.
  - b) **Demand Loan:** Usually against cash securities i.e. CDR,NSC, LIC etc. for less than 3 years and repayable on maturity of security. The cash securities are charged with the bank.
  - c) **Over draft:** The limit is marked against the cash securities in the account of the customer and upto that amount the account can be overdrawn. The securities are charged to the bank.
  - d) **Cash Credit facilities:** The banks permit mostly this facility for day today need for operations of the business against the stocks and debtors of the business. The borrower submits the stock statement monthly with details of stock, debtors and creditors and level of activity during the month. Banks after reducing the margin from paid stock and/or Receivables permit the Drawing Power in the account and upto that extend or with in the limit sanctioned, whichever is lower, borrower can overdraw the account. Simply we can say it is Overdraft account with limit and securities are stocks and receivables instead of cash securities.
  - e) **Trade Bill Discounting:** The Borrower sells the goods on credit and requires the facility against the same as working funds are blocked therein. If we are not extending the Cash Credit facility against receivables than we have the better method to finance in the form of Bills discounting.  
 Here Bills implies the set of documents containing invoices, packing list, dispatched receipts i.e. Lorry receipt, railway receipts, Bill of lading etc. along with the Bill of Exchange mentioning the due date and duly signed by the buyer of goods. The same set of documents are discounted called as Bills discounting by Bank. These documents are with Letter of Credit or Without Letter of credit issued by Buyer's Bank. The documents are sent to Buyer's Bank to get the confirmation of due date and after receipt of same discount the bills and after deducting the commission and interest of intervening periods' credit the proceeds in seller account.
  - f) **Foreign Bill Purchased (Similar to inland Bills):** Foreign bills are drawn as soon as export is made to overseas buyer. The Bills are discounted and Packing credit extended against that order is adjusted and balance amount is released to their current account. On due date the Bills discounting account settles after receipt of payment from the buyer.
  - g) **Packing Credit:** It is the facility extended to exporters of goods, where by exporter get the facility sanctioned and limit is marked. As soon as the exporter submits the Copy of Order or Letter of credit received from abroad, Amount to the extent of 75% to 90 % is released to his account after ensuring the genuineness of the order / LC so that the exporter can make the consignment ready to be exported. The Packing credit is adjusted out of sale proceeds / Foreign Bills discounting.
  - h) **Retail Schemes:** Banks nowadays, tailor maid schemes for different retail products like education loan, car loan, housing loan, property loan, etc. The objective is to spread the loan to numerous customers so that risk of sinking of substantial amount in one go is reduced.
2. **NON- FUND BASED:** These are those facilities extended to customers, where by Banks use their credit worthiness and issue simply letters of credit, solvency certificates, guarantees on behalf of customer to other parties and give undertaking that in case of noncompliance of commitment by the Bank's borrower than they will honour the commitment for which they have issued the letter. In case borrower is not able to full fill its commitments, the holder of LC/Bank Guarantee etc. devolve or invoke the same and at this stage it become fund based liability and It is Bank's liability to pay the amount to beneficiary. Bank claims the amount from its customer and if customer fails to repay than it is Banks Loss. Similarly, in foreign trade LC, Guarantee, forward booking, etc. non fund based commitments are generated against which Bank earns commission, fee etc.

*1.1. Facilities and their Assessment*1.1.1. Fund Based Facilities

The assessment of fund based facilities as mentioned above is based on past trend of the customer financials, operations of accounts, holding of collateral/ primary / personal guarantees in the account on the one side and estimations/ projections submitted for future to justify the requirements. The facilities are based on traditional methods and practice and customers are used to draft the data accordingly. No effective system of lending and monitoring is created with the changes in the environment.

1.1.2. Non-Fund Based Facilities

According to nature of the business, weather contractor, importer, exporter, manufacturer or engaged in any trading activity. The periods of business cycle involved, gestation period, credit available or tendering for further contracts are the key factor for the assessment. The periodicity of credit purchases, its lead period and available market credit are considered as base to decide the LC facility limit. Borrower engaged in construction business as contractor than works in hand, expected contract for bidding, retention and mobilization advances become key factor for deciding the guarantees facilities requirement.

The non fund based facilities not falls under maximum permissible Bank finance except Letter of Credit on DA basis, since Letter of Credit on DA basis substitute the creditors of the party by Letter of Credit facility.

## 2. Dissection of Assessment and Utilisation

The following points generate the anomaly between assessment and utilization of facilities

### 2.1. Term Loans

- i. While assessing the Term Loan for machines, Roads, Heavy equipment, we are considering the landed cost at factory, repayments based on projections so that Debt Service Coverage Ratio covers the repayment of interest and principal. The projections submitted are not deeply analysed based on business cycles, growth of other units in the same industry, technological developments in the same line. Like Manufacturing of CD/DVD (now pen drives are used), solar energy / solar panels / thermal power stations, refineries, photo shops based on film developing and printing. The due emphasis to scrutinize the projections is never given while assessing the limits based on projections only.
- ii. Do we have analysis of technicalities of units to be purchased and synchronizing with existing chain of productions? Since loan manager is not technically expert to judge the costing, requirement of additional infrastructure, technical specifications and the associated machines required, best supplier of the same, impact on sales of other products manufactured by company, futuristic projections are never considering in the light of business cycles. Same is with other industries where specialization machines having no value in case of default because they are equipped for specified utility/ function as per specification having only scrap value in case it is to be sold in the market. While making risk analysis, rating etc. due weightage is not given to these factors. Similarly, amount spent on construction of building, chimney of power house or other construction at site having no value till it is completed and bill is submitted for payment. we never evaluate such risk while assessing the facility / rate of interest / collateral securities requirement.
- iii. Valuation of collateral securities is considered as market value/ realizable value, which is comprising the accounted and unaccounted money, while in reality properties to be evaluated at circle rates only to have the prudential decision of the case. As observed generally that during realization of properties held as collateral security, when account become Non Performing Asset, no amount is realized more than circle rate even less than that.
- iv. Although technical evaluation and chartered engineers are entrusted with the work, but not effective to monitor the progress or end use of funds. More emphasis or monitoring is required to ensure the end use of funds, over or under invoicing is not in the project. Why not the bank deploys technically experts on bank pay roll at the site, to monitoring all activities at construction site and funds be released in consultation with him only.
- v. While assessing viability of Term Loan, and repayment period requested by borrower Debt Service Coverage Ratio are determined according to profitability. In case of excess profitability i.e. high Debt Service Coverage Ratio, repayment period is never reduced,

### 2.2. Demand Loan

- i. Demand loan against cash securities are extended to customers and it is primary duty to ensure securities are genuine and bank right to recover the same exist. Many a times, facilities. The purpose of loan is many a times not for business. Securities like many LIC policies, CDR eligible for TAX benefits are not eligible to be pledged, but loans are extended.

### 2.3. Overdraft

- i. Similarly bank extend overdraft facilities against cash securities, whereby limit to the extent the borrower can overdraw is marked on the account after considering value of securities. The facility to be used for business purpose and it is to be ensured that securities are pledged properly in favour of the bank.

### 2.4. Cash Credit

- i. The assessment of Cash Credit facility is assessed up to a extend of facility say Rs. 5.00 crores, by most of the Banks on turnover/sales basis. Generally accepted that unit is having working capital requirement of 25 %, i.e. the business cycle is of 3 months. Borrower has to contribute 1/5 of working capital and Bank will finance 20 % of turnover.
- ii. As Assessment is related with turnover and Drawing Power should be related with turnover i.e. how much sales in the month (cash +Credit ), how much deposited in the account, after deducting promoters margin how much Drawing Power is to be permitted. But in practice call for stock statement, permitting Drawing Power on the basis of Stock statement instead of in relations to sales achieved as projected
- iii. Never analyse the cycle of the trade i.e. Petrol pump is having mostly cash sales, while credit is available of 2 to 3 days being clearance of cheques issued. Funds required for credit sales which is settled on monthly basis. Providing Working Capital for 3 months are not justified.
- iv. If requirement of Bank finance is more than Rs. 5.00 Crores than most of the banks are using Traditional method of assessment, where by based on the projected sales, different level of current assets are assessed considering the past holding periods. The Current assets considered for assessment includes cash in hand and Bank Balance, FDR, etc. While providing Drawing Power only stocks, receivables and creditors are considered. No consideration for other current assets / there level of holding / other outflow / inflow of funds which are not projected earlier are considered while extending Drawing Power in the account.

- v. While assessing the limits / viability of the unit irrespective of industry by using ratio analysis. The figures of financial statements of current year with last two/ three years' data is analysed. The ratios mostly considered are current ratio, Returns on capital employed, liquidity ratio, debt equity ratio, leverage, debt collection period, credit period available.
- vi. Do we really analyse the financial statement in depth? How can be set of ratios will analyse the status accurately of all industries ? In seasonal industry, in leasing hire purchase business, in specialized industries we require to analyse the capital structure of the unit, financial leverage in relation to Breakeven point, also consider the equipment held on leasing or hire purchase while analysing fixed assets turnover ratio Our emphasis be on type of industry involved, Future risk of technology growth, cause and effect of various factors during the year in the financial statements and nature of facilities requested. The projections submitted be considered in light of futuristic approach instead of past trend.
- vii. The monitoring tools are QIS (quarterly information system) whereby party submits 3 forms i.e. Form I (projections for coming quarter, level of sales, current assets – current liabilities and bank finance required) Form II for actual achievements during the quarter ended. The analysis is required to compare the form I submitted earlier for the quarter and actuals achieved based on the same, operating limit be fixed for the upcoming quarter. Practically forms are collected and filed and there is no analysis of the same and moreover provisions to fix up the operating limit in the system not exist. More emphasis is required in respect to data submitted in form II be compared with the transactions in the account with the bank, its nature etc., physical verification report facts in comparison to data in form II, sales routed through account, change in industry scenario.
- viii. Stock statements submitted, its annexure, items eligible for Drawing Power are not compared with the earlier statements to review the basic changes in composition of stocks, WIP, debtors. Balance confirmation from debtors are not obtained, items of purchases and its uses in the business are not analysed.
- ix. The limit of Cash Credit is used by clients of the bank as term loan without repayment. No condition imposed to reduce the limit at least by level of profitability during the year. The emphasis is given to reduce the business cycles so that with growth the funds requirement be reduced and working capital limits be reduced.
- x. Cash Credit limit be bifurcated with level of sales achieved as projected and it should be specified for sub limits for production of units/ raw material, Sales / debtors, Debtors Bills discounting, purchases / purchase bills discounting.
- xi. Generally, unit visits are tie up with prior information with the client so that proper arrangements and staff available to show the records. He manages the show in such way that everything seems to be true and fair, production is in process, stocks are sufficient to cover the Drawing Power, where he feels lacuna data, computer system becomes out of order. Banks should have surprise unit visits without information, logical data correlation of production, stocks, sales realization's, internal controls, power consumption and level of output indicated be analysed. The emphasis be more to analyse the work culture of the unit, its system and procedure of recording daily output, internal movement of goods, recording of stocks in ward and outward, security records, payment of statutory dues, copy of Vat returns, internal audit reports, etc. Interaction with workers, supervisor at shop floor will reveal some facts to be taken care.

### 2.5. Trade Bill Discounting

- i. Though the facilities are for genuine trade transactions but many a times used as accommodation bills discounting to accommodate financial needs. The bill of exchange accompanied with papers areas per sanction to the party. The transport receipt is the main document ensuring the transportation of goods The transportation receipt submitted along with the bills are generally not as per approved IBA list Banks not get the same verified from transporter. Bills may be under Letter of Credit also, where by creditability of buyer is not ensured and seller of goods avails the funds by discounting bills from any bank only parting with small amount of brokerage to other party.  
The confidential reports of the opener of Letter of Credit i.e. buyer of consignment is generally not called to ensure genuine business transactions.  
In FUDBP/FDBP i.e. Foreign usance documentary bills discounting / Foreign documentary bills discounting under order / Letter of Credit are used as tools to show the fulfilment of export commitments in fact the transactions are based on brokerage system i.e. Beneficiary approach the Broker to open the Letter of Credit in his favour, dummy goods will be exported, on due date of payment of bills, amount is remitted by illegal means to opener of Letter of Credit and transactions are settled. Banks are not taking due care and skill to deny such transactions.

### 2.6. Packing Credit Facility To Exporters

- i. The facility is extended to exporters as concessional rate of interest. The facility is also covered under ECGC schemes. The banks assess limit under traditional method based on nature of activity, production and export cycle involved, industry etc. The facility is extended as running account facility or order to order basis. The facility is extended like Cash Credit account with only difference that here no Drawing Power is marked rather quantum of valid export orders / Export Letter of Credit in hand. The overdrawing in the account, is allowed upto 75% to 90 % of orders. The facility end use is never ensured except the follow up of exports / renewal of orders.
- ii. "Running account" facility, under which amount is credited in his account as soon as he submits the copy of order or Letter of Credit. No system to match the Packing Credit allowed against which order from which party and export made to which party. Say Packing Credit account is used as Overdraft account by placing copy of order. Although permitted by RBI but monitoring by maintaining ancillary records are never done as to Credit Report of the party to whom exports are made, their worthiness, whether related / associated company of exporter or not, the status of the order, advance received against the

same, stage of physical progress of orders to be called on monthly basis, to be visited the site to verify the same. Nothing in this regard is done while extending the facility.

- iii. Should have only system of extending facility against one to one order after ensuring Credit worthiness of importer, genuineness of goods exported at current prices of the goods prevailed (under billing be traced with advance received from abroad)
- iv. Regulatory liberty to boost exports, lead to unauthorized financial transactions. Monitoring of such advances is required but not done as desired.

#### 2.7. Non Fund Based Facilities

- i. Although facility extended not involves fund instantly. The due follow up or understanding of language used in Bank Guarantee is not given due emphasis to decide whether it is financial Bank Guarantee (Bank Guarantee given in lieu of cash commitments / cash received) or performance Bank Guarantee (Bank Guarantee extended to ensure that quality of work or items supplied / guarantee of performance of job within work schedule).
- ii. The trail of transaction for which guarantee is required, ultimate liability which the bank has to pay over and above the Bank Guarantee value, i.e. is there any interest or penalty clause in the text of Bank Guarantee, if yes than evaluation of such part is to be added to the value of the Bank Guarantee, generally not done.
- iii. It is the language of Bank Guarantee which will reveal whether Bank Guarantee is used in lieu of Letter of Credit or Finance borrowed and to ensure its repayment with interest.e.g. As External Bank Borrowing (ECB) loans have certain restriction and your account holder come with a request to issue Bank Guarantee in favor of foreign buyer, who will give 100% advance and order to be completed within one year. In case order is not completed than whole amount along with interest @ 9% be remitted back. Shows it is ECB from other regulatory method.
- iv. Stand by Letter of Credit is used by many importers to draw the amount from overseas lender at cheaper rate and making Fixed deposits of same in India at higher rate to generate gain by using the system.

### 3. Conclusion

The banking sector is facing the surge of Non-Performing Asset because of methods of assessment followed to sanction the credit facilities and methodology used to monitor is not synchronized appropriately. The method of permitting facilities within sanctioned limits is not scrutinized to ensure end use. The facility is used honestly for the purpose for which it is sanctioned. The facilities are sanctioned for future use and accordingly projections are called from the customer and accepted, while it should be thoroughly scrutinized in the light of monetary and economic cycles of the industry, growth of complementary and substitute products, new inventions in the field. Data bank should be developed predicting the demand and supply of various industries. Better quality of financial analysis and monitoring tool be developed with changing scenario of digital world and business outlook. The regulatory authorities like RBI, Finance ministry, planning department should play proper role to support and monitor effectively.

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