

A Study of Credit Appraisal Process at Bank of Maharashtra

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ABSTRACT

This study examines the credit appraisal process and repayment of Bank loans at Bank of Maharashtra. Specifically the study investigates the appropriateness of the credit appraisal process of Bank, the relationship between loan officers and customers and the effect of loan officer – customer relationship on the credit appraisal process. The study also identifies strategies to help improve the credit appraisal process of the Bank.

Finance is required at every stage of business either for meeting day to operations or for starting up a new project. One of the important sources of raising finance is loans from banks. Commercial lending is one of the prime functions of any bank. But how does the bank appraise the creditworthiness of a borrower? What protection can the borrower provide the bank in the event of him/her unable to meet the agreed obligation? What are the criteria to be fulfilled for granting loans? What are the tools used by the banks to appraise the loan proposal? These questions are being answered in this paper. This paper describes the credit appraisal process of personal loan followed in Bank of Maharashtra.

1. Introduction

Any investigation done by bank before providing any loans & advances/ project finance & also checks the commercial, financial & technical viability of the project proposed its funding pattern for recovery of such funds.

Credit appraisal is a holistic exercise which starts from the time a prospective borrower walks into the branch and culminates in credit delivery and monitoring with the Objective of ensuring and maintaining the quality of lending and managing credit risk within acceptable limits.

Credit appraisal is an assessment of the various risks associated with repayment of the loan and analysis of credit worthiness of prospective customers. It is important from the borrower perspective of banks or financial institutions to analysis the loan proposal. The borrower believed that banker does not understand his/her credit requirements. From the banker's perspective, the banker may have a bad experience with similar type of borrowers who defaulted and would follow more stringent lending policy. It is most critical to mitigate risk by the banker, to lend the loan to the right customer through proper assessment or appraisal of the proposed loan.

A personal loan is a form of debt given to an individual by the banks or financial institutions without security or collateral by the borrower for the purpose of personal needs, such as durable goods, education, medical care, marriage and other expenses. Here we are going to study credit appraisal of personal loan of Bank of Maharashtra. Following are the norms which are followed in IDBI Bank Ltd.:-

Credit appraisals for any organization basically follow the following process:

STEP1: Application of the applicant / borrower

The process of credit appraisal initially starts with application of the applicant/borrower, who intends to take loan from the bank. The application should consist of the how much amount of loan the borrower needs, the details of the applicant like name of the applicant, age, income, number of dependent, nature of employment, work experience, repayment capacity, purpose of loan, applicant's experience /qualifications, applicant's social and financial standing and political environment.

STEP2: Due Diligence Process

Due diligence is a continuous process through which bank evaluates a target client for taking financial exposure as also to ensure asset quality. It involves interview with the Applicant, Pre-sanction inspection, Market enquiries/ Information, Banking Arrangements, Credit Score, Scrutiny of Financial Statements, Industry reports, External Credit Rating etc. Pre-Sanction visit is a very important step. Visit should be carried out to the borrower's residence and project site/farmland to collect/ cross check the necessary information about the genuineness of the applicant, documents submitted as also his credit requirement. A visit report shall be prepared covering details of observations and kept on record.

STEP 3: Assessment/ Appraisal

Credit assessment is done by taking into account all the merits and demerits of the proposal. The process should be used to arrive at exact requirements of the client, his repayment capacity, market conditions and other relevant factors as also to get a view on securities to be stipulated depending upon anticipated risk of each proposal. Credit Score/Rating of proposal is arrived based on the compliance of various parameters by the applicant which helps in assessing the credit risk. More than anything else, the Appraising Officer

should be satisfied about the bankability of the proposals that he appraises.

STEP4: Sanction/approval of proposal by appropriate sanctioning authority

The Appraising Officer should ensure that all required details are available and furnished in the appraisal note based on which the decision will be taken by sanctioning authority. The proposal when submitted for sanction should be accompanied by the Pre-sanction Field Inspection Report. The sanctioning authority shall go through the application/ papers submitted thoroughly.

STEP5: Issuing of Sanctioning Letter:

On the receipt of the sanction of the proposal by the appropriate authority, sanctioning letter is being issued, incorporating various terms and conditions, repayment schedule, security etc. as stipulated by the sanctioning authority. This is an important document as it conveys an offer from the Bank along with its governing terms and conditions. It should be recorded in the application received and disposed register/ Tracker mechanism.

STEP6: Documentation:

Loan documents are based on the type of the facility sanctioned and security stipulated for the loan. Facility document covers the terms and conditions of sanction whereas security documents are obtained for creation of security as per sanction. In the normal course, documentation is done at the branch in the presence of branch official. Once documents are executed, the same should be entered in the "Documents Register" and details of security creation are recorded in the "Security Register". Security documents executed by the borrower are subjected to vetting by panel advocate as per extant guidelines and must be kept valid and enforceable at all times by obtaining revival letters/ acknowledgement of debt from time to time. Safe custody of documents is to be ensured at the branch.

STEP 7: Disbursement of loans:

Release of Sanction limit shall always be supported by borrower's 'request letter'. In case of Cash Credit, request letter may be obtained at the time of initial limit set up and renewal. In case of Term Loan, each disbursement shall be supported by separate request letter. Disbursement note is prepared to certify compliance of the conditions stipulated in sanction. If not, the matter should be brought to the attention of sanctioning authorities and their directions sought before release of any amount.

2. Literature Review

- ❖ According to Banking Strategy, Credit Appraisal and Lending Strategies by Author(s): (1990) Hrishikesh Article Section Pacific Business Review International Bhattacharya "Analyses lending strategies, credit appraisal, risk analysis and lending decisions keeping in mind the broad framework of corporate banking strategy, and helps us understand better the vast and significant changes in the financial market. Numerous examples from the world of business have been provided to facilitate better understanding".

- ❖ Credit Appraisal of Banks by SathyaVarathan, PriyaKalyanasundaram and S.Tamilenthi"(1991) Credit Appraisal is a holistic exercise that starts from the time when a prospective borrower walks in culminates in credit delivery and monitoring with the objective of ensuring and maintains the quality of lending and managing credit risk within acceptable limits. Credit Appraisal determines whether to accept the proposal or not. There are two types of projects that are received by the banks for the funding purpose. The first is starting of a new project or setting up a new company, the second one is for its working capital needs.
- ❖ In "Credit is inevitable in banking by Dr.RamJassYadav" (2001) Credit risk basically means the risk of default made by a customer owing to non repayment of the credit that he had obtained from the bank. Thus a proper evaluation of the customer that measures the financial condition and ability of the customer to repay the loan taken from bank. Credit appraisal, primarily is a process of collecting information related to the customer and thus assessing the risk involved for the bank by checking the technical, financial & economical viability of the project. A major step towards this is the verification of the primary & collateral security that is available with the banks for security purpose or rather recovery purpose.

3. Need of the study

- It provides insights of the credit appraisal process for various kinds of loans.
- An important need of appraisal is obtaining an understanding of the anticipated expenditure and benefits of a project, usually expressed in terms of its inputs (costs) and outputs (results).

4. Scope of the study

- This report provides a wide view of the different stages of credit appraisal system of the Bank, starting from the loan application to loan disbursement.
- Appraisal is an important decision making tool
- Appraisal involves the comprehensive analysis of a wide range of data, judgments and assumptions, all of which need adequate evidence. This helps ensure that projects selected for funding.

5. Problem Statement

To study the Credit Appraisal Process at Bank of Maharashtra. The main function of the banks are mobilizing of funds and lending the same to the needy. The difference between both is the interest rate which is the profit for the bank. Bank will be safer only till all the borrowers pay their due in time. Once a bank borrower/counter party fails to meet the obligations on agreed terms, becomes credit risk for banks to recover those loans and advances made.

6. Objective

- To study the meaning and importance of Credit appraisal
- To study the procedure of obtaining loan from Bank.
- To study and understand the terms and conditions of sanctions and advances
- To study the credit appraisal process

7. Limitations of the study

- Limitation of time was one of the most important factors for collecting data. A longer time period would have ensured to collect more information in details.
- Every organization has some secret that is not exposed to others. While collecting data by face to face conversation with the officers they did not discuss much information which was related to the investment process.
- Due to lack of experience, there is a chance of having some mistake in the report but best effort has been applied to avoid any kind of mistake.

8. Research Methodology

Research Methodology is the systematic, theoretical analysis of the methods applied to a field of study.

Research Design: Research design is the detailed blue print used to guide a research study towards its objective. It helps to collect, measure and analysis of data. Data constitutes the subject matter of the analyst. The primary sources of the collection of data are observations & interviews. For this project the research design is analytical in nature.

Analytical Research Design: Within analytical research articles, data and other important facts that pertain to a project is compiled; after the information is collected and evaluated, the sources are used to prove a hypothesis or support an idea. Using critical thinking skills, a person is able to effectively pull out small details to form greater assumptions about the material.

Data Sources: A data source is simply the source of the data. It can be a file, a database on a DBMS or even a live data feed. Researcher need to consider the sources on which to base and confirm their research and findings. They have a choice between primary data and secondary sources and the used of both, which is termed triangulation, or dual methodology.

Primary Data: Data observed or collected directly from first-hand experience. For this project no relevant primary data. All data is collected through secondary method.

Secondary Data: The data collected in the past or other parties is called secondary data like manual, Credit policy of the bank, Circulars, Format of appraisal, Bank portal website, Internal reports of the bank etc.

9. Data Analysis and Interpretation

Data analysis is a process for obtaining raw data and converting it into information useful for decision-making by

users. Data is collected and analysed to answer questions, test hypotheses or disprove theories.

❖ Data Analysis of Home Loan

The following example illustrates the procedure and document collected as well as how the amount of the loan has been finalized by the bank.

Mr. Abhishek Gagan wanted to purchase a house whose construction work is completed. The total cost of the house is 24, 40,000 along with other cost. Mr. Abhishek is a salaried person, teacher by profession (Govt. service).

The applicant has given the guarantee of Mr. Kunal Kawale who is family friend of Mr. Abhishek Gagan. The borrower as well as the guarantor has given the following documents.

- Identity Proof (Passport, Driving License, Voter Id, Pan Card).
- Address Proof
- Proof of date of birth
- Pan no.
- Income Tax Return / Form No. 16 for the last 3 months.
- Last salary slip / annual package letter / Current CTC
- Bank statement for last 6/12 months where the salary is credited
- Marriage certificate
- Bank statement of existing loan accounts.
- Personal asset and liabilities statement
- Passbook Xerox

The bank called Mr. Abhishek Gagan for the interview when he applied for the loan to know about his background and after feeling satisfied the bank asked him to provide the documents.

The following information is taken from the applicant

Name of Applicant	Abhishek Gagan
Full Address a) Office	Sant Dnyaneshwar Vidhyalay, kaulkhed, Akola
b) Residence	Laxmi Housing Society, Goarakshan road, Akola
Purpose	Purchase of house
Age of applicant	39
Monthly Income	Rs. 41,310 p.m
No. of dependents	3
Income from other source	-----
Total annual income of the applicant	495.720
Amount of loan applied for	2000000
Maximum loan amount admissible	2000000
Margin Proposed	15%
The applicants outside liabilities	-----
ECONOMICS	
Total Receipts	Rs. 4,95,720
Total expenditure	Rs. 1,75,000

Surplus	Rs. 4,50,000
Net Monthly Income	Rs. 41,310
EMI	240
Interest	10.30%
Year of services	10 yrs
Processing fee	6100

Table 1.1

The cost of residential property and means of Finance

Sources of funds	Amount	Application	Amount
Amount already Invested	3,40,000		
Loan applied for	20,00,000	Cost	23,25,150
Saving in account	1,00,000	Stamp Duty and other charges	1,14,850
Total	24,40,000	Total	24,40,000

Table 1.2

The following information is taken from the guarantor

Name of Applicant	Kunal Kawale
Occupation of Guarantor	Salaried
Full Address a) Office b) Residence	Shop No. 5, khandelwal Nagar, Akola Sudhir colony, Jatharpeth, Akola
Age of Guarantor	40
Monthly Income	Rs. 55,000
No. of dependents	4
Income from other source	-----
Total annual income of the guarantor	6,60,000
Total family expenses	2,20,000
No. of accounts in bank	2
Total amount deposited in bank	10,00,000

Table 1.3

Procedure for EMI calculation

A Eligibility on the basis of margin	Amount
-Cost of unit	24,40,000
-Own contribution	4,40,000
-Loan Amount	20,00,000
B. Eligibility on the basis of Income	Amount
-Monthly income of applicant	41,310
-40% of monthly income	16,524
Rate of Interest	10.30%
Repayment period	20 years
EMI factor for 20 years	0.0103218839
Installment	240
60% of Monthly income	24,786
Present deduction	Nil
Repayment capacity	24,786
Permissible bank finance	24,786
Loan applied for	20,00,000
Loan Recommended by bank	20,00,000
MPBF	20,00,000

Table 1.4

Interpretation:

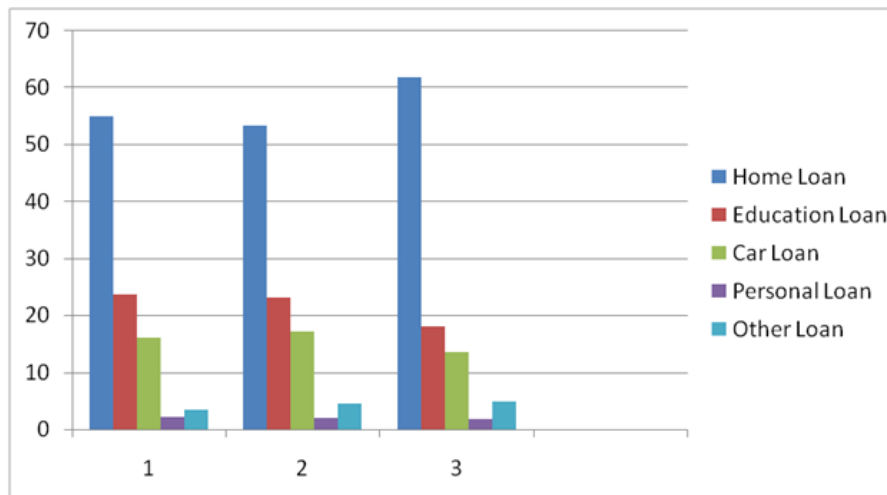
Name	: Abhishek Gagan
Age	: 39 years
Occupation	: Teacher (Govt. Service)
No. of dependents	: 3
Net salary	: 41,310
Purpose	: Purchase a new house
Cost of house	: 24, 40,000
Loan applied for	: 20, 00,000
Credit score	: 93.85%

- Since the applicant has 16 years of service left, fulfills the RBI guidelines and have the credit score more than 80%, the applicant is fulfilling the criteria of housing loan scheme. Thus, the loan is sanctioned.

❖ Loan policy of the bank:**Analysis of last three years:**

Type of loan	2011-12		2012-13		2013-14	
	Amount in Cr. Rs	Percent age(%)	Amount in Cr. Rs	Percent age(%)	Amount in Cr. Rs	Percent age(%)
Home Loan	25.50	54.76	26.50	53.20	41.00	61.65
Education Loan	11.00	23.62	11.50	23.10	12.00	18.05
Car Loan	7.50	16.10	8.50	17.10	9.00	13.53
Personal Loan	1.00	2.15	1.00	2.00	1.20	1.80
Other Loan	1.57	3.37	2.30	4.60	3.30	4.96
Total Loan	46.57	100	49.80	100	66.50	100

Graphical Representation:



Analysis and Interpretation-

- From the above graph it is shown that the figure of personal loan is 1.20 crore in 2013-14 of bank of Maharashtra. Various kinds of loans are provided by the bank. The graph shows that among all the loans maximum demand is for home loan, then education loan then agriculture loan then other loans and last personal loan. It is seen that there is continuous growth in demand for loans each year and least demand is for personal loan.

10. Findings

- Credit Appraisal is the process by which a lender appraises the technical feasibility, economic viability and bankability including creditworthiness of the prospective borrower.
- For year 2013-14 the demand for Home loan is 61.5%, Education loan is 18.05%, Car loan is 13.53%, Personal loan is 1.80% and Other loan is 4.96%. Thus the demand of home loan is the highest.
- Investment is the major revenue generating source of income of the bank, which has a tremendous increasing growth rate. The ratio of classified loan and total investment proves the high recovery rate of the investment division of the bank. Therefore the credit management and credit appraisal system of the bank are excellent.
- Here in this study an assessment of the credit appraisal procedure system of the bank was made and critically evaluated. Some problems were found such as time consuming procedures, lack of skilled officers etc and finally some suggestion are made for improvement.
- Success in the banking business largely depends on effective lending. Less the amount of loan losses, the more the income will be from investment operation the more will be the profit and here lies the success.

11. Suggestion

- An integrated planning should be made to reduce time taken by the credit appraisal procedures of Bank. The officers of the branch level should make a plan for the sequence of activities.

- There is no shortage of skilled officers in investment department but if the HR department arranges training for the investment officers that will make them up-to-date.
- One proper standard procedure should be developed for all types of clients and no interpersonal relationship should be involved in approve a loan
- There is a lack of coordination between Branch and Head office. For this, sometimes Branch investment offices can't able to give loans to their valuable clients. Head office has to give certain level of power to the branch authority, so that they can keep the client for long time.

12. Conclusion

- Banking sectors no more depends on only on a traditional method of banking. In this competitive world now a day's banking sector is wide enough to cover any kind of financial services. The major task of bank is to survive the services in this competitive environment by managing its assets and liabilities in an efficient way. To make the assets specially loan and advances, banks must have to be more careful otherwise this asset will become a burden for the bank
- Usually it is seen that credit appraisal is basically done on the basis of fundamental soundness. But after different types of case studies, our conclusion was such that credit appraisal system is not only looking for financial wealth. Other strong parameters such as borrower's background, industrial background, rating of the borrower's company, availability of resources, risk associated with credit facilities, funding pattern, experience of promoters etc. also play an important role in analysing credit worthiness of the firm/company
- In all, the viability of the project from every aspect is analysed, as well as type of business, industry, promoters, past records, experience, projected data and estimates, goals, long term plans also plays crucial role in increasing chances of getting project approved for loan.

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