Chapter 10
SME Lending Operations – New Approaches

10.0 Introduction

One of the objectives of the study is to suggest various strategies to strengthen the credit flow to the SME sector. In this regard, it is appropriate to examine various lending operations relating to SME lending to identify gaps and suggest for improvement. Towards this end, this chapter deals with SME lending operations.

In general, lending operations include appraisal, follow up of advances, annual review and renewal of limits, rehabilitation of sick units and recovery from borrowers. Reserve Bank of India has been issuing guidelines from time to time to suggest changes in lending norms. These have been issued based on the recommendations of the expert committees/working groups appointed by the Reserve Bank of India. In addition, each bank is working its own internal operational guidelines keeping in mind the broad guidelines of the Reserve Bank of India. Despite these initiatives, there is a felt need to simplify the existing systems and procedures so that SME customers are more satisfied. For availing of bank finance, entrepreneurs have to formulate a project proposal as per the requirements of the banks. Here, the main difficulty of the entrepreneurs, particularly the first generation entrepreneurs is to collect data/information for formulation of the project. At present, they collect the same from various sources. This consumes a lot of time and also proves to be a painstaking job. Often, such data/information is not available at one place. Towards this end, the primary need is to set up an Information Centre which would facilitate them to formulate the project. Further, banks have to offer a need-based finance for which a cash flow-based lending shall be thought of. Further, banks have to ensure the end-use of funds. For this purpose, the existing system of credit monitoring system should be made effective. Similarly, the present system of annual review borrowal accounts should be made more effective by using the available data from SME
borrowers. In the same way, though the number of sick units is on the rise, the success rate in rehabilitation of sick SME units is limited. In this respect, a checklist of Do’s and D’nots has to be prepared. Further, branch managers look for a checklist of all recovery measures which is not attempted. Such checklist would help to choose the appropriate recovery measures. Lastly, SME borrowers do expect Factoring and Forfeiting services and Export finance which are in great demand. Keeping in mind these felt needs, this chapter attempts to suggest certain improvement in lending operations relating SME units. These suggestions relate to 1. Proposal to set up an Information Center, 2. Cash flow based lending, 3. Credit monitoring system, 4. Annual review of a borrowal account, 5. Rehabilitation of sick units- Do’s and D’nots. 6. Recovery measures – A check list, and 7. Factoring, Forfeiting and Export financing

10.1 Information Center

10.1.1 At present, the first generation (new) entrepreneurs have to formulate a project proposal for availing of credit facilities from banks and financial institutions. The process of formulation of the proposal starts as soon as they conceive an idea to set-up an industrial or service unit. The project proposal contains lot of data/information relating to the proposed activity or project. Such data/information relate to potential demand for the proposed products/services, prospects of the industry, requirements of plant and machinery, availability of raw materials, provision for labor, position of electricity, storage and processing facilities, details of land and building marketing arrangements, etc. This list of data/information depends upon activity, size, location, product, etc. In addition, there are numerous formalities to be completed by the entrepreneurs at various Government departments for obtaining the necessary licenses, clearance certificates etc. The entrepreneurs are also interested to know about the potential suppliers of the plant and machinery, raw materials, etc. There are many players in the market about whom the information has to be collected.
More importantly, technology related matters have to be studied by them for which lot of data/information are needed. In this way, the list of their data/information requirements may go on.

**10.1.2** It is a time taking process to collect such huge data/information from several sources. For this purpose, they have to run from pillar to post. Lot of money has to be spent for this purpose. On many occasions, they may not succeed in getting the required data/information despite making several trips to the Government departments. Thus, it has been a frustrating experience. Towards this end, the Government of India in 1977 rightly thought of assisting the entrepreneurs by setting up District Industry Centers (DICs), which are part of the industry department. But this experiment is not successful which is evident from the discussions held with the entrepreneurs. DICs suffer from the shortage of staff and the resources. The data/information are not updated. Moreover, delays are observed due to lengthy procedures. They are rigid in their functioning. Hence, it is suggested to create an Information Center in the private sector.

**10.1.3** Initially, a Non Government Agency (NGO) may be identified in a district who may take up the task of setting up the Information Centre. With its initial investment and bank loan, the necessary infrastructure has to be created. The required staff may also be recruited. The necessary technology has to be procured. Thereafter, it should contact various government agencies to understand the formalities to be done for availing of public utilities. Market related data/information has to be gathered. Profile of units in the area has to be created. The list of local suppliers of materials and machines has to be prepared for each of the activities. This might take nearly one year to create the data/information base which needs to be updated on yearly basis.

**10.1.4** Necessary procedures have to be worked out for making data/information available to the entrepreneurs on request. Since the
Center is expected to be run on commercial basis, all services of the Center should be made available at some fees. Wide publicity is also necessary. Later on, a Federation of such NGOs in different districts running the Information Centers may be formed which will offer certain common services to them. Since the Center is part of promotion and development of SMEs, the Small Industrial Development Bank of India (SIDBI) is advised to take initiative in motivating the NGOs to start the Information Centre.

10.2 Cash Flow Based Lending

10.2.1 There are three methods for assessment of working capital to SMEs viz., Maximum Permissible Bank finance (MPBF), Turnover Method and Cash Flow Based Lending. The first two are in practice for a long time. But the last one i.e. Cash Flow Based Lending is yet to be made a part of the system. In order to ensure a need based finance to SMEs, it is essential to go in for Cash Flow Based Lending (CBL). The assessment of working capital under three methods is indicated as under:
### Assessment of Working Capital Under Different Methods

<table>
<thead>
<tr>
<th>Activity</th>
<th>MPBF Method (One Year) Rs. in 000s</th>
<th>Turnover Method (One Year) Rs. in 000s</th>
<th>Cash Flow Based Lending Method (One Quarter)</th>
<th>Rs. in 000s</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Approved Sales</td>
<td>1000</td>
<td>1000</td>
<td>Cash Receipts</td>
<td>20</td>
</tr>
<tr>
<td>2. Approved Total Current Assets (TCA)</td>
<td>400</td>
<td>400</td>
<td>Cash Sales</td>
<td>210</td>
</tr>
<tr>
<td>3. Other Current Liabilities (OCL)</td>
<td>50</td>
<td>50</td>
<td>Realization of book debts</td>
<td>30</td>
</tr>
<tr>
<td>4. Working Capital Gap (WCG)</td>
<td>350</td>
<td>350</td>
<td>Non-operational receipts</td>
<td>72</td>
</tr>
<tr>
<td>5. Projected Net Working Capital (NWC)</td>
<td>45</td>
<td>45</td>
<td>Bank Loan – Short term for WC*</td>
<td>105</td>
</tr>
<tr>
<td>6. Expected NWC (25% of WCG or TCA for MPBF Method 5% of projected sales for Turnover Method)</td>
<td>87</td>
<td>50</td>
<td>Cash Payments : Payments to suppliers of materials</td>
<td>80</td>
</tr>
<tr>
<td>7. Bank Finance [((4-5) or (4-6)) whichever is lower for MPBF Method : 20% of projected turnover for Turnover Method]</td>
<td>263 (max)</td>
<td>200 (min)</td>
<td>Payments for manufacturing, selling, administrative and general expenses</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>77</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Non-operational payments</td>
<td>2822</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Repayment of loan with interest</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Surplus</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Opening Cash/Bank Balance</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Closing Cash/Bank Balance</td>
<td>60</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>*At the beginning of the quarter</td>
<td></td>
</tr>
</tbody>
</table>

#### 10.2.2

As seen from above, under MPBF, limits are sanctioned for one year and these are maximum limits. The amount is Rs. 263000. Under the Turnover method, the limits are for one year but the same are minimum limits. The amount is Rs. 200000. Firstly, banks are expected to calculate the working capital requirements under MPBF method and then try to find out whether MPBF limits are above the minimum entitlement of the SME unit under the Turnover method. In the example, the MPBF limits of Rs. 263000 which are greater than minimum bank finance of Rs.200000. But the assessment under the
traditional methods is based on approval of projected sales and inventory levels. In reality, banks find it difficult to decide the inventory levels. But the SME units are supposed to be good in this regard since they are in the field. Hence, they can only indicate what is actually required and not the banks. This view holds true in respect of availability of credit on the purchase of raw materials also. Thus, the system of assessment of working capital has led to under/over assessment of bank finance. What SME units expect is just a need based finance i.e. neither maximum limits nor minimum limits. This expectation can only be met by assessing working capital finance under the Cash Flow Based Lending method. Under this method, bank finance is just equal to cash deficit which arises when cash receipts fall short of cash payments. In the above example, bank finance is assessed at Rs. 72000. This deficit is on account of mismatch in cash flows. To elaborate, at the beginning of the next quarter cash receipts fall short of cash payments to the extent of Rs.72000. But the end of the quarter the situation is different. Cash receipts are in excess of cash payments by Rs.137000, out of which Rs.77000 will be utilized to repay bank loan along with interest.

10.2.3 Cash Flow Based Lending is more SME customer friendly. Here, bank finance is sanctioned in the form of short term loan which may be repaid in suitable installments. This is well sited particularly when SME units are dealing in seasonal products / construction activities / order based activities. The customer is assured of bank finance which is based on projected cash flows which are estimated by him and approved by the bank. Hence, the Cash Flow Based Lending method is popular in developed countries. Recognizing the importance of this, in March 1997, the Reserve Bank of India rightly asked the banks to switch over from MPBF method to Cash Flow Based Lending. But the banks are hesitant to do so due to the element of fear of credit risk. Credit risk is believed to be on the higher side due to heavy dependence on projected cash flows which can be over stated.
to avail of more bank finance. Therefore, banks are worried about lack of transparency on the part of entrepreneurs. Moreover, there is no stock statement which is submitted under MPBF method. The stock statement facilitates the bank to ensure the end-use of funds. Under the Cash Flow Based Lending, the end use of funds is ensured through the monitoring of cash flows i.e. actual cash flows to be compared with budgeted cash flows. This can be understood better from the following example:
### Cash Budget

(Rs. in 000's)

<table>
<thead>
<tr>
<th>Cash Budget</th>
<th>Apr</th>
<th>May</th>
<th>Jun</th>
<th>Jul</th>
<th>Aug</th>
<th>Sep</th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>540</td>
<td>720</td>
<td>360</td>
<td>360</td>
<td>100</td>
<td>180</td>
<td>300</td>
<td>360</td>
<td>360</td>
<td>240</td>
<td>240</td>
<td>450</td>
</tr>
<tr>
<td><strong>Cash flow from operations</strong></td>
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<tr>
<td><strong>A. Receipts</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>1. Cash sales</td>
<td>54</td>
<td>72</td>
<td>36</td>
<td>36</td>
<td>10</td>
<td>18</td>
<td>30</td>
<td>36</td>
<td>36</td>
<td>24</td>
<td>24</td>
<td>45</td>
</tr>
<tr>
<td>2. Collection from debtors</td>
<td>297</td>
<td>459</td>
<td>621</td>
<td>378</td>
<td>324</td>
<td>129</td>
<td>150</td>
<td>252</td>
<td>315</td>
<td>324</td>
<td>234</td>
<td>216</td>
</tr>
<tr>
<td>3. Total Receipts</td>
<td>351</td>
<td>531</td>
<td>657</td>
<td>414</td>
<td>334</td>
<td>147</td>
<td>180</td>
<td>288</td>
<td>351</td>
<td>348</td>
<td>258</td>
<td>261</td>
</tr>
<tr>
<td><strong>B. Payments</strong></td>
<td></td>
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<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>1. Payment to trade creditors</td>
<td>252</td>
<td>378</td>
<td>504</td>
<td>252</td>
<td>252</td>
<td>70</td>
<td>126</td>
<td>210</td>
<td>252</td>
<td>252</td>
<td>168</td>
<td>168</td>
</tr>
<tr>
<td>2. Wages</td>
<td>81</td>
<td>108</td>
<td>54</td>
<td>54</td>
<td>15</td>
<td>27</td>
<td>45</td>
<td>54</td>
<td>54</td>
<td>36</td>
<td>36</td>
<td>67.5</td>
</tr>
<tr>
<td>3. Office expenses</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
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<tr>
<td>4. Taxes</td>
<td></td>
<td>25</td>
<td>25</td>
<td>25</td>
<td>25</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Total payments</td>
<td>383</td>
<td>536</td>
<td>633</td>
<td>356</td>
<td>317</td>
<td>172</td>
<td>221</td>
<td>314</td>
<td>381</td>
<td>338</td>
<td>254</td>
<td>311</td>
</tr>
<tr>
<td><strong>C. Cash from operating activities</strong></td>
<td>-32</td>
<td>-5</td>
<td>24</td>
<td>58</td>
<td>17</td>
<td>-25</td>
<td>-41</td>
<td>-26</td>
<td>-30</td>
<td>10</td>
<td>4</td>
<td>-50</td>
</tr>
<tr>
<td><strong>D. Cash at start of month</strong></td>
<td>10</td>
<td>-22</td>
<td>-27</td>
<td>-3</td>
<td>55</td>
<td>72</td>
<td>47</td>
<td>6</td>
<td>-20</td>
<td>-50</td>
<td>-40</td>
<td>-36</td>
</tr>
<tr>
<td><strong>E. Cumulative cash (D+C)</strong></td>
<td>-22</td>
<td>-27</td>
<td>-3</td>
<td>55</td>
<td>72</td>
<td>47</td>
<td>6</td>
<td>-20</td>
<td>-50</td>
<td>-40</td>
<td>-36</td>
<td>-86</td>
</tr>
<tr>
<td><strong>F. Target cash balance</strong></td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td><strong>G. Cumulative surplus or loan required (E-F)</strong></td>
<td>-32</td>
<td>-37</td>
<td>-13</td>
<td>45</td>
<td>62</td>
<td>37</td>
<td>-4</td>
<td>-30</td>
<td>-60</td>
<td>-50</td>
<td>-46</td>
<td>-96</td>
</tr>
</tbody>
</table>

**10.2.4** In the above case, the maximum cash deficit is Rs.96 lakhs. This is some thing like MPBF allowing the borrower to draw maximum from the account. But he will be permitted to do so as per budgeted cash deficit which arises when cash inflows fall short of cash outflows. Consequently in April, he can draw up to Rs 32 lakhs. But in July, August and September, the borrower is not allowed to draw any amount since cash inflows are likely to be greater than cash outflows. Excess drawing is allowed up to 10% of budgeted cash deficit if need is so genuine. It is mandatory for a borrower to submit a statement of actual cash receipts and cash payments within a week as soon a month gets over. Thus, it facilitates the banks not only to sanction the
need based finance but also to ensure the end-use of bank funds. This system of cash flow lending is in use in developed countries. But in India, some beginning is made in respect of financing of seasonal activities. Still much is expected to be done to switch over from the MPBF method to the Cash Flow Based Lending method.

10.3 Credit Monitoring

10.3.1 Follow-up of advances and supervision as part of lending operations, is in vogue in banks. The follow up and supervision aims at assessing the working of the units financed by them and ensuring the end-use of funds. This includes stock verification, study of ledger data, factory inspection, study of quarterly information system (QIS), discussion with the borrower, study of market report, etc. From the follow-up exercise, it is expected to obtain signals of incipient sickness in the units/irregularities in the borrower accounts and to take appropriate preventive action. (An exhaustive list of such signals is given in Appendix I).

Unfortunately, the present system follow-up and supervision is not adequate and efficient enough to meet the above expectations. To elaborate, there are too many signals, one does not know which one to be attended. Further, although sickness/irregularity is identified, timely preventive action is not taken. In the list of priorities of branch manager, the follow-up of advances and supervision is generally the last item. Consequently, preventive action is not taken up or, action is taken with a considerable delay. It is also observed that the follow-up of advances and supervision has become a routine matter since accountability is not fixed. Therefore, it has been a matter of concern. Finally, in respect of high valued advances, it calls for some expertise for studying the operational and financial data of the borrowers. But this expertise is yet to be mastered since the present system of follow-up of advances is too simple.
Thus to overcome these limitations of the existing system of follow-up of advances and supervision, a “Credit Monitoring” is suggested as a tool to supplement the present follow-up system and not to supplant the same. Details of the credit monitoring are as under:

10.3.2 Suggested Credit Monitoring System (CMS)

- Credit monitoring is expected to be a continuous process and, therefore, an officer in the branch will have to be identified exclusively for this job, who may be designated as Credit Monitoring Officer (CMO). He will not be involved in credit sanctions for which there will be a separate officer who will be responsible mainly for processing of credit proposals.

- CMS should be applicable to all accounts. But initially, it is better to cover bigger advances say, Rs.10 lakhs or more. Similarly, this refers to those accounts which are potentially sick SSI units wherein loan default is for less than 12 months.

- The CMO will be responsible for studying data/information gathered from various sources for obtaining signals of incipient sickness of the potential sick SSI units and taking up preventive action with the help of Branch Manager and other field staff.

- He will also maintain a profile of the borrowers for which a 'Borrower Profile Card' is suggested in Appendix II.

- Credit monitoring ensures special attention to the high valued borrowal accounts enjoying credit limit in excess of Rs 10 lakhs so that it would be possible to take early preventive action.

10.3.3 Sources of Information

To obtain the signals of incipient sickness or an account becoming an NPA, the CMO has to refer to various sources of information. These include:

- Conduct of cash credit, term loan, bills, DPG, etc. reflecting excess borrowing, defaults in loan installments, diversion of bank funds, etc.
• Operations in the ledger account i.e. the borrower deposits sale proceeds in the cash credit account adequately
• Stock inspection report
• Factory visit report
• Receivables management to focus on the age of receivables
• Renewal proposal and process note
• Minutes of the meetings held with the borrower and also with co-banks in the consortium meetings
• Market report
• Compliance of terms and conditions of the last credit sanction
• Report of the last statutory audit, RBI inspection report, concurrent audit and, stock audit
• Published annual report of the unit

10.3.4 Identification of Potential NPAs / Sick Units in SSI Sector

From the above mentioned sources of information, the CMO has to collect data to identify signals. Here, he should concentrate on few but useful signals which should cover operational performance, conduct of borrowal accounts, movement in stock position, market reputation, prompt submission of various statements, non-compliance of terms of the last sanction, diversion of funds, collection of dues from customers, etc. An attempt has been made to develop a format for identification of signals as furnished in Appendix III. Signals have to be identified on monthly basis. For each month, the CMO has to study the accounts allotted to him and has to bring such signals, if any, to the notice of the branch manager. In the same format, it is attempted to put (3) mark or (6) mark against each signal. Presence of a signal is marked by the sign (3) and the absence of a signal is marked by the sign (6). If there is a repeat occurrence of a signal, preventive action has to be taken up immediately, otherwise the account may become sick/non-performing soon. In the format, it is shown that the ABC Industrial Unit did not experience any signal of sickness in the first four months. But in the fifth month, sales
declined. Consequently, cash credit account was overdrawn, bills account was out of order and there was a default of term loan. In the next month i.e. Month 6, sales once again picked up but the party did not deposit the entire sale-proceeds in the account. As a result of this, loan default and irregularity in cash credit and bills account continued. In addition, funds were also diverted. Now, this is a potential NPA and, there is still one month left to prevent slippage and retain it as standard asset. For this purpose, preventive action has to be taken up.

10.3.5 Preventive Action

Each signal calls for certain preventive action. Sometimes, it may be advisable to watch the signal for some time and thereafter take action. In any case, CMO will not only bring the presence of signals to the notice of the branch manager and also suggest the type of action to be taken up. He will instruct the staff at the counter to keep an eye on transactions recorded in the ledger book. Such action would depend on the nature of sickness/irregularity. But certain actions are common which include writing of a letter to the borrower, discussion with the borrower, visit to the factory-site, keeping a close watch on the transactions recorded in the ledger book, writing a letter to the higher authorities to indicate the developments in the account, etc. In Appendix IV, it is attempted to discuss various actions to be considered to prevent sickness.
Appendix I

Checklist of Signals

A. Stock Inspection

1. By comparing the stock statement of a borrower with his stock register, it is possible to ensure whether the stock position as declared by him is in accordance with the books of accounts. If there is a major variation, a signal is thrown. In case of large borrowers, the verification of stock includes:
   (a) stock kept at the factory premise;
   (b) finished stock at the sales depots of the company;
   (c) raw materials sent to outsiders for conversion or processing; and
   (d) stock in transit

   Besides physical verification of stock, it is necessary to see:
   (a) purchase price of raw material as indicated in the invoices;
   (b) position of goods in process and finished stock as on the given date duly certified by the production manager; and
   (c) pricing policy of the company and methods of valuation of stock adopted.

   Any major variation in stock value as per the stock statement on one hand and books of accounts on the other, gives an indication of misappropriation of stock.

2. The physical verification of stock ensures the end use of loans. If the stock is inadequate, it indicates that the funds are not fully utilized for the agreed purpose.

3. If the stock not belonging to the company is stored in the factory premise, it indicates that the company is indulging in malpractices.

4. If the stock statements are deliberately not submitted for a long time, it shows that a major portion of the stock does not exist.

5. If the company has maintained excessive stock than required, it also indicates that the company is indulging in trading practices (and not production activities alone).
6. If the company has taken dual finance from two different bankers on the same stock, it indicates the dishonesty of the borrowers.

7. It is difficult to ensure the quality of the stock. But, if there is no movement of a major part of finished goods, it shows that the stock is outdated and not saleable.

B. **Ledger Book**

1. Poor turnover in an account indicates that either the sales are being routed through other banks or have, in fact, been dropped. In either case, the officer should make an enquiry. Otherwise, it may lead to misuse of funds by the borrower.

2. Cheques for large and round amount, post-dated and frequently issued in favor of those parties not related to business may need to be examined carefully. A dialogue with the borrower could be initiated to find out the root cause and to take remedial steps.

3. The bill account reveals the major transactions of the business. Frequent return of bills may mean that the borrowers’ goods are being rejected by purchasers or the purchasers are sending payments directly to the borrower. When the bills are received back, the borrower is promptly advised that the bills have been returned by the collecting branch for the reasons, ‘payment not forthcoming’ and that he should replenish his account forthwith. Often, banks are more worried about the account and not the reasons for non-payment.

4. If there has been irregularity in the account for a longer period, it indicates that outflows are in excess of inflows of cash.

5. If there are no operations in the account during a part of the year, it indicates that the unit has stopped working during that period. This is a signal for analyzing the reasons for the inactive operations in the account.

6. The behavior of the account during the year would help us in getting the signal. The actual drawings should be related to the business requirements. It is expected that the unit normally requires more funds during the busy season. It is also expected that the unit has to
maintain a minimum level of stock and therefore, it requires minimum amount of funds all through the period. Any variation in these expectations would throw a signal.

7. If there is a heavy withdrawal of cash, banks may consider the same as a signal of sickness.

C. Discussion with Borrowers

1. Major breakdown in plant and machinery
2. Labor strike
3. Change in management
4. Sudden death/illness of partner/director
5. Disputes among partners/directors
6. Frequent reconstitution of the firm/board
7. Frequent requests for enhancement of limits

D. Market Reports

1. Recession in industry
2. Unsatisfactory position of the inputs
3. Unsatisfactory reports about the party
4. Sharp fall in prices
5. Unsatisfactory changes in government policy as regards imports, exports, price fixation, etc.
6. Routing transactions to other bank/s

E. Financial Statements and Other Data

1. Unsatisfactory trend in profits
2. Rise in book debts
3. Shortage of working funds
4. Unsatisfactory position of equity
5. Diversion of short term funds for long term use
6. Building up of unproductive assets
7. Unhealthy accounting practices
### Borrower's Profile Card

**Name** --------------------- **Branch** -------------- **RO/ZO :** -----------

**Constitution** ----------------- **Type of A/c : SS I/Corporate /Trading/**

**Service**

**Industry (Code/Sub-code):** --------------- **Products** ---------------

**Contact Person : Name** ------------- **Guarantor : Name** -----------

**Address** ------------------ **Address**------------------

**Tel No.** ------------------ **Tel No.** ------------------

**Fax No.** ------------------ **Fax No.** ------------------

**E-mail** ------------------ **E-mail** ------------------

**Associated Firm (if any):** ------------ **Position of A/c:** Sick/CDR/
Recalled/BIFR/
DRT/Decreed/Others

**Introducer :** ---------------- **Bank internal rating :** ----------------

**Single/Multiple (Lead Bank)** ---------------- **Since when dealing with the**
Bank---------- **Year** -----

**Date of Last Sanction:** CC ------------**Renewal Date**---------------

**TL** ------------ **Sanctioning Authority:**

**Branch/ZO/CO**

**Others** ------------------

**Securities** : **Primary** ---------------- **Expiry Date of Insurance Policy**

**Collateral** ------------------ **Expiry Date of Documents:**-----

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Cash Credit (Hyp)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Cash Credit (Pled)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bills</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Others (Short Term)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Term Loan</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Non Fund Based Limits</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(OB) : Outstanding Balance
## Appendix III

### Identification of Potential NPA:

**ABC Industrial Unit**

 ✓ **mark** for presence of a signal  
 x **mark** for absence of a signal

<table>
<thead>
<tr>
<th>Sr.No</th>
<th>Signal</th>
<th>Month</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Fall in sales/cash losses/erosion in net worth</td>
<td>M-1</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>2</td>
<td>Overdrawals in cash credit account</td>
<td>M-2</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>3</td>
<td>Bills A/c out of order</td>
<td>M-3</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>4</td>
<td>Other short-term loan – default</td>
<td>M-4</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>5</td>
<td>Term loan-default : Interest/prin</td>
<td>M-5</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>6</td>
<td>Development of DPG/LC/BG</td>
<td>M-6</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>7</td>
<td>Delay/Non submission of stock statement</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Incomplete documentation in terms of creation/ registration of charge, mortgage, etc.</td>
<td>M-1</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>9</td>
<td>Non fulfillment of terms of last sanction</td>
<td>M-2</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>10</td>
<td>Diversion of funds</td>
<td>M-3</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>11</td>
<td>Payment from customers held up</td>
<td>M-4</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>12</td>
<td>Adverse market report</td>
<td>M-5</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>13</td>
<td>Unfavourable factors affecting the unit</td>
<td>M-6</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>14</td>
<td>Others (specify)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Appendix IV

Credit Monitoring Steps

(1) Identify the potential NPAs when the loan default is for two months.

(2) Study the causes – whether default is due to inherent weaknesses or due to temporary liquidity or cash flow problem.

(3) Offer contingency help immediately in the form of ad-hoc limits if cash flow mismatches are genuine.

(4) If limits are found to be inadequate leading to loan default during the year, ask the borrower to submit the renewal proposal and enhance suitably.

(5) If cheques are drawn on parties not related to business or heavy cash withdrawal and no corresponding increase in stock, pass cheques for payment after a detailed scrutiny. Borrowers should be advised to state the purpose of the cheques for which it is drawn.

(6) Visit the factory immediately, if the stock statement is not submitted and verify the securities.

(7) Collect the interest on monthly basis. Frequent visits are called for wherever there is a default of interest payment.

(8) Keep the documents live, scrutinize them periodically.

(9) Implement the report of the concurrent auditor, statutory auditor, branch inspector, credit audit, regional manager's report, etc.

(10) Read the local news-paper daily, ascertain the position of accounts with other banks, exchange information about the borrower in the consortium meeting, etc.

(11) Initiate any other steps to prevent slippage in standard asset.

10.4 Annual Review of Borrowal Accounts

10.4.1 Banks are expected to carry-out an annual review of borrowal accounts. SMEs are no exception to this. Two problems are experienced in regard to the present system of annual review in banks i.e. delays in receiving renewal papers from a borrower and the
quality of review exercise in banks requiring improvement. To avoid such delays, it is necessary to impress upon the entrepreneurs regarding benefits of the review which is done on timely basis. More importantly, banks and borrowers should try to prevent any standard asset becoming sub-standard due to non-renewal of cash credit limits for a period exceeding 180 days from the date of expiry of the same. But, for ensuring effective review of borrowal accounts much needs to be done. In banks, cash credit limits are valid for one year. Before the date of limits to expire, renewal of limits exercise has to be carried out. For renewal / enhancement of limits, banks require audited financial statements. But, tiny and decentralized units find it difficult to get their books audited. This is because of non-availability of auditors who are not interested in such units. In such cases, banks may simply renew the existing limits based on provisional financial statements and factory inspection. This would at least prevent standard accounts becoming sub-standard. Further, banks have to seek minimum information for renewal of limits because a lot of information is already available with the banks such as profile of a borrower account, conduct of various credit facilities etc. Only limited data/information should be called for.

10.4.2 To ensure the qualitative review of borrowal accounts in banks, there is a felt need to develop a format to study of both qualitative as well as quantitative data/information. The suggested format as discussed below, considers six important aspects of financial health of the firm. These include: sales performance, utilization of total assets, profit performance, liquidity and short solvency, capital structure and dealings of the firm. To fill up the format, banks need have to any additional data/information data since the same are available from the existing sources such as balance sheet and profit and loss account, ledger books, market reports etc. It is easy to fill-up the format and it takes less time to draw inferences. The format is specially designed to be used at the time of renewal/enhancement of limits. Lastly, the
The suggested format is as under:

**Annual Review Format - ABC Co Ltd**  
( Rs. in Lakhs )

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Indicator</th>
<th>31.3.2004</th>
<th>31.3.2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Sales value (Rs.)</td>
<td>300</td>
<td>400</td>
</tr>
<tr>
<td></td>
<td>Sales quantity (units in lakhs)</td>
<td>300</td>
<td>300</td>
</tr>
<tr>
<td></td>
<td>Selling price (Rs.)</td>
<td>1.0</td>
<td>1.33</td>
</tr>
<tr>
<td>2.</td>
<td>Total assets (Rs.)</td>
<td>300</td>
<td>600</td>
</tr>
<tr>
<td></td>
<td><strong>Sales/Total assets</strong></td>
<td>1.0</td>
<td>0.67</td>
</tr>
<tr>
<td></td>
<td>Fixed assets (Rs.)</td>
<td>100</td>
<td>410</td>
</tr>
<tr>
<td></td>
<td>Current assets (Rs.)</td>
<td>170</td>
<td>175</td>
</tr>
<tr>
<td></td>
<td>Non current assets (Rs.)</td>
<td>30</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>Productive fixed assets (Rs.)</td>
<td>70</td>
<td>70</td>
</tr>
<tr>
<td></td>
<td>Non productive fixed assets (Rs.)</td>
<td>30</td>
<td>340</td>
</tr>
<tr>
<td></td>
<td>Plant capacity utilization (%)</td>
<td>67</td>
<td>67</td>
</tr>
<tr>
<td>3.</td>
<td>Profits (Rs.)</td>
<td>30</td>
<td>33</td>
</tr>
<tr>
<td></td>
<td>Profit/Sales (%)</td>
<td>10</td>
<td>8.25</td>
</tr>
<tr>
<td></td>
<td>Selling, Admin, and Gen Exp/Total Expenses (%)</td>
<td>16</td>
<td>19</td>
</tr>
<tr>
<td></td>
<td>Cash Surplus from Operations. (Rs.)</td>
<td>28</td>
<td>(17)</td>
</tr>
<tr>
<td></td>
<td>Dividend (%)</td>
<td>8</td>
<td>10</td>
</tr>
<tr>
<td>4.</td>
<td>Current Ratio</td>
<td>1.05</td>
<td>0.89</td>
</tr>
<tr>
<td></td>
<td>Stock Level (Months)</td>
<td>2.0</td>
<td>1.8</td>
</tr>
<tr>
<td></td>
<td>Collection period (Month)</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td>Payments period (Month)</td>
<td>1.0</td>
<td>1.33</td>
</tr>
<tr>
<td></td>
<td>Bank borrowings/CA (%)</td>
<td>75</td>
<td>89</td>
</tr>
<tr>
<td>5.</td>
<td>Capital (Rs.)</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>Long term debt/equity</td>
<td>0.5:1.0</td>
<td>3.0:1.0</td>
</tr>
<tr>
<td></td>
<td>Cash Bal. + Under-drawn limits</td>
<td>5</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>Operational Commitments</td>
<td>8</td>
<td>56</td>
</tr>
<tr>
<td>6.</td>
<td>Dealings with Bank, FI, Workers and Govt.</td>
<td>Good</td>
<td>Unsatisfactory</td>
</tr>
<tr>
<td></td>
<td>Market Reputation</td>
<td>Good</td>
<td>Very Good</td>
</tr>
</tbody>
</table>

**10.4.3** In the format, the relevant data are given for ABC Co. Ltd. From the study of the data, it is possible to carry out the annual review in the following order:

1. Sales value of the company went up from Rs. 300 in 2004 to Rs. 400 in 2005, showing a rise 33.3% But this rise is on account of hike in the selling price. Had there not been any hike in the price, the sales value would have remained constant. Sale quantity being
constant, is a matter of concern to the bank.

2. Total assets value went up by 100% during the period. The total assets i.e. Rs. 600 in 2005 consist of fixed assets, current assets and non-current assets. It is clearly seen from the figures that there is a substantial increase in the value of fixed assets which went up from Rs.100 in 2004 to Rs. 410, a rise of Rs. 310. Further, the break-up of fixed assets indicates that these are non-productive assets i.e. land and building. This is another area of concern.

3. Profits went up by 10% during 2004-05 over the previous year’s figures. But the profit / total sales ratio declined from 10% in 2004 to 8% in 2005 due to selling and administrative expenses which went up disproportionately and these are controllable expenses. More importantly, cash deficit is also reported during 2005 when the profit is as high as Rs. 33. This indicates cash crunch in business. Despite cash deficit, the firm declared higher rate of dividend based on the reported profit.

4. The problem of liquidity and short term solvency is further confirmed from the current ratio which is less than 1.0 in 2005. Due to liquidity problems, the company has reduced the level of stock, collected payments from the customers on timely basis and deferred the payments to the suppliers of materials. In addition, bank borrowings are more than desired. In other words, cash account shows irregularity.

5. Capital structure is also unsatisfactory when the debt/ equity ratio is as high as 3:1. With capital balance remaining constant, the firm had to raise borrowings from non-institutional sources since the institutional sources of funds are generally not available just to finance non-productive assets. The situation is so critical that cash balance and undrawn limits together are not adequate to meet the operational commitments.
6. Lastly, overall dealings of the firm with bank, financial institution (FI), workers and the Government are assessed as 'Unsatisfactory'. But market reputation is rated as 'Very Good' due to increase in sales value, total assets, profits, customers being ready to buy the products even at higher price, higher rate of dividend and creditors being ready to extend credit. But in the books of the bank, the company is looked down. This is a matter of concern.

10.4.4 From the above observations, it can be inferred that the company is in need of additional support to honor the operational commitments as on the balance sheet dated 31-3-2005. Such financial support can be extended after asking the company to submit the projected cash flow statement for the next three months or so. In addition, factory inspection has to be conducted to verify the position of the assets acquired. Since the credit risk is high, the firm may be advised to offer certain collateral securities. Thus, from the review, it is possible to assess both strength and weakness of the company from the banker's angle. This assessment is based on analysis of both quantitative and also qualitative data/information. Hence, banks are suggested to use the suggested format.

10.5. Rehabilitation of Sick SSI Units – Do’s and Don’ts

10.5.1 Banks are expected to handle the sick SSI units as per the guidelines of the RBI. The actual work starts from the day when a sick unit is identified and concludes when the account is closed either by recovery or write-off. Based on interactions held with the branch managers and the survey of sick units, it is attempted to offer certain suggestions to banks in the form of Dos and Don’ts:

(A) Early identification of the sick company is necessary for the effective cure of sickness. But it is observed that bank branches commit a lot of delay in identifying sick unit and also in reporting to the regional office, the reason being a fear-element
in their mind i.e. reporting of more sick units to the controlling office which might undermine their performance. In this regard, to ensure the early identification of the sick unit by the bank branches, suitable arrangements need to be made. One of such arrangement may be to motivate them to do the needful. For this purpose, each bank may have to prepare a booklet containing few success stories narrating how early identification helps in rehabilitating a sick unit.

(B) For identification of a sick unit, the audited balance sheet is a must to ascertain the level of accumulated losses and net worth. If audited balance sheet is not available due to certain genuine difficulties, the branch manager may accept a provisional balance sheet duly signed by the entrepreneur. Even this is not possible, the manager may visit the unit and prepare a report. On the basis of conduct of accounts and the factory inspection report, the manager may form an opinion that the unit has become sick and proceed to study the causes of sickness and assess the viability of the project.

(C) After identification of the sick company, a viability report has to be prepared by the borrower himself or with the help of some outside consultant. In most of the cases, the outside consultant's help is sought for. But in the context of consultant's report, bank's experience is not satisfactory. Quite often, it is experienced that the report of the consultants may not reveal major weaknesses of the project, and assumptions made in their report for estimating sales, bank finance, etc., are found to be unrealistic. Hence, banks have to make many changes in the project report which leads to almost preparing the same afresh. So, it is necessary to make arrangements for ensuring a larger involvement of the outside consultants in the matters of formulation and implementation of the project report.
For the preparation of rehabilitation scheme and implementation of the same, coordinated efforts of banks and financial institutions are called for. But, much is desired to put this into practice. Otherwise, the process of rehabilitation process suffers. To strengthen the consortium arrangements, it is suggested that there should be a fair understanding among the members of consortium to ensure that:

(i) Appraisal should be at one stage instead of carrying out the same at each institutional level.

(ii) Documentation should be completed at one stage.

(iii) There should be free exchange of information regarding outstanding balances, position of securities etc.

(iv) There should be regular review meetings with the borrowers.

(v) There should be common terms and conditions.

Besides strengthening consortium arrangements, it is also necessary to adopt a time bound programme for preparation and implementation of the rehabilitation package for a sick unit. Efforts should be made to complete these tasks in a period of six months to safeguard the interest of sick companies.

For effective preparation and implementation of the rehabilitation package, attitudinal changes are desired both in banks and sick companies, so that full trust is established. Consequently, the companies are enabled to disclose their problems with the branch managers more openly and quickly.

For effective co-ordination, the ‘Sick Units Cell’ set up at the head office and zonal offices of the bank, needs to be strengthened to offer the required support and guidance to the
branches.

(G) For monitoring, the information from sick companies is necessary. Despite good efforts on the part of the bank, the required information is not coming forth. In this context, it is suggested that rebates and concessions offered to them under rehabilitation package may be withdrawn, when information is not submitted. But the same may be restored once the information is made available to the banks.

(H) It is reported in several studies that companies fall sick mostly on account of managerial deficiencies. Mismanagement or misuse of funds is commonly observed. Banks have to take a stern action in cases when there a deliberate attempt to make the company sick by siphoning of funds. To deal with such cases, the existing loan agreements of banks may be reexamined. It is suggested to insert a separate clause for penal action against those responsible for siphoning off bank funds. One more suggestion may be made here. In case of total failure of companies, promoters of such companies should be black listed from obtaining fresh industrial license.

(I) It is not necessary to nurse every sick unit. Branch managers should be choosy in this regard. Willful defaulters and cases where there is demand recession and no scope for diversification, need not be considered for nursing. There should be proper compliance of the RBI/bank guidelines as regards relief and concessions. Bank managers should not recommend beyond the stipulated norms.

(J) It should not lead to a situation that a sick unit remains under nursing for a long time. The unit can be nursed for a maximum period of seven years and concessions in interest rate, etc., should be given up to five years. In rare cases, a second dose
of nursing can also be considered which should be for a short period of one year. It should be the policy of the bank to withdraw concessions and recall advances even during the period of rehabilitation if funds are siphoned off. In any case close monitoring of performance of sick units is a must.

10.6. Recovery Measures – A Check List

10.6(A) Here, it is attempted to discuss about various recovery measures adopted by banks and financial institutions (FIs) for reducing the level of NPAs. Over the years, many initiatives have been taken by the Reserve Bank of India and the Government of India in introducing new measures in the light of the problems experienced by banks and also in terms of universal practices. In addition, these banks and FIs have also tried to come-out with new measures for NPA reduction. Information in respect of which each of these measures is not available at one place. Branch Managers being too busy in their day to day work, look for a check list on recovery. All these recovery measures were understood during the discussions with the branch managers and referring to literature on the subject. For convenience, recovery measures can be classified into non-legal and legal measures which are listed as under:

10.6.(B) NON-LEGAL MEASURES

1. Reminder system
2. Visit to borrower’s business premise/residence
3. Recovery camp
4. Appointment of professional agents/recovery agents
5. Rehabilitation of sick units
6. Debt Restructuring for SMEs
7. Loan compromise
8. Lokadalat or Loknayalaya
9. Circulation of List of Defaulters
10. Appropriation of subsidy or exercising the right to set-off
11. Recalling of advances
12. Write-off
13. Recovery through specialized branches
14. Other measures

10.6 (C) Legal Measures
15. Recovery through Judicial Process
16. Debt Recovery Tribunal
18. Other Legal measures.

Each of the above measure is discussed as under:

NON-LEGAL MEASURES

10.6.1 Reminder System
This is the cheapest mode of recovery by sending reminders to the borrowers before the loan instalment falls due. Generally, response to this arrangement particularly from honest borrowers is encouraging. But efforts need to be strengthened in banks in sending reminders on timely basis. Enough care should be taken to prepare a draft-letter in informal language. If possible, better quality stationery may also be used to motivate borrowers to open the letter and read the matter with interest. With the computerisation of branches, reminders can be sent through e-mail.

10.6.2 Visit to Borrower’s Business Premise/Residence
This is a more dependable measure of recovery. In India, most of the borrowers make the installments of loan unless the branch personnel meet them personally. But, borrowers are widely spread. Hence, visits need to be properly planned. Involvement of staff at all levels in the bank branch is called for. Costs involved in recovery need to be kept to the minimum. Frequent visits are called for in case of hardcore
borrowers. Over the years, it is observed that the number of visits is
going down due to cut in the workforce in banks due to voluntary
retirement scheme (VRS). Consequently, the recovery process is
affected. Branches should maintain a record of visits made and
recovery amount collected. Regional/Zonal heads should look into
how the visits are organized at the branch during their periodical
inspection.

10.6.3 Recovery Camp
In respect of agricultural advances, recovery camps should be
organized during the harvest season. To take maximum advantage,
recovery camps need to be properly planned. It is essential to take
the help of outsiders, particularly, revenue officers in the state
government, local panchayat officials, regional manager in the bank,
etc. It also calls for a professional approach to give a wide publicity of
the recovery camp to be organized in the local area, mobilize as many
farmers as possible and motivate the staff to get involved in the
recovery drive. In rural areas, the recovery camps should be
organized during the harvest season to recover the bank dues from
farmers. During the camp, those who are very regular in loan
repayment should be honored.

10.6.4 Appointment of Professional Agents/Recovery Agents
Banks may appoint Professionals/Recovery Agents whose services
shall be utilized to ascertain the whereabouts of the borrower and
enforcement of securities. There is some hesitancy on the part of
public sector banks in engaging them for recovery purposes due to
unpleasant experiences in certain cases. But in the post-VRS
scenario, it is suggested to seek help from such outsourcing agencies.
This should be done after examining the credentials of the agencies. It
is also essential to keep a constant vigil on their practices adopted by
these agents in recovery matters. In general, banks should refer such
cases to them wherein the recovery is not possible in the normal
10.6.5 Rehabilitation of Sick Companies

Sufficient write up on rehabilitation of sick units is provided earlier. By rehabilitating a sick unit successfully, recovery of bank dues takes place. But the success rate is very low i.e. less than 10%. However, banks should continue to rehabilitate because the cost of rehabilitation is lower than cost of restarting a new unit on closure of the same.

10.6.6 Debt Restructuring for SMEs

A need was felt to create a special agency to facilitate debt restructuring because there has been some hesitancy on the part of banks and financial institutions to implement RBI guidelines on debt restructuring. For large corporate, Corporate Debt Restructuring (CDR) has been set up to co-ordinate the corporate debt-restructuring programme. Certain details of CDR can be shared here.

CDR consists of Forum, Group and Cell. While the Forum evolves broad policy-guidelines, the Group takes decisions on the proposals recommended by the Cell. Initially, the borrower approaches his Lead Bank/FI with a request to restructure debt, which in-turn puts up the proposal to the Cell. The CDR covers only multiple banking accounts enjoying credit facilities exceeding Rs 20 crores (recently reduced to Rs.10 crores). In the beginning, cases of DRT, BIFR and wilful defaults, doubtful and loss accounts and suit-filed cases were outside the purview of the CDR. Thus, standard and sub-standard accounts were only eligible to seek CDR shelter. With the amendments in the scheme, even such cases may now be considered. Similarly, doubtful cases may also be dealt with. Decisions of the group are based on the ‘super majority’ principle. If 75 per cent in value and 60% in number agree to the debt restructure plan, it is binding on the other banks/FIs. The CDR is a voluntary system based on debtor-creditor agreement and inter-creditors’ agreement. No
banker/borrower can take recourse to any legal action during the 'stand-still' period of 90-180 days. Lastly, CDR will observe the RBI guidelines on Debt Restructuring issued in March 2001 and February 05, 2003.

There is significant success in debt restructuring of large corporates which is seen in terms of quick disposal of cases and loan recovery after restructuring.

Encouraged by these results, the Reserve bank of India asked banks to work out Debt Restructuring scheme for SMEs vide the circular dated November 10, 2005. In the circular, broad guidelines have been provided relating to assessment of viability, norms of restructuring, procedures etc. Currently, banks are busy in formulating the scheme. There is a big hope to recover bank dues from defaulters once the scheme is implemented for SMEs.

10.6.7 Loan Compromise

In general, it is experienced that filing of suits and recovery of dues of banks through the courts is a cumbersome, expensive, time consuming, and task without any fruitful results in many cases. One of the main reasons attributed for slow recovery of bank dues through the court is lack of proper follow-up and timely and proper action. Hence, it would be worthwhile to think of other ways to tackle the situation. The tradition of amicable settlement through panchyat and arbitration, leads to think as to why bank loan disputes cannot be settled without having a recourse to the court.

A compromise means agreeing to a borrower’s request of accepting a part of outstanding of dues in the books of the bank as full and final payment or allowing for the non-compliance of the terms of the loan, after analyzing the alternative courses of action, genuineness and capacity to repay. It is also called as voluntary debt reduction or
scaling down bank dues. In this situation, where the borrower’s ability/capacity is repaying the bank’s dues and the bank’s ability to recover the same by other means are limited, a compromise proposal can work well.

Compromise proposals can be entertained at different stages which include (a) pre-litigation stage, and (b) post litigation stage. At the pre-litigation stage, concessional measures such as reschedulement / rephasing of unpaid loan installments, rehabilitation, etc. can be used which would allow some breathing time and build/strengthen the repayment capacity of the borrower. However, when such measures initiated in the account do not yield any fruitful result and the borrower incurs heavy cash losses, it is better to go in for a compromise or scaling downs the dues. Similarly, in other cases, where business loss has crept in due to one or other genuine reasons and the borrower is not a willful defaulter and requests for minor concessions, such as waiver of penal interest, concession in interest rate, etc. the borrower’s offer can be accepted for compromise. Compromise at post-litigation/decree stage can also be entertained so that the borrower’s business or activity is uninterrupted. In order to avoid cost, labour and time involved in litigation matters and to have better image in market, borrowers offer a lump-sum amount and request the bank to withdraw the suits against them. At times, it becomes necessary, in some cases, to settle outside the court through an amicable agreement and the antecedents of the defendant are such that courts take a sympathetic view and award a lenient decree against the defendants. Sometimes, after obtaining decree, if a third party comes forward to purchase the assets, the bank may consider the case for compromise. It is also possible for the bank to go in for compromise if the decreed asset would not fetch more than the claim amount. In all cases, where suits have been already filed, whatever compromise is to be made, must be sorted out through court in the form of a consent decree, so that it will be binding on all dependents. If parties do not fulfil the
promise, remedy through court or Debt Recovery Tribunal will always open to the banks.

There can be two types of compromise. The Reserve Bank of India and the Government of India worked out One Time Settlement Schemes covering loan outstanding upto Rs. 5 crores (subsequently raised to Rs. 10 crores) and Rs. 25000 respectively. In addition, each bank is given an autonomy to evolve One Time Settlement (OTS) Scheme. It is necessary to create awareness on OTS and mobilize as many compromise proposals as possible. There should not be any delays in arriving at compromise. Such proposals should be prepared carefully keeping in mind the bank guidelines. Otherwise, this may become a vigilance case. It is better to involve all staff members in mobilizing compromise proposal. Care should be taken that the recovery through compromise does not give a wrong signal to a good borrower. Over the years, banks have succeeded to recover through compromise substantially. But there is enough scope step up the recovery drive through this measure.

The cost-benefit analysis may be done to take into account the loss which may arise in case compromise is accepted and the benefit which may accrue if the same is not made. In general, it is experienced that the banks will be in an advantageous position in opting for an amicable settlement rather than legal approach. Besides, such compromise would avoid all legal complications and time lapses. Every branch manager has to formulate a compromise proposal in the light of broad guidelines issued by the bank. The proposal should contain major items which include means or capacity of the party, determination of amount covering outstanding amount, other charges etc. efforts already made for recovery, staff accountability, etc. The proposal recommended by the branch manager should be referred to the sanctioning authority which examines several factors including fulfillment of terms and conditions of sanctioning of loan compromise, any laxity in conduct and post-disbursement supervision of the
account, any act of commission or omission on the part of staff leading to the debt proving irrecoverable, enough recovery efforts put in, valuation of securities, interest to be charged in respect of settlement though installment, etc.

Loan compromise should be considered as a last resort of recovery. It should be a voluntary exercise. It calls for a professional approach in preparing the compromise proposal for which each bank is given an autonomy by the Reserve Bank of India. Decisions on compromise proposals should be taken by adopting a ‘committee approach’. In this regard, banks have been advised to set up a Settlement Advisory Committee. Though there are many schemes of compromise, success in recovery is limited due to lack of awareness of such schemes by small farmers, small traders etc., stricter vigilance norms, the staff being hesitant to entertain compromise cases, difficulties in fixing staff accountability before recommending a proposal, etc. Efforts should also be made not to encourage good borrowers to seek compromise. In any case, due to high NPAs, banks have to depend on loan compromise as an effective measure of recovery.

10.6.8 Lok Adalat or Lok Nyayalaya

The concept of Lok Adalat was introduced in 1982 as part of strategy of legal aid. By now, it is known for effecting mediation and counseling between the parties and to reduce burden on the court, especially for small loans. Large number of Lok Adalats are being organized in different parts of the country from time to time and it has got recognition and patronage, particularly, every segment of the society. Based on experience of several states, a Central Act known as Legal Services Authorities Act, 1987 was passed providing legal basis for the Lok Adalats and Legal Authorities to the compromise arrived at between the parties through such Lok Adalats. Several people of particular localities / various social organizations are approaching Lok Adalats which are generally presided over by two or three senior
persons including retired senior civil servants, defence personnel and judicial officers. They take up cases which are suitable for settlement of debt for certain consideration. Parties are heard and they explain their legal position. They are advised to reach to some settlement due to social pressure of senior bureaucrats, judicial officers or social workers. If the compromise is arrived at, the parties to the litigation sign a statement in presence of Lok Adalats which is expected to be filed in the court to obtain a consent decree. Normally, if such settlement contains a clause that, if the compromise is not adhered to by the parties, the suits pending in the court will proceed in accordance with the law and parties will have a right to get the decree from the court.

To arrive at compromise with the party, banks may provide remission of interest, etc. In this context, certain guidelines have been formulated by banks in consultation with the Indian Banks Association (IBA). Accordingly, the bank-suits involving claims upto Rs 5 lakhs (now raised to Rs 20 lakhs) may be brought before the Lok Adalat. There should be decree for the interest claimed before suit. Now-a-days, even non-suit filed cases in the doubtful and loss categories can be considered for settlement. Debt Recovery Tribunals can also organize Lok Adalats. Lok Adalats have to finalize settlements in terms of broad guidelines on loan compromise of the bank.

In general, it is observed that banks find it difficult to collect the concerned borrowers willing to go in for compromise on the day when the Lok Adalat meets. However, banks should continue to put in their efforts in this regard.

10.6.9 Circulation of List of Defaulters
Currently, the RBI circulates the list of defaulters among banks and financial institutions (FIs) which is found useful in avoiding wilful defaulters for loan sanction. The RBI has defined a wilful defaulter for
the first time. It has provided the broad parameters for identification of wilful defaulters whose list will be circulated among banks and FIs. Auditors of companies have to report in their certificate about diversion of funds, if any. In addition, on January 30, 2001, Credit Information Bureau of India Limited (CIBIL) was set up to provide critical data required by any credit institution before arriving at credit decision. CIBIL was set up jointly by State Bank of India, HDFC, Dun and Bradstreet and Trans Union. It will collect information from its members and make it available to any credit institution on demand. Its success depends upon co-operation extended by the members in supplying the required information on timely basis.

10.6.10 Appropriation of Subsidy or Exercise of Right of Set-off
In some of the sponsored schemes, the amount of subsidy is kept in deposit accounts of the people below the poverty line (BPL) to be appropriated after a specified lock-in-period. In such cases, where subsidy is available and the account is likely to become NPA, the subsidy amount should be appropriated (keeping in view the requirements of lock-in-period) in the loan account and necessary action should be initiated for recovery/write off of the balance amount. Further, where liquid securities such as Fixed Deposits, LIC policies, Govt. Securities etc. are available and borrowers are not responding to the request made by the bank to the borrower for regularization of accounts, such securities should be encashed after giving due notice to the borrower and guarantor.

10.6.11 Recalling of Advances
When follow up efforts do not yield any fruitful result and circumstances so warrant that the loan amount to be realized at once and/or facility to be terminated in the interest of the bank, a final recall notice has to be served asking the party to adjust the irregularity in the account immediately. Wherever necessary, the party is also informed about the bank’s intention to terminate the facility after the specified
time limit. As far as possible, issuing of legal notice should be restricted to once only and in case of small advances, recall notice through an advocate may be avoided unless the circumstances require such a course of action. Recall notice should be sent if the borrower is a wilful defaulter, bank liability is significantly uncovered, death of the borrower, dissolution of partnership firm, siphoning of funds, borrower refusing to renew the credit limit, etc.

All normal recovery efforts should have been made to pursue the borrower and guarantor to repay the dues which include personal contacts, persuasion, serving demand notice, bringing local influence, proposal for transfer to recalled advance, etc. The proposal should be submitted to the appropriate sanctioning authority at least six months before expiry of Limitation period. As per the Credit Guarantee Fund Trust, requirement of a recall notice to borrower/guarantor should be issued providing therein a 30 days’ time for adjustment of the account. The notice should be served properly.

On serving a recall notice and getting the approval of the higher authorities, the accounts should be transferred to recalled-category to exercise utmost care for effecting recovery, and to have special control over accounts. Branch managers should initiate appropriate course of action for recovery depending upon the case. In respect of genuine borrowers, the action points include persuasion, personal contracts, reschedulement, remission of penal interest, one-time settlement and write off wherein the amount is small and chances of recovery are almost nil. But in respect of wilful defaulters, it is better to file a suit.

While sending a proposal to recall the advance to the higher authorities, necessary information should be provided in the prescribed formats. Such information includes statement of account, Confidential Report (CR) of borrowers and guarantors, latest stock position, valuation of securities, present activities, reasons for stopping
operations, efforts made for recovery, etc. No interest should be charged in respect of recall advances as a prudent policy. But for the purposes of filing suit, Credit Guarantee Fund Trust, etc. interest and other charges may be debited to a separate account i.e. sundries or suspense account. Any recovery made from the recalled advances, the amount to be shared with the Credit Guarantee Fund Trust on pro-rata basis. Corresponding entries have to be made in the party’s recalled advance account. Thus, the exercise of recalling of advances is one of the recovery strategies which is found to be effective in respect of genuine borrowers who avoid to face legal action through the courts.

10.6.12 Write off

If it is going to be unremunerative either to file suit and/or continuing the account in the bank's books, it is advisable for the same to go in for waiverment of legal action and/or writing off dues. By waiver of legal action, banks may take a decision not to pursue recovery through a Court of Law. But for write off, the banks can decide to close the account by transfer of funds from their profits to the loan account. Waiverment of legal action is suggested when (i) the means of the borrower are negligible, (ii) borrowers are below the povertyline, (iii) cost of recovery is higher, (iv) beneficiaries are absconding, (v) it is difficult to obtain periodic balance confirmation of debt cum-acknowledgement of debt, and (vi) securities are already sold by the borrower.

Write off is proposed under certain circumstances such as (i) Borrowers are adjudicated as insolvents and the bank has already realized part of the dues as a secured creditor (ii) Revenue authorities under the State Public Recovery Act have recovered some amount and there are no further chances of any recovery (iii) Both borrower and guarantor are untraceable after selling their assets and (iv) Decrees remain unexecuted several times due to reasons beyond the
control of the bank.

Decisions to waive legal action or write off are taken at controlling office on recommendation of the Branch Manager. If permission of the Credit Guarantee Fund Trust is required, the same should also be obtained.

For write off, various factors are considered which include (i) means or capacity of the borrower and guarantor (ii) the amount to be written off (iii) efforts of recovery already put in and (iv) staff accountability. The write off exercise is internal and the branch staff should keep the matter confidential. Even after write off, recovery efforts should continue and if any amount recovered in this regard, the same may be shared with the Guarantee Corporation on pro-rata basis. Finally, the branch managers should comply with all the bank guidelines in respect of write off.

10.6.13 Recovery Through Specialized Branches
To deal with the matters related to tribunals, certain expertise is required. Such expertise is also needed to effect recovery from hard-core NPAs. In this regard, many banks have set up Recovery Branches which are exclusively dealing with the NPAs with a total liability of Rs. 10 lakhs and above.

These branches undertake certain activities which include creation of data base of NPAs, monitoring of the NPAs and recovery from NPAs through compromise, follow-up of the decreed accounts etc. and additional attention to the matters related to special tribunals. These are set up without creating any burden to the bank by using the unutilized premise of the branch in the area which is headed by a senior executive. Officers working earlier in rehabilitation cell in the controlling office are generally posted to these branches. These handle suit filed accounts, recalled advances and the cases in which legal
proceedings are yet to be initiated. The number of accounts in these branches could be in the range of 100. These keep a close contact with the advocates and court authorities. They have also been able to finalize a few compromise proposals. Recovery from the suit filed accounts is also affected in few cases. The overall recovery is in the range of 2 to 10 per cent of the total dues. Although the recovery percentage is presently low, the same seems to be reasonable since these being chronically stagnant accounts.

These branches experience a few problems. To elaborate, response to compromise proposals from the borrowers is not encouraging. Consequently, these branches have to go through the lengthy procedures for court settlements. In decreed accounts, details of assets of the judgement debtor are not available in most of the cases since the time lag between the date of filing and the award of a decree is more than 10 years. As a result of this, execution is found to be difficult. Finally, it is essential to create the required expertise by providing at least one law officer in the recovery branch.

Even after the transfer of accounts to the recovery branches, the original branches should continue to put in their efforts for recovery and assist the recovery branches in finalizing the compromise deals. While transferring the accounts, the original branches should ensure necessary details of net worth, securities, whereabouts of the key partners/directors and guarantors, etc. In this regard, they may also prepare a fresh inspection report on the accounts to be transferred to the recovery branches. Taking into account the increasing number of NPAs and complexities of recovery, these branches may engage professional recovery agencies on fee basis. But it should be ensured that these agencies should not follow unlawful measures. Similarly, to know about the details of the properties of the borrowers/ guarantors, services of a detective agency may also be hired provided their fees are reasonable. Lastly, wherever good clients are available in the local
area, they may also be persuaded to take over the recalled/decreed accounts to effect recovery.

10.6.14 Other Measures

It is suggested to review the existing system of staff incentives for recovery from hardcore NPAs/de-recognized interest. Incentives may also be offered to lawyers who can manage to get a decree in a record time. Close monitoring of suit-filed cases is also called for. Finally, recovery function may be out-sourced to certain extent. Recovery Agents may be appointed particularly for small advances who may be paid commission on the amount recovered. In this regard, there should be an agreement between the bank and the recovery agent in which there should be a clause to adopt only ethical practices for recovery from the borrowers. Any good work done by any staff member should be recognized for promotion, etc.

LEGAL MEASURES

10.6.15 Recovery through Judicial Process

When banks are convinced that all other non-legal recovery measures would not bring any positive result and the documents may become time barred, banks resort to legal action. Before taking a decision to file a suit, the banks should ensure that there are sufficient securities available in the account and the borrowers and guarantors are having adequate attachable assets to satisfy the decree against them. The purpose of obtaining the decree serves the purpose only when it is capable being executed.

Enough care has to be taken at early stage of recovery through the courts. These stages in chronological order include summon servicing, submission of a written statement, recording the evidences, arguments, framing of issues, decision and order. Firstly, the permission to file suit has to be obtained from the controlling office in the bank. Thereafter, the approved advocate should be contacted by the branch manager to file suit. Before filing the suits, banks should
ensure that documents are live, securities are properly charged to the bank, fresh financial report on borrower / guarantor is obtained, and a complete list of witnesses is prepared. The banker should exercise the right of set off / appropriations, if available. The plaint prepared by the advocate be checked up thoroughly as to the correctness of facts and figures. All parties and guarantors are to be sued. Names and addresses and securities should be stated properly and, suit should be filed in the court of the specified jurisdiction. A notice of demand to the borrower and the guarantor should be issued before commencing any legal action. In respect of a suit against the government, statutory notice should be sent in accordance with the provisions of Section 80 of CPC.

In particular, to serve the summons, address and other details of the defendant should be collected by the branch manager. Bank’s advocate should also be contacted in time and again to impress upon him to complete court formalities relating to hearing, submission of statement, etc. The branch manager should brief the advocate on banking aspects. After the decree is awarded, the details of the same should be read carefully. Execution of decree shall be in different forms such as delivery of property, appointing a receiver or in such other manner as the nature of relief granted, attachment and sale and by arresting of Judgement Debtor (JD). Execution by arrest is not available as a matter of right and arrest or detention cannot be ordered unless it is proved to the satisfaction of the court that the borrower is unwilling to pay inspite of adequate means to pay. The burden of proving this is on the decree holder. Court may refuse simultaneous execution against the person and property of the debtor.

If the Judgement Debtor dies before satisfaction of the decree / order, the decree holder may apply for execution against his legal representatives. The legal representative shall be liable only to the extent of the property if the deceased debtor which has come to his
hand and has not been fully disposed off. The court may compel such legal representatives to provide such account as it thinks fit. Similarly, the application for execution is to be paid by the decree holder. If he is dead, the legal representatives may apply for execution.

As soon as the accounts are decreed, it should be ensured whether the decree holder is in conformity with the claims made by banks in the plaint. In case of any major discrepancy from bank’s normal claim, steps should be taken for revision / appeal within a reasonable time, say one month from the date of decree. As soon as decrees are converted, execution petition should be filed within three months of the date on which certified copies are made available to the bank branch. In decreed accounts where certain agricultural land is to be attached, bank may participate in the auction for which necessary permission from the competent authorities within the bank is needed. In case securities are attached before judgement and / or after execution of decree and kept in bank’s custody, due care should be taken as to keep them in tact. When a case is decided partly or wholly against the bank, desirability of filling of an appeal or otherwise should be considered. If there is a default clause, which states that “whenever borrower fails to pay three consecutive installment, decree becomes absolute or otherwise” steps for execution of decree for whole amount should be initiated on occurrence of the default. The judgement debtor which does not pay in terms of the decree, alternative steps for execution, by attachment and sale of the properties and/or by arrest of the judgement debtor etc. as may be deemed for should be taken promptly. Insolvency law enables a creditor, who has obtained a decree to realize his debt by serving insolvency notice of not less than a month. A debtor who fails to comply the notice within the specified period, Bank can proceed against him for adjudicating him as an insolvent. If the property to be attached which is situated outside the jurisdiction of the court which has passed the decree, it should be got transferred to the other concerned court in whose jurisdiction the
Quite often, banks have to proceed against their borrowers in the court of law where no security is available. It takes a long time to obtain a decree like in other cases, and then proceed for execution of the decree so obtained. In such case, the Code of Civil Procedures 1908, Order 37 offers a quick remedy known as summary procedure suit, which the banker can use. The procedure of summary suit can be availed in applicable cases (such as bills of exchange, promissory notes, etc.) and in case of secured advance, the procedure is not advisable as security held by the bank is not enforceable under the Order 37. But under the Limitation Act 1963, there is no difference in the period of limitation between summary suits or other suits. As part of procedures the summons of the suit is issued first and when the defendant appears, the plaintiff is to serve on defendant summons for judgement. When the summons of the judgement is served, the defendant has to obtain the leave court to defend the case. If the defendant does not turn up for hearing, the claim of the bank is presumed to be admitted.

There are certain difficulties in respect of recovery through the courts. The time consumed in the entire process is very long. The long pending of civil suits hampers the settlement of the new cases. Even after a long waiting period in majority of the cases, courts go on circumstantial evidences and technicalities of the case. The court rulings and interpretations are such that even the attachable securities, primary as well as collateral, can not be enforced by banks to realize their dues partly or fully. Even where the securities can be enforced, the process takes a considerable time. When banks finally realize their dues, the amount recovered is much less than the amount lent, once inflation is taken into account. Further, suits filed by banks do not get any priority in the courts and they have to wait for their turn for the same to come up for hearing when securities deteriorate in value and
recovery, if at all, is negligible. When it is decided to execute the
decree awarded, there may not be a purchaser or he may offer such a
low price which may not cover the amount of default resulting in a loss
to the bank. Lastly, it has developed a feeling amongst defaulters that
they can resort to or force the banks to resort to legal actions so that
they can hold up requirements as long as possible or extract as much
monetary concessions as possible.

10.6.16 Debt Recovery Tribunals (DRTs)
The proposal for setting up of special Tribunals for recovery of debts
due to banks and financial institutions (FIs) was the important legal
development in the country. This proposal was very much in line with
the recommendations of the Tiwari Committee and the Narasimham
Committee. The need was felt for creation of such Tribunals due to
considerable delays in disposal of bank cases by the courts. These
Tribunals are set up under the Recovery of Debts due to Banks and

Under the Act, two types of Tribunals are set up i.e. Debt Recovery
Tribunal (DRT) and Debt Recovery Appellate Tribunal (DRAT). The
DRT is vested with competence to entertain cases referred to them, by
the banks and FIs for recovery of debts due to the same. Each DRT
consists of a Presiding Officer who is appointed by the Central
Government who is or has been or is qualified to be a District Judge.
But DRAT constitutes of only one person who is / has been / or is
qualified to be, a High Court Judge or, he must have, for at least three
years, held a post in the Indian Service Grade I or, he must have
worked as the Presenting Officer of DRT for atleast three years. The
order passed by a DRT shall be appealable to the Appellate Tribunal
but no appeal shall be entertained by the DRAT unless the applicant
deposits 75% of the amount due from him as determined by it.
However, the Affiliate Tribunal may, for reasons to be received in
writing, waive or reduce the amount of such deposit.
Under the ‘debt’ means “any liability (includes of interest) which is alleged as due from any person to a bank or a FI during the course of any business activity undertaken by the bank or the FIs or the consortium under any Law for time being in force, in cash, or otherwise further secured or unsecured, or whether payable under a decree or order of any civil court, otherwise substituting on and legally recoverable on the date of applications”.

Any case involving debt exceeding Rs 10 lakhs can be referred to Tribunal. However, the Central Government may reduce this ceiling, if need arises. Every suit or other proceeding pending before any court immediately before the date of establishment of a Tribunal under this Act being a suit or a preceding, the course of action whereon it is based is such that it would have been, if it had arisen after such establishment, within the jurisdiction of such Tribunal shall stand transferred on that date to such Tribunal. Under the Act, banks, All India Financial Institutions and RRBs are eligible to approach the Tribunal.

There may be three propositions relating to procedures. First, the Tribunal and the Appellate Tribunal shall not be bound by the procedures laid down under CPC, 1908. Second, they will be guided by the principles of ‘natural justice’. Third, subject to other provisions of this statute and of any rules, they shall have made to regulate own procedure, including the places at which they shall have their sittings.

An important power conferred on the Tribunal is that of making an interim order (whether by way of injunction or stay) against the defendant to debar him from transferring, alienating or otherwise dealing with or disposing of any property and the assets belonging to him within prior permission of the Tribunal. This order can be passed
even while the claim is pending.

After the claim is upheld by the Tribunal, it issues a certificate to the Recovery Officer and the latter has various powers in execution include attachment, sale, arrest, appropriation as Receiver and power to require the defendant (debtor) to remit the money to the Recovery Officer. Under the Act, the Recovery Officer possesses the powers as that of an Income Tax Officer for recovery debts due to the banks and FIs.

The Act provides the Tribunal and Appellate Tribunal the powers of a Civil Court in several matters. These include summoning of witnesses, discovery and production of documents, receiving evidence on affidavits and issuing commissions. The Act also requires both tribunals to dispose off the applications or appeals within a period of 6 months.

Various provisions of the Act are expected to facilitate expeditious recovery of the dues under sticky advances of the banks or FIs. The special machinery in the form of debt recovery tribunals and recovery officer will help in expediting the hearing, determinations and recovery of bank claims which generally wait in the queue for years even for reaching a stage of hearing. The creation of office of the Recovery Officer is much similar to that of the office of the Liquidator. The requirement of depositing of 75% of the claim amount for appeal will prevent endless tribunal appeals.

Procedures to be followed under the Act are simple. To start with, the concerned bank or FI is expected to make an application to the Tribunal within the specified geographical limits. The application should be accompanied by such statements or evidence and by the prescribed fees. On receipt of the application, the Tribunal shall issue summons requiring the defendants should cause within 30 days of the
service of the summons or to stay the relief prayed for should not be granted. The Tribunal after giving the applicant an opportunity of being heard, passes such orders on application as it thinks fit to meet ends of justice. The Tribunal may make an interim order whether by injunction or stay and debarring the defendant from the sale or transfer of assets. Thereafter, the Tribunal issues a recovery certificate and passes on to the Recovery Officer for recovery of the amount of debts as specified therein. The Recovery Officer should send a notice in writing and requiring the defendant or his related parties to pay the amount within the specified period. On receipt of money, the receipt will be issued. If the defendant fails to make the payment, the Recovery Officer will then seize the property and arrange for sale. He can even arrest the defendant if the circumstances so warrant. The aggrieved party may make an appeal within 45 days from the date of the order to the Appellate Tribunal which will then pass an order, confirming, modifying or cancelling the order, appealed against. There is a requirement of deposit of 75% of the claim amount though this can be waived or reduced at the discretion of the Appellate Tribunal.

At present, there are 29 DRTs and 5 Appellate Tribunals in the country. In order to provide the required infrastructure to DRTs, the RBI has asked banks and FI within the jurisdiction of the DRT should set up a Local Advisory Committee to interact with the Presiding Officer periodically and provide the required infrastructure.

In January 2000, the Act was amended. The major amendments include: the Government has powers to appoint more than one Recovery Officer in the DRT. The Recovery Officer requires the debtor to declare in affidavit the particulars of his assets. DRT can pass an order for recovery of the amount and issue certificates in case of the decrees that have been passed but has not executed. A party aggrieved by order of Recovery Officer can file an appeal before the DRT within 30 days from the date; the order is issued to him.
DRTs are criticized in respect of slow recovery considering the size of NPAs in the country. In general, it is observed that the defendants approach the High Court challenging the verdict of the Appellate Tribunal which leads to further delays in recovery. Validity of the Act is often challenged in the court which hinders the progress of the DRTs. Lastly, much needs to be done for making the DRTs stronger in terms of manpower and infrastructure.


The Act provides for enforcement of security by Banks/FIs in their favour without the intervention of court/tribunal. For this, the borrowal accounts should have been classified as NPAs and the Banks/FIs should issue a notice to the borrower to repay the liabilities in full within 60 days from the date of notice. The provisions of the Act shall not apply in case of loans up to Rs. 1 lakhs and in respect of any security interest created in agriculture land. Likewise, the cases where the amount due is less than 20 per cent of the principal amount and interest thereon, the same is outside the purview of the Act. The banks/ FIs are entitled to exercise all the rights of enforcement of securities subject to the above compliance. Such enforcement of security can be in the form of taking over possession/management of the secured assets and appointing any person to manage the assets. For this, the secured creditor shall have to submit an application in writing to the District Magistrate/Chief Metropolitan Magistrate in whose jurisdiction, the secured assets situate, to take possession of the assets and documents and forward to the secured creditor. In the case of joint financing of financial assets, the secured creditor can exercise the rights only if agreed upon by creditors whose share in the account is minimum 75% by value.
Any persons aggrieved by the measures taken under the Act may prefer an appeal to DRT within 45 days from the date on which such measures were taken. In case the appeal is made by the borrower with DRAT, he has to deposit 25 to 50% of the dues claimed in the notice issued by banks, financial institutions. The DRT has the discretion to waive or reduce the amount of this deposit. The verdict of the DRT on this appeal can be further challenged by debt recovery appellant tribunal within 30 days from the date of receipt of order of DRT.

The Act arms the lenders with powers to directly initiate recovery procedures by taking possession of the secured assets of the borrowers which would include the transfer of all underlying assets. The lender could, in effect, attach, sell or auction any of the assets taken over by them. They can also decide to take over the management of the assets, appoint any person to manage the assets taken over and also order settlement of dues from any person who has acquired the secured assets from the borrower.

The new law would not only help in recovering the existing NPAs of the Banks/FIs, but also curb the instincts toward willful defaults in future. The legislation protects banks/FIs from unnecessary legal hassles from defaulting companies and also from cross legislation among the FIs since many companies had secured loans from multiple financial institutions.

10.6.18 Other Legal Measures
Other Legal measures mainly include the recovery under State Finance Corporation Act, 1951 and Co-operative Societies Act, 1950. Section 29 of the State Finance Corporation Act, 1951 empowers State Finance Corporations (STCs) to take-over the management or
property or both of the industrial concern which has defaulted loan installments covering interest and principal. This right applies to the property mortgaged, pledged, hypothecated or assigned to the Finance Corporation. On take-over of the property, the corporation gets all the rights of the owner. This also refers to goods manufactured or produced wholly or partly from goods forming part of the security held by it. On receipt of sale proceeds of the property, the corporation is entitled to reimburse first all costs/expenses incurred in holding the property and arranging for subsequent sale and recovery of dues. If any surplus left over, the same shall be paid to the person entitled thereto. Where Finance Corporation has taken any action against and industrial concern under provisions of sub-section (I), the Finance Corporation has shall be deemed by the owner of such limited company for the purpose of suits by or against the concern, and shall then and be sued.

Despite the above wide-ranging powers, the Finance Corporations has not been able to recover much effectively because of non-cooperation from the management of the industries concern. Workers also agitate and prevent any take-over of the property. Thus, what is important is to create a conducive recovery environment and not just vesting the additional powers to the Financial Corporation as discussed above.

Recovery under the Maharashtra Co-operative Societies Act, 1960 is also possible. Credit institutions in co-operative sector have to apply to the Registrar to seek his assistance in recovery of dues from the members. The Registrar, after receiving necessary particulars, makes such inquiries, as he deems fit and then grants a certificate for the recovery amount due as arrears. The certificate granted by the Registrar shall be final and a conclusive proof and the same shall be enforceable according to the law like land revenue. Credit institutions in co-operative sector are taking full advantage of the facility provided under the Act. As discussed above, the recovery process is also slow
in this context, because of recovery climate which is not conducive besides lack of co-operation from defaulting members.

Thus, the list of recovery measures may go on when referred to innovative strategies adopted by banks and FIs from time to time. Adequate number of institutions are also set up to assist in recovery matters. Both the RBI and the GOI are busy in announcing new policy guidelines relating to recovery from NPAs. But the level of NPAs continues to remain high, through some recovery has taken place. For this, there are two reasons (a) credit expansion on continuous basis and (b) fresh NPAs added to the list every now and then. Consequently, there has been an incremental rise of Rs 3,000 crores (approximately) every year. To arrest this trend, enough care has been taken to prevent slippage in standard assets and upgrade the impaired loan assets. More importantly, the recovery drive should be taken up on a war footing. For this purpose, it is necessary to develop a healthy climate for recovery, by seeking co-operation from defaulters and institutions working at the grass-root level. In addition, there should be co-ordinated efforts by banks and FIs in recovery aspects. Recovery function in banks and FIs needs to be strengthened by inducting a professional approach. There should be adequate staff in the field to contact defaulters time and again. Staff involvement in recovery drive has to be ensured by offering sufficient incentives to them. Active lawyers may also be rewarded properly. Assistance from the professional agencies should liberally sought for. Above all, judicial machinery has to become more efficient to dispose off cases pending before them for years together. Similarly, DRTs have to gear-up to assist banks and FIs in their recovery effort. Lastly, the Government of India has to facilitate the process of seizure of assets of the defaulters and their subsequent sale for which the Central Registry and Asset Reconstruction Companies should be set up immediately. Lastly, in view of the proposed stricter NPA identification norm of 90 days in place of 180 days, which will be introduced by the end of March 2004, it is high time for banks and FIs to look into recovery matters
more closely and struggle a lot to arrest the growth in NPAs.

10.7  Factoring, Forfeiting and Export Finance

10.7.1  Factoring Services

Factoring services were started in America in the early 1920’s and in other parts of the world during 1960’s. In India, factoring business commenced in 1991. Today, there are more than 900 companies offering factoring services in 50 countries. Factoring is a financial service covering financing against receivables and collection of accounts receivables in domestic as well as in international trade. Basically, factoring is an arrangement in which receivables on account of sale of goods or services are sold to the factor at a certain discount. As the factor gets title to the goods and services on account of the factoring contract, he becomes responsible for all credit control, sales ledger administration and debt collection from the customers. Functions of the Factor include to provide finance against book debts up to 90% of the invoice value, undertake sales ledger administration covering book-keeping and collection of book debts, provide debt insurance to the client if there is a non-recourse agreement, analyze book debts and supply necessary information to the client. There are two types of factoring which include non-recourse wherein debt protection is available and recourse. There are three parties involved in factoring - client (seller of goods), customer (buyer of goods) and factor (financial institution providing factoring services). The factor levies his charges/fees for various services rendered. Factoring is very much useful to the SME borrowers who are always experiencing liquidity problems. By factoring of book debts, nearly 90% of their value is made available by the factor to the SME borrowers on assignment of the same. But the progress in introducing factoring services is not satisfactory because many of the corporates do not like their ancillary units to assign the book debts to the factor. They are hesitant to accept even the bills drawn on them by the ancillary units. Very few
banks in the public sector (State Bank of India, Canara Bank and SIDBI) have set up their own subsidiary units to offer factoring services. It is suggested that banks have to introduce factoring services besides creating a conducive environment for developing a bills-culture the same.

10.7.2 Forfeiting Services
Forfeiting is the purchase of receivables along with debt instruments, promissory notes and bills of exchange, due on a specific date and arising out of export of goods and services. Thus, the forfeiting is a source of trade finance which enables exporters to get funds from the institution called forfeiter. For SME exporters, such services are very much required. SME exporters would be able to get cash up to certain percentage of bills drawn and accepted by the importers. The exporter can convert export transaction under deferred payment arrangement into a cash transaction. Thus, the exporter can improve liquidity position. The forfeiter undertakes all risks associated with collection of debts after buying the same at a certain contract price. In the process, the exporter is relieved from the work of credit administration and collection of debts. In India, in 1992, the RBI authorized the Export and Import Bank of India (EXIM Bank) to undertake forfeiting services. Subsequently, even scheduled commercial banks have been authorized to render such services. As of today, banks in India merely act as an agent or a facilitator and they do not undertake all services including risk associated with collection of debts. But SME borrowers are very much interested in such services.

10.7.3. Export Finance
The export finance is extended to the exporters for executing export orders. The process starts with executing the export orders and ends with collection of receivables. Hence, export finance includes both Pre-shipment or Packing Credit Finance and Post-shipment Finance. Pre-shipment finance is provided when the exporter receives a confirmed
order or Letter of Credit (LC) received from him. Pre-shipment finance is provided in the form of Packing Credit which is required for purchase of materials, processing of goods, packing and shipping the goods. This is for a shorter period. The Packing Credit is liquidated out of Post shipment finance. Packing credit can be in domestic or in foreign currencies. Generally, banks cover their Packing credit facilities under Export Credit Guarantee Corporation(ECGC). In respect of Post shipment finance, it involves handling of export documents/bills, collecting proceeds thereof from a foreign bank or importer. This involves negotiation, purchase or discounting of bills. Finance is provided to the full amount of the bill. The post shipment credit is liquidated out of collection of bills. In this regard, it is essential to follow up of collection of bills. Every bank is expected to seek cover for the exchange risk. Since SME sector contributes nearly 35 per cent of the total exports in India, there is a lot of scope for the banks to provide export finance.

10.8 Conclusion

10.8.1 There are many areas of lending operations starting from project formulation, project appraisal, project implementation. Rehabilitation of problem project to loan recovery. In this chapter, it is attempted to suggest certain improvement in lending operations based on interactions held with branch managers and chiefs of SMEs in banks financial institutions. All these suggestions would help in making lending operations more SME customer friendly.

10.8.2 Thus far, problems experienced by SME customers have been analyzed based on the surveys of branch managers entrepreneurs and chiefs of SMEs in banks and financial institutions and success stories of SMEs and sick units. Several suggestions have also been made by bankers and borrowers. Hence, it is appropriate at this stage to finalize recommendations to banks, entrepreneurs besides making a summary of the study findings. These aspects are discussed in the
next chapter.

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