Internship Report on

Mitigating Credit Risk in SME Financing: IDLC Process

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Letter of Transmittal

4 November 2012

Jabir Al Mursalin

BRAC Business School (BBS)

BRAC University

Subject: Submission of Internship Report of BBA Program

Dear Sir,

It is my great pleasure to submit the internship report on ″ Mitigating Credit Risk in SME Financing: IDLC Process ″ which is a part of BBA Program to you for your consideration.

I made sincere efforts to study related materials, documents, observe operations performed in IDLC Finance Limited and examine relevant records for preparation of the report.

Within the time limit, I have tried my best to compile the pertinent information as comprehensively as possible and if you need any further information, I will be glad to assist you.

Thanking you,

Md.Tanvir Alam

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BRAC Business School (BBS)

BRAC University

Acknowledgement

At first I would like to thank my honorable internship supervisor from BRAC Business School (BBS), BRAC University, Jabir Al Mursalin for providing me such an opportunity to prepare an Internship Report on **“** Mitigating Credit Risk in SME Financing: IDLC Process**"**. Without her helpful guidance, the completion of this project was unthinkable. I would like to place my gratitude to the HR of IDLC Finance Limited to enable me to complete my internship in their esteemed organization. Very special thanks goes to Mr. Raiyan Rakib, Assistant Manager, Credit Risk Management, IDLC Finance Limited & Mr. Shazzadull Karim, Senior Officer, Credit Risk Management, IDLC Finance Limited, for helping me in all phase of the internship process.I am very thankful to Jahid Hossain, Imam Hossain, Maktabur Rahman, Ishrat Jahan, Shanzida Kabir, Bushra Ferdous for their help whenever needed during my internship tenure. I am grateful to Adnan Rashid and Avijit Barua for their support during my internship period. Their overwhelming support for my internship gave me the inspiration to do a better report. During my preparation of the project work I have come to very supportive touch of different individuals (respondents from IDLC Finance Limited) & friends who lend their ideas, time & caring guidance to amplify the report’s contents. I want to convey my heartiest gratitude to them for their valuable responses.

Executive Summary ___________________________

IDLC finance Limited is a major NBFI who is playing vital role for SME financing in Bangladesh. SME plays a very important role in economic advancement of Bangladesh. As major business of IDLC Finance Limited is providing SME loan facilities to the business along with various types of loan to individual and organizations therefore risk is associated with each and every product they are offering. Risk is the element of uncertainty or possibility of loss that prevail in any business transaction in any place, in any mode and at any time. In the financial arena, enterprise risks can be broadly categorized as Credit Risk, Operational Risk, Market Risk and Other risk. Credit risk is the possibility that a borrower or counter party will fail to meet agreed obligations. Thus managing credit risk for efficient management of a FI has gradually become the most crucial task. IDLC finance has its own process to mitigate credit risk. They make an appraisal report which shows the strength of the borrower and possible risk related to the loan how the risk can be mitigate. Besides the appraisal report IDLC maintain information about past borrower in a software named "Flexccube". So whenever these past borrower come to collect refinance, IDLC cross check the information with "Flexccube "information. Moreover IDLC gives highest priority to the CIB (Credit information bureau) report. If the report is not good and does not reflect the strength of the business than IDLC does not finance in that business. This report contains the full function of credit risk management in SME financing and at the end I provided some recommendation for better performance of credit risk management department of IDLC Finance Department.

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1. Introductory Part

1.1 INTRODUCTION

The development of financial market has been receiving heightened attention from the policy-makers in recent years. One explanation lies in the fundamental shift of development strategy reflected in the nearly universal embrace of the private sector as an engine of economic growth. The governments in both developed and developing countries, the international financial institutions which exert tremendous influence on the policy-making apparatus of developing countries and, to a great extent, the intelligentsia have all joined together as ardent advocates of private entrepreneurship. IDLC Finance Ltd, a leading financial institution of the country achieved significant growth in all areas of business up to 2nd quarter of the year 2012. IDLC began its operation in 1985 as the first leasing company in Bangladesh. In 1995, IDLC was licensed as a Financial Institution by the country's central bank and during the last two decades, the company has grown in tandem with the country's growing economy. The company's wide array of products and services range from retail products, such as home and car loans, corporate and SME products including lease and term loans, structured finance services ranging from syndications to capital restructuring and capital market services. The company also strengthened its presence in the country's growing stock market with launching a subsidiary-IDLC Securities Limited-which is offering full-fledged brokerage service for retail and institutional clients.

1.2 ORIGIN OF THE REPORT

Since practical orientation is an integral part of the BBA degree requirement, I was deputed by the BRAC Business School (BBS), BRAC University to IDLC Finance Limited to take real life exposure of the activities of the organization as a financial institution. During my internship at IDLC Finance Limited I have come across with different functions of the company. From them I have decided to work in the field of Credit Risk Management (CRM) and giving special emphasis on Credit Information Bureau report. This report has been originated as the course requirement of the BBA program. I hope the report will give a clear idea about the activities and role of Credit Risk Management in reducing the risk associated with the lease and loan thereby maintaining the IDLC's interest.

1.3 OBJECTIVES OF THE REPORT

The main objective of the study is to get a definite idea about how CRM plays a vital role in managing the risk associated with each and every product and services of IDLC Finance Limited. Furthermore, the orientation is very useful to detect whether the theoretical knowledge matches with real life scenario or not. Though the title " Mitigating Credit Risk in SME Financing: IDLC Process" very lengthy area, the specific objectives are as follows:

1. To know the necessity of Credit Risk Management.

2. To learn about the whole CRM procedure for SME loan facility in IDLC Finance Limited.

3. To know the decision making process to mitigate credit risk for SME Loan facility in IDLC Finance Limited .

4. To know about the probable modification can be done in the whole CRM process.

5.To fullfill the requirement of the internship program under BBA program.

1.4 METHODOLOGY OF THE STUDY

Analysis has been made on the basis of the objectives mentioned before in the context of " **Mitigating Credit Risk in SME Financing:IDLC Process"** The paper will be written on the basis of information collected from primary and secondary sources.

(i) Primary Data; Discussion with my Organization supervisor, discussion with SME department personnel and my team.

(ii) For the completion of the present study, secondary data has been collected. The main sources of secondary data are:

- Annual Report of IDLC Finance Limited.
- Website of IDLC Finance Limited.
- Data from published reports of SEC, DSE
- Different Books, Journals, Periodicals, News Papers etc.

1.5 LIMITATIONS OF THE STUDY

To make a report various aspects and experiences are needed. But I have faced some barriers for making a complete and perfect report. These barriers or limitations, which hinder my work, are as follows:

• Difficulty in accessing data of its internal operations.

• Non-Availability of some preceding and latest data.

• Some information was withheld to retain the confidentiality of the organization.

I was placed for only around 3 months of time & working like a regular employee hindered the opportunity to put the effort for the study. The time span was not sufficient enough to learn all the activities of the organization properly. Therefore, it was very difficult to carry out the whole analysis.

1.6 STRUCTURE OF THE REPORT

The report has two main parts: **Part One:** This is basically introductory part, the objective and scope of the study, limitations, and research methodology has been highlighted. Brief Introduction of IDLC Finance Limited, its product and service, organizational structure, performance, etc are presented. **Part Two:** Products of IDLC for which Credit Risk Management has become a key operational tool, how it performs its overall risk analysis and on the basis of the analysis identification of the ways of reducing the risk, thus maintains the core interest of the business. This part also contains the conclusion, reference & appendix of the report.

2. IDLC FINANCE LIMITED: Organization in Focus

2.1 Background

IDLC Finance Limited started its operation in the year 1985 as the pioneer leasing company as to facilitate lease financing and capital investment in industrial sector. Over the years, the company has evolved itself as a multi-product non-banking financial institution providing wide range of products and services. Over the last two decades IDLC has contributed relentlessly in the country's transition into a developing country and has emerged as Bangladesh's leading multi product financial institution. The company now offers a multitude of diverse financial services and solutions to both institutional and individual clients to cater for their unique requirement.

Throughout its history, IDLC always thrives to provide its clients the best financial solution effectively, efficiently and ethically. IDLC has been awarded the **"A+"** rating by Credit Rating and Information Services Ltd. (CRISL), the highest rating for any local institution, so far. It has also been awarded the first prize for the "Best Published Accounts: by Institute of Chartered Accountants of Bangladesh (ICAB).

2.2 History of IDLC

On May 23rd 1985, the IDLC of Bangladesh Limited was incorporated as a joint venture public limited company with the multinational collaboration of five foreign and three domestic financial institutions. Now, IDLC is one of the top twenty companies in the country with a number of product lines. The company has authorized capital of BDT 1,000,000,000/- (10,000,000 shares of Taka. 100 each) and paid up capital of BDT 200,000,000/- (2,000,000 ordinary shares of BDT 100 each).

The company maneuvered its strategic focus to service diversification in 1994 by launching its deposits schemes. In 1997, IDLC introduced Real Estate Financing and Short term Financing. During the period of 1998 and 2006, the company broadened its activities into the areas of corporate financing, underwriting, issue management, syndication and other investment banking related services and evolved as a truly multi product financial institution.

2.3 Key Milestones of IDLC

The Signposts of IDLC' journey are given below chronologically:

- May 23, 1985: Incorporation of the company.
- February 22, 1986: Commencement of leasing Business.
- May 18, 1986: Signing of first lease.
- October 01, 1990: Establishment of branch in Chittagong.
- March 20, 1993: Listing in Dhaka Stock Exchange.
- September 10, 1994: Licensed by Bangladesh Bank for Deposit Collection.
- February 07, 1995: Licensed as non-banking financial institution. Under Financial Institution Act-1993 of Bangladesh Bank.
- July 02, 1995: Licensed by Bangladesh Bank as offshore financier in Export processing zones (EPZ).
- November 25, 1996: Listing in Chittagong stock exchange.
- May 27, 1997: Commencement of House Finance and Short term Finance operations.
- January 22, 1998: Licensed as Merchant Banker by Securities and Exchange Commission.
- January 22, 1998: Licensed as Merchant Banker By Securities and Exchange Commission.
- January 15, 1999: Commencement of Corporate financing and Merchant Banking Operation.
- December 05, 2000: Exceeded Taka 1 billion mark of annual lease execution.
- May 22, 2002: Arranged the largest ever lease syndication amounting Taka 950 million by the corporate Finance Unit.
- January 29, 2004: Opening of the first retail focused branch at Dhanmondi.
- June 29, 2004: Opening of Gulshan branch.
- November 22, 2004: Launching of Investment Management Services "Cap Invest".
- February 7, 2005: Issuance of First Securitized Zero Coupon Bonds by IDLC Securitization Trust 2005.
- September 18, 2005: Launching of Local Enterprise Investment Center (LEIC), a center established for the development of SMEs with the contribution of the Canadian International Development Agency (CIDA) of the Government of Canada.
- January 2, 2005: Opening of SME focused branch at Bogra.
- April 6, 2006: Opening of branch at Uttara.
- May 18, 2006: Opening of Merchant Banking branch in the port city Chittagong.

- July 1, 2006: Reallocation of Company's Registered and Corporate Head Office at 57, Gulshan Avenue.
- September 18, 2006: Commencement of operation of IDLC Securities Limited, a wholly owned subsidiary of IDLC.
- March 14, 2007: Launching the Discretionary Portfolio Management Services "Managed Cap Invest".
- August 5, 2007: Company name changed to IDLC Finance Limited from Industrial Development Leasing Company of Bangladesh Limited.
- December 3, 2007: IDLC Securities Limited, Chittagong Branch commenced operation.
- December 18, 2007: IDLC Securities Limited, DOHS, Dhaka Branch opened.
- **January 6, 2009** Opening of Sylhet branch
- **August 26, 2009** Opening of Gazipur SME Booth
- **February 3, 2010** IDLC started its operati on at Narayanganj
- **February 24, 2010** Inaugurati on of Savar Branch
- **August 8, 2010** IDLC opened its 2nd branch in Chitt agong at Nandankanon
- **October 27, 2010** IDLC stepped in Comilla
- **December 23, 2010** IDLC inaugurated its Narsingdi Branch
- **December 27, 2010** Opening of Keranigonj Branch
- **June 15, 2011** IDLC started its operati on at Mirpur
- **August 9, 2011** Inaugurati on of Tongi Branch
- **August 16, 2011** Commencement of operati on of IDLC Investments Ltd., a wholly owned subsidiary of IDLC
- **January 18, 2012** Opening of Jessore Branch

2.4 Mission, Vision and Objective of IDLC

IDLC defines its mission statement as:

"We will focus on quality growth, superior customer experience and sustainable business practices."

For Customers: "Relentless pursuit of customer satisfaction through delivery of top quality services."

For Shareholders: "Maximize shareholders' wealth through sustained return on their investments."

For Employees: "Provide job satisfaction by making IDLC a center of excellence with opportunity for career development."

For Society: "Contribute to the well being of the society, in general, by acting as a responsible corporate citizen."

The Vision of IDLC is declared as:

"We will be the best financial brand in the country."

The goals of IDLC are:

"Long-term maximization of stakeholders' value."

Corporate Philosophy:

"Discharge functions with proper accountability for all actions and results and bind to the highest ethical standard."

Strategic objectives of IDLC are in the following statements:

- ✓ Create synergy by combining high quality and strategically balanced portfolios.
- ✓ Provide a range of financial products and services to our customers under one roof.
- ✓ Strengthening position in capital market operation.
- ✓ Balanced diversification of funding sources.
- ✓ Maximize corporate value through sustained high quality growth.
- ✓ Strengthening corporate governance practices.

IDLC's core values are:

- ✓ IDLC always places highest priority to the national interest. Utmost importance is always attached to country's growth and prosperity.
- ✓ IDLC employees are trained with the objective of developing good leaders rather than good managers.
- ✓ IDLC places emphasis on creativity and innovation to achieve organizational excellence.
- ✓ IDLC believes in adherence to the highest ethical standards.

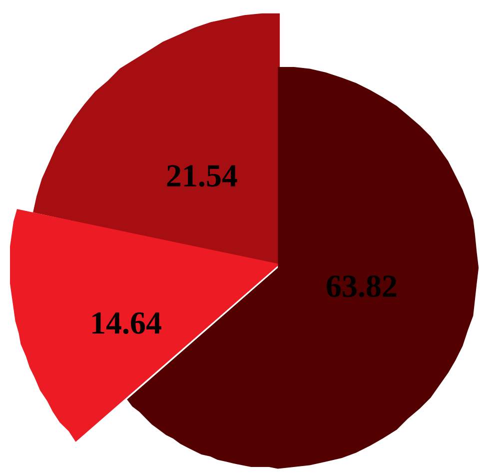
2.5 Shareholding structure of IDLC

IDLC was incorporated as a joint venture public limited company in the year 1985. Among two foreign and two local financial institutions foreign institution holds 47.3% of IDLC shares. Local sponsors and general public hold the rest 52.7% of the shares. Institutional share holding comprising of financial institution helps development through sharing of experience and professional approach at the highest policy making level. Brief profile of share holding institutions is given below:

The ownership structure of IDLC of Bangladesh Ltd is given below:

Table 1: Owners of IDLC

SPONSORS/DIRECTORS	
The City Bank Limite	28.37
Transcom Group	13.33
Eskayef Bangladesh Limited	8.00
Trans Craft Limited	4.01
Bangladesh Lamps Limited	1.32
Sadharan Bima Corporation	7.62
Mercanti le Bank Limited	7.50
Reliance Insurance Company Limited	7.00
Sub-total	**63.82**
GENERAL	
Insti tuti ons	
Bangladesh Fund	3.18
Eastern Bank Limited	2.19
Investment Corporati on of Bangladesh	1.29
Marina Apparels Limited	1.00
Other Insti tuti ons	6.98
Sub-total	**14.64**
Individuals	
General Public(Individuals)	21.54
Total Holdings	**100.00**



Source: IDLC Annual Report 2011

2.6 Diversity of Services

To ensure steady and long term growth as well as to sharpen its competitive edge in a changing and challenging business environment, IDLC always endeavors to diversify into other financial services which have long term prospects. In 1997, it expanded its range of services by introducing Housing Finance and Short Term Finance, which have broadened its customer base and have contributed significantly to IDLC's growth and profitability. In early 1999, after getting license of Merchant Banking from Securities and Exchange Commission, IDLC started its operation of underwriting, issue management, corporate financing and other investment banking related services.

2.6.1 Leasing

IDLC offers full payout lease finance for any type of machinery and equipment required in the manufacturing and service sectors.

2.6.2 Term Loans

Term loan is offered for corporate and project financing to establish project or to expand business or re-financing existing financing. IDLC's Term Loan offers:

- ✓ Funding for specific purposes
- ✓ Competitive interest rates, fixed or variable
- ✓ Flexible terms
- ✓ Variety of collateral options

2.6.4 Short Term Finance (STF)

STF provides Factoring of Accounts Receivables and Work Order Finance services to assist in the finance and management of accounts receivables and maximize business growth.

2.6.5 Home Loan & Real Estate

I. Individual House Loan Scheme for

- ✓ Purchase of apartments
- ✓ Construction of house
- ✓ Renovation & extension of house
- ✓ Purchase/construction of house for the employees under corporate house finance scheme
- ✓ Office space/premises for professionals

II. Developers' Finance Scheme for:

- ✓ Construction of Apartments projects

III. Corporate Finance Scheme for:

- ✓ Purchase of office space/chamber/display center
- ✓ Construction/purchase of commercial building
- ✓ Constructions of commercially viable projects like school, hotel, and hospital, etc
- ✓ Constructions of industrial buildings like factory, godown, warehouse etc.

i) Corporate Finance

- ✓ Syndication services for large-scale investments
- ✓ Advisory services such as corporate counseling, project counseling, capital restructuring, financial engineering, etc.
- ✓ Merger and acquisition services
- ✓ Securitization of assets

ii) Merchant Banking

- ✓ Issue Management
- ✓ Underwriting
- ✓ Private placement of stocks
- ✓ Trusteeship management
- ✓ Bridge finance
- ✓ Cap Invest
- ✓ Managed Cap Invest

iii) SME Division

- ✓ Business Loan
- ✓ Machinery Loan
- ✓ Double Loan
- ✓ Women's Entrepreneur Scheme

2.7 SWOT Analysis

The SWOT analysis for IDLC can be described as follows:

Strengths

1. **Reputation and brand image:** IDLC is well-reputed company and has developed a brand image that is recognized by the customers. IDLC is an international joint-venture company and its shareholders have long records of sustainability and reliability in their respective fields. IDLC is one of the esteemed names in financial market of Bangladesh. Since 1985, IDLC has marked its journey through introduction of various innovative products and thus meeting the needs of large corporate clients.

2. **Product portfolio:** IDLC has diverse product portfolio for customers which made them second to none in Non-Banking Financial Industry.

3. **Quality Customer Portfolio:** IDLC has a Credit Risk Management department of Multinational standard which enables the company to maintain a quality customer portfolio.

4. **Human Resources:** The Company has competent management team. The over all work force of the company is considered as key resources for the organization. IDLC personnel are motivated, competent, energetic and creative. The company provides utmost support in terms of both technical and moral.

5. **Operational efficiency:** IDLC provides customized solution to their customers to adjust their need. The company processes the loan applications quickly and smoothly. The sanction and disbursement of the loans are hassle-free.

6. **Employee Empowerment:** At IDLC decision-making is free flowing and transparent. Every appraiser is given ample opportunity to exercise his/her creativity in

accommodating a customer. Approvers are open for any discussion and sanction is largely based upon recommendation of the appraisers. The open and free flow of communication ensures clarification of any queries in no time--from any level of hierarchy. Reasonable suggestions are not only welcome but are highly appreciated. Effective suggestions by the employees are immediately set for action. This flexibility has helped IDLC a lot in shaping up its operations into a level of efficiency and to be an excellent performer in case of loan recovery.

Weaknesses

1. **High Cost of fund:** IDLC as any other NBFIs have high cost of fund in comparison to banks. As NBFIs can take deposit for less than one year from any individuals as banks can do, the deposit base of IDLC is not strong enough to reduce the average cost of fund.

2. **More Focus on Volume:** Although IDLC has department called Credit Risk Management to monitor the asset quality of the company, still the company sometimes for the sake of profit and past relationship provide loans to customers who at the end hamper the portfolio quality of IDLC.

3. **Too Much Diversification:** Too much diversification of product and services offering hamper the focus on the core services of the organization.

4. **Less People in Liability Marketing:** IDLC still employs lesser number of workforces for the aggressive liability marketing in comparison to banks and NBFI like DBH.

Opportunities

1. **Continuity of Liberalization:** Government has continued to liberalize the economy towards more market orientation. This encouraged both local and foreign investors to invest in potential sectors. The privatization plan of government is likely to have positive impact on industrialization.

2. **Foreign Investment in Prospective Sectors:** In recent days foreign investment in the various prospective sectors has increased phenomenally. This creates a good opportunity for all financial institutions to enter in the booming new sector.

3. **Local banks inefficiency:** One of the major reasons for thriving of leasing company in Bangladesh is local banks inefficiency of providing project loan. This phenomenon still persists.

Threats

1. **Threat from banks:** In recent times banks are also entering into leasing business which is generally considered as functions of Non-Banking Financial Institutions.

2. **Regularity control of government:** The legal framework of Bangladesh is relatively weak. Lack of effective foreclosure laws and manual land recording system creates possibility of forgery and disputes. This may hinder the loan recovery from the defaulters.

3. Internship Experience:

IDLC Finance Limited is a leading non banking financial institution in our country. It started its journey in back 1985. I am fortunate to work for IDLC finance limited. My work destination was IDLCs' Gulshan branch. I worked in Credit risk management and more specifically CIB and CIF unit. I worked under Raiyan Rakib, Assistant manager CRM department.

Specific job responsibilities:

- Check the CIB undertaking form
- Give reference number on the undertaking form
- Give entry of the reference number in an office notebook
- Give entry of the reference number in spreadsheet
- Give reference number on the CIB undertaking form which has errors listed as a stock list
- Give entry of the reference number of these stocks in to office notebook
- Give entry of the reference number of these stocks in spreadsheet
- Create customer information form by using flex cube software
- Edit customer information form by using flex cube software
- Give mail to respective personnel for specific query
- Download CIB report from Bangladesh Bank Website
- Print and photocopy of the specific report
- Create Error type-2 file
- Create and give entry of the error type-2 status in an official note book and in a spreadsheet.
- Maintain duplicate undertaking form list

Observation:

IDLC Finance limited is a very pleasant place to work. Everyone is helpful and very keen to support whenever needed. The environment of the workplace is very flexible. They treat the intern as their employee. They never discriminate between intern and their regular employee. Everyone was very helpful in IDLC Finance Limited. To do work they gave me a Computer and a laptop. I had also my own desk. So I found the workplace very enjoyable and very flexible for new employee and for intern.

Recommendation:

IDLC Finance Limited uses up to date software. But most of the computer is slow. So it took time to open large files. Moreover, they still use CRT monitor in their office.

So my recommendations for above problems are,

- Use high speed computer
- Use LED monitor instead of CRT monitor

4.0 SME in Bangladesh

4.1 Introduction

We have come across many definitions of SMEs in Bangladesh. According to the Industrial Policy document from the Ministry of Industries, a small enterprise is defined as a registered enterprise with less than 50 workers, excluding the cottage units, and with a fixed capital investment of less than BDT 100 million (approx. USD 1.8 million). A medium enterprise is defined as a registered enterprise with between 50 and 99 workers, and/or with a fixed capital investment between BDT 100 million and BDT 300 million (between USD 1.8 million and USD 5.4 million).

The PCBs (Private Commercial Banks) seem to have various definitions based on loan components. The small-scale segment is in general defined as enterprises with a loan component between BDT 300,000 and BDT 10 million (between USD 5,500 and USD 185,000). Medium companies are said to have a loan component between BDT 10 million and BDT 100 million (between USD 185,000 and USD 1.85 million).

Under yet another definition the World Bank estimates that Bangladesh has approximately 27,000 medium-scaled enterprises (here defined by the Government of Bangladesh as registered enterprises with assets larger than USD 600.000 equivalent) and 150,000 small-scale enterprises (registered enterprises with assets of less than USD 600.000 equivalent). The small and medium scale enterprises (SMEs) are mainly found within the industry and services sector. In 2000, the service sector represented about 51% of Bangladesh GDP, while the industry sector represented 24.4%. SMEs represent roughly 82% of the total industrial labor force and 23% of the total labor force. Agriculture accounted for 24.6% of GDP in 2000, down from 40% in the 1980's. Still, agriculture is the primary occupation of about 70% of the population. These figures are, like most other Bangladeshi statistics highly uncertain. Furthermore they reflect the fact that most economic activities in the rural areas take place in the informal sector. Agriculture, therefore, has a much larger share of the country's "real" economy than is reflected in the GDP figures.

"SMEs are a very heterogeneous group in Bangladesh, comprising a wide variety of firms of village handicraft makers, small machine shops, restaurants, printing presses, bicycle rickshaw assembly, cartwheels, electrical goods, engineering workshops, footwear, plastic products, plastic spectacle frames, print shops, specialized silk weaving, tailoring shops owned by women, building material supply, food preparation, small grocery stores, waste paper collection, etc. In the context of Bangladesh, a portion of readymade garments manufacturing enterprises also falls under SME sector. A typical SME in Bangladesh requires on average investment of only BDT 36,000/- compared to BDT 1,338,000/- required by a large-scale industry in generating one unit of employment.

In spite of their employment generating role SMEs in Bangladesh, as in the rest of South Asia, do not realize their potential as significant contributors to sustainable growth and job creation - both of which are particularly needed in this region to offset deep persistent poverty levels. Global trade liberalization, perhaps above all other forces, is reshaping the economies, bringing new possibilities, but also presenting new challenges. This applies to Bangladesh SMEs as well."

4.2 Constraints on SME Growth

The lack of growth of SMEs in Bangladesh can be attributed to several factors, including:

- Persistent low levels of national income that have precluded construction of efficient physical infrastructure needed to grow competitive businesses;
- Historical governance structures that have allowed the few well-connected to harvest and keep the majority of economic resources, and restricted access for the majority;
- Fairly long histories of government ownership/control of most productive, non-farm resources, control that is only now being transferred partially to private sector.
- Evolving but still highly fragmented policy/regulatory frameworks that have yet to create the low-level barriers to business entry, operations, and trade that support SME growth;
- Underdevelopment of core market support institutions that supply essential public and private services, including many government, financial and education services;
- Unduly restricted access for private SMEs to credit services of banks, due in large part to government-dominated financial sectors and politically motivated credit policies, whether lending targets or directed subsidies;
- Immature business development services (BDS) such as information, training, and consulting services. This is due to general constraints to private sector development, to government dominance of the marketplace. In some places it is also due to large donor flows of subsidized funds that have distorted markets and crowded out sustainable private sector provision of BDS.

4.3 Government's Role towards SME

Industrial development has been attempted in the past under widely divergent policy regimes. The early phase of industrialization was characterized by an import substitution strategy and a strong regulatory role of the Government. Later the governments have turned, although not always wholeheartedly, to market oriented deregulation. Significant achievements in population control, food production, infrastructure development and stabilization of the macro-economy have not been accompanied by sufficiently faster economic growth and the employment generation needed to alleviate poverty by enhancing the role of the private, i.e. SME sector.

The Government has recognized in the Industrial Policy document adopted in 1999, that the industrial policy should be updated to achieve the objective of accelerating industrial growth and to gain a greater industry share of the GDP. Support of small and medium enterprises is part of this policy.

The World Bank states in its Bangladesh Country Strategy document that the Government's first priority must be to raise investment by giving the private sector the reform confidence necessary to invest in export oriented manufacturing activities and by urgently and substantially improving implementation of public investment in infrastructure and human resource development. The Government's second priority should be to make the deregulation of the private sector much more effective, while third priority should be to enter into long term arrangements with domestic and overseas investors. The World Bank emphasizes completion of the long delayed privatization program.

4.4 SME Financing in Bangladesh

A survey of the small and micro enterprises operating in the Dhaka metropolitan area showed that enterprises which required between USD 4,000/- to USD 200,000/- financing have no access to any form of financial services as well as overall professional services including marketing, accounting and professional support services.

The main source of financing for SMEs in Bangladesh is loans from members of the family and friends. These loans often take time to mobilize and are therefore not helpful in times of emergency.

When SMEs turn to the private banks, they mainly do it to obtain loans to cover their working capital needs. But only a small portion of them actually obtains loans from the banks. Trade credit is the second most important source for working capital to many small entrepreneurs. But it is provided at a much higher rate of interest than loans from the banks. Moneylenders are also included in the list of sources of funds for SMEs, but are only used in emergency situations. Finally, supplier credit for capital items, other business owners, venture capital companies etc. are other sources of SME financing.

The reasons generally provided by the SMEs why purchase of fixed assets are not financed by banks are:

- The enterprises lack good collateral securities,
- Informal loans are faster and more convenient,
- Interest rates charged by relatives and friends are lower.

For many SMEs applying for formal credit is an innovative act. Proper documentation can take considerable time and effort when an entrepreneur is not familiar with such procedures.

The above notwithstanding, in a survey commissioned as background work for SEDF, the top problem sited by managers of SMEs was lack of access to SME loans. In a World Bank study of ten private banks in Bangladesh in October 2000, only four banks were active towards SMEs, the remaining were mainly focused towards trade finance and loan to larger companies.

The credit market in Bangladesh can be divided based on funding requirement and access to finance. Currently, micro-finance entities are helping activities requiring up to USD 4,000/-, and the formal commercial banking system is financing credit greater than USD 200,000/-.

In an IFC Appraisal Report for BRAC Bank, the Bangladesh banking market has been divided into four distinct segments as shown below, only one of which is the main target market of the SEDF -program, and whose credit needs are very large as detailed below under Group 3.

Table 2: Segmentation of the Credit Market by Groups in terms of Loan Size

Market Segment	**Intermediary/ Vehicle**	**Key Loan Size and Conditions**
1) Micro-credit	BRAC Rural Development Program, Grameen, ASA, Proshika and others	BDT 2,000 – 15,000 (USD 40-300); 15 % pa; 1 year; bi-weekly instalments. BRAC's average loan size is BDT 2,600 (USD 52). Grameen's average loan size is believed to be BDT 11,000 (USD 220).
2) Micro enterprises	MELA loans	BDT 20,000 – 200,000 (USD 400-4,000); 15% p.a.; monthly installments;
3) Small and Medium Sized Enterprises, SMEs	Private Banks	1-3 years; 13-15% p.a.; monthly or quarterly installments. • BDT 200,000 – 1 million (USD 4,000-20,000) • BDT 1m – 3m (USD 20,000- 60,000) • BDT 3m – 10m. (USD 60,000-200,000)
4)Large Enterprises companies and corporations	NCBs and private banks	Greater than BDT 10 million (USD > 200,000); 4-5 years; 13 % pa; quarterly installments. The private banks and international banks tend to keep credits short, less than 1 year.

Segment 1: Micro-credit

BRAC, Grameen, ASA, Proshika presently serve the micro-credit segment and numerous smaller NGO-financed schemes, through their micro-credit programs. These are characterized by a number of important factors. They often exist as part of a comprehensive program of development activities, including health programs, social development, education, compulsory savings schemes, and loans for business development (usually on a sole-trader basis) and group support for borrowing. Each member of the group assumes responsibility (moral, if not financial) for the other members' repayment obligations; the bi-weekly installment plan results in high real interest rates (e.g. 23 – 25 % effective yield for a quoted 15 % annual rate). Often the rate is considerably higher than this. The only alternative is the local moneylender, whose interest is often 40 – 50 – 60%. As of 1998, close to 10 million households were participating in some form of a micro-credit program.

Cumulative disbursements are estimated at around USD 2.8 billion, close to 25 % (in 1998) of total banking sector assets. Most of these loans have been better performing than the banking sector assets with average 95 % cash collection ratios (notwithstanding the floods of 1998 which affected the portfolio quality of most micro-credit institutions). The finance programs are therefore managed as only one part of a much larger whole, developing the rural poor members in many non-financial ways as well as financial.

1. **Segment 2: Micro- Enterprises (MELA)**

The MELA program is an example of the second segment. It was established by BRAC in December 1996 with the first loans disbursed early 1997. The target group is composed of small business owners (sole proprietors). The loans are above the micro-finance, but lower than the small enterprise level. It was felt that there was a need for loans larger than BDT 10,000 (USD 200) for financing small businesses. MELA's clients fall into 2 groups: (1) those which have graduated from BRAC micro-credit programs - these account for 60 % of the total number, but only 45 % of the total disbursed amounts; (2) "the public" – defined as those clients which had no previous association with BRAC. An analysis of the MELA programs indicates that most of its customers were of the sole proprietors' type: operating their businesses with a small number of staff and closely involved with the business. The analysis indicated that these businesses have a limited profitability.

2. **Segment 3: SME Market**

The SME Market represents credit needs ranging from USD 4,000 – USD 200,000. This group is estimated to be large, and under-served. Estimates from Bangladesh Small and Cottage Industries Corporation (BSCIC) indicate that in Bangladesh there are over 200,000 viable small enterprises which are registered with the BSCIC as members with credit needs in the range of USD 5,000 – USD 150,000. This translates into an approximate target market size of approximately USD 5 billion to USD 15 billion. In a country where the asset base of the financial systems is estimated at USD 15 billion, this represents a significantly large market. It is quite clear however that it is the lower end of SME segment which is most underserved. Almost all PCB loans to the SME sector goes to medium sized enterprises, and few government schemes directed towards the small enterprises seem to function as to the intentions.

5.0 Approaches of SME Financing by IDLC

5.1 Introduction

Successful SME financing strategy is a key success factor for IDLC. For facilitating SME financing, IDLC had earlier established a separate division, namely 'Emerging Corporate Division', in early 2003. Basically under this division, IDLC has mainly financed smaller corporate clients. In 2006, this division was renamed to SME division to reach out to really small segment of the market.

In order to tap the lower segment of the market and strengthen the SME financing, IDLC has launched Retail SME Finance Products. In this niche, IDLC has been able to do business with a higher spread, and the availability of cheap source of funds in the form of refinancing from Bangladesh Bank has contributed to greater profitability.

Around 78% of IDLC's clients belong to SME segment based on fixed capital investment size, and SME client share 56% of IDLC's total loan portfolio. Moreover, in late 2005, IDLC established a branch in Bogra, specially focused to SME financing.

5.2 Retail SME Finance Products

In October 2005, IDLC launched three Retail SME Schemes, besides its regular SME lease financing facility, Machinery Loan.

5.2.1 Business Loan

Business loan is provided in the form of term loan or working capital loan. This loan is ranged from BDT 200,000/- to BDT 5,000,000/-. Track record of at least one year of successful operation is a must for availing this financing facility. This loan has been provided for the tenure of 12 to 36 months with repayment mode of monthly installments. This facility is devised to groom small entrepreneurs to future leaders in the industry. Upto BDT 1,000,000/- financing can be provided with no collateral under this scheme. Hypothecation of Inventory and machineries, and personal guarantee from two acceptable persons and any other security as deemed fit is taken as security under this scheme.

5.2.2 Double Loan

Under this product, loan amounting to double of the FDR amount is provided and if the business is found to be feasible, that further security may not be insisted on. This loan is also provided in the form of term financing, and the range of financing is same as business loan. The scheme provide financing for the maximum tenure of 48 months, and generally two years of successful business operation is required to be eligible to attain it. The security requirement is same as business loan.

5.2.3 Women Entrepreneurs Loan

This scheme is specially devised to finance the successful businesses of women entrepreneurs, and to contribute in the emancipation of women in the society. Any woman entrepreneur with al least two years of successful business operation can avail this loan, where no collateral is needed upto BDT 1,500,000/-. All the specification of this scheme is the same as business loan. Bangladesh Bank provides special refinancing facility for this scheme, making the borrowing rate significantly low.

5.2.4 Machinery Loan (Lease)

This is actually lease financing facility for SME clients. IDLC offers the most competitive and flexible lease financing for all types of manufacturing and service equipment. In Machinery Loan, the client has the full liberty to select the equipment and supplier and also to fix terms and conditions, including price. Lease rental is determined on the basis of acquisition cost and lease term. Lease term usually ranges from 1 to 4 years. Other conditions are same as business loan. Client is required to arrange for the insurance coverage on the leased equipment for the entire lease period. He is required to maintain the leased equipment in good operating condition, though insurance shall cover most of the abnormal risks.

6.0 Credit Risk Management

6.1 Introduction

This section details fundamental credit risk management policies and strategies that are recommended for adoption by all FIs in Bangladesh. The guidelines contained herein outline general principles that are designed to govern the implementation of more detailed lending procedures and risk grading systems within individual FIs. It is the overall responsibility of FI's Board to approve FI's credit risk strategy and significant policies relating to credit risk and its management which should be based on the FI's overall business strategy. To keep it current, the overall policy and strategy has to be reviewed by the Board, preferably annually.

6.1.1 Credit Risk Policy

Every FI should have a credit risk policy document that should include risk identification, risk measurement, risk grading/ aggregation techniques, reporting and risk control/ mitigation techniques, documentation, legal issues and management of problem facilities. The senior management of the FI should develop and establish credit policies and credit administration procedures as a part of overall credit risk management framework and get those approved from Board. Such policies and procedures shall provide guidance to the staff on various types of lending including Corporate, SME, Consumer, Housing etc. Credit risk policies should:

- Provide detailed and formalized credit evaluation/ appraisal process
- Provide risk identification, measurement, monitoring and control
- Define target markets, risk acceptance criteria, credit approval authority, credit origination/ maintenance procedures and guidelines for portfolio management
- Be communicated to branches/controlling offices. All dealing officials should clearly understand the FI's approach for credit sanction and should be held accountable for complying with established policies and procedures
- Clearly spell out roles and responsibilities of units/staff involved in origination and management of credit

In order to be effective, these policies must be clear and communicated down the line. Further any significant deviation/exception to these policies must be communicated to the top management/Board and corrective measures should be taken. It is the responsibility of senior management to ensure effective implementation of these policies duly approved by the Board.

6.1.2 Credit Risk Strategy

The very first purpose of FI's credit strategy is to determine the risk appetite of the FI. Once it is determined the FI could develop a plan to optimize return while keeping credit risk within predetermined limits. It is essential that FIs give due consideration to their target market while devising credit risk strategy. The credit procedures should aim to obtain an in-depth understanding of the FI's clients, their credentials & their businesses in order to fully know their customers.

- Each FI should develop, with the approval of its Board, its own credit risk strategy or plan that establishes the objectives guiding the FI's credit-granting activities and adopt necessary policies/ procedures for conducting such activities. This strategy should spell out clearly the organization's credit appetite and the acceptable level of risk-reward trade-off for its activities
- The strategy would, therefore, include a statement of the FI's willingness to grant facilities based on the type of economic activity, geographical location, currency, market, maturity and anticipated profitability. This would necessarily translate into the identification of target markets and business sectors, preferred levels of diversification and concentration, the cost of capital in granting credit and the cost of bad debts
- The strategy should delineate FI's overall risk tolerance in relation to credit risk, the institution's plan to grant credit based on various client segments and products, economic sectors, geographical location, currency and maturity
- The strategy should provide pricing strategy and ensure that FI's overall credit risk exposure is maintained at prudent levels and consistent with the available capital
- The strategy should provide continuity in approach and take into account cyclic aspect of country's economy and the resulting shifts in composition and quality of overall credit portfolio. While the strategy would be reviewed periodically and amended, as deemed necessary, it should be viable in long term and through various economic cycles
- Senior management of a FI shall be responsible for implementing the credit risk strategy approved by the Board

6.2 Lending Guidelines

All FIs should have established "Lending Guidelines" that clearly outline the senior management's view of business development priorities and the terms and conditions that should be adhered to in order for facilities to be approved. The Lending Guidelines should be updated at least annually to reflect changes in the economic outlook and the evolution of the FI's facility portfolio, and be distributed to all lending/marketing officers. The Lending Guidelines should be approved by the Managing Director/CEO & Board of Directors of the FI based on the endorsement of the FI's Head of Credit Risk Management and the Head of Business Units.

Any departure or deviation from the Lending Guidelines should be explicitly identified in credit applications and a justification for approval provided. Approval of facilities that do not comply with Lending Guidelines should be restricted to the FI's Head of Credit or Managing Director/CEO or Board of Directors.

The Lending Guidelines should provide the key foundations for account officers/relationship managers (RM) to formulate their recommendations for approval, and should include the following:

- **Industry and Business Segment Focus**

  The Lending Guidelines should clearly identify the business/industry sectors that should constitute the majority of the FI's facility portfolio. For each sector, a clear indication of the FI's appetite for growth should be indicated (as an example, Textiles: Grow, Cement: Maintain, Construction: Shrink). This will provide necessary direction to the FI's marketing staff.

- **Types of Facilities**

  The type of facilities that are permitted should be clearly indicated, such as Lease, Term Loan, Home Loan, and Working Capital etc.

- **Single Borrower/Group Limits/Syndication**

  Details of the FI's Single Borrower/Group limits should be included as per Bangladesh Bank guidelines. FIs may wish to establish more conservative criteria in this regard.

- **Sector Lending Caps**

  An important element of credit risk management is to establish exposure limits for single obligors and group of connected obligors. FIs are expected to develop their own limit structure while remaining within the exposure limits set by Bangladesh Bank. The size of the limits should be based on the credit strength of the obligor, genuine requirement of credit, economic conditions and the institution's risk tolerance. Appropriate limits should be set for respective products and activities. FIs may establish limits for a specific industry, economic sector or geographic regions to avoid concentration risk.

- **Product Lending Caps**

  FIs should establish a specific product exposure cap to avoid over concentration in any one product.

- **Discouraged Business Types**

  FIs should outline industries or lending activities that are discouraged. The FI may have segregated sectors to be discouraged based on the following:

Government Specified	Best Practice	Company Specific
• Military Equipment/Weapons Finance • Lending to companies listed on CIB black list or	• Highly Leveraged Transactions • Logging, Mineral Extraction/Mining, or other activity that is Ethically or Environmentally Sensitive	• Finance of Speculative Investments • Share Lending • Taking an Equity Stake in Borrowers • Lending to Holding Companies

known defaulters	• Counter parties in countries subject to UN sanctions	• Bridge Loans relying on equity/debt issuance as a source of repayment.

- **Facility Parameters**

  Facility parameters (e.g., maximum size, maximum tenor, and covenant and security requirements) should be clearly stated. As a minimum, the following parameters should be adopted:
  - FIs should not grant facilities where the FI's security position is inferior to that of any other financial institution.
  - Assets pledged as security should be properly insured.
  - Valuations of property taken as security should be performed prior to facilities being granted. A recognized 3rd party professional valuation firm should be appointed to conduct valuations.

- **Cross Border Risk**

  Risk associated with cross border lending. Borrowers of a particular country may be unable or unwilling to fulfill principle and/or interest obligations. Distinguished from ordinary credit risk because the difficulty arises from a political event, such as suspension of external payments

  - Synonymous with political & sovereign risk
  - Third world debt crisis

6.3 Credit Assessment & Risk Grading

6.3.1 Credit Assessment

A thorough credit and risk assessment should be conducted prior to the granting of a facility, and at least annually thereafter for all facilities. The results of this assessment should be presented in a Credit Application that originates from the relationship manager/account officer ("RM"), and is reviewed by Credit Risk Management (CRM) for identification and probable mitigation of risks. The RM should be the owner of the customer relationship, and must be held responsible to ensure the accuracy of the entire credit application submitted for approval. RMs must be familiar with the FI's Lending Guidelines and should conduct due diligence on new borrowers, principals, and guarantors.

It is essential that RMs know their customers and conduct due diligence on new borrowers, principals, and guarantors to ensure such parties are in fact who they represent themselves to be. All FIs should have established Know Your Customer (KYC) and Money Laundering guidelines which should be adhered to at all times.

Credit Applications should summaries the results of the RMs risk assessment and include, as a minimum, the following details:

- Amount and type of facility(s) proposed
- Purpose of facilities
- Facility Structure (Tenor, Covenants, Repayment Schedule, Interest)
- Security Arrangements
- Government and Regulatory Policies
- Economic Risks

In addition, the following risk areas should be addressed:

- Borrower Analysis. The majority shareholders, management team and group or affiliate companies should be assessed. Any issues regarding lack of management depth, complicated ownership structures or inter-group transactions should be addressed, and risks mitigated.

- Industry Analysis. The key risk factors of the borrower's industry should be assessed. Any issues regarding the borrower's position in the industry, overall industry concerns or competitive forces should be addressed and the strengths and weaknesses of the borrower relative to its competition should be identified.

- Supplier/Buyer Analysis. Any customer or supplier concentration should be addressed, as these could have a significant impact on the future viability of the borrower.

- Historical Financial Analysis. Preferably an analysis of a minimum of 3 years historical financial statements of the borrower should be presented. Where reliance is placed on a corporate guarantor, guarantor financial statements should also be analyzed. The analysis should address the quality and sustainability of earnings, cash flow and the strength of the borrower's balance sheet. Specifically, cash flow, leverage and profitability must be analyzed.

- Projected Financial Performance. Where term facilities (tenor > 1 year) are being proposed, a projection of the borrower's future financial performance should be provided, indicating an analysis of the sufficiency of cash flow to service debt repayments. Facilities should not be granted if projected cash flow is insufficient to repay debts.

- Credit Background. Credit application should clearly state the status of the borrower in the CIB (Credit Information Bureau) report. The application should also contain liability status with other Banks and FI's and also should obtain their opinion of past credit behavior.

- Account Conduct. For existing borrowers, the historic performance in meeting repayment obligations (trade payments, cheques, interest and principal payments, etc) should be assessed.

- Adherence to Lending Guidelines. Credit Applications should clearly state whether or not the proposed application is in compliance with the FI's Lending Guidelines. The FI's Head of Credit or Managing Director/CEO or Board should approve Credit Applications that do not adhere to the FI's Lending Guidelines.

- Mitigating Factors. Mitigating factors for risks identified in the credit assessment should be identified. Possible risks include, but are not limited to: margin sustainability and/or volatility, high debt load (leverage/gearing), overstocking or debtor issues; rapid growth, acquisition or expansion; new business line/product expansion; management changes or succession issues; customer or supplier concentrations; and lack of transparency or industry issues.

- Facility Structure. The amounts and tenors of financing proposed should be justified based on the projected repayment ability and facility purpose. Excessive tenor or amount relative to business needs increases the risk of fund diversion and may adversely impact the borrower's repayment ability.

- Purpose of Credit. FIs have to make sure that the credit is used for the purpose it was borrowed. Where the obligor has utilized funds for purposes not shown in the original proposal, FIs should take steps to determine the implications on creditworthiness. In case of corporate facilities where borrower own group of companies such diligence becomes more important. FIs should classify such connected companies and conduct credit assessment on consolidated/group basis.

- Project Implementation. In case of a large expansion, which constitutes investment of more than 30% of total capital of a company or for a green field project, project implementation risk should be thoroughly assessed. Project implementation risk may involve construction risk (Gestation period, regulatory and technical clearances, technology to be adopted, availability of infrastructure facilities) funding risk, and post project business, financial, and management risks.

- Foreign Currency Fluctuation. Credit application should clearly state the assessment of foreign currency risk of the applicant and identify the mitigating factors for its exposure to foreign currency.

- Security. A current valuation of collateral should be obtained and the quality and priority of security being proposed should be assessed internally and preferably by a third party valuer. Facilities should not be granted based solely on security. Adequacy and the extent of the insurance coverage should be assessed.

- Type of Control on Cash Flow. The credit application should contain and assess if there is any control on the borrowers cash flow for securing the repayment. This may include payment assignment from export proceed, payment assignment from customers of the borrower etc.

- Exit Option. Credit application should clearly state the exit option from the borrower in case of early identification of deterioration of grading of the borrower.

- Name Lending. Credit proposals should not be unduly influenced by an over reliance on the sponsoring principal's reputation, reported independent means, or their perceived willingness to inject funds into various business enterprises in case of need. These situations should be discouraged and treated with great caution. Rather, credit proposals and the granting of facilities should be based on sound fundamentals, supported by a thorough financial and risk analysis.

Appendix 1.1 contains a template for credit application.

6.3.2 Risk Grading

The Credit Risk Grading (CRG) is a collective definition based on the pre-specified scale and reflects the underlying credit-risk for a given exposure. A Credit Risk Grading deploys a number/ alphabet/ symbol as a primary summary indicator of risks associated with a credit exposure. Credit Risk Grading is the basic module for developing a Credit Risk Management system.

Credit risk grading is an important tool for credit risk management as it helps the Financial Institutions to understand various dimensions of risk involved in different credit transactions. The aggregation of such grading across the borrowers, activities and the lines of business can provide better assessment of the quality of credit portfolio of a FI. The credit risk grading system is vital to take decisions both at the pre-sanction stage as well as post-sanction stage.

At the pre-sanction stage, credit grading helps the sanctioning authority to decide whether to lend or not to lend, what should be the lending price, what should be the extent of exposure, what should be the appropriate credit facility, what are the various facilities, what are the various risk mitigation tools to put a cap on the risk level.

At the post-sanction stage, the FI can decide about the depth of the review or renewal, frequency of review, periodicity of the grading, and other precautions to be taken. Risk grading should be assigned at the inception of lending, and updated at least annually. FIs should, however, review grading as and when adverse events occur. A separate function independent of facility origination should review risk grading. As part of portfolio monitoring, FIs should generate reports on credit exposure by risk grade. Adequate trend and migration analysis should also be conducted to identify any deterioration in credit quality. FIs may establish limits for risk grades to highlight concentration in particular grading bands. It is important that the consistency and accuracy of grading is examined periodically by a function such as an independent credit review group.

Functions of Credit Risk Grading

Well-managed credit risk grading systems promote financial institution safety and soundness by facilitating informed decision-making. Grading systems measure credit risk and differentiate individual credits and groups of credits by the risk they pose. This allows FI management and examiners to monitor changes and trends in risk levels. The process also allows FI management to manage risk to optimize returns.

(a) Use of Credit Risk Grading

- The Credit Risk Grading matrix allows application of uniform standards to credits to ensure a common standardized approach to assess the quality of individual obligor, credit portfolio of a unit, line of business, the FI as a whole.
- CRG would provide a quantitative measurement of risk which portrays the risk level of a borrower and enables quick decision making,
- As evident, the CRG outputs would be relevant for individual credit selection, wherein either a borrower or a particular exposure/facility is rated. The other decisions would be related to pricing (credit-spread) and specific features of the credit facility. These would largely constitute obligor level analysis.
- Risk grading would also be relevant for surveillance and monitoring, internal MIS and assessing the aggregate risk profile of an FI. It is also relevant for portfolio level analysis.
- CRG would provide a quantitative framework for assessing the provisioning requirement of a FI's credit portfolio.

(b) Risk Grading for Corporate and SME

- The proposed CRG scale is applicable for both new and existing borrowers.
- It consists of 8 categories, of which categories 1 to 5 represent various grades of acceptable credit risk and 6 to 8 represent unacceptable credit risk. However, individual FI depending on their risk appetite may implement more stringent policy.

GRADING	SHORT NAME	NUMBER
Superior	SUP	1
Good	GD	2
Acceptable	ACCPT	3
Marginal/Watchlist	MG/WL	4
Special Mention	SM	5
Sub standard	SS	6
Doubtful	DF	7
Bad & Loss	BL	8

- Having considered the significance of credit risk grading, it becomes imperative for the financial system to carefully develop a credit risk grading model, which meets the objective outlined above.

- The following Risk Grade Matrix is provided as an example. *Refer also to the Risk Grade Scorecard attached as **Appendix 1.2.2***. The more conservative risk grade (higher) should be applied if there is a difference between the personal judgment and the Risk Grade Scorecard results. It is recognized that the FIs may have more or less Risk Grades, however, monitoring standards and account management must be appropriate given the assigned Risk Grade:

Table 3: Risk Grade Matrix

Risk Rating		**Definition**
Superior – Low Risk	1	⇒ Credit facilities, which are fully secured i.e. fully cash covered. ⇒ Credit facilities fully covered by government guarantee. ⇒ Credit facilities fully covered by the guarantee of a top tier international Bank.
Good – Satisfactory Risk	2	⇒ Strong repayment capacity of the borrower ⇒ The borrower has excellent liquidity and low leverage. ⇒ The company demonstrates consistently strong earnings and cash flow certainty. ⇒ Borrower has well established, strong market share. ⇒ Very good management skill & expertise. ⇒ Credit facilities fully covered by the guarantee of a top tier local Bank. ⇒ Aggregate Score of 85 or greater based on the Risk Grade Score Sheet
Acceptable – Fair Risk	3	⇒ These borrowers are not as strong as GOOD Grade borrowers, but still demonstrate consistent earnings, cash flow certainty and have a good track record. ⇒ Borrowers have adequate liquidity, cash flow and earnings. ⇒ Credit in this grade would normally be secured by acceptable collateral (1st charge over inventory / receivables / equipment / property). ⇒ Acceptable management ⇒ Acceptable parent/sister company guarantee ⇒ Aggregate Score of 75-84 based on the Risk Grade Score Sheet
Marginal – Watch list	4	⇒ This grade warrants greater attention due to conditions affecting the borrower, the industry or the economic environment. ⇒ These borrowers have an above average risk due to strained liquidity, higher than normal leverage, thin cash flow and/or inconsistent earnings. ⇒ Weaker business credit & early warning signals of emerging

Risk Rating		Definition
		business credit detected. ⇒ The borrower incurs a loss ⇒ Facility repayments routinely fall past due ⇒ Account conduct is poor, or other untoward factors are present. ⇒ Credit requires attention ⇒ Aggregate Score of 65-74 based on the Risk Grade Score Sheet
Special Mention	5	⇒ This grade has potential weaknesses that deserve management's close attention. If left uncorrected, these weaknesses may result in a deterioration of the repayment prospects of the borrower. ⇒ Severe management problems exist. ⇒ Facilities should be downgraded to this grade if sustained deterioration in financial condition is noted (consecutive losses, negative net worth, excessive leverage), ⇒ An Aggregate Score of 55-64 based on the Risk Grade Score Sheet.
Substandard	6	⇒ Financial condition is weak and capacity or inclination to repay is in doubt. ⇒ These weaknesses jeopardize the full settlement of facilities. ⇒ Bangladesh Bank criteria for sub-standard credit shall apply. ⇒ An Aggregate Score of 45-54 based on the Risk Grade Score Sheet.
Doubtful and Bad (non-performing)	7	⇒ Full repayment of principal and interest is unlikely and the possibility of loss is extremely high. ⇒ However, due to specifically identifiable pending factors, such as litigation, liquidation procedures or capital injection, the asset is not yet classified as Bad & Loss. ⇒ Bangladesh Bank criteria for doubtful credit shall apply. ⇒ An Aggregate Score of 35-44 based on the Risk Grade Score Sheet.
Loss (non-performing)	8	⇒ Credit of this grade has long outstanding with no progress in obtaining repayment or on the verge of wind up/liquidation. ⇒ Prospect of recovery is poor and legal options have been pursued. ⇒ Proceeds expected from the liquidation or realization of security may be awaited. The continuance of the facility as a bankable asset is not warranted, and the anticipated loss should

Risk Rating		Definition
		have been provided for. ⇒ This classification reflects that it is not practical or desirable to defer writing off this basically valueless asset even though partial recovery may be affected in the future. Bangladesh Bank guidelines for timely write off of bad facilities must be adhered to. Legal procedures/suit initiated. ⇒ Bangladesh Bank criteria for bad & loss credit shall apply. ⇒ An Aggregate Score of less than 35 based on the Risk Grade Score Sheet.

- The Early Alert Report (***Appendix 3.3.1***) should be completed in a timely manner by the RM and forwarded to CRM for approval to affect any downgrade. After approval, the report should be forwarded to Credit Administration, who is responsible to ensure the correct facility/borrower Risk Grades are updated on the system. The downgrading of an account should be done immediately when adverse information is noted, and should not be postponed until the annual review process.

Risk Rating for Consumer Lending

For consumer lending, FIs may adopt credit-scoring models for processing facility applications and monitoring credit quality. FIs should apply the above principles in the management of scoring models. Where the model is relatively new, FIs should continue to subject credit applications to rigorous review until the model has stabilized.

6.3.3 Ratings Review

The rating review can be two-fold:

- Continuous monitoring by those who assigned the grading. The Relationship Managers (RMs) generally have a close contact with the borrower and are expected to keep an eye on the financial stability of the borrower. In the event of any deterioration the grading are immediately revised /reviewed.
- Normally CRG should be reviewed at least once in a year. For risk grades starting from 5 to 8, CRG should be reviewed in every six months.
- Secondly the risk review functions of the FI or business lines also conduct periodical review of grading at the time of risk review of credit portfolio.

6.4 Approval Authority

All commercial activities, which commit the FI to deliver risk sensitive products, require prior approval by authorized committees/individuals. A FI may have the Board, Management/Executive Committee, and Credit Committees for reviewing and approving financing proposals. The FI may have threshold based on percentage of equity that sets limits for review and approval of credit proposals in different committees. The Board must approve the threshold limit. Besides, approval authority may be delegated further to individual executives based on security, the executive's knowledge and experience to ensure accountability and quick decision in the approval process. The concerned CRM officials should be the owner of their independent review and identification of risks based on the credit application.

The authority to sanction/approve facilities must be clearly delegated by the Managing Director/CEO & Board to the Corporate Center and further down to the Business Units. Business Units are independent and responsible for managing all business activities within the approved limits. However, the concerned RM of the sales team / branch staff responsible for facility sales should be the owner of the customer relationship, and must be held responsible to ensure the accuracy of the facility application submitted for approval. They must be familiar with the FI's Lending Guidelines and should conduct due diligence on new borrowers, purpose of the facilities and guarantors.

The vast majority of FIs serve a number of different customer segments. This segmentation is mostly used to differentiate the services offered and to individualize the respective marketing efforts. As a result, this segmentation is based on customer demands in most cases. Based on its policy, a FI tries to meet the demands of its customers in terms of accessibility and availability, product range and expertise, as well as personal customer service. In practice, linking sales with the risk analysis units is not an issue in many cases at first. The sales organization often determines the process design in the risk analysis units.

The delegation of authority needs to be clearly documented and must include as a minimum:

- Absolute and/or incremental credit approval authority being delegated
- Executives or positions to whom authority is being further delegated
- Ability of recipients to further delegate risk approval authority
- Restrictions, if any, placed on the use of delegated risk-approval authorities

The degree of delegation of authority will depend on a number of variables including:

- Nature of financial products
- Degree of market responsiveness required

- Types of risks being assessed
- Institution’s risk philosophy and credit culture
- Experience of credit executives

The following guidelines should apply in the approval/sanctioning of facilities:

- Credit approval authority must be delegated in writing from the MD/CEO & Board (as appropriate), acknowledged by recipients, and records of all delegation retained in CRM
- Delegated approval authorities must be reviewed annually by MD/CEO/Board
- The credit approval function should be separate from the marketing/relationship management (RM) function
- Approvals must be evidenced in writing, or by electronic signature. Approval records must be kept on file with the Credit Applications
- All credit risks must be authorized by executives within the authority limit delegated to them by the MD/CEO or Board
- All applications must be reviewed by the Head of Credit Risk Management for independent assessment and identification risks and approved by respective committees or individuals delegated by Board or CEO/MD
- Respective CRM officials will be held responsible for identification of risk.
- The RM should be the owner of the customer relationship, and must be held responsible to ensure the accuracy of the entire credit application submitted for approval. RMs must be familiar with the FI’s Lending Guidelines and should conduct due diligence on new borrowers, principals, and guarantors
- The aggregate exposure to any borrower or borrowing group must be used to determine the approval authority required
- Any credit proposal that does not comply with Lending Guidelines, regardless of amount, should be referred to Head of Credit Risk Management for review and approved by CEO/MD or Board
- MD/CEO must approve and monitor any cross-border exposure risk
- A monthly summary of all new facilities approved, renewed, enhanced, and a list of proposals declined stating reasons thereof may be reported by CRM to the CEO/MD
- Any breaches of lending authority should be reported to MD/CEO, Head of Internal Control, and Head of CRM
- lly be expedient to first report to the head of the audited organizational unit on the audit’s findings in the course of a final meeting and to offer the opportunity to comment on the findings, with these comments to be taken into account in the audit report. Subsequently, all top executives and department heads are informed accordingly

- It is the task of internal auditing to monitor the swift correction of any problems detected in the audit as well as the implementation of its recommendations in a suitable form, and if necessary to schedule a follow-up audit
- Assessments of internal audit should, at a minimum, randomly test all aspects of credit risk management in order to determine that:

  - Credit activities are in compliance with the FI's credit and accounting policies and procedures, and with the laws and regulations to which these credit activities are subjected to
  - Existing credit facilities are duly authorized, and are accurately recorded and appropriately valued on the books of the FI
  - Credit exposures are appropriately rated
  - Credit files are complete
  - Potential problem accounts are being identified on a timely basis and determine whether the FI's provision for credit losses is adequate
  - Credit risk management information reports are adequate and accurate
  - Improvement in the quality of credit portfolio
  - Appraise top management

- The following audit areas are particularly relevant:

  - All operational and business procedures within the credit institution
  - Risk management and risk management control
  - The internal review system
  - The FI's internal rules and directives
  - All mandatory audit areas (especially large-exposure investments, money laundering and compliance, diligence, reporting requirements, securities trading book)

- Credit audit is conducted on-site, i.e. at the branch which has appraised the advance and where the main operative credit limits are made available
- Reports on conduct of accounts of allocated limits are to be called from the corresponding branches
- Credit auditors may visit borrowers' factory/ office premise

6.5 Procedural Guidelines

This section outlines of the main procedures that are needed to ensure compliance with the policies contained in Section 4.1 to 4.7 of these guidelines.

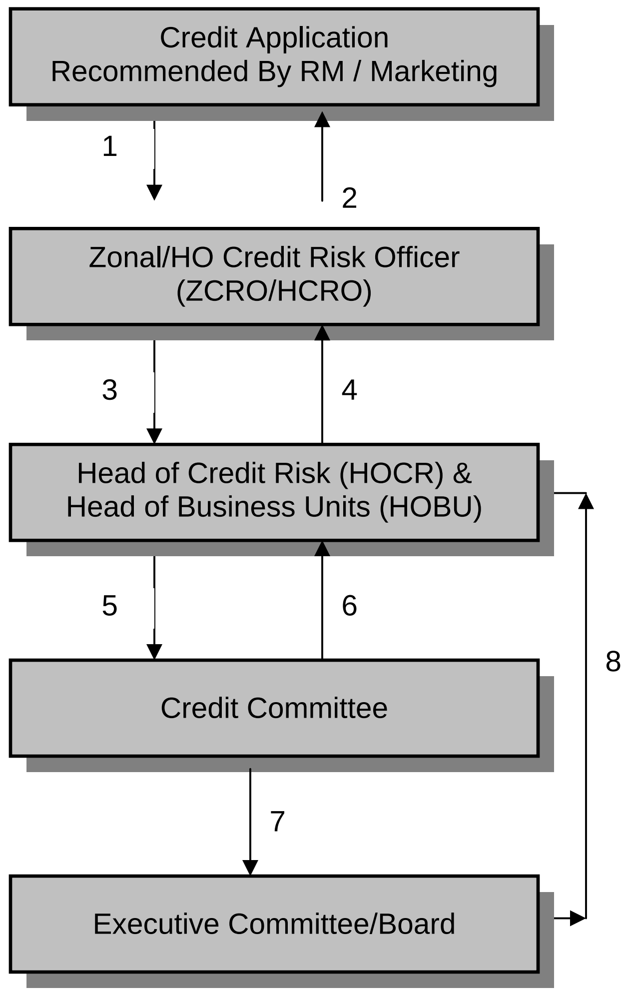
6.5.1 Approval Process

The approval process must reinforce the segregation of Relationship Management/Marketing from the approving authority. The responsibility for preparing the Credit Application should rest with the RM within the business unit. Credit Applications should be recommended for approval by the RM team and forwarded to

CRM for their review and assessment. The credit should subsequently be approved by proper approval committee.

FIs may wish to establish various thresholds, above which, the recommendation of the Head of business unit is required prior to onward recommendation to CRM and subsequent appropriate authority for approval. In addition, FIs may wish to establish regional credit centers within the approval team to handle routine approvals.

The recommended procedure for all the business units is as follows:



1. Application forwarded to Zonal Office or Head Office for review by the ZCRO or HCRO

2. Advise the review to recommending branches

3. ZCRO/HCRO supports & forwarded to Head of Business Units (HOBU) within their delegated authority and to Head of Credit Risk (HOCR) for onward recommendation

4. HOCR advises the review to ZCRO

5. HOCR & HOBU supports & forwarded to Credit Committee

6. Credit Committee advises the decision as per delegated authority to HOCR & HOBU

7. Credit Committee forwards the proposal to EC/Board for their approval within their respective authority

8. EC/Board advises the decision to HOCR & HOBU

The approval process may vary among FI's depending on the types of products and exposure. For example, lending to Corporate and SME's is mostly unstructured due to diverse nature of risk exposure. On the other hand, consumer lending is mostly structured by standardizing the product and risk aspects of individuals. As such applications for consumer lending may be done within the head of consumer unit subject to delegation of authority to do so.

Indicative Delegated Approval Authority Levels

Credit Committee	Up to 10% of Capital
Management Committee	Up to 20% of Capital
Board	Above 20% of Capital

6.5.1.1Credit Administration

The Credit Administration function is critical in ensuring that proper documentation and approvals are in place prior to the disbursement of financial facilities. For this reason, it is essential that the functions of Credit Administration be strictly segregated from Relationship Management/Marketing in order to avoid the possibility of controls being compromised or issues not being highlighted at the appropriate level.

Ongoing administration of the credit portfolio is an essential part of the credit process. Credit administration function is basically a back office activity that support and control extension and maintenance of credit. A typical credit administration unit performs following functions:

6.5.1.2 Documentation

It is the responsibility of credit administration to ensure completeness of documentation (facility agreements, guarantees, transfer of title of collaterals etc) in accordance with approved terms and conditions. Outstanding documents should be tracked and followed up to ensure execution and receipt.

Security documents are prepared in accordance with approval terms and are legally enforceable. Standard facility documentation that has been reviewed by legal counsel should be used in all cases.

Exceptions should be referred to legal counsel for advice based on authorization from an appropriate executive in CRM.

6.5.2.2 Disbursement

Disbursements under facilities should only be made when all security documentation is in place. CIB report should reflect/include the name of all the lenders with facility, limit & outstanding. All formalities regarding large facilities & facilities to Directors guided by Bangladesh Bank circulars & related section of financial Institutions Act should be complied with. All Credit Approval terms must be met before disbursement.

6.5.2.3 Credit Monitoring

After the facility is approved and draw down allowed, the facility should be continuously watched over. These include keeping track of borrowers' compliance with credit terms, identifying early signs of irregularity, conducting periodic valuation of collateral and monitoring timely repayments.

6.5.2.4 Facility Repayment

The obligors should be communicated ahead of time as and when the principal/markup installment becomes due. Any exceptions such as non-payment or late payment should be tagged and communicated to the management. Proper records and updates should also be made after receipt.

6.5.2.5 Custodial Duties

Facility disbursements and the preparation and storage of security documents should be centralized in the regional credit centers. Appropriate insurance coverage should be maintained (and renewed on a timely basis) on assets pledged as collateral. Security documentation should be held under strict control, preferably in locked fireproof storage.

6.5.2.6 Compliance Requirements

All required Bangladesh Bank returns should be submitted in the correct format in a timely manner. Bangladesh Bank circulars/regulations are maintained centrally, and advised to all relevant departments to ensure compliance. All third party service providers (valuers, lawyers, insurers, CA Firms etc.) are approved and performances are reviewed on an annual basis. FIs should be referred to Bangladesh Bank circular outlining approved external audit firms that are acceptable.

6.6 Credit Monitoring

To minimize credit losses, monitoring procedures and systems should be in place that provides an early indication of the deteriorating financial health of a borrower. At a minimum, systems should be in place to report the following exceptions to relevant executives in CRM and RM team:

- Past due principal or interest payments, past due trade bills, account excesses, and breach of facility covenants
- Non-receipts of financial statements on a regular basis and any covenant breaches or exceptions made
- Action not taken on time for findings of any internal, external or regulator inspection/audit

All borrower relationships/facilities are reviewed and approved through the submission of a Credit Report at least annually.

Computer systems must be able to produce the above information for central/head office as well as local review. Where automated systems are not available, a manual process should have the capability to produce accurate exception reports. Exceptions should be followed up and corrective action taken in a timely manner before the account deteriorates further.

6.7 Early Alert Process

An Early Alert Account is one that has risks or potential weaknesses of a material nature requiring monitoring, supervision, or close attention by management.

If these weaknesses are left uncorrected, they may result in deterioration of the repayment prospects for the asset or in the FI's credit position at some future date with a likely prospect of being downgraded to CRG 5 or worse (Impaired status), within the next twelve months.

Early identification, prompt reporting and proactive management of Early Alert Accounts are prime credit responsibilities of all Relationship Managers and must be undertaken on a continuous basis. An Early Alert report should be completed by the RM and sent to the approving authority in CRM for any account that is showing signs of deterioration within seven days from the identification of weaknesses. The Risk Grade should be updated as soon as possible and no delay should be taken in referring problem accounts to the CRM department for assistance in recovery.

Despite a prudent credit approval process, facilities may still become troubled. Therefore, it is essential that **early identification** and **prompt reporting** of deteriorating credit signs be done to ensure swift action to protect the FI's interest. Moreover, regular contact with customers will enhance the likelihood of developing strategies mutually acceptable to both the customer and the FI. Representation from the FI in such discussions should include the local legal adviser when appropriate.

An account may be reclassified as a Regular Account from Early Alert Account status when the symptom, or symptoms, causing the Early Alert classification have been regularized or no longer exist. The concurrence of the CRM approval authority is required for conversion from Early Alert Account status to Regular Account status.

6.8 Credit Recovery

The Recovery Unit (RU) of CRM should directly manage accounts with sustained deterioration (a Risk Rating of Sub Standard (6) or worse). FIs may wish to transfer EXIT accounts graded 4-5 to the RU for efficient exit based on recommendation of CRM and Corporate FI. Whenever an account is handed over from Relationship Management to RU, a Handover/Downgrade Checklist should be completed.

The RU's primary functions are:

- Determine Account Action Plan/Recovery Strategy
- Pursue all options to maximize recovery, including placing customers into receivership or liquidation as appropriate
- Ensure adequate and timely loan loss provisions are made based on actual and expected losses
- Regular review of grade 6 or worse accounts

The management of problem facilities (NPLs) must be a dynamic process, and the associated strategy together with the adequacy of provisions must be regularly reviewed. A process should be established to share the ***lessons learned*** from the experience of credit losses in order to update the lending guidelines.

6.8.1 NPL Account Management

All NPLs should be assigned to an Account Manager within the RU, who is responsible for coordinating and administering the action plan/recovery of the account, and should serve as the primary customer contact after the account is downgraded to substandard. Whilst some assistance from Corporate FI/Relationship Management may be sought, it is essential that the autonomy of the RU be maintained to ensure appropriate recovery strategies are implemented.

6.8.2 Account Transfer Procedures

Within 7 days of an account being downgraded to substandard (grade 6), a Request for Action and a handover/downgrade checklis should be completed by the RM and forwarded to RU for acknowledgment. The account should be assigned to an account manager within the RU, who should review all documentation, meet the customer, and prepare a Classified Loan Review Report (CLR) within 15 days of the transfer. The CLR should be approved by the Head of Credit, and copied to the Head of Corporate FI and to the Branch/office where the facility was originally sanctioned. This initial CLR should highlight any documentation issues, facility structuring weaknesses, proposed workout strategy, and should seek approval for any loan loss provisions that are necessary.

Recovery Units should ensure that the following is carried out when an account is classified as Sub Standard or worse:

- Facilities are withdrawn or repayment is demanded as appropriate. Any drawings or advances should be restricted, and only approved after careful scrutiny and approval from appropriate authorities.

- CIB reporting is updated according to Bangladesh Bank guidelines and the borrower's Risk Grade is changed as appropriate

- Loan loss provisions are taken based on Force Sale Value (FSV)

- Prompt legal action is taken if the borrower is uncooperative

6.8.2 Rescheduling

FI's should follow clear guideline for rescheduling of their problem accounts and monitor accordingly

b) Rescheduling of problem accounts should be aimed at a timely resolution of actual or expected problem accounts with a view to effecting maximum recovery within a reasonable period of time.

Purpose of Rescheduling:

(i) To provide for borrower's changed business condition
(ii) For better overdue management
(iii) For amicable settlement of problem accounts

Cases for Rescheduling:

Rescheduling would be considered only under the following cases-
(i) Overdue has been accumulated or likely to be accumulated due to change in business conditions for internal or external factors and the borrower is no way able to pay up the entire accumulated overdue in a single shot.
(ii) The borrower should be in operation and the assets have a productive value and life for servicing the outstanding liabilities.
(iii) The borrower must be capable of and willing to pay as per revised arrangement.

Modes of Rescheduling:

Rescheduling can be done through adopting one or more of the following means.
(i) Extension of financing term keeping lending rate unchanged
(ii) Reduction of lending rate keeping financing term unchanged
(iii) Both reduction of lending rate and extension of financing term

(iv) Bodily shifting of payment schedule

(v) Deferment of payment for a short-term period with or without extending the maturity date (this may be a temporary relief to prevent the inevitable collapse of a company).

However, under any circumstances reschedule period must not exceed economic life of the asset.

Analysis of Rescheduling Case and decision on different modes of rescheduling:

c) An account, which has been going through liquidity crisis, may be considered for rescheduling after identifying symptoms, causes and magnitude of the problem. For rescheduling an account, the criteria mentioned in Bangladesh Bank guideline, if any has to be followed strictly.

Post Rescheduling Requirements:

- Rescheduling of a contract must require prior approval of CRM and management
- All rescheduled accounts are to be kept in a separate watch list so that post-rescheduling performance of the accounts can be monitored closely
- An individual account cannot be rescheduled more than three times

3. Non Performing Loan (NPL) Monitoring

On a quarterly basis, a Classified Loan Review (CLR) should be prepared by the RU Account Manager to update the status of the action/recovery plan, review and assess the adequacy of provisions, and modify the FI's strategy as appropriate. The Board may decide the level of authority for approving the CLR based on percentage of equity.

4. NPL Provisioning and Write Off

The guidelines established by Bangladesh Bank for CIB reporting, provisioning and write off of bad and doubtful debts, and suspension of interest should be followed in all cases. These requirements are the minimum, and FIs are encouraged to adopt more stringent provisioning/write off policies. Regardless of the length of time a facility is past due, provisions should be raised against the actual and expected losses at the time they are estimated. The approval to take provisions, write offs, or release of provisions/upgrade of an account should be restricted to the Head of Credit or MD/CEO based on recommendation from the Recovery Unit. The Request for Action (RFA) or CLR reporting format should be used to recommend provisions, write-offs or release/upgrades.

The RU Account Manager should determine the Force Sale Value (FSV) for accounts grade 6 or worse. Force Sale Value is generally the amount that is expected to be realized through the liquidation of collateral held as security or through the available operating cash flows of the business, net of any realization costs. Any shortfall of the Force Sale Value compared to total facility outstanding should be fully provided for once an account is downgraded to grade 7. Where the customer is not cooperative, no value should be assigned to the operating cash flow in determining Force Sale Value.

Force Sale Value and provisioning levels should be updated as and when new information is obtained, but as a minimum, on a quarterly basis in the CLR

Following formula is to be applied in determining the required amount of provision:

1. Gross Outstanding XXX

2. Less: (i) Cash margin held or Fixed Deposits/SP under lien. (XXX)
   (ii) Interest in Suspense Account (XXX)
3. Facility Value
   (For which provision is to be created before considering estimated realizable value of other security/collateral held) XXX

4. Less: Estimated salvage value of security/collateral held (XXX)
   (See Note below)

Net Facility Value XXX

5. Incentive Programme:

FIs may wish to introduce incentive programmes to encourage Recovery Unit. Account Managers to bring down the Non Performing Loans (NPLs). The table below shows an indicative incentive plan for RU account managers:

Table 4: Incentive for NPL

Recovery as a % of Principal plus Interest	**Recommended Incentive as % of net recovery amount**	
	If CG 7-8	**if written off**
76% to 100%	1.00%	2.00%
51% t0 75%	0.50%	1.00%
20% to 50%	0.25%	0.50%

7.0 Managing Credit Risk in SME Financing

7.1 Introduction

Small & Medium Enterprise (SME) plays a pivotal role in the economic growth and development of a country. Actually, SME works as the platform for job creation, income generation, and development of forward and backward industrial linkages and fulfillment of local social needs. SMEs occupy a unique position in the economy of Bangladesh. Mainly private sector development depends on them.

The research findings of **"NATIONAL PRIVATE SECTOR SURVEY OF ENTERPRISES IN BANGLADESH-2003" (a study conducted by USAID, DFID and CIDA)** indicates that SMEs contribute to the extent of 25% of the GDP in Bangladesh, about 40% of the Gross Manufacturing Output, 80% of Industrial Jobs and around 25% of the total Labor Force and the total number of SME Entrepreneur is about 06 Million. Among other findings, the study concludes that SME sector is significantly a rapid growth oriented sector to flourish in Bangladesh.

Bangladesh is a densely populated country. Job opportunity here is very scanty; Unemployment rate is approximately 40%. Population below poverty line is 36%. Therefore, it is the prime concern for the nation to generate income through creation of job opportunity & employment. Creation of job opportunity at large scale by us is not possible.

There are many small and medium entrepreneurs in the country that have innovative idea, spirit and potentiality to do something productive for local consumers as well as export abroad. They can generate income and contribute to the GDP. They may also provide employment to other people also.

Development and growth of Small and Medium Enterprise is vital for national development. Such type of beneficial enterprising borrower can not go a long way for want of financial support because they have no access to institutional credit facilities, as they cannot provide collateral security as demanded for such credit facility. IDLC Finance Limited is committed to play positive role in the overall socioeconomic development of the country.

7.2 Rationale for SME Financing

a) The scope of investment of NBFI is gradually going to be limited due to stiff competition and small economy compared to large numbers of Financial Institution. But the SME segment is still almost virgin, untapped and uncovered by institutional finance and as such there is ample scope and good opportunity for investment so as to take the advantage to increase the portfolio providing a viable and vast lending outlet for IDLC.

b) Effective rate of return on SME Financing is comparatively higher over the large loan because of lower bargaining strength of the customers. The large customers are generally price sensitive and hard bargainers. As such the earning rate from SME Financing is higher.

c) Large customers do not usually offer tangible securities and if given, very insignificant compared to the credit volume to cover the risk. Thus the credit risk is very high in case of Large Loan because of the big exposure without any tangible security. Hence, IDLC is put into serious trouble in case of default making recovery of the loan. But in case of SME, the risk is comparatively low as the loan amount is small / moderate and in most cases is covered by security. Above all, lending risk of IDLC is minimized, as the portfolio is diversified with small credit size.

d) Under SME it is easier to recover IDLC's money by selling / foreclosing the security as the customers have not that much strength to face court case unlike big customers.

7.3 Definition of Small & Medium Enterprise (SME)

Small Enterprise (SE) means an entity, ideally not a public limited company, does not employ more than 60 persons (if it is manufacturing concern) and 20 persons (if it is a trading concern) and 30 persons (if it is a service concern) and also fulfills the following criteria:

i) A service concern with total assets at cost excluding land and building from Tk.50,000 to Tk.30.00 lac.

ii) A trading concern with total assets at cost excluding land and building from Tk.50,000 to Tk.50.00 lac.

iii) A manufacturing concern with total assets at cost excluding land and building from Tk.50,000 to Tk.1.00 crore.

Industry Classification	Manufacturing (Based on value/replacement cost of durable resources other than land and factory buildings)	Service & Trading (Based on number of workers work)
Large	> 100 million Taka	> 100
Medium	15-100 million Taka	25-100
Small	<15 million Taka	<25
Cottage	Industry in which members of a family are engaged part-time or full-time in production and service-oriented activities	

Ref.: Chapter 4, Industrial Policy 1999

7.4 Customer Segment

Initially, small entrepreneurs located within the accessible area of our branches will be the targeted areas under this program. The entrepreneurs should have an existing profitable business or a viable business plan.

Selection of Borrowers

i) Small Enterprise financing, like other credit facilities must be subject to the Bank's risk management process setup for this particular business. The process may include, identifying source of repayment and assessing customer' ability to repay, expected future cash flows, his/her past dealings with the bank, the net worth and information obtained from a Credit Information Bureau of Bangladesh Bank. The bank must be able to identify the key drivers of their borrowers businesses, the key risks to their businesses and their risk mitigates.

ii) At the time of granting facility under various modes of Small Enterprise financing, a written declaration shall be obtained from the borrower divulging details of various facilities already obtained from other institutions to ensure that the total exposure in relation to the repayment capacity of the customer does not exceed the reasonable limits as laid down in the approved policies of the bank as well as to help avoid exposure having multiple facilities.

Nationality

The borrowing company/firm must be registered in Bangladesh and shares owned by Bangladeshis. The applicant must be 100% privately owned, controlled and operated. The applicant's principal place of business must be in Bangladesh.

Age Limit

The age of the proprietor / partners / directors must range between 21 years to 55 years.

Purpose

SEs have vast jurisdiction covering food, leather, electronic, light engineering, agro-based industries, garment industries, trading, service industries etc. The SEs also do a good deal of subcontracting jobs for large and medium scale industries, especially in the garments sector. It simultaneously covers the areas of manufacturing, trading and services. Loans are disbursed in the SEs to meet the following requirements:

i) Working capital,

ii) Purchasing of capital machinery;

iii) Delivery Van / Transport for business purpose,

iv) Refurbishing office/Business premises,

v) Other eligible portfolio of the bank,

vi) Purchase of commercial land, possession for new venture.

7.4.5 Mode of Financing

Credit facilities are allowed in the form of continuous loan & term loan in the following modes:

i) Cash Credit,
ii) SOD,
iii) LIM / LTR,
iv) Packing Credit,
v) Any type of Term Loan

7.4.6 Medium and Short Term

Medium and Short-Term facilities mean facilities with maturities of more than one year but not exceeding ten years and Short Term Facilities mean with maturities up to one year.

7.4.7 Per Party Exposure Limit

The minimum and maximum exposure of the bank on single SE shall remain within the range of **TK 2 lac and TK 50 lac respectively subject to the following:**

a) **In case of working capital finance** – Maximum up to 100% of the net required working capital or 75% of the sum total of inventory and receivables whichever is lower.

b) **In case of fixed assets purchase** – Maximum up to 90% of the purchase price.

7.4.8 Security Requirement

Limit on Clean Facility for Tk. 2 lac to Tk 10 lac:
In order to facilitate growth of smaller loans, banks are free to determine security requirements for loan up to TK. 10.00 lac. As a minimum branch must take charge on assets being financed.
Branches should also obtain other common documents/charge documents as at SL 2.11, 2.15 and others as applicable.

For loan amounting TK. 10 lac to TK 50 lac:

On case-to-case basis depending on Banker-customer relationship.

i. Hypothecation on the inventory, receivables, advance payments, plants & machineries;
ii. Registered mortgage over immovable properties with registered power of Attorney and Disclaimer from the mortgagor(s);
iii. Personal Guarantee of Spouse / parents / other family members;
iv. One third party guarantee from a person acceptable to the Bank;
v. Post dated cheques for each installment and one post dated cheque for full loan value including full interest.

7.4.9 Loan Documentation

For all facilities, banks must obtain (as applicable) and not limiting to following common documents before disbursement of loan can be made:

- Loan Application Form duly signed by the customer. Loan Application From should be accompanied by a 'Borrower's Basic Fact Sheet' under the seal and signature of the borrower.
- A written declaration shall be obtained from the borrower divulging details of various facilities already obtained from other institutions.
- Acceptance of the terms and conditions of Sanction Advice
- Trade License

- Photographs of the proprietor /partners /directors duly attested.
- Personal net worth statement of the proprietor /partners / directors.
- Copy of TIN Certificate.
- Short description of the products of the enterprise.
- Project Profile (if new project).
- Quotation/Intent / Pro-forma Invoice etc (as applicable).
- Marketing distribution system of the company.
- Short profile of the proprietor / partners / directors mentioning their business experience/education etc.
- Brief description of the management of the company mentioning their educational & professional experiences.
- Name and address of the sister/allied concerns.
- Group Brochure
- Name and address of present bankers
- A latest liability statement of all the business concerns of the Group with other Banks/Financial Institutions (Mentioning – name of business concern, name of bank and branch, nature of facility, limit amount, outstanding. overdue if any etc.)
- Credit Information Bureau (CIB) report from Bangladesh Bank
- Wherever practical, insurance policy for 110% of the stock value covering potential risks with bank's mortgage clause in joint name of the bank and client.

7.4.10 In case of Proprietorship firm

Copy of financial statements for last 03 years for analysis and record is required. However, financial statements singed by the borrower will suffice where the exposure is fully secured by liquid assets.

7.4.11 In case of Partnership Firm

a) Copy of Registered Partnership Deed duly certified as true copy or a Partnership Deed on non-judicial stamp of TK. 150 denomination duly notarized.

b) Copy of financial statements for last 03 years, for analysis and record. However, financial statements singed by the borrower will suffice where the exposure is fully secured by liquid assets.

Common documents and charge documents as at SL 2.11, 2.15 and others as applicable.

7.4.12 In case of Limited Company

a) Copy of Memorandum & Articles of Association of the company including Certificate of Incorporation duly certified by Registrar Joint Stock Companies (RJSC) and attested by the Managing Director accompanied by an up-to-date list of Directors.

b) Copy of Board Resolution of the company for availing credit facilities and authorizing Managing Director / Chairman / Director for execution of documents and operation of the accounts.

c) An Undertaking not to change the management of the company and the memorandum and articles of the company without prior permission of the bank.

d) Copy of financial statements for last 03 years for analysis and record. However, financial statements singed by the borrower will suffice where the exposure is fully secured by liquid assets.

e) Personal Guarantee of all the Directors including the Chairman and Managing Director.

f) Certificate of Registration of charges over the fixed and floating assets of the company duly issued by RJSC.

g) Certificate of registration of amendment of charges over the fixed and floating assets of the company duly issued by RJSC in case of repeat loan or change in terms and condition of sanction advice regarding loan amount, securities etc.

7.4.13 Common Charge Documents applicable for Proprietorship/ Partnership/Limited Company

- Demand Promissory Note.
- Letter of Hypothecation on plant, machineries, equipments, vehicles etc.
- Assignment of receivables, lease rentals, contract receivables etc.
- Assignment of security money, advance rent, if any
- Personal Letter of Guarantee from the Proprietor / Partners / Directors
- Personal Guarantee from any other persons acceptable to the Bank.
- Post dated cheques for each installment and one undated cheque for full loan value including full interest.
- Lien on deposits/financial instruments (FDR, shares of companies listed in stock exchange, ICB Unit certificates etc with perfected lien) observing necessary formalities.
- Any other documents as expedient/ deemed necessary by the branch/bank depending on the nature of security such as, -Insurance Guarantee, Cross Corporate Guarantee, Assignment of Contract, Security Money etc.

All security documents pertinent to the mortgage of properties to be examined by the Panel Lawyer of the bank along with legal opinion.

7.4.14 Margin Requirement

Banks shall adhere to the minimum margin requirement as prescribed by Bangladesh Bank (if any).

7.4.15 Credit Information Bureau (CIB) Clearance

While considering a proposal, banks should give weightage to the Credit Information Bureau (CIB) Report of Bangladesh Bank relating to the borrower & his group.

7.4.16 Period of Loan

i) For Continuous Loan **:** 01 (One) year.

ii) For Term Loan **:** Maximum up to 05 (Five) years. But, only for Commercial Space Loan maximum up to 10 (Ten) years.

7.4.17 Mode of Repayment

a. For continuous loan credit turnover must be equal to the limit amount in a quarter and full and final adjustment within the validity period;

b. For term loan, repayment to be made by monthly installments and full and final adjustment within the validity period.

Submission of Returns

Branches shall submit the borrower-wise annual statements regarding classified loans/ advances to Head Office for onward submission to the Banking Inspection Department.

Timing of creating provisions

Branches shall review, at least on a quarterly basis, the collectibility of their loans /advances portfolio and shall properly document the evaluations so made. Shortfall in provisioning, if any, determined, as a result of quarterly assessment shall be provided for immediately in their books of accounts by the branch on quarterly basis.

Reversal of provision

The provision held against classified assets will only be released when cash realization starts exceeding-

a) In case of loss category the net book value of the assets;
b) In case of doubtful category 50% of the net book value of the assets; and
c) In case of sub-standard category 25% of the net book value of the assets.

Further, the provision made on the advice of Bangladesh Bank will not be reversed without prior approval of Bangladesh Bank.

Verification by the auditors

The external auditors as a part of their audits of banks shall verify that all requirements of Regulation- 12 for classification and provisioning for assets have been complied with. Bangladesh Bank shall also check adequacy of provisioning during their on-site inspections.

7.5 Appraisal Procedure of SME Client

After the marketing stage, appraisal procedure starts. In appraising, a comprehensive report has been prepared on the business performance of the client. The whole procedure is carried out through the following step by step procedure:

- Collecting preliminary information regarding the client: to collect the preliminary information, IDLC maintain a standard formatted checklist. This checklist is designed to collect the information regarding the necessary legal documents of the company, owners liability position, financials of the business and its sister organization and other necessary information. A sample checklist format is attached at the Appendix-1for better understanding

- Collecting CIB report of Bangladesh Bank to know the liability status of the client: before any loan disbursement, Availing report from Credit Information Bureau (CIB) of Bangladesh Bank regarding the liability status of the client is mandatory.

- Writing the main report: ECD follows a standard format to write the appraisal report on its client. This report format contains the following part to investigate the credit worthiness of the client:

    - Client's name, address, business type and other preliminary information
    - In case of an existing client, the exposure status of the client with IDLC
    - Description of the financing proposal in details and client's previous track record (in case of an existing client)

Financing rationales on client from different aspects like:

- Background of the business and the main sponsors of the business
- Analyzing the market potentials of the product client deals with
- Analyzing the shareholding structure of the company to reveal whether any problem lies with it.
- Keenly analyzing the previous 3 to 4 years financials of the client and make different comments on the changes he faced over the years
- Analyzing the business and financial condition of the sister concerns, if any and its impact on the said concern.
- Detail liability position of the client

- Projection regarding the income statement and cash flow of the client at post financing period and calculating the Debt Service Coverage Ratio.
- In case of lease, brief description of the leased equipment and its price verification

7.5.1 Credit control procedure

After the completion of appraisal procedure, the report is sent to the Credit Risk Management Committee to assess the risky ness of the investment. The risk of the investment is measured from different point of view. The major headline along with major risk parameters under which the risky ness of an investment is measured is described below:

i. **Industry risk**: Demand and supply condition, availability of the raw material, availability of the technology, extent of the competition, the growth pattern of the market, etc.

ii. **Company Risk:** company's position in the market, strength of the company in the market, market coverage of the company's product, etc.

iii. **Management risk:** Years of operation, Management structure, Experience of the key persons, status of any legal proceedings against the company, etc.

7.5.2 Loan approval procedure

After the appraisal is done, the appraisal report is submitted to the Credit Evaluation Committee (CEC). The member of this committee is the management people of Credit Risk Management and General Manager. After their approval, it goes to Deputy Managing Director (DMD) and to Managing Director (MD).

7.6 Portfolio structure of SME financing of IDLC

Sector wise distribution of the SME portfolio of IDLC is given below. This distribution shows the distribution pattern of some of the important sector.

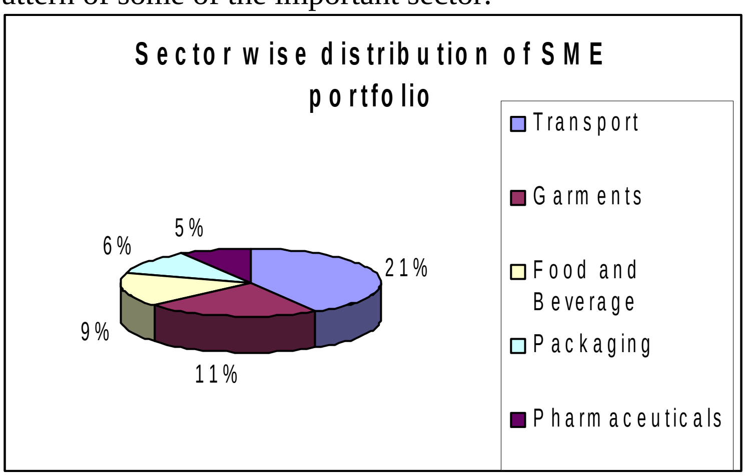


Figure: sector wise distribution of SME portfolio

Source: Primary

Product wise distribution of the SME portfolio of IDLC is described on the following diagram:

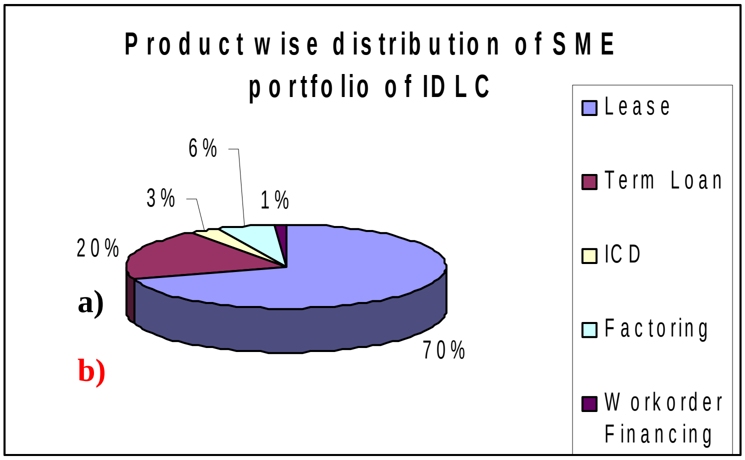


Figure: Product wise distribution of SME portfolio

Source: Primary

Some facts regarding the SME financing of IDLC

- Around 78% of total client belongs to SME based on fixed capital investment size.
- SME clients share 56% of our total loan portfolio.
- Average loan size will be ranging mostly from BDT 500,000 (USD 8,000) to BDT 700,000 (USD 11,000)

8.0 Proposals for Effective CRM In SME Financing

8.1 Introduction

In Bangladesh, SME consists of almost 90% of the total industrial setup. SME contributes almost 80% to 85% industrial employment, which is the 25% of the total employment of Bangladesh. SME accounts for 25% to 30% of total GDP. In terms of value addition, SME contributes 45% to 50% of the total value addition of a year's total production. (Source: IDLC database).

The banking system which constitutes the core of the financial sector of any country plays a critical role in transmitting monetary policy impulses to the entire economic system. Banking is a business built on risk. Yet, it is essential to manage and minimize that risk.

From Financial Institution's point of view, all the risk factor involved in the SME sector are described below

- Inadequate asset base of the owner
- Inadequate business knowledge of the owner
- Absence of formal accounting system in case of maintaining financials
- High seasonality in the business
- High competition in the business
- Inadequate security coverage from the borrower

In terms of huge business opportunity and high recovery rate, SME sector is quite a promising sector for financial institutions to make the investment. To eliminate the risk factors substantially and thus make a new ground for profitable investment, government, central banks, and financial institutions should consider the following propositions.

8.2 From the perspective of Government and Policy-makers

8.2.1 Central Bank Policy – Central Database

Bangladesh Bank facilitates the financial institutions in effective credit risk management by offering the services of CIB (Credit Information Bureau). CIB maintains a central database for all the individuals and organizations, who have ever undertaken credit facility from financial institutions. Borrowers' repayment pattern and history of credit availability can be found from CIB report. This CIB report is absolutely essential in decision making process of every credit facility.

Currently, the CIB facility offered by the Bangladesh Bank has some vital flaws. The CIB report does not contain the borrowing information and repayment behavior of the borrowers for the current quarter. As a result, financial institutions have to rely on the information of past quarter to make lending decisions. This increases the credit risk substantially as a borrower can become irregular in repaying loans or may have borrowed very recently from other financial institutions, which would be overlooked during disbursing new credit facility. Small and medium enterprises are mostly unfamiliar in the financial arena, thus, comprehensive information is a must for financing these institutions. Moreover, it usually takes more than a week to obtain CIB report which comes' offline from Bangladesh Bank, which reduces the efficiency of financial institutions in processing credit facility.

Bangladesh Bank should take immediate steps to eradicate these flaws in order to enable the financial institutions to manage credit risk effectively. CIB report should be made online for any officer of financial institutions to access any borrower's information instantly. Furthermore, skilled and sufficient human resources have to be facilitating in this regard to ensure smooth flow of the overall operation.

8.2.2 Industry and Sector Analysis

Government and the central bank have to come up with the idea to constructing a central knowledge base for the financial institutions to prudent financing decisions. Broadly, overall industry and sector analysis should be conducted by the intellectuals and researchers. This analysis should be aimed at obtaining insights into the nature, profit margin, and business dynamics of different industries and sectors, as well as assessing the strengths, weaknesses, opportunities, and challenges of these segments.

8.2.3 Uniformity of Record

Records of every transaction in every government offices have to be uniform. Different ways of recordkeeping surely leads to discrepancy, and allows room for manipulation. For example, an importer can declare deflated quotation of the imported products to dodge additional duties. But enduring a consistent HS code may ascertain such practice can be avoidable. Moreover, the regulatory bodies should encourage the organizations and individuals to follow uniform accounting principles.

8.2.4 Training & Development

Besides policies and regulations, the government also has to ensure the human resources of the financial institutions be trained and nurtured in such a way that credit risk can be minimized. Seminars and symposium have to be organized on a regular basis to ensure the financial institutions understand the new challenges and exposures of credit risk of different sectors. Intensive training should be on the offering to build up manpower for effective risk management.

8.2.4 Credit Rating

One of the effective means to increase the effectiveness and efficiency of credit risk management is to establish a credit rating procedure for prospective borrowers. Independent and renowned rating agencies should be hired for credible credit rating. This will certainly allow the financial institutions to increase the efficiency in its operation significantly, and also the cost of borrowing will decrease substantially. Recently, BRAC Bank has come to an agreement with Dun & Bradstreet, a renowned British rating agency, for credit rating of small & medium enterprises. Such steps have to be taken in broader perspective by the Government.

8.3 From the perspective of Financial Institutions

- The Board of Directors should have responsibility for approving and periodically reviewing the credit risk strategy and significant credit risk policies of the bank. The strategy should reflect the bank's tolerance of risk and the level of profitability the bank expects to achieve for incurring various credit risks.

- Senior management should have responsibility for implementing the credit risk strategy approved by the board of directors and for developing the policies and procedures for identifying, measuring, monitoring and controlling credit risk. Such policies and procedures should address credit risk in all of the bank's activities and at both the individual credit and portfolio levels.

- Financial Institutions should identify and manage credit risk inherent in all products and activities. Financial Institutions should ensure that the risks of products and activities new to them are subject to adequate procedures and controls before being introduced or undertaken, and approved in advance by the board of directors or its appropriate committee.

- Financial Institutions must operate under sound, well-defined credit granting criteria. These criteria should include a thorough understanding of the borrower or counter party, as well as the purpose and structure of the credit, and its source of repayment.

- Financial Institutions should establish overall credit limits at the level of individual borrowers and counter parties, and groups of connected counter parties that aggregate in comparable and meaningful manner different types of exposures, both in the banking and trading book and on and off the balance sheet.

- Financial Institutions should have a clearly-established process in place for approving new credits as well as the extension of existing credits.

- Financial Institutions should conduct sector wise research to know more about the business nature of different SMEs, construct specialize credit risk parameters to evaluate the credit friskiness of SME clients more properly and construct customize credit appraisal procedure for the SME client which will make the evaluation process faster and thus enable the Financial Institutions to deal with more SME Client.

- Financial Institutions should have in place a system for the ongoing administration of their various credit risk bearing portfolios.

- Financial Institutions must have in place a system for monitoring the condition of individual credits, including determining the adequacy of provisions and reserves.

9.0 Conclusion

Credit risk in its simplest definition refers to the task of loss through default on financial assets. If this risk is not managed and mitigated effectively and efficiently, the fundamental business of lending can brought trouble to entire financial industry. Establishing an effective credit risk management framework should be a top priority for every organization in this regard. But if the established framework is not feasible enough for generating sufficient return for the stakeholders, we cannot hope that it will be sustainable in the long run. So, the managements of the financial institutions have to find out an effective, at the same time, profitable and sustainable credit risk management policy for the smooth running of its operations in the lending business.

Small and Medium Enterprises (SMEs) play a vital role in the economic growth and development of the country, especially in one like ours. Bangladesh has approximately six (6) million micro, small, and medium enterprises with less than 100 workers, out of which around 27,000 are SMEs. Micro, small, and medium enterprises provide more than 75% of the income of the households in Bangladesh. The sector contributes nearly 25% of the GDP, 40% of gross manufacturing output, 80-85% of industrial jobs and constitutes around 25% of the total labor force making this sector an attractive one for lending by financial institutions.

Despite such high potential, this sector has been largely neglected by the financial sector in this country until recently. Inadequate asset base of the owners, inadequate technical know-how of the entrepreneurs, absence of formal accounting system in maintaining financials, high seasonality in the business, inadequate security coverage for credit facility, high competition in the business have constrained the financial institutions in exploring this vital segment of the economy.

Very recently, banks and NBFIs started to take notice of the potential of this sector. In terms of huge business opportunity, high margin, and encouraging recovery rate, SME sector is know proving to be a very promising sector of prudent investment for financial institutions. When squeeze in the profit margin of the traditional banking business is making telling effect on the balance sheet of financial institutions, the unexplored potential of SME financing could breathe fresh air in the financial sector.

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INDUSTRIAL DEVELOPMENT LEASING COMPANY (IDLC) OF BANGLADESH LIMITED

A. EMERGING CORPORATE DIVISION

BORROWER'S BASIC FACT SHEET
(CENTRAL BANK COMPLIANCE)

1. BORROWER'S PROFILE:

Name			**Address**
Phone		Fax	e-mail:
Off:	Res:		
National ID Card (if any):			Tax ID No.(if any)
Father's Name		Father's National ID Card (if any):	

2. REFERENCES (AT LEAST TWO):

Name			**Address**
Phone		Fax	e-mail:
Off:	Res:		
National ID Card (if any):			Tax ID No.(if any)

Name			**Address**
Phone		Fax	e-mail:
Off:	Res:		
National ID Card (if any):			Tax ID No.(if any)

3. NATURE OF BUSINESS/PROFESSION:

Industrial	Commercial	Agricultural	Services	Any other

4. EXISTING LIMITS/STATUS:

Limit	Amount	Expiry Date	Status		
			Regular	Amount Overdue (if any)	Amount Reschedule (if any)
Fund Based					
Non-Fund Based					

5. **REQUIRED LIMITS:**

	Amount	Tenor
Fund Based		
Non-Fund Based		

Details of payment schedule if term loan sought:

Latest Income Tax/Wealth Tax Form to be submitted by the borrower.

I certify and undertake that the information furnished above is true to the best of my knowledge.

APPLICANT'S SIGNATURE & STAMP

INDUSTRIAL DEVELOPMENT LEASING COMPANY (IDLC) OF BANGLADESH LIMITED **LOAN APPLICATION FORM** **(BASIC INFORMATION REPORT-BTR)**	**Photo**

Name of the Branch: **Date of Application:**

1. **CUSTOMER'S RELATED INFORMATION:**

Name of the Account:			
Date of Account Opened:		**Date of First Sanction:**	
Business Address:			
	Phone:	**Fax:**	**e-mail:**
Factory Address:			
	Phone:	**Fax:**	**e-mail:**

Nature of Business:	**Manufacturing**	**Trading**	**Service**
Type of Ownership:	**Proprietorship**	**Partnership**	**Private Limited Co.**
Total Investment in Business:			
Fixed Assets Excluding	**Land & Building:**	**Machinery:**	**Others:**
	Total Working Capital:		**Net worth (Business):**
Number of Permanent Manpower:			
	Men:	**Women:**	**Total:**
Date of Establishment/ Incorporation:		**Starting Day of Business:**	
G.I.R. No./TIN No. (Copy Enclosed) :			
Trade License No. (Copy Enclosed) :		**Date:**	**Validity:**
Date of Factory / Premises Visit:		**Premise Ownership Status:**	
Visit made by:		**Person(s) met:**	

2. CREDIT RELATED INFORMATION:

Credit facility approached for:

Type	Amount	Period for which required	B. Purpose	Mode of C. Adjustment/Repaymen
Total				

Contd/02

3. **SECURITY RELATED INFORMATION:**

a) Primary:	
i)	**Personal Guarantee of the Proprietor/Partners/Directors and his/their spouse(s)**
ii)	**Hypothecation of Stock/Inventory.**
b) Collateral:	

Location of the land	**Instrument No.**	**Date of Investment**	**Face Value**	**Market Value**	**Maturity Date**	**Interest Rate**	**Value Matur**
Note: a) Land va b) Land v							
c) Financial Obl							
Description							

a) THIRD PARTY GUARANTOR'S RELATED INFORMATION (SEPARATE SHEET SHOULD BE ENCLOSED IF REQUIRED):

1st Guarantor's related Information:			
Name of the Guarantor:		**Father's Name:**	
Present Address:		**Permanent Address:**	
Occupation:		**Personal Net worth:**	
Contact Phone Number:	**Home:**	**Office:**	**Mobile:**
2nd Guarantor's related Information:			

Name of the Guarantor:		Father's Name:	
Present Address:		Permanent Address:	
Occupation:		Personal Net worth:	
Contact Phone Number:	Home:	Office:	Mobile:

4. EXPERIENCES WITH IDLC OF BANGLADESH LIMITED:

Particulars	Long Term	Lease Finance	Short Term
Relationship Since			
No. of Expired Contracts			
No. of Running Contracts			
Current Exposure			
Previous Highest Exposure			
Payment Performance			

Contd/03

5. EXPERIENCES WITH OTHER FINANCIAL INSTITUTION:

F/I Name	Name of Account	Nature of facility	Limit	Outstanding as on	(a) Over due	CL Status	Remar

6. OWNERS RELATED INFORMATION:

Name and Particulars of the Owner: (Separate Sheet should be enclosed if required)									
Sl No	Name	Age	Designation	Relationship	% Share	Personal Net Worth	Experience	Educational/ Technical Qualification	Success Informa

CIB related information:						
Sl No	Name	Father's Name	Mother's Name	Spouse Name	Present Address	Permanent Address

7. **KEY MANAGEMENT PERSONNEL:**

Sl No	Name	Position in the Firm	Age	Education	Experience	Reputat

8. **PERFORMANCE OF SISTER CONCERNS, IF ANY: (Separate Sheet should be enclosed if required):**

Name of the Concern	Year of Establishment	Nature of Business	Annual Turnover	Annual Net Profit	Total Assets	Net Worth	Particula Credit fa Enjoy

Contd/04

9. **OTHERS BUSINESS RELATED INFORMATION:**

(i) Particulars	Monthly	Yearly
Owners Drawing from business:	Tk.	Tk.

Employees Salary:			
Employees Other Benefit (Bonus, Commission etc.)			
Capacity Utilization in the Project (for Manufacturing Unit):			
Yearly Raw Material /Goods Purchase:			
D. Purchase	**Monthly Raw Material/Goods Purchase (A)**	**Number of Month (B)**	**Total Purchase C=(AXB)**
Highest	**Tk.**		**Tk.**
Normal			
Lowest			
		Total	**Tk.**
Tied Up Period (Raw Materials Procured/ Goods Purchase): For Import:		**For Local:**	
Total Yearly Purchase:	**In Cash (%):**	**In Credit (%):**	
Yearly Sales:			
E. Sales	F. Monthly **Sales (A)**	**Number of Month (B)**	**Total Sales [C=(A**
Highest			
Normal			
Lowest			
		Total	**Tk.**
Total Yearly Sales:	**In Cash (%):**	**In Credit (%):**	
Previous Years Profit: Tk.			
III. Projected Sales Growth (Next Year):	**%**		
Working Days Per Month:			
Working Hours Per Days:			
Overhead Expenses (Monthly):			
Rent Paid		**Tk.**	
IV. Electricity, Gas, Water & Fuel		**Tk.**	
Store & Spares		**Tk.**	
Repair & Maintenance		**Tk.**	
Other Overhead Expenses		**Tk.**	
Marketing Expenses		**Tk.**	
Miscellaneous Office Expenses		**Tk.**	
	Total Overhead Expenses in Tk.		
Total Financial Expenses (Monthly)-Loan Installment:			
BALANCE SHEET RELATED INFORMATION:			
(i) Particulars	**Year of Purchase**	**Purchase Value**	**Present Va**

Assets Position:			
Land /Possession Purchase			
Civil Construction			
Plant & Machinery			
Furniture & Fixtures			
Vehicles & Transport			
Security Deposit			
Preliminary Expenses:			
Interior Decoration			
Power & Telephone Connection			
Miscellaneous Expenses			
Total Preliminary Expenses			
Other Assets			
Total Assets			
Liability Position:			
Total Long Term Loan			
Current Liabilities			
Total Liabilities			

Contd/05

CASH FLOW STATEMENT RELATED INFORMATION:

Inflow of Fund:

	Current Year	Projected Y
Previous Year's Cash + Bank Balance		
New/ Additional Bank Loan & Others		
Increase in all type of A/C Payables		
Decrease in A/C Receivables		
Increase in other current liabilities		
Sale of Fixed Assets		
Any other inflow of cash (specify)		
Outflow of Fund:		
Loan Installment (Principal Payment)		
Interest on Bank Loan		
Increase in all type of A/C Receivables		
Decrease in A/C Payables		
Increase in other current assets		
Purchase of Fixed Assets		
Any other outflow of cash (specify)		

10. OTHERS INFORMATION:

a) Major Three (03) Buyers:

Sl No	Name	Phone No.	Address	Volume of Sale	% of Total Sales	Average Receivabl (in days)

b) **Major Three (03) Suppliers:**

Sl No	Name	Phone No.	Address	Volume of Purchase	% of Total Purchase	Average Paya (in days)

c) **List of 02 (Two) Major Competitors & their Price:**

(2) Sl No.		Qty.					
			Mfg. Price	Selling Price	Gross Margin		

I/We do hereby solemnly on oath declare and affirm as follows:

i) **That I/We have not taken any loan or enjoyed any credit facility in my/our personal name or in the name of my/our Proprietorship/Partnership firm/company from any other Branch of IDLC Ltd. or any other Commercial Bank/ Financial Institution save and except as stated above.**

ii) **That the statements made above are true and nothing has been concealed and if at any time it transpires that I/We have suppressed fact regarding availing of credit facility from any Bank. I/We shall be criminally liable.**

____

____

____

Signature

Annexture-01

INDUSTRIAL DEVELOPMENT LEASING COMPANY (IDLC) OF BANGLADESH LIMITED

………………… Branch

PERSONAL NETWORTH STATEMENT

Name : ………………………………………………

….…………………………………………………………..

Address (Res.) : ………..…………………………

…………………………………………………

…………………………………………

…………………………………………………

…….…………………………

…………………………………………………

Male…….…..Female…………….….

S/O

Age

Profession

Position

Marital Status

Children-

Business Address: …………………………………………………

…………………………………………………

…………………………………………………

For the purpose of procuring and maintaining credit from time to time in any form whatsoever with Industrial Development Leasing Company (IDLC) Of

Bangladesh Limited, the undersigned submit(s) the following as being a true and accurate statement of his/her financial condition on the date mentioned herein and also agree that if any change occurs, that on materially reduces the means or ability of the undersigned to pay all claims or demands against him/her, the undersigned will immediately notify the IDLC. Unless IDLC is so notified it may continue to rely upon the statement herein given as true and accurate.

NETWORTH STATEMENT AS ON ....

LIABILITIES		ASSETS	
Payable to Bank		Cash	
(Schedule-A)		a) In hand	Tk.
a)Secured	Tk.	b) With any Banks/FI	Tk.
b)Un secured	Tk.		
		INVESTMENT	
Other Creditors	Tk.	Government Securities	Tk.
Unpaid Taxes	Tk.	Shares, debentures, Bonds etc.	Tk.
		Debtors	Tk.
		Real Estate (Encumbered)	
		(Schedule - B)	Tk.
Other Liabilities	**Tk.**	Real Estate(Unencumbered)	
(Details attached)		(Schedule - C)	
		Cash surrender value for	
		life policy	Tk.
		Other (details attached)	Tk.
	______________.	FDR/Saving Certificate	Tk _________.
Total Liabilities	Tk.	Total Assets	Tk.

Net Worth (Asset - Liabilities) = Tk. ....

Contd....P/02

PAYABLE TO BANK/FINANCIAL INSTITUTIONS:

Schedule-A

Name & Address of the Bank/Institution	Date of availing of the Loan	Limit with validity	Present Outstanding	Secured or Unsecured w nature of security

REAL ESTATE (ENCUMBERED)

Schedule-B

Location & tenure of ownership	Area of Land	Description & schedule of the property and type of Building	Mortgage & Mortgaged amount	Market Price		
				Land	Building	Total

REAL ESTATE (UNENCUMBERED)

Schedule-C

Location & ownership	Area of Land/ Building	Description & schedule of the property and type of building	Market Price		
			Land	Building	Total

The undersigned certifies that the information furnished thereon is true and correct.

Signature :

Date :

Annexture-02

The Manager
Industrial Development Leasing Company (IDLC) of Bangladesh Limited
……………….. Branch

Sub : *Declaration of sister/allied concern / liability*

Dear Sir,

I/We do hereby declare that the name(s) and particulars of my/our sister/allied concern(s) is / are as follows :

01. Name of the Business Concerns :

02. Name of the Proprietor/Partners/Directors :

03. Business Address :

04. Father's/Husband's Name of the Proprietor/Partners/Directors :

05. Residential Address of the Proprietor/ Partners/Directors :

06. Name of the Banker :

07. Liability :

Nature of facility	Limit	Present Outstanding	Security

I/We confirm that I/We have no other sister/allied concern and liabilities beyond those as declared above.

Date

Signature(s)

Name

Use additional sheet / paper, if necessary.

INDUSTRIAL DEVELOPMENT LEASING COMPANY (IDLC) OF BANGLADESH LIMITED

B.

IDLC of Bangladesh Limited

Approved by:		

APPRAISAL REPORT

1. GENERAL INFORMATION:

Branch Name				
Group Name			**Date**	
Business Name				
Business Address				
Phone	**Fax:**		**E-Mail:**	
Customer Code (CIB)				
TIN Number				
Date of Establishment				
Starting Day of Business				
Fixed Assets Excluding Land & Building				
Total Investment in Business				
Total Net Worth (Business)				
Main Sponsor				
Nature of Business				
Sector				
Sub Sector				
Legal Status				
Relationship Since				
Total Manpower				
Date of Factory/Premises Visit		**Premise Ownership Status:**		
Visit Made by:		**Person(s) Met:**		
IDLC Financing	**Lease/ Long Term Loan**	**Short Term Loan**	**Total Loan**	
Existing Net Exposure				
Current Proposal				
Cumulative Net Exposure				
Previous High Exposure				
Existing Security				
Proposed Security				
Cumulative Security				
Payment Performance				

2. FINANCING PROPOSAL (NEW):

- Purpose of financing.

- Project: Production Capacity, Capacity Utilization, No. of Working Days/Year
- Total Project Cost and financing plan, Current project status.
- Mode of Procurement: Local Procurement/Sale & Lease Back/Letter of Credit.
- Status of Equipment (if any):………
- Price Verification (if required):…………..
- Source of Client: Existing/Marketing/Reference/ Walk in.
- Rational for financing requirement

3. OWNER'S INFORMATION:

Name of Sponsor	Age	Designation	Relationship	Share %	Personal Net Worth	Experience	Educational/ Technical Qualification	Successi Informat

PARTICULARS OF SISTER / ALLIED CONCERNS:

Name of the concern	Year of Establishment	Nature of business	Annual Turnover	Annual net Profit	Total Assets	Net Worth	Particulars c credit facilit enjoyed

GENERAL COMMENTS:

- Accounts are audited/unaudited/reconstructed by us.
- Any other special notes/substantial deviation over the years.
- Comments on performance

Proposed by:

4. COMPLIANCE :

a) CIB Report dated ………………………….. Position as of ……………………………….

Nature	(a) Liability in the Name of the customer	Liability in the name of the sister/allied concerns	Total	Overdue amount	Classification	
					Amount	Status
Funded						SMA/SS/DF/BL
Non-funded						SMA/SS/DF/BL
Total						

Note: Reasons for overdue.

b) Audit Objections, if any:

Nature of Audit	Date of Audit	Objections, if any	Rectification Status

5. **EXPERIENCES WITH IDLC OF BANGLADESH LIMITED**:

Particulars	Long Term	Lease Finance	Short Term
Relationship Since			
No. of Expired Contracts			
No. of Running Contracts			
Current Exposure			
Previous Highest Exposure			

6. **FINANCIAL PERFORMANCE:** ☑ Un-audited ☑ Audited By:

Particulars	Year-01	Year-02	Year-03
Sales/Revenue			
Net Profit after Tax			
Fixed Assets			
Current Assets			
Total Assets			
Current Liabilities			
Long Term Liabilities			
Total Liabilities/Debt			
Tangible Net worth			
(a) Important Ratios			
Net Profit Margin			
Current Ratio			
Inventory Turnover in days			
Receivable Turnover in days			
Debt to Equity			
Debt to Total Assets			
Debt Service Coverage Ratio			

Note: Comments on the Ratios.

7. **KEY MANAGEMENT PERSONNEL**:

Name	Position in the Firm				Reputation

8. CURRENT EXPOSURE WITH THE CLIENT

Contract No.	Term	Loan/Lease Amount	Disbursement Date	Installment	Remaining Term	Outstanding Amount

9. PAYMENT PERFORMANCE

Non- Regular	Maintaining Temporary Overdue	Regular	Excellent

Proposed by:

C. 10. LIABILITY PERFORMANCE:

2. **Long Term Loan:**

Concern	Financial Institution	Disbursement Amount	Current Outstanding	Installment/ Month	No. of Installments due for recovery	No. of Installments actually recovered	No. of Overdue Installments	Securi

Lease Finance:

Concern	Financial Institution	Disbursement Amount	Current Outstanding	Installment/ Month	No. of Installments due for recovery	No. of Installments actually recovered	No. of Overdue Installments	Securi

3.

4. **Short Term:**

Concern	Financial Institution	Facility	Sanction Limit	Current Outstanding	Highest Balance	Lowest Balance	Recycle Times	Adjustment Times	Securi

Note: a) Supported by Bank/FI Statement.
b) Without supported by Bank/FI Statement.

11. *OTHERS INFORMATION:*

Major Three (03) Buyers:

Sl No	Name	Contact No.	Address	Volume of Sale	% of Total Sales	Average Receivabl (in days)

Major Three (03) Suppliers:

Sl No	Name	Contact No.	Address	Volume of Purchase	% of Total Purchase	Average Payable (in days)

List of 02 (Two) Major Competitors & their Price:

(1) Sl No.		Qty.					
			Mfg. Price	Selling Price	Gross Margin		

12. **WORKING CAPITAL ASSESSMENT (Only for Working Capital Financing):**

Item	Daily requirements			Tied up period in days	Amount Tk
	Unit	Rate	Amount		
(a)	(b)	(c)	d= (b x c)	(e)	f = (d x e)
Work-in-Process					
Finished Goods					
Monthly Common Expenses					
Other Miscellaneous					

Total W/C Requirement	
Equity Participation	
IDLC's Finance	

13. *RISK FACTORS:*

Proposed by:

Proposed Terms and Conditions:

1.	Borrower		:	
2.	Loan amount		:	Taka ……………… (Taka ……. million and ……………hundred thousand only)
3.	Purpose		:	
4.	Availability period		:	6 (six)/12 (twelve) months from the date of Loan Agreement.
5.	Moratorium period		:	……(………) Months from the date of 1st disbursement
6.	Mode of Disbursement		:	Disbursement can be made at one shot / in phases
7.	Loan Term		:	…….. (…………….) months including (……) months moratorium period from 1st disbursement under the Loan Agreement
8.	Rate of interest		:	1. True rate : Fixed rate/ Floating rate at …% p.a. 2. Effective rate :
9.	Interest during Moratorium Period		:	
	i.	Rate	:	…………..% p.a.
	ii.	Mode of payment	:	Interest accrued during the Moratorium Period shall be capitalized and treated as part of the Term Loan.
10.	Late payment interest (Clause 6.4)		:	15.00% p.a.
11.	Repayment of term loan		:	60 (sixty) equal monthly installment of Taka 33,950 (Taka thirty three thousand nine hundred and fifty only) which consists of principal and interest and any balance amount will be adjusted with the last installment. Installment will be due at the beginning of each month starting from the beginning of 7^{th} month and ending on the 66^{th} month from the date of 1^{st} disbursement under this Loan Agreement.

12.	Prepayment of term loan	:	a) Term Loan can be fully or partly prepa of Loan Term with payment of 2.00% subject to providing a 1 (one)/2 (two) mo to the Lender. Any notice given for prep Loan shall be irrevocable and shall commi prepay the Loan (or part thereof) and sh reduction of the Borrower's repayment Clause 9 of this Schedule A.
			b) No amount prepaid in accordance with be capable of being re-drawn.
13.	Special Covenants	:	
14.	Supervision Fee	:	
15.	Processing Fee	:	
16.	Documentation Fee	:	
17.	Legal charges & charge for security creation	:	

18. Security		
Primary	a	Hypothecation of machinery, raw materials, work-in-process, finished goods of the firm duly insured covering Fire & RSD risks with IDLC's Mortgage clause for a sum exceeding 10% above the value of the hypothecated stock / sanctioned limit whichever is higher at the cost of the customer.
	b	Irrevocable General Power of Attorney duly notarized favoring IDLC authorizing to sell the inventory/stock, machinery and equipments of the firm under hypothecation without further reference to the court in case of default.
Collateral	c	Registered Mortgage –
	d	Registered Irrevocable General Power of Attorney to be executed by the owner of the mortgaged property favoring IDLC authorizing to sell/foreclose the mortgage property without further reference to the court in case of default.
Others	e	First charge by way of registered mortgage/hypothecation on all other fixed and floating assets of the company with charge registered with the Registrar of Joint Stock Companies and Firms.
	f	…………………………… numbers of post dated cheque valuing Tk……….each and one undated cheque amounting to Tk. ………. lac favoring the IDLC.
	g	Affidavit to be executed/sworn with photograph by the third party Mortgagor before the first class Magistrate.

Registered Mortgage (item c):

Location of the land	Owner	Area	Present use of land	Khatian No	Dag/P No.
Valuation Done By:					

	h	The third party Mortgagor shall be intimated about the sanction of the facility.
	i	Personal Guarantee of the owner of the property to be mortgaged.
	j	Personal Guarantee of all the Directors and their spouses of the company.
	k	A letter of Indemnity to be obtained from the customer to the effect that the customer shall indemnify IDLC for any loss/damage for allowing waiver of obtaining Flood & Cyclone insurance cover against hypothecated items.

RATIONALE FOR FINANCING:

5 major points for financing (Points in Bullets)

Proposed by

ARM	RM	AGM	GM

Approved by

DMD	MD

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