



Inspiring Excellence

INTERNSHIP REPORT ON

Comparative Analysis of Risk Grading Model between NBFI & Bank

Submitted By

Sarah Muniyat

ID:13104052

BRAC Business School

BRAC University

Submitted To

Riyashad Ahmed

Assistant Professor & Coordinator

BRAC University

Date of Submission: 7th May, 2017



Comparative Analysis of Risk Grading Model between
NBFI & Bank

Letter of Transmittal

7th May, 2017

Riyashad Ahmed

Assistant Professor & Coordinator

BRAC University

Subject: Submission of Internship Report

Sir,

I am very pleased to submit this report, which has been prepared for the requirement of the course BUS400. The report has been compiled as per your requirements, and with those set by the host organization. These three months of the internship program allowed myself to get acquainted with the corporate world. It enabled me to learn the practical implementation of the theories as well. This project is based on the experience I have gained during my internship period in IDLC Finance Limited. Regardless of many hurdles faced while preparing this project, I tried to be as thorough as possible. If you need any further elaboration on any issue, I shall be very glad to oblige.

Regards.

Sincerely,

Sarah Muniyat,

ID: 13104052,

BRAC Business School,

BRAC University.

Approved By

X

Preface & Acknowledgement

One of the renowned names in Bangladesh financial market is Industrial Development Leasing Company (IDLC) Limited. For three months from December 20th to March 20th, I did my internship at IDLC Finance LTD. It has been successfully operating as the largest multi-product multi-segment Non-Banking Financial Institution and one of the blue-chip companies on local stock markets in Bangladesh for over the last 30 years. IDLC has been awarded the “A+” rating by Credit Rating and Information Services Ltd. (CRISL). Through the Internship process, I had a great chance to sharpen my skills in a professional working environment. Moreover, I got the privilege to meet and learn from the corporate elites.

I would like to start this research paper by acknowledging my gratefulness to the Almighty Allah; without his blessings, I would not have been able to accomplish this report. I would also like to convey my heartfelt gratitude to the following people, for their continuous guidance throughout the completion of this report. First of all, I am deeply indebted to my honorable Academic Supervisor, Mr. Riyashad Ahmed, who has guided and supported me with sincerity and patience throughout the whole Internship period. Without his supervision, preparing this report would not have been possible.

Finally, I would like to express my earnest appreciation towards my internship supervisor Mr. Adnan Rashid, AGM & Head of Credit – SME of IDLC Finance Limited. It was his encouragement, patience and valuable feedback that enabled me to complete this report.

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Abstract

The study aims to assess the Risk Grading Models of IDLC Finance Limited and BRAC Bank Limited. IDLC Finance Limited is committed to sustainable practices and strong financial performance. Risk grading Model refers to the measures taken to mitigate the amount of defaults. Having considered the significance of credit risk grading, it becomes imperative for every Financial Institutes to carefully develop a credit risk grading model. As different types of organizations serve different purposes, they make their own custom made models that best fit their requirements. This study accentuates the differences and counsels for a better version.

Methodology

I have followed two kinds of methodology for the arrangement of the report. The two ways in which I have collected information:

Primary Data:

I have collected data directly from my Company supervisor, consulted with my colleagues from Department of Credit Risk Management.

Secondary Data:

These are the secondary sources I used to gather more relevant Information.

- Go through the websites.
- Annual reports of IDLC finance limited.
- Different books, journals and newspapers.

Limitations

There are some limitations those hindered the making of this project. Firstly, the time span was not sufficient enough to gather all the data. Therefore, it was very difficult to carry out the whole analysis. Lastly, I was not allowed to disclose some information regarding both the corporations owing to the confidentiality of information.

Company Profile

Overview

IDLC Finance Limited was established in Bangladesh in 1985. The single product leasing business started off with five staff members, has today evolved into a multi-product \$750 million business which has diversified into the Corporate, SME, Retail and Capital Market segments. IDLC today represents 31 branches & booths in 15 cities with over 1,200 staffs. As the company evolved over the years, the foreign shareholding gradually moved out and the last foreign shareholding was bought out by local sponsors in 2009.

IDLC has been consistently recognized by independent bodies for the values underpinning its business and is proud to be a standard bearer for the Bangladesh financial sector. IDLC upholds the highest standards of ethics and compliance by its employees. Each employee follows the Company's code of conduct. IDLC is involved with numerous CSR activities as well.

Since 2011, the IDLC Group has embarked on a journey to grow its capabilities and become larger and better – launching new technology, new products, new branches, new sales teams, new sales channels, etc. In 2014 the Company began leveraging these investments and seriously stepped up its game.

VISSION, MISION & STRATEGIC OBJECTIVES OF IDLC FINANCE LTD.

Vision

We will be the best financial brand in the country.

Mission

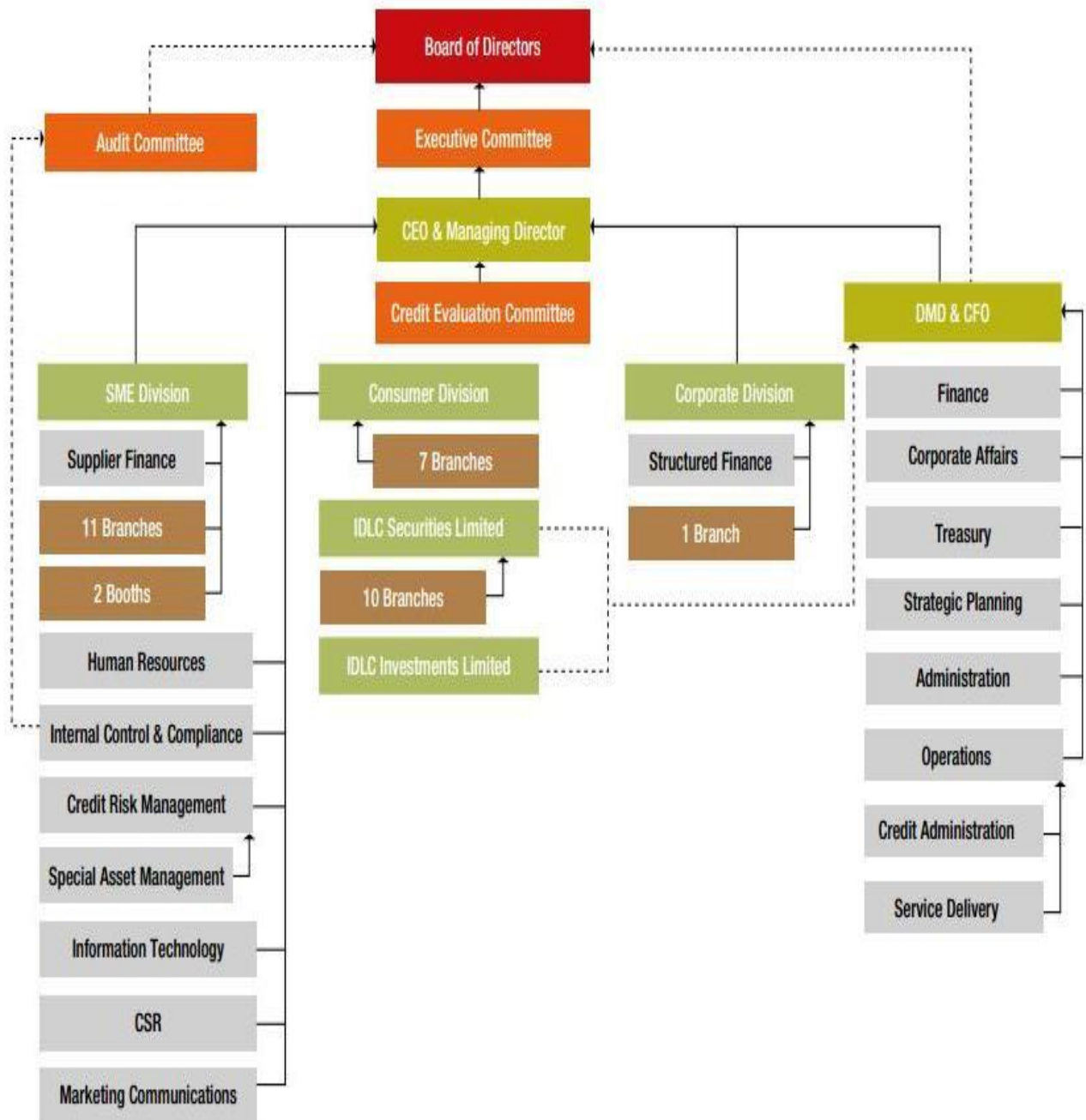
We will focus on quality growth, superior customer experience and sustainable business practices.

Strategic Objectives

- Grow and develop our talent pool;
- Fully leverage the new core banking platform;
- Optimize distribution points;
- Grow and diversify funding sources;
- Grow sales and service capabilities in the Consumer Division;
- Aggressively grow the SME portfolio;
- Focus on top-tier clients in the Corporate segment;
- Consolidate capital market operations and enhance capabilities;
- Embrace internationally accepted corporate governance and sustainable business practices.

ORGANIZATIONAL CHART (ORGANOGRAM)

Flowchart 1.1

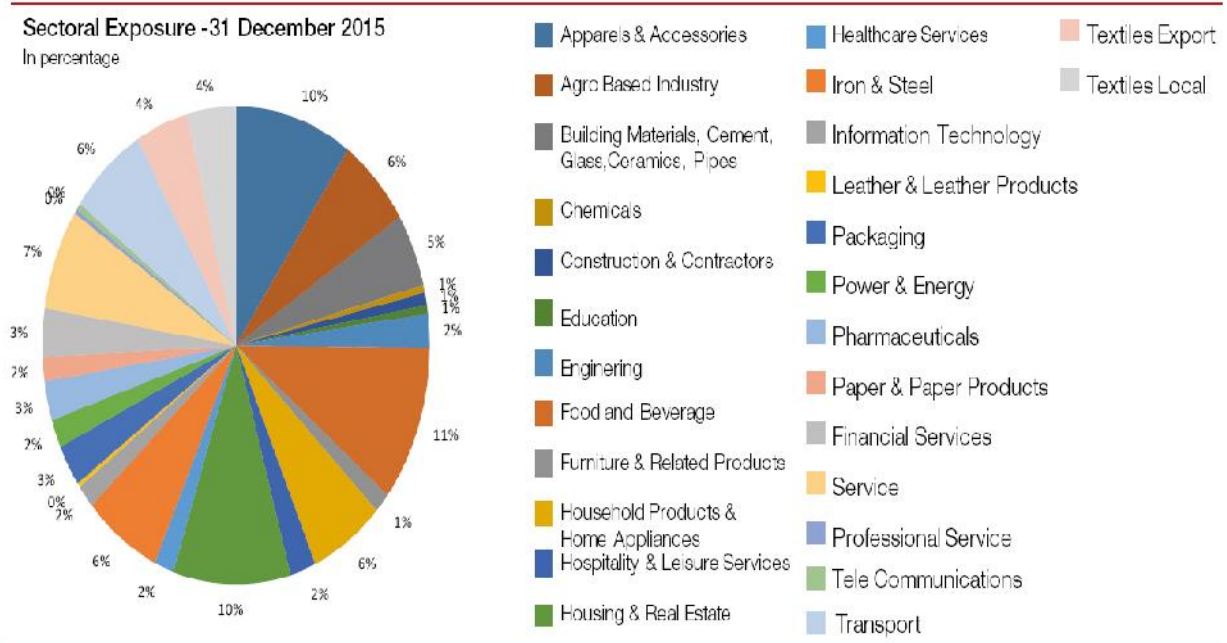


Major Products

The current product portfolio consists of Corporate and Structured Finance solutions for local and multinational corporate houses; Personal financing products such as deposits, home loans, car loans, personal loans etc.; financing facilities for Small and Medium Enterprises; Merchant Banking solutions such as Portfolio Management and Investment Banking (IPO, RPO, Bond Issuance, Rights Shares Offering etc.); and Brokerage services. With this diversified array of products, IDLC Finance Limited is at present the largest multi-product Non-Bank Financial Institution in Bangladesh, having two wholly-owned subsidiaries, IDLC Investments Limited and IDLC Securities Limited for carrying out its capital market operations.

Sector-wise Industrial Exposure

Flowchart 1.2



Responsibilities

I did my internship under the Small Enterprise Financing (SEF) division in the Credit Risk Management department. It is a very small but centralized department. There are two teams under SEF, the team I worked for consisted only 11 people. The department consists of seven credit analysts, two junior officers, one senior manager and one assistant manager. My supervisor, Mr. Adnan Rashid, has been working in IDLC for the last 8 years.

Over my course of internship in IDLC Finance Limited, I was appointed as an intern with a functional designation of “Support executive”. As a Support Executive, I had to perform the following roles as per my job description.

My main responsibility was to maneuver IDLC Monthly Business Review Magazine. It is the sole magazine of IDLC Finance and encompasses discussions and snippets regarding various economic turn of events. IDLC MBR is a dedicated platform which is concerned with economic issues, explores industry analysis, takes interest in the market fluctuation and boasts about the entrepreneurs and their initiatives. It is mostly youth centric and very relatable.

Making of MBR



My job was to gather articles and news on the current economic and business affairs along with their corresponding charts and graphs and put them into my words. Those will later get featured in the IDLC Monthly Business Review Magazine.

Special Issues



THE GREEN ISSUE



THE SME ISSUE

Contents of MBR

Cover Story



Research
in Focus



Buzzword



Analysis
Monitor



New Initiatives
in the Market



Spotlight
on Startup



Entrepreneurs'
Corner



Operating FLEXCUBE software was one of my additional responsibilities in IDLC. This software enables Credit Administration department to disburse loans to the clients. I also updated the daily Sanction and Disbursement status. Along with all these, I had to update SME database which is directly recorded by Bangladesh Bank.

Learnings

My learning experience began from day one. I have been provided with proper and adequate training from the very beginning of this journey. My supervisor and colleagues were very supportive and helpful at every step.

I was properly trained to use FLEXCUBE; an international banking software made by the second largest software making company in the world, Oracle Corporation. This banking software enables to keep records of the clients and also helps to disburse loan for the organization. Only some of the leading banks and NBFIs use this software. I was trained very effectively since one of my major responsibilities was to operate this software on a daily basis.

Most of the works in IDLC are done in Microsoft Excel. As a result, I got to learn quite a handful things from my colleagues as well as my supervisor. I also had to use different sorts of formulas that were required to sort and acquire data. It really fostered my MS Office skills.

Till my internship, I have only learnt about banking and finance through different academic courses. However, from such internship program, I got the opportunity to experience all these academic theories practically. I believe the benefits and learnings are far beyond what I could learn from academic courses.

As an intern, I have successfully dealt with people from various backgrounds and class. It has enhanced my interpersonal and communication skills to a great extent. I had to communicate not just with my coworkers but also with the superior executives. I believe I have left a lasting impression on them.

The tasks I was required to perform were on different divisions. Each had different team of employees and managers as well as different targets to achieve. Such experience has sharpened my ability to work in a team environment.

There was a time when I had to handle multiple tasks at once, under severe pressure and strict deadlines. That has taught me how to prioritize my work efficiently.

Data entry is all about proper documentation and handling a lot of important documents which I got to acknowledge at the very first stage. A single mistake can bring about a serious damage. Thus my internship has taught me how to work efficiently as well as carefully. It has improved my skills to flawlessly work with concentration for long relentless hours.

The financing system of the 21st century is highly tech savvy. As IDLC Finance Ltd. also maintains pace with the competitive business environment, its advanced banking software, activities, culture, and philosophy helped me to be the best at any field of work.

Like all banks and NBFIs, IDLC Finance Ltd. is also a strict follower of the rules and regulations imposed by Bangladesh Bank. Such policies also enriched my knowledge regarding the Financial Industry.

Preamble

Risk is omnipresent and all pervasive in any walk of life. 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. Globally, more than 50% of total risk elements in banks and Financial Institutions is Credit Risk alone. Thus managing credit risk for efficient management of a Financial Institutions has gradually become the most crucial task. Credit risk management in SME encompasses identification, measurement, matching mitigations, monitoring and control of the credit risks.

Risk Grading Model is used to forecast whether the client (Business organization or individual) has the ability to afford the loan amount s/he has applied for.

I have taken IDLC Finance Limited and BRAC Bank Limited as a representative of all the Non-Banking Financial Institute and Banks in Bangladesh, respectively. This study concentrates on the SME clients.

Problem Statement

As suggested by Financial Sector Reform Project (FSRP), Bangladesh Bank first introduced and directed to use Credit Risk Grading system in the Banking Sector of Bangladesh under the caption “Lending Risk Analysis (LRA)” in 1993. With the numerous shifts in credit culture towards a more professional and standardized Credit Risk Management approach the Banking sector had to adapt itself. (Dr. Sujit R. Saha, Professor & Director (Training), Bangladesh Institute of Bank Management (2005), CREDIT RISK GRADING MANUAL, Bangladesh Bank)

There is a prevailing difference between NBFIs and Banks regarding RGM. They have designed their own models as per requirement. As per the Study, there is no existing perfect Risk Grading Model. I have run a brief analysis on the Risk Grading models of IDLC Finance Limited (NBFIs) and BRAC Bank Limited. The purpose is to identify and assess all the pros and cons of both the models.

Analysis of the Study

Credit risk grading plays a vital role in credit risk management. The goal is to determine and assess the risks involved in all kinds of credit transactions. The model enables the management to optimize the returns by mitigating probable risks. This grading system helps the authority to take informed decisions:

- whether to lend or not to lend
- what should be the loan 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
- what would be the tenure/loan term
- what should be the Interest Rate

There are some core substances those every organization has to keep into mind before preparing Risk Grading model.

Credit risk refers to the combination of the following risks:

- **FINANCIAL RISK-** This criterion deals with liquidity, interest coverage ratio, analysis of leverage and most importantly profitability. If the counterparty does not have a profitable business, high chances that it will not be able to pay off the loan as of its due date. A highly leveraged corporation will also have limitations to make its installments on time. Bangladesh Bank has a standard parameter with corresponding scores to estimate the level of financial risk attached to a particular business entity.

FINANCIAL RISK-50%	PARAMETER	SCORE
1. Leverage: (15%) Debt Equity Ratio (×) - Times Total Liabilities to Tangible Net worth	<i>Less than 0.25×</i>	<i>15</i>
	<i>0.26× to 0.35 x</i>	<i>14</i>
	<i>0.36× to 0.50 x</i>	<i>13</i>
	<i>0.51× to 0.75 x</i>	<i>12</i>
	<i>0.76× to 1.25 x</i>	<i>11</i>
	<i>1.26× to 2.00 x</i>	<i>10</i>
	<i>2.01× to 2.50 x</i>	<i>8</i>
	<i>2.51× to 2.75 x</i>	<i>7</i>
	<i>More than 2.75×</i>	<i>0</i>
2. Liquidity: (15%) Current Ratio (×) - Times Current Assets to Current Liabilities	<i>Greater than 2.74×</i>	<i>15</i>
	<i>2.50× to 2.74 x</i>	<i>14</i>
	<i>2.00× to 2.49 x</i>	<i>13</i>
	<i>1.50× to 1.99 x</i>	<i>12</i>
	<i>1.10× to 1.49 x</i>	<i>11</i>
	<i>0.90× to 1.09 x</i>	<i>10</i>
	<i>0.80× to 0.89 x</i>	<i>8</i>
	<i>0.70× to 0.79 x</i>	<i>7</i>
	<i>Less than 0.70×</i>	<i>0</i>
3. Profitability: (15%) Operating Profit Margin (%) Operating Profit ×100 /Sales	<i>Greater than 25%</i>	<i>15</i>
	<i>20% to 24%</i>	<i>14</i>
	<i>15% to 19%</i>	<i>13</i>
	<i>10% to 14%</i>	<i>12</i>
	<i>7% to 9%</i>	<i>10</i>
	<i>4% to 6%</i>	<i>9</i>
	<i>1% to 3%</i>	<i>7</i>
	<i>Less than 1%</i>	<i>0</i>
4. Coverage: (5%) Interest Coverage Ratio (×)-Times Earnings before Interest & Tax (EBIT) Interest on debt	<i>More than 2.00×</i>	<i>5</i>
	<i>More than 1.51× Less than 2.00×</i>	<i>4</i>
	<i>More than 1.25× Less than 1.50×</i>	<i>3</i>
	<i>More than 1.00× Less than 1.24×</i>	<i>2</i>
	<i>Less than 1.00×</i>	<i>0</i>
Total Score–Financial Risk		50

Source: Credit Risk Grading Manual, Bangladesh Bank.

- **BUSINESS/INDUSTRY RISK-** This risk is associated with the counterparties and the respective industries they fall under. It takes into account the market competition, business outlook, industry growth, barriers to entry/exit etc. Whether the counterparty has the potential to own enough market share or the whole industry is suffering from a poor market growth. Moreover, the size of the potential borrower's business is measured under this category. It evaluates the most recent year's total sales revenue. For how long the Counterparty is involved in this particular business in terms of years? - That's another concern of Business Risk.
- **MANAGEMENT RISK** – Management risk mostly concerns about the existing management and management teams experience and the future succession plan. How long the existing management team has been working on their respective post etc.
- **SECURITY RISK-** This criterion emphasizes on the security coverage, collateral coverage and the personal guarantor's financial condition. They carefully evaluate whether the counterparty can back the loan up by offering security or collateral coverage. The Location of Mortgage Property is one of the main concerns here. This category simply suggests that in case if the borrower defaults then these set of coverage will make the required payments.
- **RELATIONSHIP RISK-** This area includes the account performance, Limits utilization etc.

These above mentioned criteria are the principal determinants of every Credit Risk Grading model. In case of IDLC Finance Limited and BRAC Bank Limited, the determinants of Credit Risk Grading models are relatively similar. Although there are some paramount differences those highly effect the decision making process.

Determinants of the Risk Grading Model of IDLC Finance Limited

IDLC Finance Limited has classified its Risk Grading Model into two distinct classes.

- Non-Behavioral Score
- Behavioral Score

Non-Behavioral Score has two sub-sectors.

- Financial Score
- Non-Financial Score

Non-Behavioral score gives a quantity estimate.

Financial Score

DSCR

DSCR stands for Debt Service Coverage Ratio. This ratio analyses whether the counterparty is eligible for the proposed loan or not. In order to get qualified for the loan, the DSCR of the counterparty has to score greater than or equal to 1.75. To simplify the whole calculation process, a sample is given below:

Debt Service Coverage Ratio= Fund available/ (Current Loan Burden + Summation of all proposed EMIs). It is a forecast of the next fiscal year on the basis of the latest fiscal year.

Let's assume,

Revenue= 10 Million

Issued Loan 1 Million, Outstanding EMI= .60 Million

Proposed Loan .80 Million, Outstanding EMI= .48 Million

Revenue	10 MLN
(-) COGS	60%
GP	-----
(-)OE	-----
NP	-----
(+)DEP	-----
Fund Available	2 MLN

1 MLN EMI (Outstanding)	.6 MLN
.8 MLN EMI (Outstanding)	.48 MLN
Total	1.08 MLN

DSCR= 2 MLN /1.08 MLN= 1.85

The DSCR of the aforementioned counterparty exceeds the minimum threshold and qualifies itself for the proposed loan. This is one of the major components and vastly impacts the concluding decision.

Parameter	Score
BDT 0.3 to 3.5 million: 2.4 and above	5
BDT 0.3 to 3.5 million: 2.25 to 2.39	4
BDT 0.3 to 3.5 million: 1.95 to 2.24	3
BDT 0.3 to 3.5 million: 1.85 to 1.94	2
BDT 0.3 to 3.5 million: 1.75 to 1.84	1
BDT 0.3 to 3.5 million: <1.75	0

Net Exposure as percentage of Net Working capital

When the counterparty is a first time borrower of IDLC,

Net Exposure as percentage of Net Working capital

= The Proposed Loan Amount/ Net working Capital

When the counterparty is being refinanced,

Net Exposure as percentage of Net Working capital

=The Adjusted Loan Amount/ Net Working Capital

<i>Parameter</i>	<i>Score</i>
<i>Upto 15% of Net Working Capital</i>	<i>5</i>
<i>From 16% to 25% of Net Working Capital</i>	<i>4</i>
<i>From 26% to 40% of Net Working Capital</i>	<i>3</i>
<i>From 41% to 55% of Net Working Capital</i>	<i>2</i>
<i>From 56% to 70% of Net Working Capital</i>	<i>1</i>
<i>Above 70% of Net Working Capital</i>	<i>0</i>

Inventory Turnover (in days)

The Inventory turnover in days is a measure of the average number of days in a particular fiscal year the company had sold out and restocked its inventory.

Inventory Turnover= 360 *Inventory/ Sales Revenue (Bank method= 360 days)

<i>Parameter</i>	<i>Score</i>
<i>Turnover < 30 days</i>	<i>5</i>
<i>Turnover is 30 to less than 60 days</i>	<i>4</i>
<i>Turnover is 60 to less than 90 days</i>	<i>3</i>
<i>Turnover is 90 to less than 120 days</i>	<i>2</i>
<i>Turnover is 120 to less than 180 days</i>	<i>1</i>
<i>Turnover > 180 days</i>	<i>0</i>

Accounts Receivables Turnover (in days)

The Accounts Receivables Turnover (in days) is a measure of the average number of days in a particular fiscal year the company took to collect the receivable from the trade debtors.

Accounts Receivables Turnover

= 360 *Accounts receivables/ Sales Revenue (Bank method= 360 days)

<i>Parameter</i>	<i>Score</i>
<i>Turnover < 30 days</i>	<i>5</i>
<i>Turnover is 30 to less than 45 days</i>	<i>4</i>
<i>Turnover is 45 to less than 60 days</i>	<i>3</i>
<i>Turnover is 60 to less than 90 days</i>	<i>2</i>
<i>Turnover is 90 to less than 120 days</i>	<i>1</i>
<i>Turnover > 120 days</i>	<i>0</i>

Debt to Equity Ratio

Debt/Equity Ratio is a debt ratio used to measure a company's financial leverage, calculated by dividing a company's total liabilities by its stockholders' equity. The D/E ratio indicates

how much debt a company is using to finance its assets relative to the amount of value represented in shareholders' equity. This ratio entails the proposed loan amount along with the existing liability.

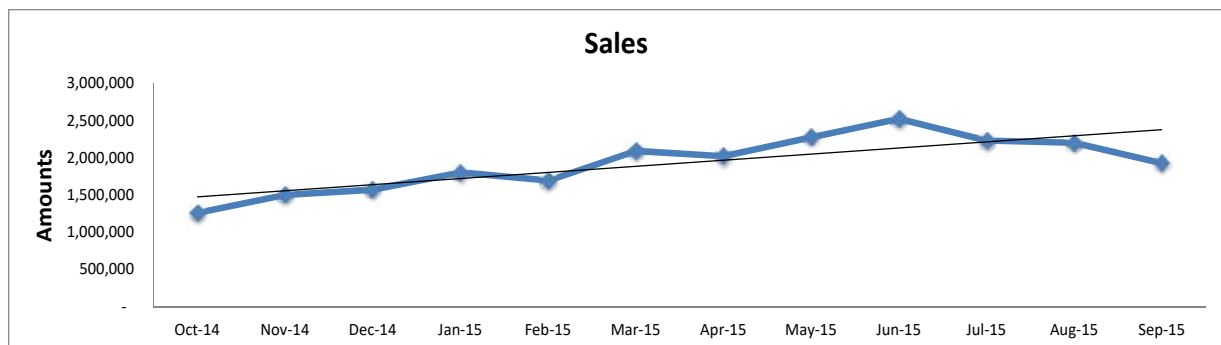
<i>Parameter</i>	<i>Score</i>
<i>Less than 0.10</i>	<i>5</i>
<i>0.1 to 0.25</i>	<i>4</i>
<i>0.26 to 0.5</i>	<i>3</i>
<i>0.51 to 0.75</i>	<i>2</i>
<i>0.76 to 1</i>	<i>1</i>
<i>More than 1</i>	<i>0</i>

Debt/Equity Ratio= (Total Liability + Associated Loans) / Total stockholders' equity

Seasonality of the Business

The past trend in sales can exhibit a lot about how a business will turn out in the coming future. The industries behave differently in different seasons. For instance: The fall is the peak time for RMG sector, summer is the best for Beverage industries etc.

Hypothetically,



This figure shows that, this particular counterparty has been very consistent in its sales

figure. A very few ambiguous shifts are observed. It depicts that the counterparty has a steady income. May and June were the highest grossers.

Seasonality of the Business= Total sales of last fiscal year/ Summation of the highest two months of gross sales from the latest fiscal year.

This analysis also estimates the probable monthly sales figure.

<i>Parameter</i>	<i>Score</i>
<i>Less than or equal to 20%</i>	5
<i>More than 20% but less or equal to 25%</i>	4
<i>More than 25% but less or equal to 35%</i>	3
<i>More than 35% but less or equal to 45%</i>	2
<i>More than 45% but less or equal to 50%</i>	1
<i>More than 50%</i>	0

Non-Financial Score

Years of Relevant Business Experience

For how long the client has been serving this business entity? - This is the primary consideration. It dictates how much experience s/he has in this particular field of work. Moreover, it also shows how much he is acquainted with this particular industry.

<i>Parameter</i>	<i>Score</i>
<i>Above 10 years</i>	5
<i>9 to 10 years</i>	4
<i>6 to 8 years</i>	3

<i>4 to 5 years</i>	<i>2</i>
<i>2 to 3 years</i>	<i>1</i>
<i>Below 2 years</i>	<i>0</i>

Banking Habit

This is the credit summation in the client's bank account as a percentage of yearly sales. It shows how the client is leveraging his or her bank account. It also depicts how much the client is aware of rules and regulations of Financial Institutes. Those who have prior good relationship with banks or other financial institutes, they are usually easy to assess.

<i>Parameter</i>	<i>Score</i>
<i>More than or equal to 100%</i>	<i>5</i>
<i>75% to 99%</i>	<i>4</i>
<i>51% to 74%</i>	<i>3</i>
<i>26% to 50%</i>	<i>2</i>
<i>11% to 25%</i>	<i>1</i>
<i>Less than 10%</i>	<i>0</i>

Recycle Time

It is the measure to what extent a counterparty has leveraged its Cash Credit service. Mostly the big business firms and corporate elites can avail the Cash Credit service in Bangladesh. It is a short term cash loan to a company. A bank provides this type of funding, but only after the required security is given to secure the loan. The firm that avails the loan can frequently keep drawing from the account up to a certain specified limit. Recycle time measures the total amount credited for a certain period of time against the sanction limit. It suggests that the company is better off when the credit summation is greater.

<i>Parameter</i>	<i>Score</i>
<i>More than or equal to 5 times</i>	<i>5</i>
<i>4 to 4.99 times</i>	<i>4</i>
<i>3 to 3.99 times</i>	<i>3</i>
<i>2 to 2.99 times</i>	<i>2</i>
<i>1 to 1.99 times</i>	<i>1</i>
<i>Less than 1 time</i>	<i>0</i>

Recycle Time= Summation of all the credited amount/ Sanction Limit

***Aforementioned components are the key components of Non-behavioral Score.**

<i>Components (Financial Score)</i>	<i>Weightage</i>
<i>DSCR</i>	<i>15%</i>
<ul style="list-style-type: none"> ▪ <i>Net Exposure as percentage of Net Working capital</i> ▪ <i>Acquisition Cost of FA/ Lease Equipment</i> ▪ <i>Net Exposure as Percentage of Fixed Asset (in case of construction financing)</i> 	<i>10%</i>
<i>Industry wise Profit Margin</i>	<i>5%</i>
<i>Inventory Turnover (in Days)</i>	<i>5%</i>
<i>A/R Turnover (in days)</i>	<i>5%</i>
<i>Total Liability to Equity Ratio (after availing the loan)</i>	<i>6%</i>

<i>Net Exposure as Percentage of Concern's Equity</i>	5%
<i>Seasonality of the business (for two months)</i>	5%

Components (Non-Financial Score)

Weightage

<i>Years of Relevant Business Experience (Years)</i>	3%
<i>Banking Habit (Credit summation as a percentage of yearly sales)</i>	5%
<i>Recycle Time</i>	3%
<i>Business Premises Ownership</i>	5%
<i>Personal Guarantors & Client Reference</i>	5%
<i>Security Coverage (As % of Proposed Facility)</i>	10%
<i>Formal Facility (Including Net Exposure with IDLC) as Percentage of PNW (Personal Net Worth)</i>	3%

Behavioral Components

This section deals with the client's demographic factors.

Nature of the business (Sister concern)

Informal partnership businesses especially those businesses which are involved in dubious activities. It also includes the mention of Sister concerns which are involved in the different line of business. The form of business, e.g.: Partnership, Proprietorship etc. It also takes into account any prior records of illegal acts.

Length of time in the current location

Location plays a prominent role in order to make a business thrive. Different industries call for different locations. It does not only depend on the availability of resources but also the neighborhood. For instance, continuous change of the business location can indicate to a probable barren business.

Attributes of the main business sponsors'

Concerning if any close affiliation with any political leader or any immediate family members are actively involved in the politics or business sponsors have any vices (moral weakness) like drug or alcohol addiction, gambling habits, etc. Presence of either of these will negatively impact the business entity.

Marital Status of the main sponsor

If s/he is married, risk is relatively low since s/he has people dependent on his income, he cannot just flee away whenever he wants to. If otherwise, the risk is higher.

Legal Documents

Copy of compliance documents depending on industry e.g. Drug license (For Pharmacy)/ BSTI Certificate (For Food Items)/ Fire License (for Chemical Company) /Acid using permission (if required)/Permission for Diagnostic center, Trademark of the products and ETP for emission of environmentally hazardous chemicals.

Repayment Track Rerecord

Requires rerecording of the repayment track for the applicants for refinancing. This is not applicable for the first time borrowers.

Nature of Borrowings

Previous record of the sources of borrowings, e.g., loans from the co-operative society or habituated with the cooperative loans, habituated with the informal borrowings (from friends, relatives and other business concerns).

Nature of maintaining sales data

Sales register or ledger book is properly maintained or not.

Tenure of the rental agreement

Whether the tenure of the rental agreement of the business premises will be completed within the financing period or not.

Residence status

Whether client lives on his owned premise or rented. Permanent residence makes the client more trustworthy and eligible for availing the loan.

Proprietor's Personal Net worth

Whether the main sponsor(s) have substantial personal net worth to afford the proposed loan.

Market reputation & Feedback from Buyers & Suppliers

Gathers feedback from Buyers & Suppliers on the client's prevailing market reputation.

<i>Score</i>	<i>Attribute</i>
<i>4.76 to 5</i>	<i>Extremely low risk</i>
<i>3.76 to 4.75</i>	<i>Low risk</i>
<i>2.76 to 3.75</i>	<i>Below average</i>
<i>1.76 to 2.75</i>	<i>Average risk</i>
<i>0.76 to 1.75</i>	<i>High risk</i>
<i>00 to 0.75</i>	<i>Extremely high risk</i>

Determinants of the Risk Grading Model of BRAC Bank Limited

BRAC Bank Limited has classified its Risk Grading Model into four distinct classes.

- Financial Risk
- Business or Industry Risk
- Management Risk
- Relationship Risk

<i>Financial Risk</i>	<i>Weightage</i>
<i>Debt to Equity Ratio</i>	<i>15%</i>
<i>Inventory Turnover Days</i>	<i>6%</i>
<i>Asset Turnover</i>	<i>9%</i>
<i>Current Ratio</i>	<i>6%</i>
<i>Interest Coverage Ratio</i> <i>(EBITDA / Interest Expense)</i>	<i>6%</i>
<i>Net Profit Margin</i> <i>(Earnings after Tax / Sales)</i>	<i>12%</i>
<i>Net Cash After operation to Current Liabilities</i>	<i>6%</i>
<i>Total</i>	<i>60%</i>

<u><i>Business/Industry Risk</i></u>	<u><i>Weightage</i></u>
<i>Age of Business</i> <i>(The number of years the company engaged in the primary line of work)</i>	6%
<i>Business Outlook</i> <i>(Critical assessment of medium term prospects of industry, market share and economic factors.)</i>	4%
<i>Industry Growth</i>	4%
<i>Market Competition</i> <i>(Ranking the customer against other competitors)</i>	6%
Total	20%

<u><i>Management Risk</i></u>	<u><i>Weightage</i></u>
<i>Experience</i> <i>(Quality of management based on total number of years of experience)</i>	4.8%
<i>Succession Plan</i>	3.2%
Total	8%

<i>Relationship Risk</i>	<i>Weightage</i>
<i>Account Conduct</i>	<i>12%</i>
<i>Total</i>	<i>12%</i>

<i>Grading</i>	<i>Parameter / Score</i>
<i>Superior</i>	<i>100</i>
<i>Very Good</i>	<i>80-100</i>
<i>Good</i>	<i>70-80</i>
<i>Satisfactory</i>	<i>60-70</i>
<i>Acceptable</i>	<i>50-60</i>
<i>Marginal/ Watch List</i>	<i>40-50</i>
<i>Special Mention</i>	<i>35-40</i>
<i>Substandard</i>	<i>30-35</i>
<i>Doubtful</i>	<i>25-30</i>
<i>Loss</i>	<i>< 25</i>

Findings & Recommendations

The Risk Grading Models of both IDLC Finance Limited & BRAC Bank Limited show many resemblance. Although there are some differences present.

A component that both the firms share in common is NPL (Non-Performing Loan). In case of BRAC Bank LTD. the clients who fail to make nine consecutive Monthly Installments are regarded as NPL clients. These clients will never be refinanced. On the other hand, failure to make only six consecutive EMIs will land a spot at IDLCs NPL Clients list.

The RGM of BRAC Bank LTD. emphasizes more on the Financial Factors. It takes into account the components, such as, Current Ratio, Net Profit Margin and weighs higher on financial risk.

Whereas, the RGM of IDLC Finance LTD. stresses more on the Behavioral Factor. Although it only weighs 10%, but the components are rich with different aspects. Since this study highlights the SME Industry (Small & Medium Enterprises), the clients are anticipated to be relatively new or financially inconstant. Hence, IDLC Finance prefers to focus more into the Behavioral Score.

The Relationship Risk component Succession Plan adds a lot of value to the BRAC Bank LTD.s Risk Grading Model. The succession plan refers to the plan after the demise or retire of the current management. If a Business entity does not have any second line or new leaders to take over the current management if requires then the business will very likely to doom. IDLC should consider including this element into their Risk Grading Model.

IDLC's Behavioral Factor is very well designed. The background check on the Main Sponsors has the potential to bring a very big difference. If the client has any illicit prior records, the firm can save itself from making a huge loss. Marital Status and Permanent Residence are important to judge a clients' reliability, trustworthiness and loyalty. BRAC Bank LTD. should take these into consideration.

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