Credit *Management*

The systematic process by which a bank plans, organises, directs and controls its lending activities to maximise risk-adjusted returns while keeping credit losses within levels the bank can absorb.

By the end of this section, students should be able to:

01 Understand the principles and process of bank credit management

02 Apply qualitative and quantitative techniques to evaluate borrowers

03 Explain loan security, pricing, and documentation requirements

04 Describe methods for credit monitoring, supervision, and managing NPLs

What is Credit?

Credit, from the Latin word *credere* ("to trust"), refers to a transaction in which a lender (the bank) provides funds, goods, or services to a borrower on the understanding that repayment, usually with interest, will be made at an agreed future date.

IN BANKING

Credit is the core income-generating asset: loans and advances typically constitute the largest and most profitable, but also the riskiest, category of bank assets.

CREDIT MANAGEMENT

The systematic process by which a bank plans, organises, directs and controls its lending activities so as to maximise risk-adjusted returns while keeping credit losses within levels the bank can absorb. It covers the entire credit life-cycle: origination, appraisal, sanctioning, disbursement, monitoring, and recovery or exit.

Objectives of Credit Management

Creditworthy Borrowers

Ensure credit is extended only to borrowers who can service and repay the debt.

Risk–Return Balance

Achieve an optimal balance between risk and return on the loan portfolio.

Asset Quality

Maintain asset quality and minimise non-performing loans (NPLs).

Regulatory Compliance

Ensure compliance with central bank guidelines and Basel capital & provisioning standards.

Liquidity & Profitability

Support the bank’s liquidity and profitability — interest income is a major revenue source.

Sound Credit Culture

Promote consistent decision-making and a sound credit culture across the institution.

Why Effective Credit Management Matters

01	**Largest Asset Class**	Loans are usually the largest asset class and the main source of interest income for a bank.
02	**Leading Cause of Failure**	Poor credit decisions are the leading cause of bank distress and failure worldwide.
03	**Protects Stakeholders**	Sound credit management protects depositors' funds and shareholders' capital.
04	**Public Confidence**	It underpins public confidence in the banking system and supports financial stability.
05	**Risk-Based Pricing**	It enables banks to price risk appropriately and allocate capital efficiently.

Key Concepts and Terminology

Term	Meaning
Credit risk	The possibility that a borrower will fail to meet obligations in accordance with agreed terms.
Creditworthiness	The overall capacity and willingness of a borrower to repay debt as agreed.
Non-performing loan (NPL)	A loan on which the borrower has not made scheduled payments for a specified period (commonly 90 days).
Collateral / security	An asset pledged by the borrower to secure a loan, which the bank may realise on default.
Credit portfolio	The aggregate of all loans and advances held by a bank at a given time.
Provisioning	Setting aside funds (loan loss reserves) to cover expected or incurred credit losses.

Classification by Maturity

Short-term Credit

Up to 1 year

Overdrafts, working capital loans, trade finance facilities

Medium-term Credit

1–5 years

Equipment/asset finance, medium-term business loans

Long-term Credit

Over 5 years

Mortgage loans, project & infrastructure finance, syndicated term loans

Classification by Facility Type

Overdraft Facility

A short-term, revolving facility that allows a current-account holder to withdraw more than the account balance up to an approved limit. Interest is charged only on the amount utilised. Commonly used to bridge temporary working-capital gaps.

Term Loans

A lump sum advanced for a specific purpose (e.g., asset purchase, expansion) and repaid in instalments (principal and interest) over an agreed period. Subdivided into short-, medium- and long-term loans.

Working Capital Finance

Credit extended to finance a firm’s day-to-day operating cycle; purchase of stock/inventory, payment of creditors, and bridging the gap before receivables are collected. Includes cash credit, overdrafts, and revolving credit lines.

Trade Finance & Specialised Facilities

Letters of Credit (LCs)

An irrevocable undertaking by a bank to pay a seller on behalf of a buyer once specified documents are presented.

Bills Discounting / Invoice Finance

Advancing funds against trade bills or invoices before their maturity.

Bank Guarantees

A bank's promise to meet an obligation if the customer defaults (e.g., bid bonds, performance bonds).

Mortgage / Real Estate Finance

Long-term credit secured by a charge over land or buildings, used to finance property purchase, construction, or development.

Consumer / Retail Credit

Personal loans (secured or unsecured), credit cards, revolving consumer credit lines, and asset/hire-purchase finance.

Syndicated & Project Finance

Large facilities extended jointly by a group of banks to a single borrower for major projects or infrastructure.

Further Classifications

BY SECURITY

Secured Credit

Backed by collateral such as land, buildings, machinery, inventory, receivables, shares, or cash deposits.

Unsecured (Clean) Credit

Granted purely on the borrower's creditworthiness, without collateral; carries higher risk and is typically priced higher and capped at lower amounts.

BY CURRENCY AND SOURCE

Local-currency versus foreign-currency credit

On-balance-sheet lending versus off-balance-sheet facilities

(e.g., guarantees, letters of credit, which are contingent liabilities)

The Credit Policy

A formal statement, approved by the board of directors, that sets out the principles, standards, and parameters within which a bank's lending activities are conducted. It translates the bank's risk appetite and strategic objectives into operational guidance for credit staff.

TYPICAL CONTENTS

- Statement of overall lending philosophy and risk appetite
- Target markets and sectors (industries, geographic areas, customer segments)
- Prohibited or restricted lending activities
- Lending authority and approval limits (delegated authority matrix)
- Single-obligor and sector/portfolio concentration limits
- Pricing guidelines and minimum acceptable margins relative to risk
- Collateral and security requirements, including margins/haircuts
- Documentation standards and requirements for loan agreements
- Credit grading/rating system and criteria for classifying loans
- Provisioning and write-off policy (consistent with IFRS 9 / regulatory standards)
- Procedures for loan review, monitoring, and problem-loan management
- Roles and responsibilities of Board, Credit Committee, Risk Management, and business units

The 5 Cs of Credit

C	**Character**	The borrower’s integrity, reputation, and track record of meeting obligations; assessed via credit references, credit bureau reports, and past dealings with the bank.
C	**Capacity**	The borrower’s ability to generate sufficient cash flow to service debt, derived from income statements, cash-flow projections, and business viability.
C	**Capital**	The borrower’s own financial stake/net worth in the business, indicating the level of commitment and cushion against losses.
C	**Collateral**	Assets pledged as security, providing a secondary source of repayment if cash flow proves insufficient.
C	**Conditions**	The purpose of the loan and the prevailing economic, industry, and competitive conditions that may affect repayment.

The CAMPARI Framework

A complementary qualitative checklist widely used in commercial lending:

C — Character
Willingness and integrity of the borrower

A — Amount
Whether the amount requested is appropriate and justified

A — Ability
Legal and managerial capacity to borrow and run the business

R — Repayment
The source, schedule, and certainty of repayment

M — Margin
The interest rate/return relative to the risk taken

I — Insurance / Security
The collateral or fallback available if things go wrong

P — Purpose
The specific, legitimate use of the funds

Other qualitative considerations

Quality and experience of management/promoters (management risk)	Banks evaluate the track record, competence, integrity, and depth of the management team or promoters. Strong, experienced leadership reduces the risk of poor decisions or operational failures; weak or unproven management increases it.
Industry and competitive analysis	Banks examine the industry's structure, competitive intensity, the borrower's market position, ease of new entrants, and how cyclical or stable the sector is. Tools like Porter's Five Forces help gauge structural risks that could affect cash flows and repayment ability.
Macroeconomic and regulatory environment	External factors such as economic growth, interest rates, inflation, currency movements, and regulations (tax, environmental, industry-specific rules) are reviewed. Adverse changes in these can weaken the borrower's performance even if the company itself is well-run.
Corporate governance structures, ownership, and legal form of the borrower	Banks look at board composition, transparency, shareholder structure, related-party dealings, and the legal entity type (e.g., limited company vs. partnership). Sound governance and clear ownership reduce agency risks and improve confidence in reported information and decision-making.
Relationship history and account conduct with the bank	Past behaviour with the lending bank (or other banks) is scrutinised loan repayment record, overdraft usage, compliance with covenants, and overall account conduct. A clean, long-standing relationship is a positive signal; past defaults or irregular behaviour raises red flags.

Ratio Analysis

Ratio analysis restates raw financial-statement numbers as relationships, so the credit officer can judge a borrower's financial health in a way that is comparable across companies and over time.

Category	Examples	Purpose
Liquidity	Current ratio; Quick (acid-test) ratio	Ability to meet short-term obligations
Leverage / Solvency	Debt-to-equity; Debt-to-assets	Extent of reliance on debt financing
Profitability	Gross/net profit margin; ROA; ROE	Earnings performance and efficiency
Coverage	DSCR; Interest coverage ratio	Adequacy of cash flow to service debt
Efficiency / Activity	Inventory, receivables & asset turnover	Effectiveness of asset utilisation

Further Quantitative Tools

Cash-Flow Analysis

Banks project the borrower's future cash flows to test the adequacy and timing of funds available for debt service, often under base-case and stressed (sensitivity) scenarios. Loans are repaid from cash rather than accounting profit.

Credit Scoring Models

Statistical models assign points to borrower characteristics (income, employment, existing debt, repayment history) to produce a score that predicts default probability; widely used for consumer and small-business lending.

Altman's Z-Score

A multivariate model combining working capital, retained earnings, EBIT, market value of equity, and sales relative to total assets, used to predict corporate bankruptcy risk.

Internal Credit Ratings

Banks assign borrowers to risk grades (e.g., AAA to D) based on quantitative and qualitative scores, which then drive pricing, provisioning, and approval authority.

Collateral Valuation

Quantitative assessment of market value, liquidity, and loan-to-value (LTV) ratio of pledged collateral, including appropriate margins/haircuts for valuation and forced-sale risk.

Break-Even & Sensitivity

Used for project and business loans to determine the sales level at which the borrower covers costs, and to test how changes in key variables affect repayment capacity.

Credit Assessment Process —

01

Loan Application & Information Gathering

The borrower submits a formal application together with required documents: identification, business registration, financial statements, business plan/cash-flow projections, collateral documents, and Know-Your-Customer (KYC) information.

02

Preliminary / Eligibility Screening

The relationship officer checks that the request fits the bank's target market, product criteria, and exclusion list, and that basic documentation is complete before committing further resources to appraisal.

03

Credit Investigation and Due Diligence

Verification of identity, legal status and ownership; credit bureau/reference checks; site visits/inspection of premises and collateral; verification of financial statements (and independent audit confirmation where material).

04

Credit Analysis

Application of qualitative techniques (5 Cs, CAMPARI, management and industry assessment) and quantitative techniques (ratio analysis, cash-flow projections, scoring/rating models), culminating in a credit appraisal report with a recommendation.

05

Risk Grading / Rating

The borrower and facility are assigned an internal risk grade, which determines the required approval level, pricing, and provisioning treatment.

Credit Assessment Process

06

Credit Decision (Approval / Decline)

The proposal is decided upon by the appropriate authority — an individual credit officer, a credit committee, or the board — depending on the amount and risk grade, in line with the delegated lending-authority matrix.

07

Sanctioning and Documentation

Where approved, formal loan offer letters and legal agreements are prepared, terms and conditions (covenants, repayment schedule, pricing) are communicated, and collateral documentation is perfected (e.g., registration of mortgages/charges).

08

Disbursement

Funds are released once all conditions precedent are satisfied, sometimes in tranches linked to project milestones.

09

Post-Disbursement Monitoring and Review

Tracking account conduct, covenant compliance, and timely repayment; periodic review of the borrower's financial performance and collateral value; early-warning systems to flag deteriorating accounts.

10

Problem-Loan Management

For accounts showing signs of distress, the bank considers restructuring, rescheduling, additional security, or, as a last resort, recovery/enforcement action, guided by the bank's remedial-management and provisioning policies.

Summary

The credit assessment process is not a one-off event but a continuous cycle.

Sound origination and analysis must be followed by disciplined monitoring throughout the life of the facility, since risk conditions can change well after disbursement.

Proper credit management remains a key determinant of a bank’s long-run soundness.