

# Assessing Credit Risk for SMEs

2 Days

## COURSE OVERVIEW

This 2-day seminar is aimed at all those who would like to acquire a solid foundation of credit analysis and lending skills to SMEs. Participants learn the necessary skills and judgment to analyze, and if required, to approve a business loan.

Designed to be highly participative, participants work in groups throughout the course. The groups work together through exercises and case studies and share their experiences to help understand and apply the principles surrounding SME lending.

## LEVEL

Introductory - Intermediate

## WHAT WILL I GET OUT OF IT?

Participants will be able to:

- Identify and obtain information to give a comprehensive picture of the client's business.
- To identify and minimise the risks that face businesses both within a particular industry and from a business and management risk perspective.
- Define and understand the terms operating cycle and capital investment cycle and understand its importance to the cash flow of a business.
- To understand and identify the "real" cause of borrowing of the business, and in doing so assess whether the sales growth is long-term or short-term.
- Determine historical trends in the ratios and then analyse these ratios against current ratios to determine the viability of the business
- Understand cash flow and its effect on the operations of a business.
- Determine the timing for disbursing funds and establish a repayment arrangement
- Monitor and manage the loan and build upon the relationship developed with the client

## WHO'S IT FOR?

Delegates could come from a broad range of backgrounds, such as:

- Commercial credit analysts
- Commercial lenders, loan officers, relationship managers
- Investors
- Other financial professionals

## COURSE CONTENT

### Acquire the Appropriate Information

- The Banking Environment and Gathering Information
- Forms of Business Organization
- Gather Financial Data
  - Effective Credit Decisions and Risk Management
  - Credit Risk Management
  - Unsecured Lending
- Obtaining information and identifying cross-business opportunities

This introductory phase will discuss the role of financial institutions and lenders in the lending process. The regulatory environment and its effect on banks' operations, and how operations define the function and responsibilities of a lender, is also considered. Risk analysis and management is also introduced by considering the key issues in credit management, through the use of an analytical tool to identify risks in a loan situation, and reviewing and evaluating a credit application. Participants will use financial statements to assess risk, build a better understanding of the business, and identify other selling opportunities.

### Understand the Risk

- Principles of Sound Lending
  - Personal or Corporate Equation (or Personal Factor)
  - Ability and Capacity to Repay
  - Willingness to Repay
  - Security
- Preliminary Assessment of Loan Proposals
  - Screening Applications
  - Amount of Loan
    - Purpose of Loan
    - Reason (Cause) of Borrowing
    - Lending Policies
  - The Applicant's Business
  - Collecting Information
  - Continue or Decline

The concept of lending principles, risk and credit management are introduced as the foundation for all lending. The principles of sound lending are considered as a means of minimizing the risk of default, and to provide the basis for this segment of the program.

In this respect, participants will consider the personal or corporate equation as a basis of relationship with the borrower, the ability or capacity to repay, as well as the willingness to repay, and the provision or availability of support through security covering the loan.

Their considerations then focus on the preliminary screening of a loan proposal to determine whether it appears reasonable, legal and within the bank's policy.

Participants will consider the appropriate questions to be asked about the applicant's business so that they will be better placed to understand what is presented in the financial statements.

As a final step in this process, participants will consider the types and sources of information available to them in their analysis. Participants will apply principles learnt through a series of exercises and/or case studies.

- Causes of Borrowing
  - Borrowing Caused by Sales Growth
  - Borrowing Caused by Slowdowns in the Operating Cycle
  - Borrowing Caused by Purchases of Fixed Assets
  - Borrowing Caused by Other Factors

This step considers how borrowing is caused by changes in the operating and capital investment cycles of a business and by other reasons not directly connected to the asset conversion cycle, such as changes in equity structure or unprofitable operations.

- Analyzing Industry & Business Risk
  - Industries
  - Industry Risk Characteristics
  - Business Analysis Perspective
  - General Characteristics
  - Product-Market Match
  - Supply and Production Analysis
  - Sales and Distribution
  - Analyzing Management
  - Drawing Your Conclusion

Initially participants will consider where business analysis fits into loan analysis and how it will help integrate information gathered and lead to a loan decision.

Analysis of business risk involves assessment of the strategic plans and systems within a business and evaluating management's ability to carry out those plans. In this segment participants analyse risks related to the general nature of a business, the product-market match, supply and production risks, sales and distribution risks, and the ability of its management. Methods of approach in analyzing different types of business and management risks are discussed and considered, as well as how the various degrees of risk can be assessed and evaluated.

#### **ANALYSE REPAYMENT CAPACITY**

- Analyzing Financial Statements
  - What are you, as a Lender, looking for?
  - Accounting Risk in the Income Statement
  - Analyzing Asset and Liability Management
  - Working Capital

In this step, participants will consider how they can form hypotheses about the structure and content of financial statements they will analyze.

The segment will enable participants to recognise typical asset and liability structures of different types of businesses; determine the degree of accounting risk in a trading and profit and loss statement; understand the effects of different accounting methods on the trading and profit and loss statement and balance sheet.

- Principles of Cash Flow Analysis
  - Cash Budgets
  - Statements of Cash Flows
  - Cash Flow Cycles
  
- Analyzing Projections
  - The Logic and Purpose of Projections
  - Sensitivity Analysis
  - Projecting Cash Flow
  - Projecting Balance Sheets

This step briefly looks at the area of cash flow and projections and their effect on the operations of a business.

Participants will be exposed to how to integrate information from their historical analysis of a borrower's industry, business, and financial statements into a forecast of future cash flow available for debt repayment. They discuss the reasons for making projections and consider common methods for making them. Both long-term and short-term projections will be discussed as well as conducting a sensitivity analysis, to test the vulnerability of the repayment capacity of the business.

#### **STRUCTURE, PRICE, MONITOR & MANAGE LOANS**

- The Loan Decision
- Loan Structure: Selecting the Right Facility

This phase we will consider the loan decision-making process, summarizing the analysis of the business, and making the decision needed to complete the transaction.

Major focus will be on choosing the right loan product, and in matching the loan with the borrower's timing of financial needs and capacity to service the debt, based on previous analysis and possible loan support. Consideration is also given to pricing the loan and provision of support for the loan, as well as the repayment terms and other conditions to be met.

- Loan monitoring & Collection & Taking Appropriate Action

Loan performance and monitoring of progress is discussed with the objective of minimizing problem loans. Lenders often forget that credit risk only starts once the loan is drawn. This phase seeks to draw together all the lending skills covered to effectively manage & monitor risk, once a loan is drawn. Lenders also use their lending skills to determine and build value-added relationship opportunities.