FOUNDATION LEVEL CREDIT COURSE

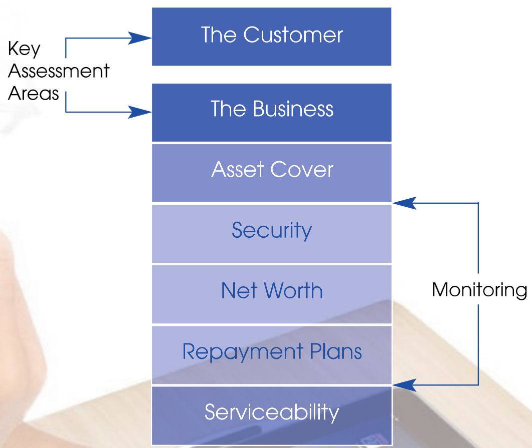
EXTRACTS FROM **UNIT 2** SMALL BUSINESS LENDING

Key Assessments Areas

The key areas for risk assessment, which need to be examined are:

- The customer and his business
- asset cover for the advance (and security)
- repayment ability/serviceability of debt
- monitoring of performance.

These areas are shown diagrammatically. This diagram should be studied carefully in order to avoid the pitfall of lending to the applicant with little regard to the business, its net worth or serviceability! If any of the key areas is ignored, problems will be encountered sooner or later. A full assessment must be made to reach a balanced judgement.



It is vitally important to remember that a business, no matter how strong its balance sheet, cannot carry a debt burden greater than can be serviced by the income earning capacity of the business. It is for this reason that great emphasis will be placed on understanding the trading 'profile' of the business. This is displayed in the trading and profit and loss account and is projected in the profit budget.

CARIBBEAN ASSOCIATION OF BANKS
Keeping the Industry Proactive, Protected and Profitable

Keith Checkley & Associates

EXTRACTS FROM **UNIT 3** LARGER BUSINESS LENDING

Capital Project Appraisals

CSA Member Activity 5

Before studying the next section, refresh your memory on your Accountancy studies. You will recall that the basic object of any investment is that after paying out a certain amount of cash today, a larger amount will be received back over a period of time. A lender of funds for capital investment has, therefore, to be certain that a realistic assessment of the project has been undertaken. From the accountancy perspective, there are four main methods of assessing capital investment projects:

Payback - this involves the calculation of the time it will take to recover the initial outlay.

Average Rate of Return (Return on investment) -this indicates the average annual percentage return on either the average or alternatively the total amount of the investment.

Discounted Cashflow (Net present value return on investment) - this method involves the discounting of future cash inflows from the project. It adjusts the return to allow for the time value of money.

Yield (or internal rate of return) - this method uses the same principles as the net present value approach but with the objective of establishing the discount rate at which the present values of the cash inflows and outflows match.

Traditionally, project appraisal approaches have centered on either **(a)** Identifying the Payback Period of the project, or **(b)** Identifying the Accounting Rate of Return on the project. However, with the evolution of discounted cashflow techniques, there are more sophisticated approaches: **(a)** Identification of the Net Present Value (NPV) of the project cashflows, or **(b)** Identification of the Internal Rate of Return (IRR) for the project.

Payback Method

The payback period of a project is found by identifying the number of years it takes before the cumulative forecasted cashflows equal the initial cash outlays related to the project.