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MSME Loan Appraisal, Sanction and Disbursement: A Process-Based Study of Credit Decision-Making in a Public Sector Bank

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ABSTRACT

Micro, Small and Medium Enterprises (MSMEs) depend significantly on institutional credit to meet working-capital requirements, acquire assets, expand operations and manage business cash flows. This study examines the practical process of MSME loan appraisal, sanction and disbursement through a process-based case study of a public sector bank. The study adopts a qualitative and descriptive approach based on supervised on-the-job training, direct observation of branch-level activities, review of loan-related documentation and practical exposure to customer verification, financial assessment, proposal preparation, site visits, end-use verification and post-sanction monitoring. The study finds that MSME credit decisions are not based on a single financial indicator or the availability of collateral. Instead, effective appraisal requires an integrated assessment of borrower credibility, business characteristics, financial position, repayment capacity, documentation, KYC compliance and field-level verification. The observed workflow demonstrates that documentation and verification provide the foundation for appraisal, while sanction and disbursement represent distinct stages that require fulfilment of applicable conditions. Post-sanction monitoring further extends the bank's responsibility beyond the initial release of funds. The study also identifies practical challenges such as incomplete documentation, the need to understand different business models, confidentiality requirements and the translation of classroom concepts into operational banking work. Based on these observations, the paper recommends stronger preliminary document screening, systematic tracking of pending requirements and structured post-sanction monitoring. The study contributes a practical branch-level perspective on how credit-risk concepts are translated into day-to-day MSME lending activities.

Keywords: MSME lending; credit appraisal; credit risk; KYC; loan sanction; loan disbursement; repayment capacity; banking

Introduction

Micro, Small and Medium Enterprises are an important component of the Indian business ecosystem and contribute to employment, entrepreneurship, production and local economic activity. Despite their importance, MSMEs frequently face financing constraints arising from working-capital requirements, asset purchases, business expansion and fluctuations in operating cash flows. Commercial banks therefore play an important role in providing institutional credit to this segment.

MSME lending, however, involves more than assessing a loan amount against collateral. A credit proposal requires the lender to develop an overall understanding of the borrower, the business, the purpose of finance, the financial position and the ability to repay. Documentation, KYC, verification and internal credit procedures support this assessment and help reduce information gaps and credit risk.

The present study emerged from practical exposure received during an on-the-job training programme at a branch of a public sector bank. The study focuses on the process through which an MSME credit proposal moves from the identification of the customer's requirement to appraisal, verification, sanction, documentation, disbursement and post-sanction monitoring. The institutional identity and branch-specific confidential information have intentionally been omitted from this paper.

The purpose of the study is not to evaluate the performance of a particular bank or to present confidential customer-level data. Instead, it seeks to document and analyse the practical sequence of MSME credit processing and connect observed activities with established concepts of credit appraisal and risk management.

Research objectives

To understand the process followed for appraisal of MSME loan proposals at the branch level.

To identify the financial, business, documentation and verification factors considered during MSME credit appraisal.

To understand the requirements and sequence involved in loan sanction and disbursement.

To identify practical and operational challenges associated with MSME credit processing.

Review of Literature and Theoretical Framework

Credit appraisal is the systematic evaluation of a borrower's willingness and ability to repay a proposed credit facility. The assessment generally combines borrower information, business characteristics, financial statements, cash-flow information, existing obligations, security considerations and external business conditions. The underlying objective is to determine whether the proposed credit is appropriate in amount, purpose, structure and repayment terms.

A commonly used conceptual framework is the 5 Cs of credit: Character, Capacity, Capital, Collateral and Conditions. Character relates to the borrower's integrity and repayment record; Capacity concerns the ability of the business to generate sufficient cash flows for repayment; Capital reflects the owner's financial commitment; Collateral provides secondary security; and Conditions capture industry, economic and transaction-specific circumstances. The framework is useful because it encourages a multidimensional assessment rather than reliance on one indicator.

Financial statement analysis is another important component of credit assessment. The balance sheet provides information on assets, liabilities and owners' funds; the profit and loss statement indicates revenue, expenses and profitability; and cash-flow information helps assess the actual movement of funds. Ratios relating to liquidity, profitability, leverage, turnover and debt-service or interest coverage can support the assessment of financial health and repayment capacity.

Credit risk arises when a borrower may fail to meet contractual repayment obligations. In MSME lending, the risk can be influenced by irregular cash flows, dependence on particular customers or suppliers, industry conditions, competition, business concentration and changes in demand. Consequently, sound lending requires both pre-sanction appraisal and post-sanction monitoring.

KYC and customer due diligence support the reliability of borrower information by establishing and verifying identity and relevant ownership or authorized person details. Site visits and end-use verification provide an additional practical layer of assessment by allowing the lender to compare documentary information with the actual business environment. These controls are particularly useful where the operating characteristics of smaller businesses cannot be fully understood from financial statements alone.

The theoretical framework adopted in this study therefore views MSME lending as an interconnected process: information collection → KYC and documentation → financial and business assessment → risk evaluation → verification → credit decision → sanction → documentation → disbursement → monitoring.

Research Methodology

The study follows a qualitative, descriptive and process-based research design. It is based primarily on practical observation and supervised exposure obtained during an on-the-job training programme at a branch of a public sector bank. The research does not use a questionnaire or a statistically selected respondent sample.

Data sources

Primary practical data: direct observation of branch-level activities and supervised participation in permitted credit-processing tasks.

Documentary sources: non-confidential loan-processing documents, formats and records that were available for learning purposes during the training.

Secondary sources: banking literature, regulatory material, institutional publications and financial-sector references relevant to MSME lending and credit appraisal.

Nature of practical exposure

The practical exposure included understanding customer credit requirements, reviewing loan documentation, assisting with KYC-related checks and follow-up, organizing information for loan-related notes, exposure to financial assessment, preparing or assisting with site-visit documentation, end-use verification and post-sanction reporting. Activities requiring formal credit authority, including independent approval or sanction of loans, were not performed by the researcher.

Data analysis approach

The observations were organised thematically around the stages of the credit cycle. The analysis compares the observed workflow with established concepts of credit appraisal, risk assessment, KYC, documentation, sanction, disbursement and monitoring. Since customer-level data were confidential and no survey instrument was used, the findings are presented as process observations rather than statistical estimates.

MSME Credit Processing Framework

The study identifies a connected workflow through which an MSME credit proposal progresses. The stages are described below.

Understanding customer requirements

The process begins with understanding why finance is required and what type of facility may be relevant. The nature of the business, purpose of borrowing and expected use of funds provide the initial context for evaluating the proposal.

Document and KYC review

Relevant identity, registration, financial and business documents are reviewed for availability, completeness and consistency. KYC-related checks help establish the identity of the customer and relevant persons associated with the business. Missing information or inconsistencies can result in additional clarification and follow-up.

Preliminary screening and detailed appraisal

After initial screening, the proposal can proceed to more detailed assessment. Financial statements, bank statements, tax-related information and other relevant records may be considered to understand profitability, liquidity, leverage and repayment capacity. The assessment also needs to reflect the nature of the business and its operating environment.

Risk assessment and verification

Credit risk is assessed by bringing together financial and non-financial information. Site visits and verification activities can help confirm the existence and nature of business operations and provide context that may not be visible in documents. End-use verification further helps establish whether funds are being utilised for the intended purpose.

Proposal preparation and credit decision

Relevant information is organised into a loan proposal or credit note for review by authorized personnel. The credit decision is distinct from the preparatory work performed by support staff or interns. Formal approval remains the responsibility of the authorized decision-making authority.

Sanction, documentation and disbursement

Sanction represents the formal approval of a credit facility subject to specified terms and conditions. Documentation involves completion and execution of applicable agreements and supporting documents. Disbursement is a subsequent stage in which the sanctioned amount is released after the applicable pre-disbursement requirements have been fulfilled.

Post-sanction monitoring

The credit relationship does not end at disbursement. Depending on the facility and applicable procedures, monitoring may include repayment behavior, end-use verification and follow-up visits or documentation. This provides an opportunity to identify changes in the borrower's situation at an earlier stage.

Table 1 - Key stages and risk-control purpose in MSME credit processing.

Stage	Key activity	Risk-control purpose
Customer requirement	Understand purpose, facility and business need	Establish suitability and context
Documentation & KYC	Collect, review and verify information	Reduce information gaps and identity risk
Financial appraisal	Assess financial position and repayment capacity	Evaluate ability to service debt
Verification	Site/end-use and supporting checks	Compare documents with actual business conditions
Credit decision & sanction	Review proposal and approve subject to conditions	Control credit exposure through authorised decision-making
Documentation & disbursement	Complete conditions and release funds	Ensure legal/operational compliance before release
Monitoring	Track end-use and repayment	Identify emerging risk after disbursement

Findings and Discussion

Credit appraisal is multidimensional

The study indicates that MSME appraisal cannot be reduced to profitability or collateral alone. A meaningful credit assessment combines financial information with borrower credibility, business characteristics, repayment capacity, documentation and verification. This supports the broader principle that collateral should not substitute for assessment of creditworthiness.

Documentation is a core part of credit assessment

Documentation was observed to have a role beyond administrative record keeping. The information contained in different documents provides the basis for understanding the borrower and testing consistency across the proposal. Incomplete documentation can therefore delay processing and increase the need for repeated clarification.

Financial analysis supports, but does not replace, business understanding

Financial statements and ratios provide structured information about a business, but the interpretation of those figures depends on the nature of the business and its operating conditions. Exposure to MSMEs from different sectors highlighted that similar financial indicators may need to be interpreted differently depending on business model, cash-flow pattern and industry environment.

Verification strengthens the appraisal process

Practical exposure to site-visit reporting and end-use verification showed the value of comparing documentary information with actual business conditions. Verification can provide additional context regarding operations, infrastructure, stock or assets and the use of funds. It therefore complements financial analysis rather than replacing it.

Sanction and disbursement are distinct stages

The observed process demonstrated that sanction is a formal credit decision, while disbursement is the subsequent release of funds after applicable conditions are satisfied. This distinction is important because approval of a facility does not automatically mean that funds can be released without completion of required documentation and pre-disbursement conditions.

Monitoring extends responsible lending beyond disbursement

End-use verification and post-sanction reporting highlighted that responsible lending continues after funds are released. Monitoring provides a mechanism for maintaining visibility over the borrower's position and the utilization of funds, thereby supporting early identification of potential concerns.

Practical challenges in MSME credit processing

Obtaining complete and consistent documentation can require repeated customer follow-up.

Different MSME sectors have different operating and cash-flow characteristics, requiring context-specific understanding.

Banking confidentiality restricts the extent to which individual cases and financial details can be reproduced for academic purposes.

Moving from classroom concepts to actual credit files requires attention to process detail and professional judgement.

Post-sanction information must be organised accurately so that subsequent monitoring and review are meaningful.

Recommendations

Strengthen initial document screening

A clear preliminary checklist for major documents and information can help identify gaps before a proposal enters detailed appraisal. Early identification can reduce avoidable back-and-forth and improve process clarity for both staff and customers.

Systematically track pending requirements

A simple status-based mechanism can record documents, clarifications or other requirements that remain pending. Such visibility can support prioritisation and timely follow-up when several proposals are being processed simultaneously.

Maintain structured post-sanction records

End-use verification and post-sanction observations can be maintained in a consistent format so that information is easier to review and follow up. The approach should remain aligned with the bank's applicable internal policies and authorised procedures.

Expected outcomes

The recommendations are expected to improve process visibility, reduce avoidable delays, strengthen coordination and support more organized post-sanction monitoring. They are intended to improve the flow of information without weakening the controls required for prudent lending.

Limitations of the Study

The study has several limitations. First, it reflects practical exposure at a single branch and therefore cannot be generalized to every branch or lending situation. Second, the training period limited the number and variety of MSME proposals that could be observed. Third, confidential customer and bank information could not be reproduced, restricting the use of case-level quantitative data. Fourth, the researcher was an intern and did not independently perform authorised credit decisions or sanction loans. Finally, the study did not collect questionnaire-based primary data from customers or employees; its findings are therefore process-oriented and interpretive.

Conclusion

MSME lending requires a balance between supporting legitimate business financing needs and maintaining sound credit discipline. The present study demonstrates that the credit process is best understood as an integrated sequence rather than a set of isolated activities. Customer requirements, documentation, KYC, financial analysis, business assessment, verification and risk evaluation collectively inform the credit decision, while sanction, documentation and disbursement form distinct stages subject to applicable conditions.

The practical exposure further shows that financial analysis is most useful when combined with an understanding of the underlying business and its operating environment. Verification and post-sanction monitoring add important controls by connecting documentary information with actual business conditions and subsequent fund utilisation. Overall, the study bridges academic concepts of credit risk and financial analysis with their practical application in MSME banking and provides a process-based perspective that can support further research using larger samples, multiple branches and quantitative measures such as processing time, documentation gaps and customer experience.

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