

# PERSPECTIVE

## Corporate Origination: The Final Frontier



Deals in the corporate and investment banking world are significantly different from retail lending.

The cycle is typically initiated when the banker gets a whiff of the potential opportunity with a corporate house. A meeting with the CFO or Treasurer is followed by an 'in principle' offer or term sheet, which itself could need a brief internal approval process. With corporate houses getting a flurry of offers from several banks, deal structures, rates and fees are negotiated. The banker or relationship manager who has the best relationship wins the deal, possibly not always on desired terms, but at rates closer to the best offered by competition.

The deal size could vary from a few million dollars to several hundred million. Acquisition financing could be upward of a billion dollars.

### Credit Application

The internal approval process is data and paper intensive. Credit analysts access industry and company data and crunch numbers churning out ratios, generating cash flow statements, making forecasts, analyzing sensitivity to justify the huge exposure taken on a single obligor, either secured on project assets or unsecured. Finally, it's the 'name' that lends itself to carry the day.

The financial spreads and analysis would be accompanied by a free flow write-up on the corporate house's management credentials, industry analysis, project details, track record of the company, and a justification of the exposure.

Risk adjusted returns, loss given default, expected loss, probability of default are some of the analytical parameters considered by banks in assessing the proposal. Statistical analysis of past loans in the industry is the premise for such analysis.

The term sheet would contain the essence of the deal, setting out the nature and size of the facilities, interest rates and fees, repayment terms, security, events of default and covenants.

The entire application is then summarized in a covering sheet, which would provide in a nut shell the elements of the credit application.

Note the usage of the term credit application, or credit memorandum. Corporate customers are

offered a basket of facilities, which could comprise term loans, short term revolvers, overdraft for working capital, letters of credit, bank guarantees, foreign exchange facilities and the more exotic derivatives.

The credit application is recommended at multiple levels, and vetted in many banks by risk management and approved at senior credit committee level. For very large transactions which amount to a significant percentage of the bank's capital, the approval could rest with the board of directors, some of whom could be external shareholders.

### Credit Approval

Determining the approving authority is based on a complex matrix. The credit policy book in banks has many permutations and combinations of parameters starting from loan or facility size to credit rating, nature of security, category of facilities, local or global relationship and industry segment. For large and perceived risky transactions, an approver would not be loath to finding a deviation or a clause in the credit policy to send the proposal further up the chain.

The credit application very often does not see a simple one-way path. The risk manager and approvers would have several queries which need to be resolved by the analysts or relationship managers. The application would then need to be resubmitted. The approvers would typically add more onerous conditions in addition to those proposed by the line.

In the competitive world of corporate banking, the last word may not be with the bank. Once the offer is made, as per approved terms, there could be a further round of negotiation on some of the terms and covenants. The application may then need to be resubmitted seeking approval for the revised terms. Sometimes the approvers are taken into confidence during the negotiation stage, so that the approval of the final agreed terms is smoother.

## Documentation and Compliance with Approval Terms

The corporate origination story does not end here. The customer is provided the bank's standard legal documents for execution. The corporate house's legal counsel pores through the fine print in the documents to ensure that the terms are not one sided or difficult to comply. Again there could be a protracted phase of negotiation, for concluding the final wording of the legal documents.

Customers would then need to comply with the pre-conditions for drawing down facilities, which could be completion of security formalities, filing of security notings with the controller of companies and provision of guarantees. Since some of these formalities take a considerable period of time, especially those involving statutory authorities, banks may waive this pre-condition, in good faith, with the express understanding that the conditions would be complied with, in a stipulated time frame.

Draw down of facilities, would mark the end of the origination process.

## A System Perspective

From a system perspective, the elements of the corporate origination process can be broadly classified into 1) data capture 2) financial analysis 3) workflow 4) documentation. Each of these four areas pose interesting challenges.

### Data Capture and STP

The data captured in the term sheet during origination would need to lend itself to straight through processing for account opening in the bank's product processors/accounting systems. Each of these systems could have its own data expectations which would be mandatory to allow the account to be boarded within it. While most of the basic features may be standardized across systems, the nuances could surface only during deployment.

### Financial Analysis

Large global banks could have their own internal parameters laid down in credit policy for financial analysis. Components of balance sheet, income and expense statements, cash flow analysis and ratio analysis, could vary depending on the nature of the industry: manufacturing, construction and

finance. Leading credit rating institutions have standardized financial spreadsheet and analysis tools. Banks have shown flexibility in adapting to the standard risk assessment and analytic solutions provided by these institutions with possibly some bespoke features. A productivity challenge here would be making use of the financial statements available in the web portal of corporate houses, without re-keying the same into the spreadsheets.

### Workflow

The flexibility required in the approval process poses significant challenges for 'workflow' from a technology perspective. Retail loan origination being highly structured, with in built standard deviations and simple approval matrix, lends itself to a structured workflow. In corporate origination, some of the challenges in 'workflow' are:

- back and forth movement of the credit application to provide for queries from risk managers/approvers and resolution of the same down the line
- the credit approver for a transaction being identified through very complex business rules, which could keep changing; many permutations and combinations are possible
- any one in the credit recommendation and approval chain adding his/her own terms and conditions, which would require identification for audit purpose
- the risk managers/approvers may like to refer the credit application to an authority like the CEO/country head in case of banks with global operations. This may be required for very large exposures and such 'referrals' may be done ad hoc or 'run time' in technology terms
- approvers for large deals in corporate and investment banking, would typically be committees rather than individuals

### Documentation System

After workflow, documentation is a key component of corporate origination. The credit application's lengthiest component would be the free flow write-up on the corporate. Popular desktop word processing applications are used for the write-up. Various industry and analyst

reports, copies of financial statements, field investigation and appraiser reports, are commonly attached and form part of the credit application. Documentation management systems need to be integrated with the 'workflow' capabilities provided by the corporate origination systems, to provide an integrated solution.

### **Corporate Origination: The Final Frontier?**

Given the relatively lower volumes, and the high degree of flexibility required (read manual intervention), its no wonder that automation is yet to make a complete inroad into corporate origination.

Back-end product processors to front-end CRM systems, SOX compliance to Basel II, banks have invested significantly in technology. The focus has been on retail solutions, channels, regulatory compliance, risk management et al.

The senior corporate bankers are busy dealing with their high end corporate customers and sewing up highly structured deals. Accessing systems either for inquiry on the portfolio or originating a loan has been passé. And that's set to change.

The rarefied world of corporate origination is now practically the final frontier, for technology led transformation. Technology can play a significant role in transforming the current paper-intensive process into a more efficient one, improving productivity, reducing turn around time in processing credit applications, and importantly bringing in electronic audit trails.

### **Author**

#### **R Balachandran**

Product Manager - Finacle  
Infosys Technologies Limited



Infosys Technologies Limited, Plot No. 44, Electronics City, Hosur Road, Bangalore - 560100. India • Tel.: +91 80 28520261 • Fax: +91 80 28521747  
e-mail: [finaclemktg@infosys.com](mailto:finaclemktg@infosys.com) • [www.infosys.com/finacle](http://www.infosys.com/finacle)

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