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Why do we need to study FINANCE?



Almost half of all ventures fail because of poor financial management

-Dun & Bradstreet

Case Study



S Ltd.			(Amt in Crs.)	
Particulars		PRE STRUCTURING	POST STRUCTURING	
<u>Equity:</u>				
Share Capital		6.31		6.31
Reserves & Surplus		22.90		34.69
		29.21		41.00
Non- Current Liabilities		27.14		38.29
<u>Current Liabilities:</u>				
WC from Banks	13.59		0.68	
other current liabilities	41.28	54.87	39.47	40.15
Total		111.22		40.15
<u>Assets:</u>				
Fixed Assets		66.33		62.64
Investments		6.17		4.64
		72.50		67.28
<u>Current Assets:</u>				
Inventory	6.96		8.40	
Other current Assets	31.76	38.72	43.76	52.16
Total		111.22		119.44
Gross Turnover		131.22		156.6
EBIDT		17.38		28.91
PAT		6.32		12.52
Ratios:				
Current Ratio		0.71		1.30
Acid Test Ratio		0.58		1.09
Debt Equity Ratio		0.93		0.93
TOL/TNW		2.81		1.91
Rating		BB-	4	BBB-

Parameters for choosing the right Source of Finance

- Amount of Money required
- Cost of Fund
- Tenure
- Security cover available
- Risk Profile of Borrower
- Prevalent Economic Conditions

Sources of Finance

- Short Term



- Long Term

Sources of Short Term Finance

- Working Capital by Banks
- Factoring
- Commercial Paper
- Inter Corporate Deposits

Mobilisation of Information

Working Capital Finance by Banks

- Cash Credit / Overdraft / WC DL
- Purchase/ Sale Bill Discounting
- Letter of credit
- Bank Guarantee
- Buyer's Credit

Cash Credit/ OD /
WCDL

➤ Borrower is
allowed to
borrow up to

➤ **Ratios :**

Current

Ratio – Min –

1.25 , Desired –

Purchase/ Sale Bill

Discounting

- Under this Bank takes the Bill drawn by borrower on his (borrower's) customer.
- Bank pays after deducting discount/ Interest & commission.
- The Bank presents the Bill to the borrower's customer on the due date and collects the total amount.

Bills Discounting

- Constitutes a vital part of the working capital finance and is a major Trade Finance activity.
- Bills can be clean or backed by L/C.
- Liability in case of dishonor of the bill shifts, depends on recourse terms .

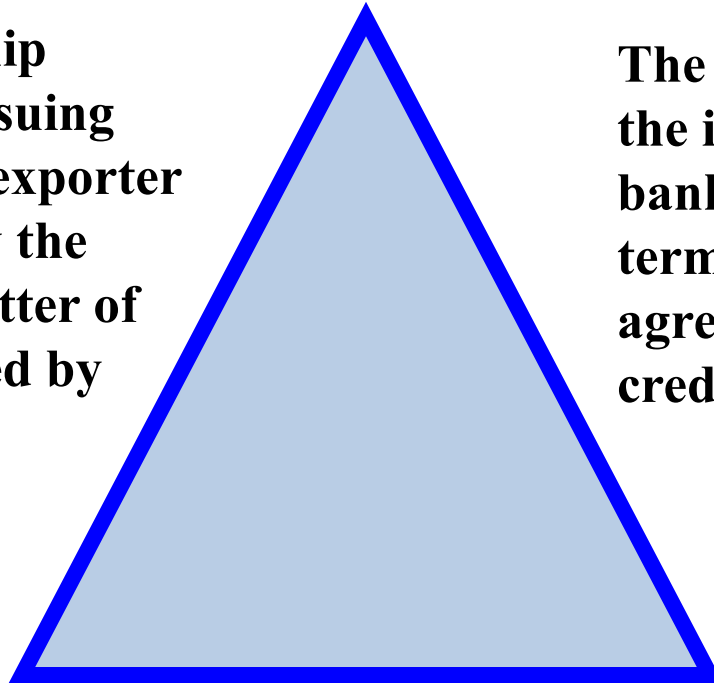
Letter of Credit (L/C)

- Issued by a bank at the request of an importer/ Purchaser.
- The bank promises to pay an exporter/Seller, upon presentation of documents specified in the L/C.
- An L/C reduces the risk of non fulfillment because the bank agrees to pay against documents.
- The L/C can be sight or Usance (30 -180 days).
- The L/C must contain a specified validity date and stated maximum amount .

Issuing Bank

The relationship between the issuing bank and the exporter is governed by the terms of the letter of credit, as issued by that bank.

The relationship between the importer and the issuing bank is governed by the terms of the application and agreement for the letter of credit (L/C).



Beneficiary
(exporter)

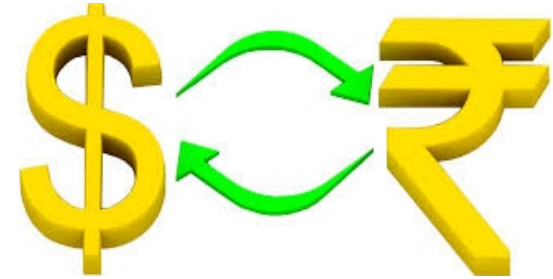
The relationship between the importer and the exporter is governed by the sales contract.

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Bank Guarantee

- Type of Guarantees :
 - Advance Payment BG
 - Performance BG
 - Others – to Govt. Dept.
- Tenure – 3 to 36 Months
- Margins – 5 to 100 %

Buyer's Credit



- Short term credit availed by an importer(buyer).
- Availed from overseas lenders - banks and financial institutions.
- Helps importers to access cheaper foreign funds closer to LIBOR rates.
- Normally it is quoted as “3M Libor + 100 bps”

Buyer's Credit

Steps Involved:-

Buyer's Credit

- In India, buyer's credit tenure is :
 - 3-12 months for RM imports
 - 1-3 Yrs for Capital Goods
- Every 3/6 months, the interest on buyer's credit may get reset.
- The exporter gets paid on due date.
- The currency of imports can be different from the

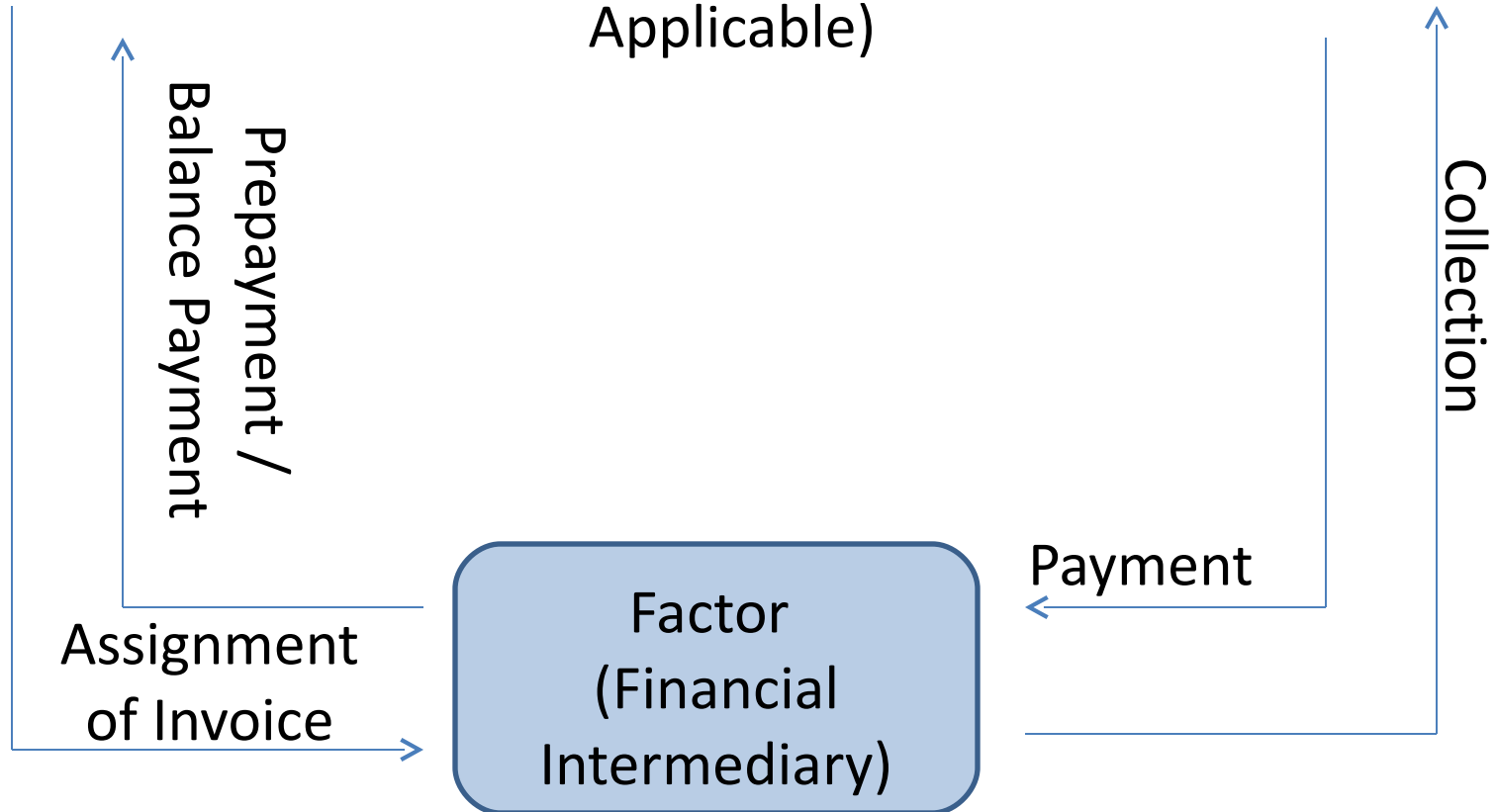
Factoring

Sales Contract/ Purchase Order

Seller/
Your Self

Shipment/ Invoicing
(Bill of Exchange,
Promissory Note as
Applicable)

Buyer/ Debtor



Factoring

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Advantages

- Clean credit
- Focus

Disadvantages

- Not available for Small Customers
- May harm customer relationship.

Commercial Paper

- An unsecured money market instrument issued in the form of a promissory note.
- Corporates , Primary dealers and Financial Institutions are eligible to issue CP.
- Maturities between Min 7 days & Max 1 year
- Denomination of Rs 5 Lakhs or multiple thereof.

Issue of Commercial Paper

C.P. can be issued by company whose

- Tangible net worth is not less than Rs 4 Crs.
- Working capital limits are sanctioned by bank/s or Fls.
- Borrowal account is classified as a Standard Asset by the financing bank.

Commercial Paper

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- Advantages
 - Flexibility
 - Low Cost
 - alternative to borrowing from bank
 - It is unsecured so no lien is created on assets
- Disadvantages
 - Available only to select blue chip with good rating
 - Low credit limits from bank
 - Very closely regulated by RBI
 - Only for short tenure

Inter Corporate Deposits(ICD)

- A deposit made by one company to another.
- Generally for tiding short term fund mismatch.
- Borrowing under ICD is restricted to 50% of the Net owned funds .
- Tenure - 7 to 365 days.

Inter Corporate Deposits

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- More flexible
- **Advantages**
- Can raise money at short notice
- Very Less documentation except letter and PDC'S

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- **Disadvantages**
- Interest rates are higher than those in the other markets.
- ICD market is not well organised with very little information available publicly about transaction details.

Tips to save borrowing cost

Some Common Situations & SUGGESTIONS

- **If you have imports**

Always use buyer's credit@Libor+1% i.e approx 2 %

(If no exports, go for hedging also)

- **If you have exports**

- **If you are supplier to biggies like HUL, ITC, PFIZER, ONGC etc.....**

Never take spot payment against cash discount. It costs you 18% to 24% p.a. instead take bill discounting from banks @ 10%-12% p.a

- **If you have 100% collateral for your CC limit**

Better convert your part CC to mortgage loan/ OD at much better rates

- **If you want to increase negotiation power**

Go for External Rating to take best interest rates benefit.

- **If you are in a liquidity crunch for temporary reason**

Go & explain your problem to bank and take Adhoc limits instead of spoiling track record of not paying creditors

- **If you are in good financial position**

Always avail cash discount from your supplier say 2% p.m. and use bank limits @ 11-12 % p.a.

- **If you are importer and exporter**

Always deal with a forex branch of bank to avail better Rs. \$ rates

- **If you have large limits say 50 Cr +**

Always deal with more than one bank to negotiate better....



Thank you!

CA. B. L.
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