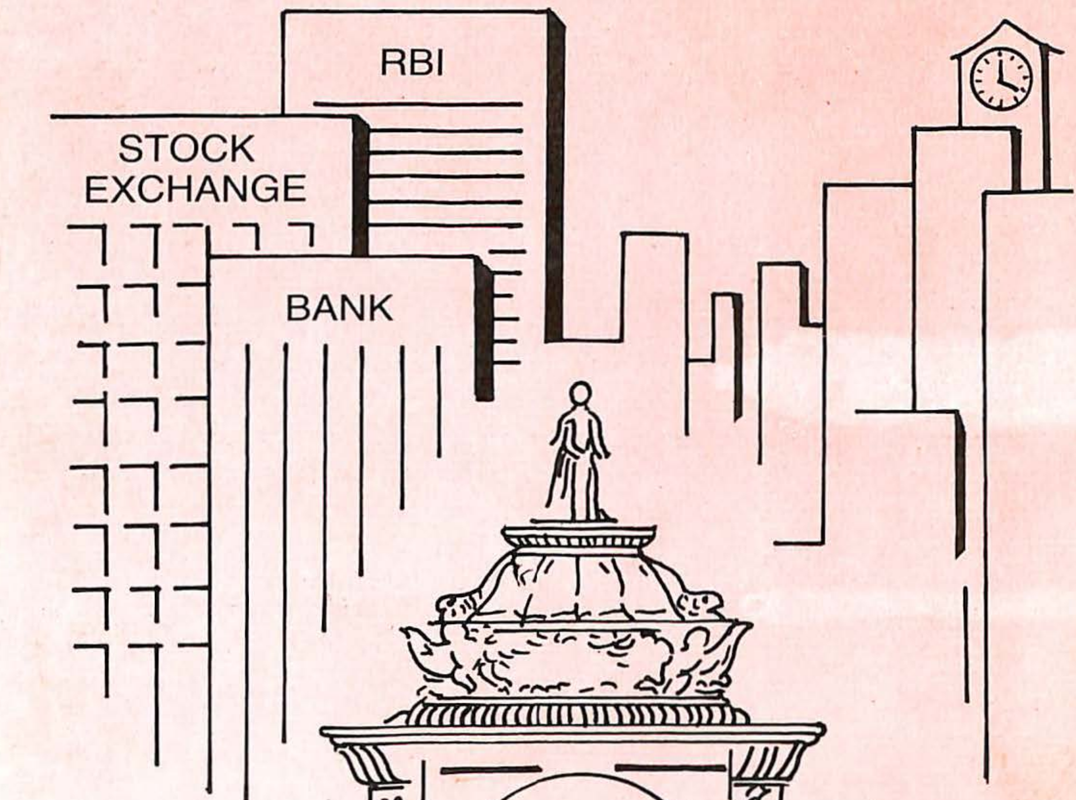
LENDING UNDER CMA TO CORPORATE SECTOR

BANKER'S APPRAISAL NOTE ON DATABASE PROPOSAL/IMPACT OF RELAXATION IN CLASSIFICATION NORM ON BANK FINANCE-TERM LOAN INSTALMENT PAYABLE WITHIN TWELVE MONTHS.



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CONTENTS

1. Credit Monitoring Arrangement 1

2. Relaxation in Classification Norms - Term loan instalment payble within next twelve months - I 6

3. Relaxation in Classification Norms - Term loan instalment payble within next twelve months - II 20

4. Banker's Appraisal Note on CMA database proposal 24

5. Consortium Finance 38

Preface

Credit appraisal of CMA data base proposal assumes vital importance in the bank. Reserve Bank of India has announced relaxation in classification norm pertaining to term loan instalment falling due for payment within twelve months. As a result there shall be increase in MPBF proportionately. I have thought it proper to analyse the interpretation in the cause of corporatte sector.

A brief and concise appraisal note on CMA data base proposal should prove to be useful to the banker and the borrower.

This small booklet should prove to be useful to the banker, borrower, faculty at training college centre, Chartered Accountant/ Company Secretaries in practice, Financial consulant and a student interested in credit management in banks.

1.1.1994. K. M. CHITNIS
PUNE

Credit Monitoring Arrangement

Credit Authorisation Scheme (CAS) was introduced by RBI in the year 1965 with an objective to regulate working capital finance to large industrial borrowers. In terms of the scheme, it was essential on the part of banker to obtain approval of RBI before release of credit facilities to CAS borrower. Every borrower enjoying fund based credit facilities from the banking/ term lending institutions beyond the 'Cut-off' point as announced by RBI from time to time was called a 'CAS borrower'. CAS was a financial discipline stipulated by RBI in respect of large borrowal accounts. It was in accordance with the economic policy laid down by the Government from time to time.

Marathe Committee Recommendations

RBI appointed a committee in November 1982, under the Chairmanship of Mr. S. S. Marathe, former Secretary to Government of India, Ministry of Industry to review the working of CAS from the point of view of its 'operational aspects'. Over a period of years it was observed that the CAS borrower would not receive credit from the bank when it was needed and there would often be delay in releasing the credit limits to the borrower. It was one of the major defficiencies in the system as observed by Marathe Committee. In terms of recommendations by Marathe Committee, the RBI brought about relaxation in CAS as follows :

Speedy Release of Funds : FAST TRACK APPROACH

The Reserve Bank of India upon the recommendation of Marathe Committee permitted the commercial banks to release the funds to CAS parties without reference to Reserve Bank for its prior approval subject to certain conditions.

Under the scheme the eligible CAS parties would be shifted on to the FAST TRACK and thereby funds would be released early.

Working of the 'FAST TRACK'

1. The banks within their discretion were permitted to release funds to the extent of 50% of the additional limits asked for by the CAS party, without reference to RBI.
2. In case of export oriented manufacturing unit the banks were permitted to release funds to the extent of 75% of the additional limits asked for by the CAS party without reference to Reserve Bank for its prior approval.

What are the FIVE CONDITIONS ?

Eligible borrower was required to fulfil the conditions as follows-

1. Reasonableness of estimates/projection of production, sales, current assets etc.
2. Proper classification of current assets and current liabilities in conformity with the Reserve Bank guidelines.
3. Maintenance of minimum current ratio of 1.33:1 (unless exempted).
4. Prompt submission of quarterly operating statements as also annual accounts by the borrowers, and
5. Regular annual review of the credit limits.

Liberalisation of CAS

As per the guidelines issued by RBI effective from July 1987, the banks were permitted to release 100 percent of the additional working capital limits to all CAS parties provided they satisfied the basic disciplines of (i) maintaining a current ratio of 1.33 (ii) submission of statements under the Quarterly Information System and (iii) broad adherence to inventory/receivable norms.

Withdrawal of CAS

RBI subsequent to relaxation in CAS in July 1987, observed as follows-

i) Compliance of current ratio by the majority of CAS parties.

ii) Compliance with inventory norms and submission of QIS statements.

iii) 40 percent credit to priority sector by banks.

In the context of above improvement on the part of CAS parties, RBI finally withdrew CAS effective from October, 10,1988.

It needs to be noted that withdrawal of CAS should not be construed as dilution of basic financial discipline enforced by RBI from time to time. RBI says financial disciplines remain essential, are feasible and should continue to be enforced

What is CMA ?

As per RBI Circular No. CPC.BC.95/279A-88 dt. 8th Oct. 1988, addressed to Scheduled Commercial banks, the prior authorization in respect of 'Credit Sanction' to CAS borrowal accounts by RBI came to an end effective from 10th October 1988. However, post sanction scrutiny of large borrowal accounts shall continue and RBI decided to rename the scheme as 'Credit Monitoring Arrangement'. As per the revised arrangements though the prior authorization has been withdrawn, basic objective of erstwhile CAS continues as follows:

(i) To ensure that additional bank credit is in conformity with the approved purposes and priorities and that the bigger borrowers do not pre-empt scarce resources;

(ii) To enforce financial discipline on the large borrowers on uniform principles;

(iii) Where a borrower is financed by more than one bank, to ensure that the customer's proposal is assessed in the light of the information available with all the banks; and

(iv) To bring about improvement in the techniques of credit appraisal by banks and their system of follow-up.

The above objectives continue to be valid and the banks should consider proposals for sanction of credit facilities within the broad framework of guidelines issued by RBI from time to time for attainment of these objectives not only in respect of large credit limits which would be submitted to the Reserve Bank for post-sanction scrutiny under the revised arrangement but also in all other cases where borrowers enjoy working capital limits of Rs. 10 lakhs and above from the banking system.

Post sanction scrutiny by RBI

Every large borrowal account enjoying credit facilities from the banking system beyond the 'cut-off' point as announced by RBI from time to time is to be reported to RBI within 15 days from the sanction of additional facilities/renewal of existing limits by the banking system. It is essential that the banker must ensure that the borrowers conform with the basic financial discipline as stipulated by RBI from time to time. Banker while according credit lines to borrower must ensure financial discipline as follows;.

(i) Reasonableness of estimates/projection in regard to sales, chargeable current assets, current liabilities (other than bank borrowings) and net working capital;

(ii) Classification of current assets and current liabilities in conformity with the guidelines issued by the Reserve Bank;

(iii) Maintenance of minimum current ratio of 1.33;1 (except where a relaxation is permitted as in the case of sick/weak units, diamond exporters etc.);

(iv) Prompt submission of quarterly operating statements as indicated in RBI Circular IECD.No.PMS.203/C.446 (PL)-87/88 dated 22 April 1988; and

(v) An undertaking by the borrower to submit his annual accounts promptly and regular annual review being carried out by the bank even where enhancement in credit limits is not involved.

In terms of the arrangement, the banks are required to review the organization and administration and ensure that credit proposal is not kept pending beyond three months. In the event of any bank not resorting to basic financial discipline under CMA, the RBI may ask the defaulting bank to refer all the large cases for its prior authorization.

RBI has announced following changes in terms of its credit policy for the half year effective from oct. 1993.

Lending norms

Although the Reserve Bank will advise the overall levels of current assets for different industries to be used as broad indicators, banks will now be free to decide the levels of holding of individual items of inventory and receivables, taking into account production, processing cycle and other relevant factors for the purpose of determining maximum permissible bank finance. Banks are also free to decide the period and quantum of ad hoc credit limits without levy of additional interest. A minimum current ratio of 1.33 is, however, required to be maintained. Assessment of working capital needs of borrowers on the basis of 20 per cent of the projected turnover is extended to all borrowers having working capital limits upto Rs. 1 crore from the banking system.

Assessment of working capital

The entire term loan instalments falling due for payment in the next year need not be reckoned as item of current liability for the purpose of arriving at the maximum permissible bank finance and its one third portion need no longer be treated as item of current liability.

Term loan instalment payable within next twelve months - Relaxation in Classification Norms

Reserve Bank of India (RBI) announced relaxation in the classification norms for term loan instalments falling due for repayment within twelve months in terms of communication No. IECO. 20/08.12.01/92-93 dt. 20-1-1993 and subsequent communication No. CPC. BC. 129/07/01.279/92 dated 7.4.1993 addressed to Scheduled Commercial Banks. Accordingly the borrowal accounts would be benefited by increase in Maximum Permissible Bank Finance (MPBF) under Credit Monitoring Arrangement (CMA). The said relaxation is considered by RBI consequent to representation by trade and industry for quite some time. Before it is possible for us to explain the RBI directives, let us in brief glance through the working capital system in accordance with CMA.

Working capital finance requirement of the CMA borrower is assessed by the banker in terms of method No. II of the Tandon Committee recommendations as accepted by RBI. As per the said method, the banker computers MPBF i.e. borrowers eligibility to receive working capital finance from the banking system. MPFB as computed by the banker is subject to financial discipline stipulated by RBI from time to time. Banker computers MPBF as per method II as follows :

1.	Total Current Assets (TCA)	xxx
2.	Other Current Liabilities (OCL) (Other than bank borrowing)	xxx
3.	Working Capital Gap (WCG) (1-2)	xxx
4.	Minimum stipulated net working capital (NWC) i.e. 25% of TCA	xxx
5.	Actual/Projected NWC	xxx
6.	Item 3 minus item 4	xxx
7.	Item 3 minus item 5	xxx
8.	Maximum permissible bank finance (Item 6 or 7 whichever is lower)	xxx

Basically the concept of working capital finance as evolved in terms of Tandon Committee recommendations and as accepted by RBI envisages financial discipline as follows :

i) Application of financial norms i.e. method No. II.
ii) Application of inventory/receivable norms (Now withdrawn).
iii) Classification of current assets and current liabilities as per the norms prescribed by RBI.
iv) Maintainance of Current Ratio at 1.33:1 under method No. II and
v) Release of working capital finance and its follow-up by the banker in terms of 'Quarterly Information System' as evolved by RBI.

Let us now understand the impact of relaxation in clasification norm on MPBF in terms of illustration as follows :

Name of the borrower - ABC Ltd.

Estimates for the year 1993-94

		(Rs. in crores)
i)	Consumption of Raw Materials	68.00
ii)	Cost of Production	119.00
iii)	Cost of Sales	117.40
iv)	Sales	150.00

Estimated balance sheet as at the end of 31.3.1994 : (Rs. in crores)

Capital & Liabilities			Assets	
Net worth		36.00	Fixed Assets and	
Term Liabilities		55.65	Non-current Assets	79.00
Long Term Source of funds		91.65	Long Term use of funds	79.00
Bank borrowing	27.95		Current Assets	50.60
Other current liability	10.00	37.95	Short term use of funds	50.60
Current Liability				
Short Term Source of funds		37.95		
Total Rs.		129.60	Total Rs.	129.60

Let us now apply inventory and receivable norms and workout the level of current assets acceptable to the banker -

Inventory and receivable norms are as under :

Raw Materials	2 Months Stock	Raw material comsumption
Stock in process	3/4 months	Cost of production
Finished Goods	1 month	Cost of sales
Receivables	11/2 months	Sales (Rs. in crores)

Item	RBI norm	Calculations	Level of CA as per the norm
Raw Material	2 months	Raw Materials stock consumption 68/12 x 2 = 11.40	11.40
Stock in Process	3/4 months	Cost of Production 119/12 x 3/4 = 7.40	7.40
Finished Goods	1 month	Cost of Sales 117.40/ 12 x 1 = 9.80	9.80
Receivables	11/2 month	Sales 150.00/12 x 3/2 = 18.80	18.80
Other Current Assets			3.20
Level of current assets as per the norms and acceptable to the banker -			50.60

Computation of Net Working Capital (NWC) & Working Capital Gap (WCG)

NWC		NWC		WCG	
Long Term Sources	91.65	TCA	50.60	TCA	50.60
Less Short Term use	79.00	Less TCL	37.95	Less OCL	10.00
NWC	**12.65**	NWC	**12.65**	WCG	**40.60**

Let us now compute MPBF as per method No. II

Working of MPBF

1.	Total Current Assets	50.60
2.	Other Current Liability	10.00
3.	Working Capital Gap	40.60
4.	25% TCA i.e. Minimum NWC required	12.65
5.	Actual NWC as projected	12.65
6.	MPBF 3-4 or	27.95
7.	3-5 whichever is lower	27.95

Thus the MPBF as per the existing method of lending works out at Rs. 27.95

Classification of Current Liability - Term Loan Instalment :

As per the guidelines issued by the RBI an item due for payment within a period of one year from the date of balance sheet is classified as a current liability.

As stated earlier, RBI in order to extend increase in the size of MPBF has revised the classification norms for term loan instalment payable within twelve months. RBI, in this regard had issued earlier guidelines as follows :

1. Only one-third of the term loan instalments payable within the next twelve months should be treated as current liabilities. all overdue term loans would continue to be treated as current liabilities unless such loans have been rescheduled by the financial institution/bank.
2. Two-thirds of the non-overdue term loan instalments payable within the next twelve months and which are to be kept outside tghe current liabilities,

need not be taken into account while computeing Net Working Capital (NWC).

3. The entire amount of term loan instalments due within the next twelve months would however continue to be treated as current liabilities for the purpose of calculating Current Ratio.

Banks have been asked by the RBI to implement the instruction with immediate effect and review/renewal/enhancements proposal would be appraised accordingly.

Let us now in continuation of earlier illustration understand the impact of revised classification norms and instructions by RBI on MPBF. The scrutiny of the financial statement of ABC Ltd. reveal the fact that OCL of Rs. 10.00 crores include term loan instalment of Rs. 3.00 crores payable within next twelve months i.e. by 31.3.1994. In the context of revised instructions by RBI, the banker would recast OCL as follows :

		Rs.in crores
OCL		10.00
Term loan instalment due within 12 months	3.00	
Only 1/3rd to be treated as CL i.e.	1.00	
Less 2/3rd excluded from CL i.e.	2.00	2.00
OCL for the purpose of computatin of MPBF		
OCL as worked out for the purpose of computation of MPBF		**8.00**
Computation of MPBF:		
Total Current Assets		50.60
Less 25% margin on TCA		12.65
Less other Current Liability		37.95
MPBF		**29.95**

Thus consequent to revision in classification norm in regard with term loan instalment due within twelve months we observe increase in MPBF by Rs. 2.00 crores i.e. increase in MPBF to the extent of 2/3rd portion of term loan instalment due within twelve months. Let us now understand the implication of the RBI instructions under different financial situations as follows :

Model - A - I Calculation of MPBF as per the existing method of lending :

Capital & Liability		Assets	
Net Worth	36.00	Fixed & Non Current Assets	79.00
Long Term Liability	55.65		
Long Term Fund	**91.65**	Long Term use	**79.00**
Bank Borrowing	27.95	Current Assets	50.60
Other Current Liability	10.00	Short Term use	50.60
Current Liability i.e. Short Term funds	37.95		
Total	**129.60**	Total	**129.60**

a) Calculation of MPBF

1. Total Current Assets	50.60
2. Less other Current Liability	10.00
3. Working Capital Gap	40.60
4. 25% margin on TAC	12.65
5. Projected NWC	12.65
6. MPBF 3-4 or 3-5 whichever is less	27.95

b) **Calculation of NWC**

Long Term Funds	91.65	Total Current Assets	50.60
Less Long Term uses	79.00	Less Total Current	37.95
NWC	12.65	NWC	12.65

c) **Calculation of Current Ratio (CR)**

Total Current Assets	50.60
Total Current Liabilities	37.95
Current Ratio	1.33:1

Interpretation of financial statements - ABC Ltd.

i. MPBF at Rs. 27.95 Crores has been worked out as per the existing method of lending.

ii. OCL at Rs. 10.00 crorers includes term loan instalment of Rs. 3.00 crores payable within next twelve months.

iii. NWC of Rs. 12.65 crores represents twentyfive percent of TCA.

iv. Current ratio at 1.33 : 1 is maintained.

Model - A - II

Calculation of MPBF as per revised guidelines applicable to term loan instalments due for payment within next twelve months.

Capital & Liability		Assets	
Net Worth	36.00	Fixed & Non Current Assets	79.00
Term Liability	57.65		
Long Term Source of Funds	93.65	Long Term Use of Funds	79.00
Bank Borrowing	29.95	Current Assets	50.60
Other Curent Liability	6.00		
Current Liability & Short Term Source of Funds	35.95	Short Term use of Funds	50.60
Total	129.60	Total	129.60

a) Calculation Of MPBF

1.	Total Current Assets	50.60
2.	Less Other Current Liabilities	6.00
3.	Working Capital Gap	44.60
4.	25% Margin on TCA	12.65
5.	Projected NWC	14.65
6.	MPBF 3-4 or 3-5	29.95

b) Calculation of NWC

Long Term Funds	93.65	Total Current Assets	50.60
Loss Long Term Uses	79.00	Less Total Current Liability	35.95
NWC	14.65	NWC	14.65

c) Calculation of Current Ratio :

Total Current Assets	50.60
Total Current Liabilities	37.95 *
Current Ratio	1.33 :1

* It is to be noted that as per RBI guidelines, for the purpose of calculation of Current Ratio, the term loan instalment due for payment is to be included in Current Liability and hence current liability i.e. Rs. 37.95 - Rs. 35.95 plus Rs. 2.00 crores 2/3 rd of term loan instalment is taken into consideration.

Estimated Balancesheet : Model AII

i. MPBF in terms of revised guidelines is worked out at Rs. 29.95 crores.

ii. Enhancement in MPBF has been utilized for bringing about reduction in the level of OCL by Rs.2.00 crores.

iii. Current ratio at 1.33 : 1 is maintained as the overall position of current assets and current liabilities remains unchanged.

iv. Actual NWC in terms of current ratio approach works out at Rs. 12.65 crores.

v. Notional NWC by treating 2/3rd portion of term loan instalment due for payment within next twelve months as Non-current liability for the time being for the purpose of computation of MPBF works out at Rs. 14.65 crores.

Model - A - III

Calculation of MPBF - consequent to increase in the level of current assets as accepted by the banker.

Capital & Liability		Assets	
Net Worth	36.00	Fixed & Non Current Assets	79.00
Term Liability	57.65		
Long term funds (Introduced by the borrower)	0.50		
Long Term Source of Funds	94.15	Long Term Use of Funds	79.00
Bank Borrowing	29.95	Current Assets	52.60
Other Current Liability	7.50		
Short term source of funds	37.45	Short term use of funds	52.60
Total	131.60	Total	131.60

a) Calculation of MPBF :

1.	Total Current Assets	52.60
2.	Less Other Current Liabilites	7.50
3.	Working capital Gap	45.10
4.	25% margin on TCA	13.15
5.	Projected NWC	15.15
6.	MPBF - 3-4 or 3-5 whichever is less	29.95

b) Calculation of NWC

Long Term Funds	94.15	Total Current Assets	52.60
Less Long Term Uses	79.00	Less Total Current Liabilities	37.45
NWC	15.15	NWC	15.15

c) **Calculation of Current Ratio :**

Total Current Assets	52.60
Total Current Liabilities	39.45
Current Ratio	1.33 :1

* It is to be noted that as per RBI guidelines, for the purpose of calculation of Current Ratio, the term loan instalment due for payment is to be included in Current Liability and hence 2/3rd of term loan instalment i.e. Rs. 2.00 crores is taken into consideration.

Estimated Balancesheet - Model - A - III

i. MPBF in terms of revised guidelines has been worked out at Rs. 29.95 crores.

ii Enhanced portion of bank finance i.e. MPBF has been utilized for bringing about increase in the level of current assets by Rs. 2.00 crores. It is to be noted that the increase in the level of current assets needs to be approved by the banker in the context of overall financial discipline as stipulated by RBI.

iii. Increase in the level of current assets by Rs. 2.00 crores is financed out of enhanced portion of MPBF. Increase in the level of current assets is accompained by increase in the level of NWC on account of matching contribution i.e. 25% of the increase in the level of CA Rs. 0.50 crores in the form of long term funds raised by the borrower. It is a part of overall financial discipline stipulated by RBI.

iv. Current ratio at 1.33 : 1 is maintained.

v. Actual NWC at 13.15 crores represents 25% of the TCA.

vi. Notional NWC at Rs. 15.15 crores has been worked out and treated as per RBI guidelines.

vii. There has been reduction in the level of OCL by Rs. 50.00 lakhs. It is due to repayment out of long term funds / bank finance.

Model - A - IV

Calculation of MPBF - consequent to increase in the level of Current Assets as accepted by the banker -

Capital & Liabilities		Assets	
Net Worth	36.25	Fixed & Non Current Assets	79.00
Term Liability	57.65		
Long Term Source of Funds	93.90	Long Term use of Funds	79.00
Bank borrowing	29.95	Current Assets	51.60
Other Current Liability	6.75		
Current Liability -Source of Short Term Funds	36.70	Short Term use of Funds	51.60
Total	130.60	Total	130.60

a) Calculation of MPBF

1.	Total current assets	51.60
2.	Less other Current Liabilities	6.75
3.	Working Capital Gap	44.85
4.	25% margin on TCA	12.90
5.	Projected NWC	14.90
6.	MPBF 3-4 or 3-5 whichever is less	29.95

b) Calculation of NWC

Long Term Funds	93.90	Total Current Assets	51.60
Less Long Term Uses	79.00	Less Total Current	36.70
NWC	**14.90**	NWC	**14.90**

c) Calculation of Current Ratio :

Total Current Assets	51.60
Total Current Liabiliteis	38.70*
Current Ratio	1.33:1

* It is to be noted that as per RBI guidelines, for the purpose of calculation of Current Ratio, the term loan instalment due for payment is to be included in Current Liability and hence 2/3rd of term loan instalment i.e. Rs. 2.00 crores is taken into consideration.

Estimated Balancesheet - Model A - IV

i. MPBF in terms of revised guidelines is worked out at Rs. 29.95 crores.

ii. Enhanced portion of MPBF is utilised for the following purpose:

a. Raising the level of Current assets by Rs. 1.00 Crores.

b. Reduction in the level of OCL which hs been brought down to Rs. 6.75 crores.

iii. Borrower has inducted long term funds to the extent of Rs. 0.25 Crore. It is a matching contribution towards increase in the level of CA by Rs. 1.00 Crore.

iv. Current ratio at 1.33 : 1 is maintained.

v. NWC at Rs. 12.90 crores is in order.

vi. Notional NWC is projected at Rs. 14.90 crores.

Conclusion:

Entire pacage of CMA accompanied by QIS is a financial framework provided by RBI to the banking system for effective management of working capital of CMA accounts. It has been provided with inbuilt arrangement for compliance of financial disciplie stipulated by RBI. Thus the CMA borrower is in a position to obtain additional finance from the banker consequent to relaxation in the norm for term loan instalment due for payment within next twelve months. At the same time, the RBI has ensured that the financial discipline is not diluted and the borrower operates within the framework of financial discipline.

Increase in additional finance may be utilized as follows :

i) Bringing about reduction in the level of other current liability.

ii) Bringing about increase in the level of current assets. Borrower shall bring the matching contribution from long term Sources. Revised level of current assets needs to be approved by the banker.

Estimated Balance Sheet

Capital Liability	A-I	A-II	A-III	A-IV
Net Worth	36.00	36.00	36.00	36.00
Term Liability	55.65	57.65	57.65	57.65
Long Term Funds	-	-	0.50	0.25
i) Bank Borrowing	27.95	29.95	29.95	29.95
ii) Other Current Liability	10.00	6.00	7.50	6.75
i+ii Current Liability	37.95	35.95	37.45	36.70
Total	129.60	129.60	131.60	130.60

Calculation of Current Ratio (CR) :

3) Total Current Assets	50.60	50.60	52.60	51.6O
Total Current Liability	37.95	37.95	39.45	38.7O
Current Ratio	1.33:1	1.33:1	1.33:1	1.33:1
NWC	12.65	12.65	13.15	12.9O

as at the end of 31.3.1994

Assets	A-I	A-II	A-III	A-IV
Fixed Assets & Non Current Assets	79.00	79.00	79.00	79.00
Current Assets	50.60	50.60	52.60	51.60
Total	129..60	129.60	131.60	130.60

2) Total Current Assets	50.60	50.60	52.60	51.60
Less Total Current Liability	37.95	35.95	37.45	36.70
NWC	12.65	14.65	15.15	14.90
3) TCA	50.60	50.60	52.60	51.60
Less OCL	10.00	6.00	7.50	6.75
WCG	40.60	44.60	45.10	44.85
25% of TCA	12.65	12.65	13.15	12.90
Projected NWC	12.65	14.65	15.15	14.90
MPBF	27.95	29.95	29.95	29.95

Term loan instalment - due for payment within twelve months - Revision in classification Norms - II

In terms of 'Credit Policy' announced by Reserve Bank of India in October, 1993, the treatment to be given to term loan instalment falling due for payment in the next twelve months; has been revised. As is seen as per the earlier instructions the only one third portion of the term loan instalment due for payment within next twelve months was to be treated as current liability. Now that Reserve Bank of India has announced that the entire term loan instalment falling due for payment in the next twelve months need not be treated as current liability for the purpose of arriving at MPBF. Accordingly, the revised instructions in the context of term loan instalment due for apayment within next twelve months are as follows.

1. The entire amount of term loan instalments payable within the next twelve months should not now be treated as an item of current liabilities. However, all overdue term loans would continue to be treated as current liabilities unless the loan has been rescheduled by the financial institution/bank.

2. The entire amount of term loan instalments payable within the next twelve months and which would be kept outside the current liabilities, need not be taken into account while computing **Net Working Capital (NWC).**

3. It is to be noted that the entire amount of term loan instalments falling due within the next twelve months should, however, continue to be treated as current ratio. This is stipulated in conformity with internationally accepted accounting policies and procedures.

Let us now work out the impact of revision in classificaion norms on MPBF by means of an illustration pertaining to ABC Ltd. We reproduce herebelow the summary of balancesheet.

Rs. in crores

Liabilities		Assets	
Net worth &			
Long Term debts	91.65	Fixed and	79.00
		Non Current Assets	
Current Liability	37.95	Current Assets	50.60
	129.60		129.60

Other Current liability at Rs. 10.00 crores includes Rs. 3.00 crores i.e. term loan instalment due for payment within next twelve months. Consequent to change, the treatment of term loan instalment, there shall be increase in MPBF by Rs. 3.00 crorres. i.e. Rs. 27.95 crores + Rs. 3.00 crores = 30.95 crores. Under the circumstances keeping in tune with the approach as adopted in the previous chapter the total change works out as follows :

Estimated Balance Sheet

Capital Liability	A-I	A-II	A-III	A-IV
Net Worth	36.00	36.00	36.00	36.00
Term Liability	55.65	58.65	58.65	58.65
Long Term Funds	-	-	0.75	0.50
i) Bank Borrowing	27.95	30.95	30.95	30.95
ii) Other Current Liability	10.00	4.00	6.25	5.50
i+ii Current Liability	37.95	34.95	37.30	36.45
Total	129.60	129.60	132.60	131.60

Calculation of Current Ratio (CR) :

3) Total Current Assets	50.60	50.60	53.60	52.60
Total Current Liability	37.95	37.95	40.20	39.45
Current Ratio	1.33	1.33	1.33	1.33
NWC	12.65	12.65	13.40	13.15

as at the end of 31.3.1994

Assets	A-I	A-II	A-III	A-IV
Fixed Assets & Non Current Assets	79.00	79.00	79.00	79.00
Current Assets	50.60	50.60	53.60	52.60
Total	129.60	129.60	132.60	131.60

2) Total Current Assets	50.60	50.60	53.60	52.60
Less Total Current Liability	37.95	34.95	37.20	37.45
NWC	12.65	15.65	16.40	15.15
3) TCA	50.60	50.60	53.60	52.60
Less OCL	10.00	4.00	6.25	7.50
WCG	40.60	46.60	47.35	45.10
25% of TCA	12.65	12.65	13.40	13.15
Projected NWC	12.65	15.65	16.40	15.15
MPBF	27.95	30.95	30.95	30.95

Banker's Appraisal Note on CMA database proposal

An Outline OF Bank Proposal

Enhancement In Working Capital Limits Of ABC LTD.

Name of the Branch	:	Faridabad
Region	:	New Delhi
Zone	:	Northern Zone
Name of the Company	:	A. B. C. Ltd.
Constitution	:	Public Limited Company.
Address	:	Sector XYZ Faridabad.
Year of formation	:	1975
Banking with us	:	Since 1975
Manufacturing Activity	:	Manufacturing of Electrical goods.
Directors	:	1. Mr. S. K. Gupta 2. Mr. D. K. Somani 3. Mr. Y. S. Goyal 4. Mr. G. B. Parmar

It is a subsidiary company of GRS Ltd. GRS Ltd. is a highly reputed company enjoying various credit facilities with us in consortium with other banks. The position of the account is as under :

Working Capital Limits	Rs. 15.00 Crores
Balance Outstanding	Rs. 14.50 Crores.

Account is operated satisfactorily and has been classified as No. 1 in terms of Health Code System.

Present request :

The company has requested enhancement/renewal in fund based and nonfund based limits as under. :

1. Enhancement in Working Capital Limit from Rs. 1.16 crores to Rs. 1.40 Crores.
2. Enhancement in letters of credit - cum bank guarantee limit from Rs. 0.70 Crores to Rs. 1.40 Crores.
3. Renewal of Bills Purchase limit of Rs. 0.80 Crores against outstation cheques.

History :

The unit was initially started as a proprietory firm and subsequently it was converted into a Private Limited Company. The company became sick due to mismanagement, and over a period of years the unit was sinking and it was in the year 1985 GRS Ltd. came forward and took over the unit in the name of ABC Ltd. as its subsidiary company. Consequent to change in the management of the company the performance of the unit improved and ultimately the losses were wiped out. At present the working of the unit is satisfactory. As at the and of 31st December 1993 the company has achieved the total targeted sales or Rs. 4.60 crores. The company has earned the net profit of Rs. 8.00 lakhs. The company could achieve the target inspite of various constraints such as power cut/non receipt of imported raw material.

Plan of the company :

The working of the company is headed by the professional management. The management has been facing cut-throat competition from small scale units as they have been exempted from payment of excise on the product. The company as a part of its modernisation programme has entered into Technical Collaboration Agreement with a Swiss Company viz. C. B. D. Ltd. The modernisation programme when completed in 1994 as per the schedule will bring about reduction in manufacturing cost and saving in raw materials consumption. The programme as per the schedule would be commissioned by the end of 1994. **The increase in sales for the year 1994 at 23 percent i. e. Rs. 5.72 crores as estimated is reasonable and acceptable to the bank :**

The company has projected net profit of Rs. 10.00 lakhs for the year 1994 - though on lower side is justified under the circumstances.

Net Worth :

The capital of the company has been contributed by Shreyas Investments Ltd. - a wholly owned subsidiary of GRS Ltd. The profits earned by the company in the recent years have been retained in business and as a result there has been improvement in the net worth. It is expected that the net worth would be Rs. 1.14 Crores by 31st December 1993.

Cash credit & other facilities :

The company achieved the projected sales during the year 1993. The working capital facilities were utilized fully. The company is prompt in submitting quarterly operating statements. The company observes financial discipline in respect of working capital limits as stipulated by the bank from time to time.

Letter of Credit cum bank Guarantee limit was overdrawn occasionally, the reason for which being increase in the lead time for import of raw material. Overdrawn position was apprised to the central office.

Term Liability :

The company was sanctioned a term loan of Rs. 0.82 crores for acquisition of capital goods by the term lending institution. The present outstanding balance is Rs. 0.21 crores. Consequent to implementation of modernization programme the term loan liability would be Rs. 1.08 crores.

Management of Inventory :

The main raw material needed by the company is required to be imported and lead time for which is six months. the average holding of the imported raw material is 70 days and the same is considered to be satisfactory.

The level of indigenous raw material, work in process and finished goods is within the Tandon Committee norms.

Book - Debts / Receivables :

The average credit offered to the clients is 90 days. The major supplies are to the large corporate companies and the State Electricity Boards. **As such the quality of book debts is good.** It is expected that there will be reduction in the credit offered from 90 days to 80 days.

Assesment of working capital requirement

Working Capital needed by the company in terms of estimates for the year 1994 is computed as follows :

	(Rs. in crores)
Net Sales	5.43
Cost Of Production	4.74
Cost Of Sales	4.66

Current Assets Holding	Level of Current Assets	Amount
1. Raw Materials		
Imported	70 days	0.54
	Indigenous	50 days
0.16		
2. Other Consumables	-	0.02
3. Stock In Process	20 days Cost of production	0.24
4. Finished Goods	10 days Cost of sales.	0.12
5. Receivables	80 days	1.38
6. Other Current Assets (A)		0.28
7. Total Current Assets		2.74
8. Current liabilities other than (B) bank borrowings		0.63
9. Working Capital Gap (C) (A-B)		2.11
Projected Net Working Capital i.e 25% of the TCA or actual whichever is more		0.71
Permissible bank borrowing		1.40

Cover for Advances :

The stock of inventory and outstanding in the book debts is adequate enough to cover the advance. The necessary charge is registered with the registrar of companies and insurance cover is obtained. The company has been submitting hypothecation and book debts statements reqularly. The unit is being visited by the bank of ficials reqularly and the security is verified.

Inspection and Audit :

There are no adverse comments on the account by the internal inspector / external auditors / RBI inspectors.

Marketing Arrangement :

The entire product is marketed through the parent company viz. GRS Ltd. the companies market share is stable. There has been timely recoveries form the clients and the element of bad debts is negligible.

Working of the company- Profitability :

The company has been facing competition form the small scale units. The SSI units have an advantage in respect of excise duty. There has been increase in import duty which affects the cost adversely, However, the company is confident of controlling the cost by undertaking the modernization programme as stated earlier.

Integrity of the company :

The working of the company is satisfactory. Credit facilities are operated within the sanctioned limits. The entire turnover is routed through bank account with us only. The periodical statements are submitted timely. There is no element of diversion of short term funds for long term use. The repayment in respect of term loan is regular. Thus the dealings of the company are satisfactory.

Letter of credit cum bank guarantee limit :

The major portion of raw material is to be imported by the company. It represents seventy percent of the total consumption. The lead period for he import of raw material is six months. The requirement for the letters of credit limit works out as follows :

		(Rs. in crores)
1.	Raw material requirement for 12 months	2.80
2.	Requirement for six months	1.40
3.	FOB value	0.90

The company is required to execute Bank Guarantee to the customs authorities towards benefits available in respect of customs duty payable by the actual user. The Bank Guarantee at Rs. 30.00 lakhs is reasonable and justified in terms of projected sales at Rs. 5.50 crores.

Points in favour of the company :

1. The net worth at Rs 1.15 crores indicates positive approach by the management towards business. It is improvement in terms of managements stake in the business.
2. The company has turned the corner and it has started earning profits. It's working is managed by professional management.
3. The company is banking with us exclusively.
4. It's integrity is satisfactory.

Recommendations :

Working Capital limits be enhanced from Rs. 1.16 crores to Rs. 1.40 crores.

1. Cash credit limit of Rs. 1.10 crores.

Security	:	Hypothecation of inventory and book debts.
Margin	:	10% on imported raw material.
		25% on indigenous raw material.

		40% on receivables. Receivables beyond 90 days may not be considered.
Rate of Interest	:	As per instructions issued by Central Office from time to time.

2. Bills Discounting Limit Rs. 0.30 crores.

Security	:	Bills drawn on approved parties with usance maximum upto 90 days.
Interest	:	As per rules.

3. Bills Purchase Limit Rs. 8.00 Lakhs.

Security	:	Cheques drawn by the first class parties.
Commission & Interest	:	As per rules.

4. Letter of Credit cum Bank Guarantee Limit of Rs. 0.70 Crores be enhanced to Rs. 1.20 Crores.

Security - for L/Cs	:	The goods under L/C
		Guarantee : Counter guarantee of the company.
Commission	:	L/Cs - As per FEDAI rules Guarantees - @ 1% PA

Profit & Loss Account

(Rs. in Crores)

	1992	1993	1994
1. Gross Sales	4.38	4.65	5.72
Less Excise	0.16	0.22	0.29
2. Net sales (1-2)	4.22	4.43	5.43
3. Cost of sales			
a. Raw materials	2.92	3.16	4.02
b. Spares	0.03	0.03	0.04
c. Power/funel	0.06	0.06	0.07
d. Labour	0.27	0.29	0.31
e. Repairs/Maintainance	0.04	0.04	0.05
f. Depreciation	0.06	0.10	0.14
g. Other Manufacturing Expenses	0.10	0.10	0.20
Sub Total	3.48	3.78	4.8
Add Opening stock in process	0.05	0.09	0.15
Sub Total	3.53	3.87	4.98
Less closing sock in process	0.09	0.15	0.24
(Cost Of production) Sub Total	3.44	3.72	4.74
Add Opening stock of finished goods	0.05	0.08	0.04
Sub Total	3.49	3.80	4.78
Less closing stock of finished goods	0.08	0.04	0.12
(Cost Of Sales) Sub Total	3.41	3.76	4.66
4. Gross profit (2 - 3)	0.81	0.67	0.77
5. Interest	0.20	0.20	0.28
6. Selling and General Admn. expenses	0.32	0.30	0.40
Sub Total	0.52	0.50	0.68
7. Operating Profit	0.29	0.17	0.09
8. Other Income	0.01	0.03	0.01
9. Net profit before Tax	0.30	0.20	0.10
Tax provision	0.21	0.12	-
10. Net profit after Tax	0.09	0.08	0.10

Financial Highlight & Ratios

A/C. ABC Ltd.

Particulars		Actuals	Projections
	1992	1993	1994
1. Paidup Capital	0.30	0.30	0.30
2. Reserves	0.74	0.78	0.84
3. Networth	1.04	1.08	1.14
4. Gross Fixed Assets	1.15	1.16	2.05
5. Depreciation	0.40	0.50	0.55
6. Net Fixed Assets	0.75	0.66	1.40
7. Long term debts	0.07	0.04	0.86
8. Other term liabilities	0.14	0.17	0.18
9. Current Assets	1.97	2.14	2.74
10. Current Liabilities	1.47	1.57	2.03
11. Sales (Net)	4.22	4.43	5.43
12. Gross Profit	0.81	0.67	0.77
13. Depreciation	0.06	0.10	0.14
14. Interest	0.20	0.20	0.28
15. Income tax	0.21	0.12	-
16. Net Profit after tax	0.09	0.08	0.10
17. Net cash acruals	0.15	0.17	0.24
18. Dividend (%)	15%	15%	15%
19. Capital Expenditure	0.03	-	0.88
20. Retained earnings	0.04	0.03	0.06
Ratios :			
1. Current Ratio	1.33:1	1.36:1	1.35:1
2. Debt Equity Ratio	1.60:1	1.65:1	2.70:1
3. Operating Profits/Sales %	6.84	4.03	1.50
4. Net Profit/ Sales %	2.09	1.78	1.87
5. Retained Profit/Net Profit	49%	43%	56%

BALANCE

Liabilities	1991	1992	1993	1994
Current Liabilities				
Short Term Bank Borrowing	0.80	0.64	0.91	1.40
Trade Creditors	0.24	0.36	0.36	0.40
Taxes Payable / provision	0.22	0.12	0.04	-
Other Accrued Liabilities	0.42	0.33	0.25	0.21
Other Current Liabilities	-	0.02	0.01	0.02
Total Current Liabilities .. .. .. (A)	1.68	1.47	1.57	2.03
Long Term Loans	0.09	0.07	0.04	0.86
Deposits	0.12	-	0.11	0.18
Other Term Liabilities	-	0.14	0.06	-
Term Liabilities .. .. .. (B)	0.21	0.21	0.21	1.04
Total Liabilities (A) + (B)	1.89	1.68	1.78	3.07
Net Worth				
Capital	0.30	0.30	0.30	0.30
Reserves	0.70	0.74	0.78	0.84
Total	1.00	1.04	1.08	1.14
Total Liabilities + Net Worth	2.89	2.72	2.86	4.21

SHEET

(Rs. in Crores)

Assets	1991	1992	1993	1994
Current Assets				
Stock / Inventory	0.72	0.64	0.81	1.08
Book-Debts	1.25	1.20	1.12	1.32
Export receivables	-	0.09	0.05	0.06
Other Current Assets	0.06	0.04	0.16	0.28
Total Current Assets	2.03	1.97	2.14	2.74
Net Fixed Assets	0.79	0.75	0.66	1.40
Investments	0.07	-	0.06	0.07
Fixed & Non Current Assets	0.86	0.75	0.72	1.47
Total Assets	2.89	2.72	2.86	4.21

SOURCES	1991-92	1992-93	1993-94
Profit before tax	0.30	0.20	0.10
Add Depreciation	0.06	00.10	0.14
Gross funds generated	0.36	0.30	0.24
Less Taxes paid/payable	(0.22)	(0.12)	-
Less Dividend paid/payable	(0.04)	(0.04)	(0.04)
A - Sub Total - Net funds Generated	0.10	0.14	0.20
Increase in term loan	-	0.08	0.88
Increase in public deposits	0.02	-	-
Increase in investment	0.07	-	-
B - Sub Total	0.09	0.08	0.88
Increase in bank borrowings	-	0.27	0.50
Decrease in inventary	0.08	-	-
Decrease in receivables	-	0.12	-
Decrease on other current assets	0.02	-	-
C - Sub Total	0.10	0.39	0.50
Total funds Generated A + B + C	**0.29**	**0.61**	**1.58**
USES			
Increase in fixed assets	0.03	-	0.89
Decrease in term loan	0.02	-	-
Decrease in other term liabilities	-	0.08	0.06
Increase in investment	-	0.06	-
D - Sub Total	0.05	0.14	0.95
Decrease in bank borrowing	0.16	-	-
Decrease in other current liability	0.04	0.17	0.03
Increase in inventory	-	0.17	0.28
Increase in receivables	0.04	-	0.20
Increase in other current assets	-	0.13	0.12
E - Sub Total	0.24	0.47	0.63
Total Funds Used (D + E)	**0.29**	**0.61**	**1.58**

Summary

Long Term Sources	0.19	0.22	1.08
Less Long Term Uses	0.05	0.14	0.95
	+ 0.14	+0.08	+0.13
Short Term Sources	0.10	0.39	0.50
Less Short Term Uses	0.24	0.47	0.63
	- 0.14	- 0.08	- 0.13

Consortium Finance

We are aware that the working Capital Finance needed by the large borrowers is subject to financial discipline stipulated by RBI from time to time. Accordingly, large working capital requirements beyond certain "cut off" point under the system is considered under **'Consortium Arrangement'.** Till recently the borrowers enjoying fund based credit limit of Rs. 5.00 crore and above were called upon to enter into consortium arrangement with the banking system. Banker as we know undertakes **calculating risk** while according sanction for large working capital requirements by the various borrowers. It is essential that the banker should not resort to overrisk in terms of size of the advance thereby jeopardizing the bank funds in the event borrowal account turns out to be difficult of recovery. Therefore, under consortium arrangement financial risk is shared amongest the number of bankers.

Guidelines issued by RBI before the implementation of Shetty Committee recommendations were as follows :-

1. The banker with the largest share shall be deemed as leader for formation of consortium arrangements.
2. The number of consortium shall be restricted to around ten.
3. The risk shall be shared by the member banks on prorata basis. It is essential that the appraisal, sanction and follow-up of credit is carried out effectively under the arrangement.
4. Banker other than the consortium member shall not extend any credit facility to the borrower.

5. An existing member of consortium may be replaced by non-member bank at the instance of the borrower

6. Appraisal shall be done by the leader if the share exceeds 50% of the fund based limit. The appraisal notes are circulated amongest the member banks. Credit proposal is placed before the bank's board and sanction is obtained.

7. Consortium meetings shall be held every quarter. Every year there shall be atleast one meeting for the purpose of review/renewal/enhancememt of limits and the said meeting shall be represented by the senior officials of the member banks competent to take decision on behalf of the respective banks.

8. The officials attending the meeting shall have authority to accept the decision of the consortium in respect of following :–

   (a) Acceptance for assessment of woking capital requirement.
   (b) Sharing of limits, and
   (c) Terms and conditions of sanction

9. The main objective of consortium meeting shall be as follows:
   (a) To assess the performance of borrower and fix-up operative limit on the basis of QIS Statememt.
   (b) Decide the quantum of credit of individual banks.
   (c) Review the position of performance on the basis of QIS.
   (d) New member may be inducted by obtaining consent by the existing members.

It is essential that the leader must co-ordinate uniformly in the working capital facilities granted to the borrower. Leader bank shall ensure that the consortium spirit is maintained.

Reserve Bank of India studied the various aspects of the scheme in terms of following in the year 1988.

(a) Effective release of credit to borrower.

(b) Uniformity in execution of documents.

(c) Timely submission of the data by the borrower.

RBI advise the banks as follows :

(i) Consortium leader shall ensure that the credit as required is released in time.

(ii) The borrower shall operate account with the member banks according to sharing pattern and within the sanctioned limit.

Shetty Committee Recommendations :

RBI in January, 1993 had constituted a committee under the Chairmanship of Shri J.V. Shetty, Chairman and Managing director of Canara Bank for review of existing guidelines on lending under consortium arrangement and to suggest measures for inprovement thereof. RBI inplemented modifications in the scheme as suggested by the committee effective from October, 1993 as follows :–

(i) The threshold limit under the arrangement stands raised upwards from Rs. 5.00 Crore to Rs. 50.00 Crore.

(ii) Banks may enter into syndication arrangement in respect of highly rated corporate borrowers enjoying working capital facilities of Rs. 50.00 Crore and above.

(iii) (a) Borrowers are allowed to induct new members in the consortium.

(b) Banks may leave the consortium after two years subject to compliance of certain terms and conditions.

(c) Non-member shall not consider any credit facility without prior approval of the consortium.

(iv) Existing guidelines remain unchanged in respect of sick and weak units.

(v) Banks shall convey credit decision on credit proposal within the prescribed timeframe.

(vi) Bank shall await for the revised set of documents as evolved by the Indian Banks' Association.

About the author

Mr. K.M.Chitnis, M.A. (Eco.), B.Com, ACS, CAIIB & Cert. in Industrial Finance, has had worked for over twenty years as officer, Accountant, Branch Manager and Member of Faculty in a nationalised bank. He has specialised in 'Credit Appraisal' and 'Financial Management' and has published several papers on this theme. Mr. Chitnis has been associated with many management institutions and universities including Indian Institute of Bankers. He is author of books on banking – Viz.

(1) Credit Appraisal in Banks
(2) Working capital Management of Large Industrial Units
(3) Management of CRR and SLR in Banks.
(4) Analysis & Interpretation of Quarterly Operating Statements.

Mr. Chitnis participated in the seminar on International Financial System at Salisbury, USA convened by the Institute of World Affairs (IWA), USA. He was awarded scholarship by IWA. Mr. Chitnis participated in a number of training programmes conducted by NIBM and BTC. Presently, Mr. Chitnis is Assistant General Manager, Bank of Maharashtra, Pune.

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