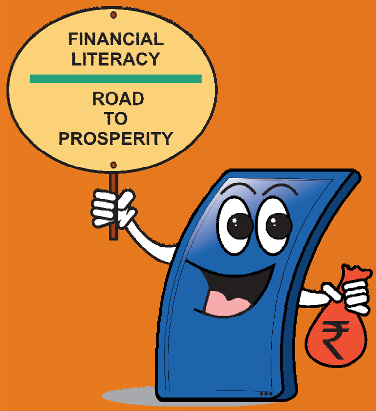
TG – FAME Series

(Target Group Financial Awareness Messages)



FINANCIAL LITERACY for Entrepreneurs

Financial Inclusion and Development Department, RBI

Message 1
Loans without collateral? Yes, it is possible!

Message 2
Loan Application Process

Message 3
Timelines as Prescribed by BCSBI for Disposal of Loan Applications

Message 4
Must - know Finance Terms for Entrepreneurs

Message 5
Be Proactive and Approach the Bank in Case of Stress

Message 1: Loans without collateral? Yes, it is possible!

Credit Guarantee Trust

A joint initiative of the Ministry of Micro, Small and Medium Enterprises (MSME), Government of India, and the Small Industries Development Bank of India (SIDBI) with an objective to provide credit to the MSE sector without the need for collateral and third party guarantee.

The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) would provide cover facility of up to Rs. 200 lakhs.

cgtmse

www.cgtmse.in

Guarantee and annual fees charged by CGTMSE are to be borne by the borrower or member lending institution

Instructions from the RBI to all banks not to accept collateral security for loans up to Rs. 10 lakhs provided to the MSE sector

General Credit Card (GCC)

Non-farm entrepreneurs can obtain credit facilities for both working capital and term loan requirements by getting a General Credit Card (GCC) from the bank.

A GCC is issued as a smart card/debit card (biometric smart card compatible for use in the ATMs/handheld swipe machines and capable of storing adequate information of entrepreneur's identity, assets and credit profile, etc.). Wherever accounts are not digitized, the GCC may be issued as a card/passbook or a credit card-cum-passbook incorporating the name, address, photograph of the holder, particulars of borrowing limit, validity period, etc., for the time being which will serve as an identity card as well as facilitate recording of transactions on an ongoing basis.

The limit on the card will be fixed by the bank on a case-to-case basis based on a risk assessment. The rate of interest on the loans obtained through GCC will be decided by the bank. As an entrepreneur, you are expected to know how much the bank charges on your loan.

Message 2 : Loan Application Process

STEP 1 Prepare your business plan and funds requirement estimate

You can either visit the Udyami Mitra portal or go to a bank directly.

Apply Online at https://udyamimitra.in/

BANK

STEP 2 Get a loan application number and acknowledgment for the application.

STEP 3 Respond to all queries from the bank/portal on the application promptly; wait for their decision.

STEP 4 Track your application to check whether the loan has been sanctioned or rejected.

Message 3 : Timelines as Prescribed by BCSBI for Disposal of Loan Applications

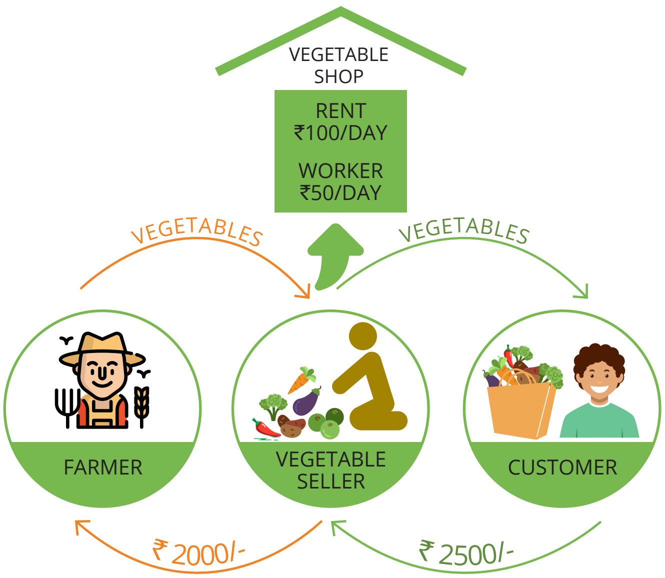
The Banking Codes and Standards Board of India (BCSBI) has prescribed timelines for disposal of loan applications that are complete in all respects and are accompanied by documents as per the 'checklist' provided. The banks which are members of the BCSBI have to adhere to the following:

- MSE loan application for a credit limit or enhancement in the existing credit limit of up to Rs. 5 lakhs: 2 weeks
- For credit limit above Rs. 5 lakhs and up to Rs 25 lakhs: 3 weeks

The Code does not replace or supersede regulatory or supervisory instructions issued by the Reserve Bank of India (RBI) and banks will comply with such instructions/directions issued by the RBI from time to time.

Message 4: Must-know Finance Terms for Entrepreneurs

Scenario 1: Financing with Own Capital



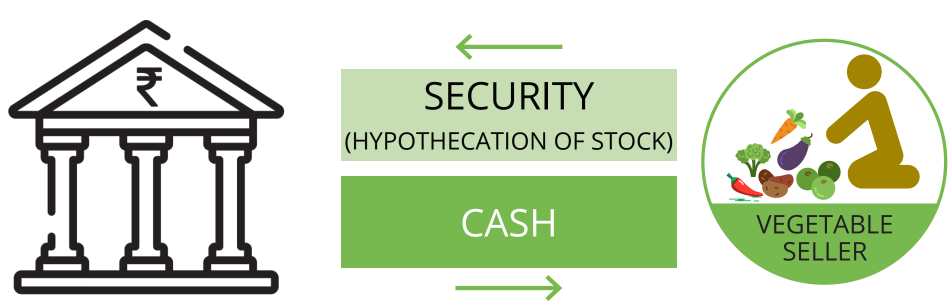
A vegetable seller puts in his own capital of Rs. 2,000 and buys vegetables from a farmer. He pays Rs. 100 in rent per day and Rs. 50 in wages per day to a helper. He sells the vegetables for Rs. 2,500. The Rs. 100 in rent and the Rs. 50 in wages paid are called 'Operating Expenses'. The Rs. 2,000 spent on buying vegetables for selling is the 'Cost of Goods Sold'. The profit in this case is computed thus:

Profit = Selling Price – Cost of Goods Sold – Operating Expenses = 2500 – 2000 – 150 = Rs. 350

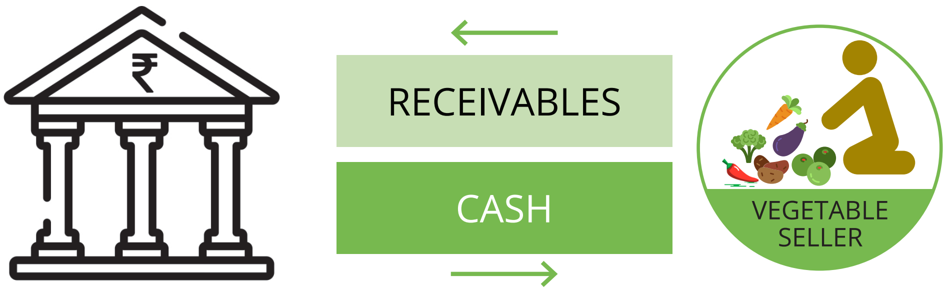
Scenario 2: Cash Credit against Hypothecation of Stock

Suppose the vegetable seller does not have his own capital to buy all the vegetables he requires or he wants to expand his business. In such a scenario, he can take a loan from the bank by offering the vegetables to be purchased as security. This type of financing is called cash credit where the bank lends against self-liquidating security.

The whole amount of the bank loan need not be drawn, only the amount needed based on current requirement. The interest on this type of facility is charged only on the outstanding and not on the entire loan limit.



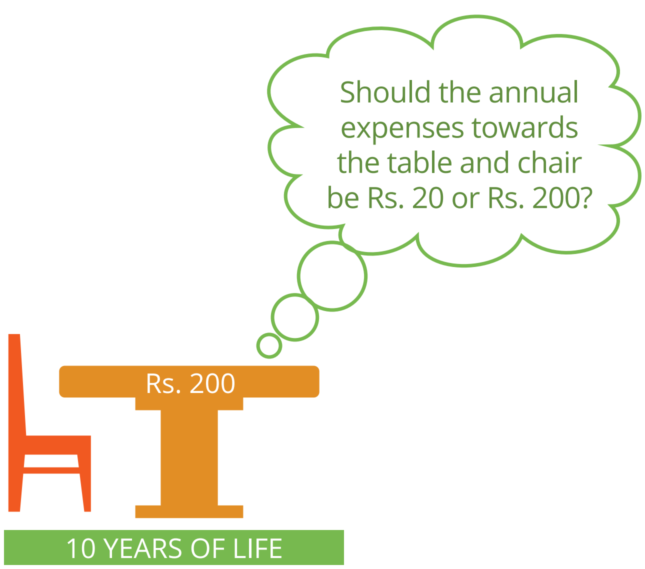
Scenario 3: Receivables Financing



In business, it is often necessary to provide credit, which means to accept payments from customers on a future date as per agreement. When that happens, there is not enough money to buy supplies for the next day and pay for other obligations like rent and wages. The payments that are to be received at a later date as per agreement are called receivables and the customer who is expected to pay at a later date is called a debtor.

In such a situation, when money from sales is delayed, business need not stop for want of funds. The vegetable seller can go to the bank and request lending against receivables. The bank provides finance against the amount of receivables after reduction of margin. Interest on the loan is charged only on the outstanding amount of the loan.

Scenario 4: Purchasing Fixed Assets and Accounting for them



Now that the profits have increased, the vegetable seller decides to buy a table and chair for the shop. Suppose he buys furniture for Rs. 200.

He is now in a dilemma. Should he reduce this entire cost of Rs. 200 from this year's profit, even though he will be using the furniture for the next ten years? If he does, his profit will reduce by Rs. 200. So, instead, the vegetable vendor decides, since the life of the furniture is ten years, that for this year he will allocate funds towards only 1/10th of the cost. When he does this, the amount to be charged to the current year as expenses is called depreciation.

Items bought for running the business that are going to be used for more than one year are called Fixed Assets. Examples of fixed assets include land, building, machinery, equipment, etc.

Depending on the life of the fixed asset, every year the value of the fixed asset has to be reduced. This reduction is effected by setting apart the reduced amount as an expense which is called depreciation.

Scenario 5 : Long-term Loans

As the business grows, the vegetable vendor realises that since vegetables are perishable, he had to throw away a fair amount which is not bought by customers. This in turn was eating into his profits. He feels that if he had a cold storage system he may be able to increase the life of the fresh vegetables and cut down on wastage. He makes enquiries for a freezer; a good freezer will cost him about Rs. 20,000. The vegetable vendor learns that he can avail a loan through http://udayamimitra.in and applies. His loan is sanctioned at an interest rate of 10 per cent per annum. With the loan money he buys a freezer and is now able to keep the vegetables fresh for an additional two days. This, in turn, lead to an increase in profits for the vegetable vendor.

Terminologies: Term Loan

Loans that are availed for a specific purpose and are to be repaid over a long period (one year and above) are called 'Term Loans'.

Business Summary

The vegetable vendor's total sales figure was Rs. 10 lakhs and the cost of goods sold was Rs. 8 lakhs. The vegetable vendor thus made a gross profit of Rs 2 lakhs. He paid Rs. 36,000 and Rs. 18,000, respectively, on rent and wages (assuming 360 days in a year). His cash credit outstanding was Rs. 2,000 at the end of the year. For simplicity in understanding, assuming the outstanding was Rs. 2,000 each day of the year, he paid a total interest of Rs. 200 on the cash credit outstanding. He repaid Rs. 6,000 towards the term loan on the last day of the year and the term loan outstanding on the balance sheet is Rs. 14,000. An amount of Rs. 2,000 was charged as interest for the year on the term loan. So, the total interest paid for the year is Rs. 2,200. A depreciation of Rs. 2,000 on the freezer and Rs. 20 on the furniture was claimed as expenses for the year amounting to a total depreciation of Rs. 2,020 (depreciation rate of 10 per cent assuming a ten-year life for both freezer and furniture). The fixed assets net of depreciation is Rs. 18,180 (Rs. 20,000 – Rs. 2,020).

Profit and Loss Statement		Balance Sheet	
Sales	: Rs. 10,00,000	Assets	
COGS	: Rs. 800,000	Cash	: Rs. 1,39,100
Gross Profit	: Rs. 200,000	Receivables	: Rs. 2,500
		Fixed Assets	: Rs. 18,180
Operating Expenses		Total Assets	: Rs. 1,59,780
Rent	: Rs. 36,000		
Wages	: Rs. 18,000	Liability	
Operating Profit	: Rs. 146,000	Cash Credit	: Rs. 2000
Interest	: Rs. 2,200	Term Loan	: Rs. 14,000
Depreciation	: Rs. 2,020	Owners Capital	: Rs. 2,000
Profit before Tax	: Rs. 141,780	Retained Profits	: Rs. 1,41,780
		Total Liability	: Rs. 1,59,780

Message 5: Be Proactive and Approach the Bank in Case of Stress

You are not capable of paying your debts.

There is erosion in the net worth due to accumulated losses to the extent of 50% of your company's net worth during the previous accounting year.

Your enterprise is in stress and you apprehend failure.

In the above situations, you can make an application to the bank branch or to the committee that is constituted at the district/divisional/regional level by the bank.

The bank/committee will explore various options to resolve the stress in your account.

RECTIFICATION

The bank/committee may obtain a commitment, specifying actions & timelines from you to regularize the account. They may also consider providing additional need-based finance.

RESTRUCTURING

Consider the possibility of restructuring your account if it is viable and after ascertaining that you are not a wilful defaulter (i.e. no diversion of funds, fraud or malfeasance).

RECOVERY

If the bank/committee feels that the first two options are not viable, they may initiate recovery of the loan from your enterprise.

*Summary of Financial Terms

Profit & loss statement	:	A statement showing income and expenses of the company. This is prepared for a particular period (usually 1 April to 31 March).
Balance sheet	:	A statement showing the position of assets and liabilities of the company as on a particular date.
Revenue	:	Amount received by way of sales of products and services. This includes both cash and credit sales.
Cost of goods sold	:	This is the direct material cost incurred in manufacturing or procuring a product that is sold to the customers.
Gross profit	:	Gross profit is the difference between revenue and cost of goods sold. It does not include operating expenses like rent, salaries, etc.
Operating expenses	:	Expenses that are not directly associated with the production of goods, e.g., rent, salary, and SG&A (selling, general and administrative expenses).
Interest	:	Charges paid to the lender of money on the outstanding loan amount.
Depreciation	:	Annual charges applied to fixed assets depending on their life. Depreciation is accounted as an expense in the profit and loss account.
Profit before tax	:	Gross Profit – Operating Expenses – Interest – Depreciation
Assets	:	Current assets such as cash, inventory and non-current assets or fixed assets such as plant & machinery.
Liabilities	:	Shareholder capital, current liabilities such as creditors and short-term loans to be paid within one year and term liabilities (liabilities to be paid after one year).
Receivables	:	Payments that are to be received from the customers on a future date as per agreement.
Current assets	:	Current assets include cash, account receivables and other liquid assets that can be readily converted to cash.
Fixed assets	:	Assets that are used for the long term and which are not sold during the normal course of the business.
Cash credit	:	Working capital loans to finance current assets and manage day-to-day running of the business.
Term loan	:	A long-term loan generally taken to buy fixed assets and which is repaid in installments over a period of time.
Equity capital	:	Shareholder’s capital which represents ownership interest in the company.

Recent Initiatives for MSMEs

Trade Receivables Discounting System (TReDS)	Do you face the problem of delayed payments from your buyers? If yes, you can discount your receivables through TReDS. Three entities licensed by RBI, viz. RXIL, Mynd Solution and A.TReDS, operate the TReDS platform.
Certified Credit Counsellors	Are you hesitant to apply to banks for MSME loans due to lack of knowledge on preparing business proposals, maintaining financial documents, etc.? You may approach Certified Credit Counsellors (CCCs) who are registered by SIDBI. A list of such counsellors is available at: https://udyamimitra.in/Home/CCC. These counsellors may assist you with business decisions.

*The definitions of the above terms are indicative in nature. They differ from one industry to another and are subject to interpretation.

TARGET SPECIFIC FINANCIAL LITERACY MATERIAL

One of the recommendations of the Committee on Medium-term Path on Financial Inclusion chaired by Shri.Deepak Mohanty, Executive Director, Reserve Bank of India was 'A 'one size fits all' approach for Financial education might be less than ideal as different target groups need different kinds of financial education. As a result, the content needs to be customised for different target groups'.

The Financial Inclusion and Development Department of the Reserve Bank of India has come up with customised financial literacy content for five different target groups, namely farmers, small entrepreneurs, school children, self-help groups (SHGs), and senior citizens. This book is one among the series of five books on customised financial literacy content.

Disclaimer
This book is presented as reading and teaching material with the sincere purpose of making the reader financially literate. It is not intended to influence the reader into making a decision in relation to any particular financial product/s or service/s.

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