CAIIB

Advanced Business & Financial Management

Module B : Chapter 7

Features of Term Loans

www.edutap.co.in hello@edutap.co.in +91 8146207241

Conditions In Loan Agreements

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- Reconstitution of the board.
- Induction of the independent directors.
- A seat on the board.
- Prior consent or approval of the lender required for:
  - Examples; Mergers, hiving off, restructuring, new projects, equity expansion or dilution, investments in or creation of subsidiaries, fresh or big funding exercise etc.
- Statutory registrations or approvals
- Infusion of additional funds by the promoters.
- Prohibition on withdrawal of loans or funds already brought in by the promoters.
- Consent required of the lender if any other loans are being repaid.
- Restrictions on dividend pay-outs.
- Strong Corporate governance.

- Requirements of rating by independent and reputed rating agency.
- Ceiling on further borrowings.
- Inspections and visits.
- Insisting on First charge failing which pari-passu charge.
- Prohibition on creating further charges.
- Pledge of promoters’ shares or collaterals of personal assets of the promoters.
- Restrictions on promoters' right to dispose their shares.
- Appointment of compliance officers and proper Key Managerial Persons.
- Maintenance of prudent financial ratios including debt equity.
- Submission of quarterly data and annual audited financial statements.

Pros & Cons

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- All the conditions listed earlier might add value to improve governance of the borrower.
- Borrower retains his shareholding and control over management.
- It is as good as a risk capital available at a fixed cost leaving major portion of the monetary gains and advantages of future to the Equity Shareholders.
- Repayment over a long period works out cheaper because of depreciation due to inflation.
- The interest paid is tax deductible and therefore the interest expenditure is much lower.
- Submission of timely data as required by the lender helps the management to inculcate discipline in the organisation.
- It also helps and guides the company to evaluate the performance.
- There is a convenience of fixing the quantum and period of repayment based on your funds flow.
- The link of communication with the term loan providers is better and quicker compared with that with capital market intermediaries and hence solutions can be found out faster.

- The real rate of interest may turn out to be cheaper or lower considering the inflation and fall in the value of rupee.
- Restrictive clauses sometimes really come in the way of a dynamic organisation and may hinder the management's decision-making process.
- Companies with medium to heavy borrowings are always rated a few notches below the ones having no or low borrowings.
- If one leverages too much with regard to debt versus equity, it may sometimes prove disastrous leading to debt trap.
- Interest on such loans, though declining due to repayments, is a fixed cost and in case of falling business volumes, the profits hit the bottom line disproportionately.

Thank You

For More Info Contact us:

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