E-Book

PROJECT FUNDING & FINANCIAL DUE DILIGENCE

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

Southern India Regional Council

Chennai

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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FOREWORD

Financial institutions have a key role to play in driving global sustainability through directing financing towards measures to achieve the Sustainable Development Goals. This helps banks and other financial institutions implement the due diligence recommendations of the OECD Guidelines for Multinational Enterprises in the context of their corporate lending and underwriting activities.

Currently no widely recognized standard on responsible business conduct (RBC) exists for these type of transactions, although they represent a significant portion of client services of commercial banks. Due diligence can help banks prevent or address adverse impacts related to human and labour rights, the environment, and corruption associated with their clients as well as avoid financial and reputational risks.

This book identifies key actions under each step of the due diligence process and includes discussion of key considerations, such as challenges, existing practices, or regulations specific to the corporate lending and securities underwriting transactions which may impact due diligence approaches.

We are conscious of the fact that in a publication meant for professional accountants like this there is a scope for further improving form, contents, presentation and coverage. Accordingly comments and suggestions on the e-book are welcome at sirc@icai.in

CA. Panna Raj S.

Chairman, SIRC of ICAI

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CHAPTER-1 – DEFINITION OF PROJECT & KEY PROJECT TERMS

1. What is "Project" – Before moving on to understand and analyse what is 'Project Funding' it is necessary to understand the concept of project. This is more relevant while executing a project for either setting up a

new industry/expansion or for providing service like Hotels, Hospital, Software to name a few. This will go a long way in putting across ideas to the potential investor/ lender and will also set the road map for efficient project management.

Several definitions are attributed to Project depending upon the nature of task undertaken. Britannica Dictionary defines a Project as-

•A planned piece of work that has a specific purpose that requires a lot of time.

•In management parlance, Project is defined as – consists of temporary endeavour undertaken to create a unique product, service or result.

- •Another definition in management environment – 'that which is created for the purpose of delivering one or more business products according to specific business case. Organizations and individuals manage projects with wide range of objectives. These can take many forms, from constructing a building to planning an event and even completing a certain duty. Retailers, for example, may pursue projects that improve the way they track order fulfilment. Construction teams complete projects anytime they plan and build something.
- KEY PROJECT TERMS TO KNOW- Irrespective of the Project undertaken and in order to ensure that the Project milestones are adhered to, overruns are avoided etc. there are some fundamental terms which one must understand –
- These are-
- Project Life Cycle- The Project Life Cycle refers to the five phases all projects must progress through, from start to finish. The five phases of project life cycle serve as the most basic outline that gives a project definition. These five phases are initiation, planning, execution, monitoring and closure. Unless all these work in tandem and unison, the project will not get completed as per schedule and cost overruns are a natural consequence with financing agencies seeking explanations and casting doubts on the Project. Hence it is absolutely necessary to follow through each phase meticulously. This requires experienced and well-versed project team to be in place drawn from all areas who have a sound background of executing projects.
- Project Scope- Project Scope is a key aspect of the project planning stage. In many ways, it is the starting point. Determining Project scope requires the project manager and their team to

set goals and objectives, detail deliverables, create tasks, establish important dates and more. Project scope defines desired outcomes and all specific factors which will affect reaching them

- **Stakeholder**- A stakeholder refers to anyone and everyone involved in a project. A stakeholder can be involved at every stage of the project, or just in a certain way. Stakeholder analysis helps categorize how investors, team members, vendors, contractors and more can affect your project.

- **Deliverable-** A deliverable refers to the specific outcome (s) a project creates. Deliverables can be "tangible" or "intangible", meaning they can be a physical product or something conceptual. Typically, deliverables are the need that inspired the project in the first place. If someone contracts a builder to design and construct an office space, the office is a tangible deliverable.
- **Milestone-** Milestones are predetermined achievements that help track project progress. Think of milestones as check points. These check points are decided on or before a project begins, so the project manager and team know when they are on track to achieve deliverables. Without milestones, it is difficult to know if the project is on the road to success or needs to reroute.
- **Resources-** A resource is anything necessary to complete the project. In a construction project, materials are an essential resource. That said, other resources- like time, labour and equipment – are just as important. A Project Manager must be able to identify all of the project resources in order to create a resource plan and manage the resources accordingly. When resources are left unaccounted for, it is easy to mismanage them.

Dependencies- Project Dependencies refer to how resources must be shared and allocated within a project. Many projects will use the same physical materials for different purposes and across different stages. Understanding his dependency is the only way to ensure there is enough of resource to go round. Similarly, all projects are broken down into tasks. When one task cannot begin before another is completed, these tasks share a dependency.

During the pandemic when content creators saw their opportunities shrink, NFTs allowed them to sell their content and earn incomes such as royalties in unique ways.

CHAPTER-2– PROJECT FUNDING

In the previous chapter, we looked at the definition of the term 'Project' and key Project terms. Project execution and project finance go hand in hand with Project terms. Before we go on to discuss the process involved in Project Funding and options available, it is necessary to understand what Project Finance is all about including evolution of Project Funding over the years.

- The process by which Bitcoin and other cryptocurrencies come into circulation and the **Project Funding**- Meaning- Project Finance is a means of funding projects that are typically infrastructure heavy, capital intensive or relate to Public Utilities. These projects are treated as distinct entities from their parents during their life time. A Project Finance venture undertaken is completely an off-Balance sheet item for the parent. Therefore, entire financing that the entity avails must be repaid exclusively out of its own cashflow and subject to its own assets. The Parent's assets cannot encroach for payback of its subordinate's liabilities even if the venture fails.

Popular sectors where Project Finance finds its applications include real estate, mining, telecommunication and power to name a few.

Another definition of Project Finance is the long-term financing of infrastructure and industrial products based upon non-recourse or limited alternative of financial structure where project debt and equity used to finance the project are paid back from the cash flow engendered from the project.

Project Finance is one of the key focus areas in today's world because of continuous growth and expansion of the industries at a rapid rate. Project Finance is centuries old form of financing high risk development-oriented projects. They are mostly non-recourse loans, which are fortified by the project assets and paid entirely from project cash flow, rather than from general assets or credit worthiness of the project sponsors, a decision in part braced by financial modelling.

- **Features of Project Funding-** When starting a new project or introducing new aspect to the business, functioning does not meet the planned finance schedule all the time. Some kind of financial leverage is needed to make the project come to reality. Thus, Project Financing addresses exactly the monetary requirements of the exclusive project. It means a loan obtained for fulfilling the finances that a new project brings along with it. Here the security is the Project itself. So, it means the loan can be repaid after the project completes or begins generating revenue. Thus, it is the funding of infrastructural or industrial projects on long term basis. The Project commences the cash flow once it has been completed. It is a common type of financing. So used widely in the Indian market industry, lending institutions, banks and NBFC's provide term loan.
- Project funding are of two types in terms of collateral required. Primary and Secondary. The primary form of collateral is the project itself. And the secondary collateral is the value of the loan and this collateral is apart from the project. The reason for this basically, is the profile of the company. How old is it? Whether it is a newly established firm? Or a firm that has been in business for long years? The risk factor involves the perspective of banks and lending institutions. In the Project Funding, Capital can be raised for any type of project. So, this is one of the vital features of project funding. It involves investors funds. Also, financed loans need to be repaid once the cash flow starts.

  - **It is non-Recourse-** in project financing the borrower is not liable to obligations in the cases of default. It is a type of mortgage and institutions take while funding while financing the project. When discrepancies like the borrower being unable to make the partial or complete repayment of the loan. Banks, Financial Institutions and lending firms use that mortgage to recover the loan amount. Their recovery will be identical to the mortgage value plus unpaid interest if any, and cannot exceed it.

Benefits of Project Finance – There are many benefits of Project Funding due to its specifications. Here are some of the major benefits of Project Finance-

- Risk Sharing- There is an opportunity for risk sharing in Project Financing. It is due to the presence of multiple entities such as lenders or investors. The scope of risk sharing in project funding is a collective one, this also minimizes the risk at the same time.
- Extending Debt Capacity- The debt would not fall on one lending institution or investment firm. Thus, the capacity of containing debt is also enhanced due to the presence of multiple entities.
- Financing projects through general project finance enables the sponsors to retain the confidentiality of the vital information. It is regarding the project which is going to be financed. It is keeping up with the competitive market through competitive advantage.
- Any introduction of new industrial technology or development and commercialization of a new product/ service, these types of projects fill perfectly. It is the Project Financing eligibility criteria for the project.
- Projects based on improvements to the existing product or services are also completely eligible to receive project funding.
- Projects that ensure sustainable development. That has reduced material consumption or cost optimization projects. Those having the potential to function in the field of modern technology also fall under the project financing eligibility criteria.
- The Project must be justifiable to the investors and lending institutions. A new and exclusive opening of an aspect that would be commercialized in the form of a completed project. Once the lending facilities get convinced, the project will generate considerable cash flow. They can provide the funds with reliability.
- Interest Rates- Project funding interest rates depend upon the profile and credit rating and previous performance of the borrower and overall feasibility of the project. The investors and lending institutions decide on an interest rate benchmarking it to MCLR.

History of Project Funding – Funding of Projects was in vogue right in the beginning of 20th Century. Industrial Revolution brought with it establishment of cluster of industries both in manufacturing and service sectors. Early part of 20th century witnessed setting up of manufacturing units across the globe at frenzied pace. Demand for funds got accentuated so that units could be set up. Early-stage promoters did not have the resources of their own to set up big industries like iron and steel, textiles, shipping, engineering to name a few. They were required to look for outside sources to fund the ventures. Lending agencies were far and few and they also did not have adequate funds to lend. Thus, was born private sources of funding. This came at a high cost and contained several conditions. Viability of projects became an issue because of high cost of funds. Promoters who were keen to establish industries for larger social benefit including generation of employment and availability of merchandise locally, devised novel methods to raise funds as follows-

- The term Capital came into prevalence and to begin with, Preference shares carrying assured returns and with limited voting rights were offered to prospective lenders. This gained popularity over the years since it assured the investors a fixed return. But it had a flip side to it. Companies had to pay a fixed amount to each shareholder every year and it was proving expensive. Thus, was born the concept of equity which gained immense popularity. But all this proved inadequate since raising Capital was not easy. Promoters devised ways to work around the problem in the form of loan which had fixed maturities and carried certain rate of interest. Loans were required to be paid within a specified time, frame. It gained popularity since the Liability was restricted to the term of the loan. But then finding Lenders were not easy. Thus, ways were required to find a source. Our ingenious Indian industrialists did not want to give up. Promoters thought of setting up banks. This gave birth to Central Bank of India established by the house of Tatas and United Commercial Bank by the Birla's. This benefitted not only the Promoters of the Banks, but also other entrepreneurs looking for Loans.

➢

➢ Post-independence, with thrust on industrialization and Establishment of more banks, scenario changed. But banks were tasked with providing working capital to companies plus they were required to lend to weaker sections of society as per Government Policy. This left the banks with low money to lend to industrial ventures. Thus, was born development financial institutions both at national and state level. These institutions were required to Exclusively lend money for projects. These institutions did a fairly good job of lending money as Term loan for both manufacturing and infrastructure projects. Liberalization of the economy and reforms process set in motion by the Government meant rapid Growth of industries. The late 90's and early 2000 saw tremendous Increase in economic activity with new entities being set up at a Frenzied pace. The service sector, which was till then was a dormant player, started growing exponentially fuelled by huge growth in demand for services in sectors like tourism, hotels, health care to name a few. Globalization was becoming a trend with cross border movement becoming the norm. India growth story created a huge opportunity for foreign companies to establish Industries. Indian industrialists started looking inwards to acquire Companies globally. This meant demand for newer forms of fund raising became necessary. Getting foreign entities to invest/ lend became easy due to liberal policies followed by the Government which encouraged foreign investment. Thus, the Project lending scenario has undergone a sea change with options plenty. We will Examine in the following chapters the process involved in raising Finance for a Project, types of funding available and risk factors involved.

CHAPTER-3 – PROJECT FUNDING SOURCES AND METHODS

PART-A- PROJECT FINANCING

As we saw earlier, project financing is an essential aspect of project success. A detailed and well incorporated process should be applied in the planning, controlling and managing records of a project. It is not easy to attain the goals and objectives of a project since the process is constrained by challenges in finance management and project costs. The aim is to discuss the different project funding sources along with their success implications of a project. The benefits and limitations of joint ventures to business strategy and project funding will be expounded. The project planning processes and problems facing finance management and project costs will also be debated.

Definition of Project Financing- Defined basically, project financing is a funding arrangement relying on the future cashflow of the project as a source of repayment. The arrangement uses project assets and interests as collateral security. The lenders and sponsors (read investors) share joint venture risks in funding the project. The process of financing can be present at any stage of a project based on strategy of financial managers (Sharp & Peters 2017). Project financing can occur at any given stage as per the terms of the financial management team (Sharp & Peters 2017). For example, drawdown of funds take place according to the progress of the project in most cases to avoid excess amount from being drawn and also to keep the interest burden low. The generally applied sources of financing for projects are equity, loans, overdrafts (when project is about to go on stream) or grants. (Lock,2017). Potential funding sources are detailed as follows-

A survey said that 90% of respondents identified money as the greatest obstacle to implementation of any project. The various sources of finance can be broadly divided into two categories viz. Equity Capital and Debt Capital (borrowed capital). The combination of Equity and Debt must be judiciously chosen and I will vary according to the nature of the project. The Project Manager can choose any one or a combination of two or more of these methods to finance the project.

Share Capital- Equity and Preference Capital.
Term Loan.
Debenture Capital.
Commercial Banks.
Bills Discounting.

Some more types of financing available are-
Seed Capital- In consonance with the Government Policy, which boosts a new class of entrepreneurs and also aims wider spreading of ownership and control of manufacturing units, a distinct scheme to complement the resource of an entrepreneur has been presented by the Government. Assistance under this scheme is accessible in the nature of seed capital which is generally given by way of long-term interest free loan. Seed capital is provided to small as well as medium scale units promoted by eligible entrepreneurs.

Government Subsidies- Subsidies drawn out by the Central as well State Government form a very significant type of funds presented to a Company for implementing its project. Subsidies may be available in the nature of absolute cash grant or long- term

interest free loan. In fact, while settling the means of finance, Government subsidy forms a key source having a vital bearing on putting into place many a vital project.
Long-term sources include sales and leasing, loan capital, and share capital. Sales and leasing are where assets can be sold to a certain project development company and then leasing back for a mentioned term. These assets can be used to fund the project. Loan capital consists of three categories: venture capital, business angels, and debentures. Venture capital increases the value of shares so that they can be sold at a profit. Venture capitalists mostly consider those companies considered too risky by others. Business angels are private investors who seek equity in exchange for their investment (Harrison & Lock, 2017). Debentures loans are raised by the floating charge of a company's assets. Interest payments here are made before shareholders received their dividends. Share capital is profits shared among company shareholders in direct exchange for their investments in projects.

Joint Ventures - Firstly, joint ventures increase access to specialized technology and skilful personnel (James, 2016), thereby improving the quality of projects and increasing the likelihood of long-term success. Secondly, joint ventures share risks and costs where a project fails, allowing projects more of a safety net in long-term projects. Thirdly, joint ventures tend to have a larger customer database (James, 2016), increasing their profitability, which increases funding and chances of a successful project. Finally, joint ventures forge long-lasting business project relationships and improve lessons learned jointly over time.

Risks of Joint Ventures- Particular attention should be paid to projects in which two forces are participating because there is a chance that the resources and capabilities of the two will not be equal (Reuer, Kleijn & Lioukas, 2014). Next, difficulties with communication are a common issue that can lead to misunderstandings that will result in poor outcomes (Yan & Luo, 2016). Finally, the difference in corporate cultures may affect the outcomes as well.

Other Sources- Foreign Funding-Equity and debt are the only two sources through which the funding can be done for projects but these options are not much viable. With the advent of foreign direct investments in India, the Indian projects have been receiving foreign investments with which they can easily fund their projects and execute them well.
Getting international funding for projects becomes very beneficial for the company as they receive the capital that they were looking for and also with the foreign investments comes the foreign technology and knowledge that further accelerates the potential of the project.
Procuring international funding can be a very daunting task but with the expertise of FDI India, this can be easily achieved by companies. Even the government of India is

promoting foreign investments in the country and also promoting the idea of Atma Nirbhar Bharat for which FDI is one of the biggest motivators.

Let us have a look at the options for international funding for projects in India.

Equity-Based Funding

i) The government of India has given the allowance of international funding in the majority of the sectors and one thing that must be checked is the percentage of the FDI which is allowed in the sector where the investments are being made.

ii) Finding equity-based international funding for projects in India can be done easily. For getting international funding for projects, partnerships can be formed with international companies in joint ventures. They will help in the funding as well as in the technology aspect of the project as well.

iii) By the method of acquiring an international shareholder and a partner in a joint venture will give access to the international capital markets where the foreign investor belongs, that will help in raising additional equity and getting low-cost debt.

iv) Listing of an Indian company on the international stock markets and alternate investment exchanges can be done through the organic listing or through the process of a reverse merger with a company that is already listed. Equity-based international funding for projects can be most suitable as it is a more economical option of fundraising.

Debt Based Funding

- To raise debt-based international funding it is best from getting debt funds from international banks and financial institutions. The major countries such as the US, Canada, UK, Switzerland, Japan, China and Taiwan readily give business loans to the Indian companies.
- International funding through small banks and debt funds is ideal for the MSME sector. The rate of interest, in this case, can be higher but will be comparatively lower than the domestic funding options.

Through the Joint Ventures also international funding can be raised for projects as they have their banking relations. They help in getting a low-cost debt but it is essential for the foreign partner to be a part of the business

Apart from this, there are some more funding options to choose from to ensure project completion which are-

Viability Gap Funding Scheme-

The Viability Gap Funding (VGF) Scheme aims at supporting infrastructure projects that are economically justified but fall marginally short of financial viability. Support under this scheme is available only for infrastructure projects where private sector sponsors are selected through a process of competitive bidding. The total VGF under the scheme does not exceed 20% of the total project cost, however, the Government may decide to provide additional grants up to a limit of a further 20%.

- Procedure for getting Viability Gap Funding-

The process for availing viability gap funding (VGF) involves:

1. Submission of project proposals that include requisite information by the Government/ statutory entity owning the underlying asset
2. Projects based-on model documents would be preferred over standalone documents
3. Empowered Institution (EI) may seek required details for satisfying eligibility criteria
4. The EI shall inform the sponsoring Government/ statutory entity whether the project is eligible for financial assistance within 30 to 60 days
5. The EI may refer the case to Empowered Committee (EC) for further clarity on eligibility
6. Projects shall be approved and implemented in accordance with the procedures specified from time to time
7. The inter-se allocation of VGF between an ongoing scheme and this scheme shall be determined by the EC.

- AREAS QUALIFIED UNDER VIABILITY FUNDING SCHEME

List of sectors permissible for viability gap funding (VGF) include:

- Public infrastructure such as roads, airports
- Public amenities such as power, water supply, waste management
- Infrastructure projects in special economic zones (SEZ) and national investment and manufacturing zones (NIMZ)
- Education, health and skill development.

- DOCUMENT CHECKLIST FOR GETTING 'IN PRINCIPLE APPROVAL' FOR VIABILITY FUNDING SCHEME

A. EI Memo with annexures

B. Feasibility Report/ Detailed Project Report

C. RFP Bidding Document

1. Volume I – Instruction of bidders
2. Volume-II- Draft Concession Agreement
3. Volume-III- Schedules

D. Statement on deviation from MCA, if any.

E. Other Project Agreements as applicable. The above documents and soft copy thereof are to be provided in 6 sets for consideration b y member of Empowered Institution.

DOCUMENTS NEEDED FOR FINAL APPROVAL-

The documents required for grant of final approval for viability gap funding (VGF) are:

1. Empowered Institution (EI) memo for final approval
2. Appraisal report of the project by Lead Financial Institution
3. Executed project agreement
4. Certificate from the sponsoring authority that all conditions specified in the scheme have been complied with

The above documents and soft copy thereof are to be provided in 6 sets for consideration by member of EI.

Apert from this, other source of Project Funding is-

- Bridge Finance
- External Commercial Borrowings
- Alternative Investment Funds
- Funding Under Government Schemes (MSME)
- Funding under Government Schemes (MUDRA)
- Funding under Government Schemes (Start-ups)
- Infrastructure Investment Trusts (INVITS)
- Issues of Shares
- Real Estate Investment Trusts (REIT)

We will look at various funding options in detail in following chapters.

CHAPTER-4. FOREIGN DIRECT INVESTMENT POLICY- FDI

Any discussion on foreign funding sources will not be complete without dwelling upon the policies laid down by the Government from time to time. In order to encourage growth of Industries and bring in latest cutting-edge technologies to India, Government has been proactive in encouraging Foreign Investment in Indian entities. Lot of policy initiatives have been taken in relation to type of investments, limits of investments, sectors etc. Many sectors which were closed for investment have been opened up like never before. This presents a golden opportunity for entities looking for investments and technologies from foreign sources.

Foreign Direct Investments are broadly categorized as Direct and Restricted. Direct investment permits investment in entities through the Automatic route while restricted route requires approval of Authorities before investment can be made.

Broad contours of the FDI Policy can be analysed as follows-

- The FDI Policy generally allows foreign investors (except for investors based out of Pakistan & Bangladesh who need to obtain prior Government approval) to make foreign investment in most sectors under the automatic route (i. e. without Government approval) subject to sectoral conditions.
- The extant of FDI Policy permits FDI up to 100% in the manufacturing sector under automatic route. Since the liberalisation process, FDI in manufacturing has been continuously encouraged by the Government, permitting FDI up to 100% in manufacturing through automatic process.
- Category of FDI

CATEGORY I	CATEGORY II	CATEGORY III
100% FDI permitted through automatic route	Up to 100% FDI permitted through Government Route	Up to 100% FDI permitted through Government + Automatic Route

- Automatic Route- Under Automatic Route, the Non- Resident investor or the Indian Company does not require any approval from the Government of India.
- Government Route- Under the Government Route, prior to investment, approval from the Government of India is required. Proposals for foreign Direct Investment under the Government Route, are considered by the respective Administrative Ministry/ Department.
- For detailed definitions/ conditions please refer to **Consolidated FDI Policy**
- Sector Specific Conditions- Non-Scheduled Air Transport Services- 100%
- Helicopter Services/ Seaplane Services requiring DGCA Approval.
- **Prohibited Sectors-**

- **Prohibited Sectors-**
  - Lottery Business including Government/ Private Lottery, online lotteries etc.
  - Gambling & Betting including Casinos
  - Chit Funds
  - Nidhi Company

- Trading in Transferable Development Rights (TDR)
- Real Estate Business or construction of Farm Houses**
  ** Real Estate Business shall not include development of townships, construction of residential / commercial premises, roads or bridges, and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI(REITs) Regulations 2014.
- Manufacturing of Cigars, Cheroots, cigarillos and cigarettes of tobacco or tobacco substitutes.
- Sectors not open to Private Sector Investment- Atomic Energy, Railway Operations (other than permitted activities under the Consolidated FDI Policy)

Procedure for Government Approval -

- Filing of Application- Proposal for foreign investment, along with supporting documents to be filed on line, on the Foreign Investment Facilitation Portal, at the following URL www.fifp.gov.in

Internal Procedure for Approvals

- DPIIT will identify the concerned Ministry/ Department and thereafter, circulate the proposal within 2 days. In addition, once the proposal is received, the same would also be circulated online to the RBI within 2 days for comments from FEMA perspective.
- Proposed investments from Pakistan and Bangladesh would also require clearance from the Ministry of Home Affairs.
- DPIIT would be required to provide its comments within 4 weeks from receipt of an online application, & Ministry of Home Affairs (if applicable) to provide comments within 6 weeks.
- Pursuant to the above, additional information/ clarifications may be asked from the applicant which is to be provided within 1 week.
- Proposals involving FDI exceeding INR 50bn (approx. $ 775 mn) shall be placed before the Cabinet Committee of Economic Affairs.

Final Approval

Once the proposal is complete in all respects, the same gets approved within 8-10 weeks.

<u>FDI REPORTING REQUIREMENTS</u>

<u>Documents for Form FC-GPR (Foreign Currency - Gross Provisional Return) SMFCS Certificate</u>

- Declaration by the Authorised Representative of the Indian Company/LLP
- Pre and post shareholding pattern in the Indian company
- Copy of government approval (if applicable)
- Copy of the order of the High Court on the scheme of merger/ demerger/ amalgamation (if applicable)
- RBI approval on the amount of refund with respect to the amount of the issue (if applicable)
- Valuation certificate
- Approval letter (if non-compliant with the guidelines – if applicable)
- Relevant RBI approvals for an issue of equity shares against funds payable to the foreign investor
- FIRC/ Debit statement
- Know Your Customer (KYC)
- Board Resolution

Note:

As per the RBI notification on "Foreign Investment in India - Reporting in Single Master Form" of 7th June 2018, now provides for all the extant reporting structures of various types of foreign investments in India are now provided under a Single Master Form (SMF) which is required to be filed online.

As per the RBI Notification ARF and FC-GPR is merged into a single revised FC-GPR (SMF). All new filings for the Form FC-GPR (SMF) have to be done in Single Master Form only.

CHAPTER-5 – STAGES IN PROJECT FINANCE

There are quite a few stages and requirements to ensure that the Project is executed in an orderly manner within the time limit set. Let us look at some of the prerequisites required to ensure that there is no cost and time overrun and the Finance is used optimally.

STAGE-1

- Project Financial Management- Planning of resources, estimation of costs, budgeting, and cost control are the essential elements of Financial Management in projects. The PMBOK guidelines outline the specific elements of financial management and emphasize the importance of paying close attention to the process of planning, spending and monitoring them throughout the course of a project. It is critical for project managers to identify the required financial resources that will be used in a particular project, quantities of these components, and specify the undertakings (Larson & Gray, 2015). Additionally, financial managers have to estimate duration, prospective risks, chosen funding source, costs of construction, and tax benefits.

  Project managers are required by PMBOK to ensure cost control is conducted such that it caters to variations in the plan caused by any change of cost baseline or other concerns. Aspects of being included are a financial plan, revenue benefits, request change, and contract requirements.

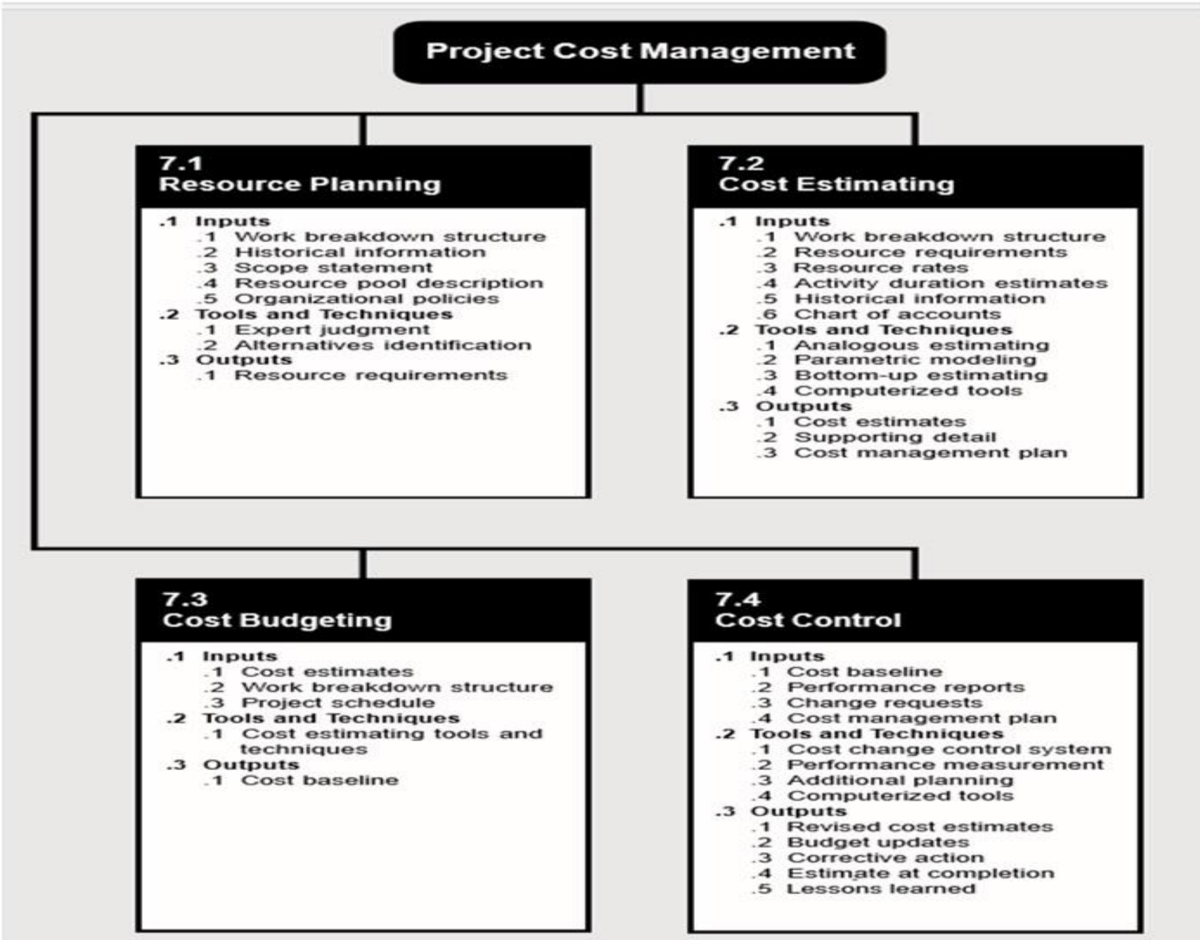
- Financial Management Plan involves
  - i) Resource Planning
  - ii) Estimating Cost
  - iii) Cost Budgeting
  - iv) Cost Control

Resource planning is done at the beginning phase by defining the resources (people, equipment, and materials) needed. Resources are things like labour, equipment, and time required to accomplish a project. Work breakdown structure (WBS) is developed by the project manager. In it, project elements that are crucial for resource planning are specified. In addition, Harrison and Lock (2017) recommend incorporating and evaluating information from previous projects for efficient preparation. The scope statement is the final component of the resource planning in which the project is justified using set objectives.

Cost estimate involves the development of approximate costs of the resources that will be required to complete the identified scheme. This is the general price tag a project is required to be funded to achieve its goal. Methods that can be used for cost estimation are parametric models and analogous estimation. For instance, if more work than initially anticipated is required for the design stage of an assignment, the project manager is needed to carry out additional calculations and determine whether these alterations will offset the original plan and expected savings. Several tools are developed to facilitate similar estimations, for example, bottom-up and analogous estimating, parametric modelling, or computer-based solutions (Kerzner & Kerzner, 2017).

Cost budgeting is used to allocate costs over a time period and gives a periodic and project cost a task that helps in the effective establishment of cost baseline, which is necessary for evaluating project performance (Martinelli & Milosevic, 2016). A cost baseline is used to measure the actual performance progress, for example, where a project involves the construction of a plane. The first task would be to construct a WBS for the project. However, the WBS requires people to allocate costs at the different levels of WBS, thus accomplishing cost budgeting.

Cost control measures variance from cost baseline and assists in applying decent corrective measures to attain minimum costs. Cost control software is used to define effective cost control measures.



Resource planning is arguably the biggest challenge to project cost and finance management. Other areas like cost control are reliant on proper resource planning. Any failure to effectively plan adequate resources forces managers to seek resources at short notice with potentially higher costs or lesser quality, thereby further compounding project costs. One can argue that The Millennium Dome project is one example that failed due to inadequate resource planning (Abbasi, Wajid, Iqbal & Zafar, 2014). Had the team contracted the right human resources for marketing and budgeting, the project may have succeeded

STAGE-2- UNDERSTANDING PROJECT FUNDING

For whom it is important to understand Project funding?

Financial Managers.

Sponsors

Lenders

Consultants & Practitioners

Project Managers

Builders

Suppliers

Engineers

Why is it important to understand project finance? The people involved in a project are used to find financing deal for major construction projects such as mining, transportation and public utility industries, that may result such risks and compensation for repayment of loan, insurance and assets in process. That's why they need to learn about project finance in order to manage project cash flow for ensuring profits so it can be distributed among multiple parties, such as investors, lenders and other parties.

Simply put, project finance is essentially financing on the security of the project itself, with limited or no recourse against the sponsors of the project or other parties involved in the development and implementation of the project. Due to such characteristics of project finance, the loans sought by the borrowers are always approved by the lenders on the basis of strong in-house appraisal of the cost and viability of the ventures as well as the credit standing of project promoters.

An understanding of the possible money streams into a particular project and the possible expenditure streams out of the same is essential to structure the finance. Such understanding would be based on an analysis of the legal framework governing the project, all of the project's documentation including all government approvals with regard to the implementation and financing of the project and the finance documentations. Project finance is quite often channelled through a project company known as special purpose vehicle or project development vehicle. Internationally, in addition to a private limited company, a limited company, a partnership and an unincorporated entity structure are all recognized as suitable project development vehicle. However, in India, a private limited company is regarded to be an appropriate project development vehicle as it ensures limited liability for the developers of the project, enables the shareholders to incorporate the various terms and conditions agreed to between them in the articles of association of the project company, thereby binding not only the shareholders themselves but also the company to such agreed terms. Besides, a private limited company also has greater avenues open for equity and loan financing.

Some Jargons:

1. Full Recourse Loan: A loan in which the lender can claim more than the collateral as repayment in the event that the loan is enforced. Thus, a full recourse loan places the Sponsor's assets at risk.

2. Non-Recourse Loan: A loan in which the lender cannot claim more than the collateral as repayment in the event that the loan is enforced.

3. Limited Recourse Loan: A loan in which the lender can claim more than the collateral, subject to some restrictions, as repayment in the event that the loan is enforced.

STAGE-3 - Project Financing Participants and AgreementsSponsor/Developer

: The sponsor(s) or developer(s) of a project financing is the party that organizes all of the other parties and typically controls, and makes an equity investment in, the company or other entity that owns the project. If there is more than one sponsor, the sponsors typically will form a corporation or enter into a partnership or other arrangement pursuant to which the sponsors will form a "project company" to own the project and establish their respective rights and responsibilities regarding the project.

Additional Equity Investors: In addition to the sponsor(s), there frequently are additional equity investors in the project company. These additional investors may include one or more of the other project participants.

Construction Contractor: The construction contractor enters into a contract with the project company for the design, engineering, and construction of the project.

Operator: The project operator enters into a long-term agreement with the project company for the day-to-day operation and maintenance of the project. Feedstock Supplier: The feedstock supplier(s) enters into a long-term agreement with the project company for the supply of feedstock (i.e., energy, raw materials or other resources) to the project (e.g., for a power plant, the feedstock supplier will supply fuel; for a paper mill, the feedstock supplier will supply wood pulp).

Product Off taker: The product off taker(s) enters into a long-term agreement with the project company for the purchase of all of the energy, goods or other product produced at the project.

STAGE-4 – PRINCIPAL ADVANTAGES & DISADVANTAGES OF PROJECT FINANCING ADVANTAGES

1.Non-Recourse: The typical project financing involves a loan to enable the sponsor to construct a project where the loan is completely 'non-recourse' to the sponsor, i.e., the sponsor has no obligation to make payments on the project loan if revenues generated by the project is insufficient to cover the principal and interest payments on the loan. In order to minimize the risks associated with a non-recourse loan, a lender typically will require indirect credit supports in the form of guarantees, warranties and other covenants from the sponsor, its affiliates and third parties involved with the project.

2. Maximise Leverage: In a project financing, the sponsor typically seeks to finance the cost of development and construction of the project on a highly leveraged basis. Frequently, such costs are financed using 80 to 100 percent debt. High leverage in a non-recourse project financing permits a sponsor to put less in funds at risk, permits a sponsor to finance the project without diluting its equity investment in the project and, in certain circumstances, also may permit reductions in the cost of capital by substituting lower-cost, tax-deductible interest for higher-cost, taxable returns on equity.

3.Off-Balance-Sheet Treatment: Depending upon the structure of project financing, the project sponsor may not be required to report any of the project debt on its balance sheet because such debt is non-recourse to the sponsor. Off-balance-sheet treatment can have the added practical benefit of helping the sponsor comply with covenants and restrictions relating to borrowing funds contained in other indentures and credit agreements to which the sponsor is a party.

4.Maximize tax benefit: Project financings should be structured to maximize tax benefits and to assure that all possible tax benefits are used by the sponsor or transferred, to the extent permissible, to another party through a partnership, lease or other vehicle.

DISADVANTAGES

Project financings are extremely complex. It may take much longer period of time to structure, negotiate and document a project financing than a traditional financing, and the legal fees and related costs associated with a project financing can be very high. Because the risks assumed by lenders may be greater in a non-recourse project financing than in a more traditional financing, the cost of capital may be greater than with a traditional financing

STAGES IN PROJECT FINANCING

Project Identification	
Risk identification & Minimizing	Pre-Financing Stage
Technical & Financial Feasibility	
Equity Arrangement	
Negotiation & Syndication	Financing Stage
Commitments & Documentation	
Disbursement	
Monitoring & Review	Post Financing Stage
Financial closure/ Project Closure	
Repayments & subsequent monitoring	

CHAPTER-6- PREPARATION OF PROJECT REPORT FOR FUNDING

A project report is essential before a decision for setting-up of any project is taken. The most important thing in any project financing is preparation of Detailed Project Report (DPR) which should be made beautifully for getting the project approved from banks/financial institutions. After preparation of DPR the proposal is moved to the banks/financial institutions for processing of the file.

PART-A

Project Report must include the following:

A. Technical Feasibility:

All the factors relating to infrastructure needs, technology, availability of machine, material etc. are required to be scrutinized under this head. Broadly speaking the factors that are covered under this aspect include:

1. Availability of basic infrastructure- It includes the land and its location as per present and future needs, lay out and building plan including finalization of structure, availability of water and power, availability of cheap labour in abundant supply.

2. Licensing/ registration requirements

3. Selection of technology/ technical process- The technical process/technology selected for the project must be readily available either indigenously or necessary arrangements for foreign collaboration must be finalized. Further the selected technology must find a successful application in Indian environment and the management shall be capable of fully absorbing the technology.

4. Availability of suitable machinery/raw material/ skilled labour etc- After selection of technical process, the availability of suitable kind of machinery is most important factor which

needs to be considered. It should be ensured that the suppliers are capable to supply the plant and machinery timely along with all spare parts.

B. Managerial Competence-:

The ultimate success of even well-conceived and viable project may depend on how competently it is managed. The promoters of the project have to provide necessary leadership and their qualification, experience and track record will be closely examined by lending institution. The detail of other projects successfully implemented by the same promoters may provide the necessary confidence of these institutions and help final approval of the project. The reputation of the promoter's group in the market is also very important factor which the banks/ financial institutions consider while lending to the companies. Also, the bank/ financial institutions check the payment history of past loan raised by the companies in which the promoters are directors which shows their willingness of repayment of the loans. CIBIL is a very strong tool in the hand of banks/ financial institutions to verify the payment history and the number of loans raised by the companies from the date of existence.

C. Commercial Viability:

Any project can be commercially viable only if it is able to sell its product at profit. For this purpose, it would be necessary to study demand and supply pattern of that particular product to determine its marketability. Various methods such as trend method, regression method for estimation of demand is employed which is than to be matched with the available supply of a particular product.

D. Financial Viability:

Factors need to consider for financial viability:

1.Cost of project: A realistic assessment of cost of project is necessary to determine the source for its availability and to properly evaluate the financial viability of the projects. For this purpose, the various items of cost may be sub-divided as many sub-heads as possible so that all factor are taken into consideration for arriving at the total cost.

Cost includes the following:

Land Cost- Acquisition of project land, registry charges, and charges for other clearance.

2.Site Development Cost: To make the project easily accessible it is necessary to build roads, water tank, boundary walls, arranging electricity, levelling the site, demarcation of site, making available the basic amenities etc.

3.Buildings Cost- It includes lay out and building plan along with the structure cost, building the site office, factory sheds, godown, residential flats for staff etc.

4.Plant and Machinery: Cost of plant and machinery, any foreign assistance for installation, salary of technical staff, transportation cost, foreign currency fluctuations (if any), bank commissions, L/C Charges etc.

5. Miscellaneous Fixed Assets

6. Preliminary Expenses: Licence required to start commercial production from the local authorities along with other clearances etc.

7. Contingencies: Normally 5% extra cost is taken as contingency to avoid any kind of cost over-run at the end of implementation of project.

8. Margin for Working Capital: For running a project it is necessary to fuel it with the working capital. It works like a lubricant for any kind of business. It is financed against receivables and stock. A proper assessment of the same should be done. Banks now generally require that 25% of the total current assets (working capital) shall be the margin to be provided from the long-term resources and 75% shall be financed by them.

E. Means of Finance:

After estimation of the cost of the project, the next step will be to find out the source of funds by means of which the project will be financed. The project will be financed by contribution of funds by the promoter himself and also by raising loans from others including term loans from banks and financial institutions. The means of financing will include:

1. Issue of share capital including ordinary/preference shares.

2. Issue of secured debentures.

3. Secured long-term and medium-term loans (including the loans for which the application is being put up to term lending institutions).

4. Unsecured loans and deposits from promoters, directors etc.

5. Deferred payments.

6. Capital subsidy from Central/State Government.

F. **Security Coverage and Promoters Contribution**:

In today scenario and being to play safe, the bankers wants that at least the promoters should contribute 40% of the total project cost. The long-term sources of funds are utilized for acquisition of land, procuring the fixed assets and construction of building etc. But for day-to-day expenses, payment of staff salary, purchasing the stocks etc. the project requires short term loan or working capital loans. Hence the financing for a project is the mix of both long term and short-term loans. In project funding the bank has charge on the land, building, any super structure thereof and hypothecation of stocks & receivables and all the current assets relating to project. It is considered as primary security but the bankers may ask for collaterals also in addition to the primary security.

G. Profitability Analysis:

After determine the cost of the project and means of financing, the viability of the project will depend on its capacity to earn profits to service the debts and capital. To undertake the profitability analysis, it will be necessary to draw estimates of the cost of production and working results. These estimates are made for a period which should at least cover the moratorium and repayment periods. Generally, in case of project loans repayment begins after 2-3 years, the time gap between the disbursement of loan and repayment of first instalment is called moratorium period. Further repayment should start in that quarter or month when it is assured that the project will have sufficient cash profit to service the same in that particular quarter or month. Also, the moratorium and repayment period is decided while submitting the proposal to the banks hence while selecting these periods' accurate calculations should be done.

H. Projected Balance Sheet, Profit and Loss Account and Projected Cash Flow:

The projected financials of the project is prepared for the entire tenure as estimated above.

I. Break-Even Point:

Estimations of working results pre-suppose a definite level of production and sales and all calculations are based on that level. The minimum level of production and sales at which the unit will run on "no profit no loss" is known as break-even point and the first goal of any project would be to reach that level. The break-even point can be expressed in terms of volume of production or as a percentage of plant capacity utilization. Break-even in terms of volume of production = Total Fixed Cost/ Contribution per unit.

J. Debt Service Coverage Ratio (DSCR):

Debt Service Coverage Ratio is calculated to find out the capacity of the project servicing its debt i.e. in repayment of the term loan borrowings and interest. The DSCR is worked out in the following manner: D.S.C.R = (PAT + Depreciation + Interest on Long Term Borrowings) / (Repayments of Term Borrowings during the year + Interest on long-term borrowings) The higher D.S.C.R. would impart intrinsic strength to the project to repay its term borrowings and interest as per the schedule even if some of the projections are not fully realized. Normally a minimum D.S.C.R. of 2:1 is insisted upon by the term lending institutions and repayment is fixed on that basis.

K. Sensitivity Analysis:

While evaluating profitability projections, the sensitivity analysis may be carried in relation to changes in the sale price and raw material costs, i.e., sale price may reduce by 5% to 10% and raw material costs may be increased by 5% to 10% and the impact of these changes on DSCR shall be analysed. If the new DSCR, so calculated after changes, still proves that the project is viable, the financial institution may go ahead in funding the project.

L. Internal Rate of Return:

This is an indicator of earning capacity of the project and a higher IRR indicates better prospects for the project. The present investment in the cash flow which is assumed to be negative cash flow and the return (cash inflow) are assumed to be positive cash flows. Normally bankers want that internal rate of return should be at least 18% because it depicts the strength of the project and its earning and repayment capacity at the same time. Better the IRR better rating to the project.

M. Environmental, Political and Economic Viability:

The performance of the project is also influenced by the external factors also such as existing government policies regarding particular sector, easiness in getting the licence to operate in a particular region or state, effects of the project on the environment, tax exemptions for particular region etc. Hence while compiling the project report, it is important to study the industry scenario, government policies etc and these should be covered in the project report.

N. **Project Appraisal:**

Project Appraisal is a process of detailed examination of several aspects of a given project before recommending the same. The lending institution has to ensure that the investment on the proposed project will generate sufficient returns on the investments made and that loan amount disbursed for the implementation of the project will be recovered along with interest within a reasonable period of time.

The various aspects of Project appraisal are:

1. Technical Appraisal

2. Commercial Appraisal or Market Appraisal (Demand of the product, supply of the product, distribution channels, pricing of the product and government policies.

3. Economic Appraisal

4. Management Appraisal (assessing the willingness of the borrower to repay the loan)

5. Financial Appraisal Methods of the Project Financing

There are three methods in Project Financing:

1. Cost Share Financing or Low interest loan financing.

2. Debts Financing.

3. Equity Financing.

PART-B

Sources for Financing Fixed Assets

The type of funds required for acquiring fixed assets have to be of longer duration and these would normally comprise of borrowed funds and own funds. There are several types of longer-term loans and credit facilities available which a company may utilise to acquire the desired fixed assets. These are briefly explained as under.

1.Term Loan: -

(a) Rupee loan: Rupee loan is available from financial institutions and banks for setting up new projects as, well as for expansion, modernisation or rehabilitation of existing units. The rupee term loan can be utilised for incurring expenditure in rupees for purchase of land, building, plant and machinery, electric fittings, etc. The duration of such loan varies from 5 to 10 years including a moratorium of up to a period of 3 years. Projects costing up to Rs. 500 lakhs are eligible for refinance from all India financial institutions and are financed by the State level financial institutions in participation with commercial banks. Projects with a cost of over Rs. 500 lakhs are considered for financing by all India financial institutions. They entertain applications for foreign currency loan assistance for smaller amounts also irrespective of whether the machinery to be financed is being procured by way of balancing equipment, modernisation or as a composite part of a new project. For the convenience of entrepreneurs, the financial institutions have devised a standard application form. All projects whether in the nature of new, expansion, diversification, modernisation or rehabilitation with a capital cost up to 5 crores can be financed by the financial institution either on its own or in participation with State level financial institutions and banks.
(b). Foreign Currency term loan: Assistance in the nature of foreign currency loan is available for incurring foreign currency expenditure towards import of plant and machinery, for payment of remuneration and expenses in foreign currency to foreign technicians for obtaining technical know-how. Foreign currency loans are sanctioned by term lending institutions and commercial banks under the various lines of credits already procured by them from the international markets. The liability of the borrower under the foreign currency loan remains in the foreign currency in which the borrowing has been made. The currency allocation is made by the lending financial institution on the basis of the available lines of credit and the time duration within which the entire line of credit has to be, fully utilised.

2. Deferred Payment Guarantee: - (DPG)

Assistance in the nature of Deferred Payment Guarantee is available for purchase of indigenous as well as imported plant and, machinery. Under this scheme guarantee is given by concerned bank/financial institutions about repayment of the principal along with interest and deferred instalments. This is a very important type of assistance particularly useful for existing profitmaking companies who can acquire additional plant and machinery without much loss of time. Even the banks and financial institutions grant assistance under Deferred Payment Guarantee more easily than term loan as there is no immediate outflow of cash.

3. Soft Loan: –

This is available under special scheme operated through All India financial institutions. Under this scheme assistance is granted for modernisation and rehabilitation of industrial units. The loans are extended at a lower rate of interest and assistance is also provided in respect of promoters' contribution, debt equity ratio, repayment period as well as initial moratorium.

4. Supplier's line of credit: -

Under this scheme nonrevolving line of credit is extended to the seller to be utilised within a stipulated period. Assistance is provided to manufacturers for promoting sale of their industrial equipment's on deferred payment basis. While on the other hand this credit facility can be availed of by actual users for purchase of plant/equipment for replacement or modernisation schemes only.

5. Buyer's credit: -

Under a buyer's credit arrangement, a specific long-term loan is granted by a designated lending agency in the exporter's country to the buyer in the import, country against a guarantee by an acceptable bank or financial institution. The supplier receives payment for the exports on his delivering to the lending agency the requisite documents specified in the loan agreement and the relative commercial contract. The lending agency realises the payment from the buy (importer) in instalments as and when they fall due. Ordinarily, the supplier of his obligation reckons the period credit as the duration from the date of completion.

6. Debentures: -

Long - term funds can also be raised through debenture with the objective of financing new undertakings, expansion, diversification and also for augmenting the long-term resources of the company for working capital requirements. Debenture holders are long term creditors of the company. As a secured instrument, it is a promise to pay interest and repay principal at stipulated times. In the contrast to equity capital which is a variable income (dividend/ security, the debenture / notes are fixed income (interest) security).

7. Leasing: -

Leasing is a general contract between the owner and user of the assets over a specified period of time. The asset is purchased initially by the lessor (leasing company) and thereafter leased to the user (lessee company) which pays a specified rent at periodical intervals. The ownership of the asset lies with the lessor while the lessee only acquires possession and right to use the assets subject to the agreement. Thus, leasing is an alternative to the purchase of an asset out of own or borrowed funds. Moreover, lease finance can be arranged much faster as compared to term loans from financial institutions.

8. Deposits from public: -

It is a valuable source of finance particularly for well-established large companies with a huge capital base. As the amount of deposits that can he accepted by a company is restricted to 25 per cent of the paid-up share capital and free reserves, smaller companies find this source less attractive. Moreover, the period of deposits is restricted to a maximum of 3 years at a time. Consequently, this source can provide finance only for short to medium term, which could be more useful for meeting working capital requirements. In other words, public deposits as a source of finance cannot be utilised for project financing or for buying capital goods unless the payback period is very short or the company uses it as a means of bridge finance to be replaced by a regular term loan.

9. Own Funds: -

Equity: Promoters of a project have to involve themselves in the financing of the project by providing adequate equity base. From the bankers/financial institutions' point of view the level of equity proposed by the promoters is an important indicator about the seriousness and capacity of the promoters. Moreover, the amount of equity that ought to be subscribed by the promoters will also depend upon the debt: equity norms, stock exchange regulations and the level of investment, which will be adequate to ensure control of the company. The total equity amount may be either contributed by the promoters themselves or they may partly raise the equity from the public. So far as the promoter's stake in the equity is concerned, it may be raised from the directors, their relatives and friends. Equity may also be raised from associate companies in the group who have surplus funds available with them. Besides, equity participation may be obtained from State financial corporation/industrial development corporations. Another important source for equity could be the foreign collaborations. Of course, the participation of foreign collaborators will depend upon the terms of collaboration agreement and the investment would be subject to approval from Government and Reserve Bank of India. Normally, the Government has been granting approvals for equity investment by foreign collaborators as per the prevailing policy. The equity participation by foreign collaborators may be by way of direct payment in foreign currency or supply of technical know-how/ plant and machinery.

Amongst the various participants in the equity, the most important group would be the general investing public. The existence of giant corporations would impossible but for the investment by small shareholders. In fact, it would be no exaggeration to say that the real foundation of the corporate sector are the small shareholders who contribute the bulk of equity funds. The equity capital raised from the public will depend upon several factors viz. prevailing market conditions, investors' psychology, promoters track record, nature of industry, government policy, listing requirements, etc. The promoters will have to undertake an exercise to ascertain the maximum amount that may have to be raised by way of equity from the public after asking into account the investment in equity by the promoters, their associates and from various sources mentioned earlier. Besides, some equity may also be possible through private placement. Hence, only the remaining gap will have to filled by making an issue to the public.

Preference share: Though preference shares constitute an independent source of finance, unfortunately, over the years preference shares have lost the ground to equity and as a result today preference shares enjoy limited patronage. Due to fixed dividend, no voting rights except under certain circumstances and lack of participation in the profitability of the company, fewer shareholders are interested to invest moneys in preference shares. However, section of the investors who prefer low risk fixed income securities do invest in preference shares. Nevertheless, as a source of finance it is of limited import and much reliance cannot be placed on it.

Compliance with Different Laws & Regulations: In this context it would be pertinent to note that while initiating the process for making a public issue of equity /preference shares, the promoters will have to comply with the requirements of different laws and regulations including Securities Contracts (Regulation) Act, 1956, Companies Act, 2013 and SEBI guide-lines etc., and various rules, administrative guidelines, circulars, notifications and clarifications issued there under by the concerned authorities from time to time.

Retained earnings: Plough back of profits or generated surplus constitutes one of the major sources of finance. However, this source is available only to existing successful companies with good internal generation. The quantum and availability of retained earnings depends upon several factors including the market conditions, dividend distribution policy of the company, profitability, Government policy, etc. Hence, retained earnings as a source plays an important role in expansion, diversification or modernisation of an existing successful company. There are several companies who believe in financing growth through internal generation as this enables them to further consolidate their financial position. In fact, retained earnings play a much greater role in the financing of working capital requirements.

Unsecured Loans: If there is some shortfall in the mean-of-finance, the promoters/ directors can mobilize funds from their friends, relatives and well-wishers. Such loans are always unsecured i.e., the lenders cannot have any charge over the assets of the company. Banks and financial institutions stipulate the following conditions if unsecured loan is to form part of the means-of-finance. - The promoters shall not repay the unsecured loan till the term loan persists. - Interest if any payable on unsecured loan shall be paid only after meeting the term loan repayment committees. -The rate of interest payable on unsecured loan shall not be higher than the rate of interest applicable for term loans. Normally unsecured loan component is expected not to exceed 50% of the equity capital.

10.Bridge Loans: -

This is a temporary loan meant for tying up the capital cost of the project. The necessity for bridge finance arises in situations where finance from particular source is being delayed. However, the availability of finance from that source is certain.

11.Seed Capital: -

In consonance with the Government policy which encourages a new class of entrepreneurs and also intends wider dispersal of ownership and control of manufacturing units, a special scheme to supplement the resource & of an entrepreneur has been introduced by the Government. Assistance under this scheme is available in the nature of seed capital which is normally given by way of long-term interest free loan. Seed capital assistance is provided to small as well as medium scale units promoted by eligible entrepreneurs.

12.Government subsidies: -

Subsidies extended by the Central as well as State Government form a very important type of funds available to a company for implementing its project. Subsidies may be available in the nature of outright cash grant or long - term interest free loan. In fact, while finalising the mean of finance, Government subsidy forms an important source having a vital bearing on the implementation of many a project.
Conclusion The key to any project finance is to use a right mix of debt and equity. Further, there should be a right mix of foreign currency and rupee loans. It is also essential that there should be flexibility in respect of switching from foreign currency to rupee loan and vice versa. There are a number of issues highlighted herein above which need to be considered for the purpose of financing of the project. Besides, it is important that due care is taken in drafting the documents concerning the financing of the project. The companies should adopt the project financing structures so that the objective of shareholder's wealth maximization can be achieved. As the world is heading towards a global integrated market and the failure of governments as well as the demand for private capital in infrastructure assets is increasing, project finance will continue to play an important role in both developed and developing markets.

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PART-2 – FINANCIAL DUE DILIGENCE

CHAPTER- 1

Definition of Due Diligence- Word 'Diligence' denotes to carry out the work with utmost care so that the end result is comprehensive. Word 'Due' denotes detailed analysis of various factors involved in conducting the Diligence which helps in drawing the Due Diligence Report.

Definition of Financial Due Diligence- Financial due diligence is the process of systematically examining the details and history of a business to confirm the value of the business. Financial due diligence focuses on the quality of earnings and future performance in addition to accounting processes and controls, making it different than an audit or review.

Why is it important to conduct Financial Due Diligence?
Business is fraught with various risks.

Risks possibility increases while establishing new ventures. Some of the potent risks are-

1 Promoters background including their experience in running ventures

2 Risk posed by factors like-

A Environmental

B Political

C Economic

D Government Policies

E Locational

F Competition

E Availability of men & materials

F Market Size

All these factors need to be thoroughly evaluated before deciding to lend or invest in a venture.

What is Due Diligence in Project Funding?

Due Diligence in Project Finance involves thoroughly reviewing all proposals involved in a deal.

In the Project Finance business, deal origination happens through the direct relationship that relationship managers across different sectors enjoy in the industry. Proposals are presented in the form of appraisal notes put up to either the credit committee or a committee of senior management, whichever is the appropriate sanctioning authority. Due diligence in project finance involves thoroughly reviewing all proposals involved in a deal.

An appraisal note ideally contains a write up on the company background, its management and shareholding pattern, its physical and financial performance, purpose of the project being funded, details of costs involved and means of financing, the market for company's products, future prospects and profitability projections, risk analysis, and the terms and conditions of sanction.

CHAPTER-2

How is Due Diligence in Project Finance carried out?

Due diligence in project finance is a process that consists of multiple steps to ensure the most comprehensive analysis:

1. Assessment of promoter history and background
2. Evaluation of the company and project business model
3. Legal due diligence
4. Analysis of financial statements and capital structure
5. Determine major risks associated with the project
6. Analysis of tax effects
7. Credit analysis and evaluation of loan terms
8. Project valuation

Due Diligence in Project Finance – Key Processes

While there are multiple steps when conducting due diligence in project finance, there are four key processes that require significant evaluation.

Assessment of Promoter History and Background

An assessment of the promoters' history is conducted to ensure the commitment of promoters to the project. The main motive is to identify the background and track record of the promoters sponsoring the project. The following terms are assessed:

- **Assessment of group companies** –
- Involves in-depth study of various companies promoted by the sponsor. Assessment of group companies is necessary even in cases where no direct support from companies to the project company exist. In case the group is facing a severe financial crunch, the possibility of diversion of funds from the project company cannot be ruled out. In such circumstances, the lenders need to take adequate steps to ring-fence the project revenues.
- **Track record of sponsors** – In case of any subsisting relationship with the sponsor, the track record of the sponsors should be studied in light of its relationship. The lender should identify any incidences of default and analyse the causes for the same.

- **Management profile of sponsor companies** – Helps in assessing the quality of management. Lenders are typically more comfortable taking exposure with professionally managed companies.
- **Study of shareholders agreement** – Study of the shareholders agreement should be done in order to get clarity on issues such as voting rights of shareholders, representation on the board of directors, veto rights (if any) of shareholders, clauses for protection of minority interest, procedure for issuing shares of the company to the public and the method of resolution of shareholders disputes.
- **Management structure of project company** – Study of shareholders agreement helps in determining the management structure of a project.

Evaluation of the Company and Project Business Model

An extensive evaluation of the business model assists the lenders in assessing the financial viability of the project. Typically, a business model is developed in consultation with financial and technical consultants. The lenders need to undertake the following steps while accessing a business model:

- **Understanding the assumptions** – Major assumptions are involved regarding revenues, operating expenses, capital expenditures, and other general assumptions like working capital and foreign exchange
- **Assessment of assumptions** – Involves evaluating the various assumptions and benchmarking the same with respect to industry estimates and various studies. Sometimes the lenders appoint an independent business advisor to validate the assumptions made in the business model.
- **Analysis of project cost** – One of the most important stages in due diligence, as a substantial amount of capital expenditure is to be incurred. The project cost is benchmarked to other similar projects implemented in the industry. Also, there needs to be the assurance that appropriate contingency measures and foreign exchange fluctuation measures have been incorporated into the estimated project cost.
- **Sensitivity analysis** – A business model involves many estimates and assumptions. Some of these assumptions do not materialize in view of changing business scenarios. Hence, it is important to sensitize the business model to certain key parameters. The lenders need to assess the financial viability of the project in light of sensitivity analysis coupled with ratio analysis.
- **Benchmarking with the industry** – An analysis of the key ratios in light of available industry benchmarks is useful in an overall assessment of the business plan.

Legal Due Diligence

Legal due diligence is usually conducted using an independent legal counsel appointed by the lenders. Legal due diligence consists of a few steps:

- Determining the rights and liabilities of the different participants within the project scope
- Analysing the schedule and implementation plan of the project
- Evaluating the appropriateness of liquidated damages if the project fails to deliver as promised

Analysis of Financial Statements and Structure

The following aspects need to be considered when assessing the financial structure and statements:

- **Debt to equity ratio** – A good project would ideally have a low debt-equity ratio which helps in reducing the cost of the debt, thereby increasing the net cash accruals. Higher net cash accruals enable the company to build up sufficient cash reserves for principal repayment and provide a cushion to the lenders.
- **Principal repayment schedule** – The lender endeavours to match the principal repayment schedule with the cash flow projections while leaving sufficient cushion in the cash flow projections. One way of safeguarding lenders' interests is to negotiate the creation of a sinking fund for this purpose
- **Sinking fund build-up** – Build-up of a sinking fund or Debt Service Reserve Account is usually established in order to safeguard the lenders' interests. Such a fund entails deposit of a certain amount in a designated reserve account which is used towards debt servicing in the event of a shortfall in any year/quarter of the debt repayment period.
- **Trust and retention mechanism** – In projects, a trust and retention mechanism is often incorporated in order to safeguard the lenders' interest. The mechanism entails all revenues from the company to be routed to a designated account. The proceeds thus credited to the account are utilized towards payment of various dues in a predefined order of priority. Generally, the following waterfall of payments is established: statutory payments including tax payments, operating expenditure payments, capital expenditure payments, debt servicing, dividends, and other restricted payments.

CHAPTER-3

The above is a brief summarization of steps to be followed while carrying out Financial Due Diligence. In fact, lenders/ investors look for more details and accordingly structure the exercise. In the following pages we will look at the detailed method of conducting a due diligence before decision is taken to lend/ invest in a Project.

GENERAL INFORMATION

- Full Registered name of the Company and each subsidiary and joint ventures if any.
- Type of Company- Large/ MSME
- Date of Incorporation including of subsidiaries
- Brief description of the history of the Company including of subsidiaries for change in name, registered office or authorised business.
- Briefly describe proposed business of the Company and that of subsidiaries.
- Please provide complete address of the Company and of subsidiaries including overseas offices if any.
- Bio Data of the Promoter
- Implementation Schedule
- Please provide details (with a description of the nature and size of such interest) of any interest (including any partnerships, collaborations, business affiliates, associations of persons, sole proprietorships, joint ventures or other entities or interest groupings) held in any enterprise by any of the following:

  i) any Promoter of the Company; or
  ii) any company in a group of companies of which any Promoter is part of the Group") or
  iii) any individuals having a controlling interest in the Company or its subsidiary or in the Group.

- Companies under the same management, if any.

MANAGEMENT

- Names of the Members of Board of Directors and a brief summary of their experience and details of Directorships held.
- Name of key managerial personnel including Secretary

SHARE CAPITAL

- Details of Authorised/ paid up/ nominal value of each share capital
- Details of promoters holding.
- Details of share capital remaining to be paid up.

SECRETARIAL & REGULATORY

- Copies of Memorandum & Articles of Association of the Company (including any amendments carried out with copies of resolution required by law to amend the clauses).

- Check Object Clause/ Capital Clause/ Situation of Registered Office/ Provisions of Articles of Association. Cross check with MCA website.
- Certificate of Incorporation of the Company.
- Certificate of Commencement of business.
- Certificate from the Company that proposed business to be carried out is in accordance with the provisions of MOA.
- Brief description of the land parcels proposed to be used by the Company for establishing the Project including a brief description of whether the land is free or leasehold. If freehold supporting documents in evidence of the same. If leasehold – copies of leasehold agreements with amount of lease rent payable as well increase if any year on year/ deposits etc including details of lessors, copies of encumbrance certificates, latest tax paid receipts etc. Also check whether the property is free from encumbrances.
- In most of the cases, allotment of land is done by the concerned Industrial Area Development Board of the respective states. Check all related documents including lease deed executed/ period of lease/ whether option to buy at a later date is available.
- List of Statutory Registers including Board Meeting Minutes, any other register etc.
- Copies of all important Resolutions passed by the Board.
- Copies of documents filed with the Registrar of Companies including agreements filed, if any.
- Full list of all consents, permits, licences and authorisations that are required by the Company in relation to the business and permissions or approvals obtained in respect of any equity shareholding in the Company including under the provisions of Foreign Exchange Laws, together with full copies of, all licences, permits or other authorisations issued to the Company in relation to the Business/ Shareholding by any Government Agency and any related agreements or correspondence thereto.
- Copies of all regulatory consents relating to the business relating to the Project without limitation all licences, consents and permissions required under applicable statutes, and as required under the planning stage.
- List of Vendor agreements entered into by the Company in relation to the business including agreements with Architects, surveyors and contractors in respect of construction
- A list of all performance bonds, guarantees or similar security arrangements entered into by or on behalf of the Company in connection with any of the consents, permits, licences or authorisations in relation to the business.
- Copies of any agreement or arrangement with any Company (whether intended to be legally enforceable or not) relating to the prices or conditions for the sale of products or provision of any services, or for the purchase of any supplies (for example, cartels)
- Copies of any undertakings or orders made to competition authorities nationally.
- Compliance with the following laws-
    - Environment (Protection) Act, 1986
    - Water (Prevention and Control of Pollution Act), 1981
    - Air (Prevention and Control of Pollution) Act, 1981
- Copies of documentation and correspondence relating to any Governmental or Regional incentives, subsidies or grants made available in relation to the Company.

- Copies of all hire purchase or instalment purchase agreements, finance leases, letters of credit, performance and other bonds and similar documents involving or relating to the Company.
- Copies of licences required to occupy property including copies of all concerned documents.
- In case of all immovable properties like land, all Governmental and other approvals relating to the use of land (for example – conversion of land user from agricultural to non- agricultural, if applicable, sanction of building plans etc.)
- List of Plant & Machinery required.
- List of all other assets like Furniture & Fixtures, Computers, Vehicles, Office Equipment including documents for these assets.
- Copies of all conditional sale agreements, financing leases and lease-back agreements.

BUSINESS AND OPERATIONAL

- Critical technologies or know how, formulation to be used by the company or under development for the purpose of business including-
  - Software
  - Hardware
  - Process
  - Any technologies that are under development
- Confirm whether the use of any particular technologies by the Company has limited the future direction of the business.
- Verify copies of agreements or, if no agreement exists, arrangements that the company has entered into with suppliers of equipment, raw material, knowhow and/ or infrastructure that includes any exclusivity arrangements.
- Details of the source of rights of the Company to use each of the technologies. Check whether it was purchased, leased, licenced, developed internally or developed externally and assigned or licenced to the company.
- For purchased technology- relevant purchase agreements
- For leased technology- relevant lease agreements
- For licenced technology (usually software) -relevant licence agreements.
- Verify copies of-
-
  - For technology developed externally or internally – relevant development agreement.
  - Technical service agreements
    - Agreements/Memorandum of understanding, letters of intent or otherwise for manufacture, supply, purchase or lease of any critical equipment, raw material or knowhow including technical consultancy agreement.
    - Agreements with any collaborators, technical or otherwise
    - Any marketing agreements post production.

CONTRACTS

- Copies of all service, supply, installation, turnkey contracts, licence, distribution, franchise, agency, research and development, marketing, consulting and management contracts granted to or entered into by the Company.
- Copies of all agreements of the Company and related parties with Governments and Government agencies, in relation to the business-
  - Local Authorities
  - Special arrangement for any facility for the business.

INTELLECTUAL PROPERTY

- Schedule of all patents, trademarks, service marks, trade names, copyrights, knowhow and registered designs owned by or licenced to or by or used by the Company and copies of all relevant registrations (including patents granted), applications, consents, licences and sub licences.

BACK GROUND AND BUSINESS DESCRIPTION-

What does a lender/ investor see?

- Promoters- Sound experience with proven capabilities to expand and innovate.
- Existing Status of Business- Idea of Project Team should be clear about where they are and what they want to achieve.
- Management- Strong, experienced team with qualified personnel
- Infrastructure facilities- Quality (Latest?) and useful life of PPE.
- Clientele- Clients with visibility (depict quality), Government contracts (ensure revenues & clean status) preferred.
- Strategic Tie-ups- Technical & or Financial
- What is the vision of the entrepreneur? – What will he do and for how long.
- Where is the value being added- USP? – Is it location, target customer base, price strategy or something else.
- How the Competition is being evaluated- Direct & Indirect

PROJECT FINANCIALS-

Project Costs to include-

- Cost of land & Land Development
- Cost of Building & Structures
- Cost of Plant & Machinery
- Permanent Working Capital
- Preliminary expenses- legal, travelling & brokerage.
- Funding- Matching Cashflow principles- Timings of inflows & Outflows to coincide.
- Lease model or Capex Model
- Remember to maintain balance
- A well-prepared FINANCIAL MODEL brings more clarity and is preferred by lenders/ investors.
- Some numbers Lenders/ Investors are interested in-
- Project cost
- Break-even point/ time
- DSCR

- Cash flow analysis
- NPV/ IRR/ Profitability Index
- ROE
- Debt Equity Ratio

Besides this, the potential lender/ investor looks for-

- Clear & Complete understanding of Project.
- Reliable Sources of information.
- Precise but presentable data
- Command over numbers
- Credible client & Credible investor
- Confidentiality
- Detailed Project Financials including profitability assumptions, projected cashflow statements, projected balance sheet, break even analysis, working capital computation, Debt Service Coverage Ratio and Internal Rate of Return calculations to be prepared for 7 years. Projected financials must contain detailed workings and assumptions, repayment & interest schedule etc. Indicate the critical assumptions and give meaningful comments on projected capacity utilization, selling prices assumed for finished products/ raw materials cost, gross profit percentage compared to industry average, indicate the critical factors on which viability depends including steps to mitigate potential risks.

PROJECT REVENUES-

- Find innovative means
- Better be realistic- Market knows everything

Given the present advancement in industry and business with global players vying for a pie of the market in India, Indian Companies and Promoters are equally interested to launch ventures and are not afraid to take calculated risks and take the business to the next level. Conducive Government Policies are driving the momentum. The current global scenario of economic meltdown brought about by the Pandemic and war in Ukraine are short lived.

The flip side is, past experience of lending agencies and investors. Large corporations could not convert the business into successful ventures and enormous amount of bank money turned bad forcing the lenders to turn cautious while choosing a project to lend. Strict mechanisms have been put in place to determine the viability of a project before decision to lend/ invest is taken. On its part, RBI continuously monitors the situation and brings in regulatory mechanism and checks and balances. Thus, going forward, Financial Due Diligence will cover all aspects of a business apart from financials. It is therefore, necessary to ensure that the indenting promoters take care to ensure that the proposed project meets all criteria and demonstrates clearly the intention to implement the project in accordance with sound business principles.

Given the complexity of the task of meeting all obligations, a dedicated project team with fully committed stakeholders is the need of the hour. Finance Professionals have a huge role to play and Companies must leverage their strength.

PART-3- CASE STUDIES

CASE STUDY-1

PROJECT FOR MANUFACTURING TWO-WHEELER

ABC Automotive Limited was incorporated as a Limited Company under the Indian Companies Act, 1956 for manufacture of 100 cc two wheelers in technical collaboration with Peugeot-France, maker of two wheelers and cars in Europe in the 80's. Under the terms of the Technical Collaboration Agreement, M/s. Peugeot agreed to provide-

1.Full technical support in establishing the factory for producing the two-wheeler.

2. Provision of technical drawings related to plant lay out, machinery, production process, stores, factory building, finished goods store, admin block etc.

3. Assistance in construction of facilities.

4. Full drawings of the two-wheeler to be manufactured.

5. Training of personnel in Peugeot facility in production process and related technical aspects.

6. Vehicles to be manufactured in India will be assembled with the vehicle being imported in Semi knocked down condition since availability of technology to manufacture the product having the same features is not locally available.

7. Peugeot will, as part of the agreement, help in localization of materials and components in such a way that, localization to the extent of 70% will be achieved in 5 years' time. Rest of the Components like self-starter kit, critical engine parts will continue to be imported from Peugeot. Agreement also provided for adequate supply of spares and establishment of service centres including training of service personnel at dealer point.

8. The Agreement did not provide for help in marketing of the final product since the product was basically manufactured for catering to local market.

9. For providing the above services, ABC Automotive Limited will pay Technical Service Fee @ 3% to Peugeot subject to provisions of Income Tax Act and Foreign Exchange Regulations Act. (FERA). In addition, ABC Automotive Limited will pay Royalty to Peugeot Royalty at 3 % on each vehicle produced and sold.

10. Peugeot did not have any equity stake in the Project.

Based on the discussions held between both the parties, technical collaboration agreement was signed. Necessary approvals were obtained from the authorities for establishing the unit.

Swot analysis revealed the following-

Strength-

- Product with Electric Starter first of its kind to be produced and marketed in India.
- Technically advanced product.
- Proven mileage of 74kms to a litre of fuel.
- Gradient climbing capability.
- Produced in collaboration with leading two-wheeler manufacturer – Peugeot of France by established industrial group.

Weakness-

- Technology yet to be proved.
- Marketability of the product due to pricing is an issue
- Customer perception and acceptability.
- Non availability of locally manufactured raw materials and components.
- Promoters did not have prior experience of running automotive industry.

Establishment of the unit commenced as per plan and the entire project was to be completed and commissioned in a span of 15 months. Other features of the Project were-

- Land area- 100 acres allotted by the Karnataka Industrial Area Development Board in upcoming Industrial Area on the outskirts of Bangalore at a distance of 50 kms from Bangalore City on outright sale basis at highly subsidised rates.
- Establishing the Unit in the upcoming industrial belt meant waiver of VAT for a period of 5 years with the amount of VAT converted to interest Free loan repayable seven years after establishment of the Unit over a period of 5 years in equal instalments.
- Project Cost – Rs. 60 cr at the then prevailing scenario.

The following is the detailed break up of Project Cost.

Sl. No	Details	Amount (Rs. In cr)
1.	Land- Freehold	2.50
2.	Land Development	0.50
3.	Buildings including factory & admin	5.00
4.	Plant & Machinery (Imported)	15.00
5.	Plant & Machinery (Indigenous)	5.00
6.	Miscellaneous Fixed Assets Including Lab Equipment, Quality Control, Testing track, Furniture, Interiors, Systems, IT etc.	13.00

7.	Roads, Canteen, Dispatch Yard, Godown etc.	9.50
8.	Professional Fee including Architect Fee	1.00
9.	Preliminary & Pre- operative expenses including project team salaries and related expenses	5.00
10.	Margin Money for working capital -25%	0.50
11.	Contingency- 5%	3.00
	TOTAL	60.00

Sl. No	Sources	Amount – Rs. (In cr)
1.	Margin Money from Promoters in the form of Equity -	15.00
2.	Term Loan	40.00
3.	Working Capital Facility from Banks	2.00
4.	Public Issue of Equity Shares	3.00
	TOTAL	60.00

Following details are available-

- Installed Capacity of the plant was 25000 units per year with capability to double the same without additional investment.
- Consortium of three All India Financial Institutions agreed to lend Term Loan Facilities subject to conditions being met.
- Consortium of two Banks agreed to extend working Capital Facility plus non fund facilities in the form Letter of Credit Facility and Bank Guarantees.
- The implementation of the project got delayed due to various factors like non availability of timely term loan from financial institutions, Inadequate experience of the project team who were new to the concept since they did not possess experience of executing a Project even though they were from Automobile Industry.
- Funding from the promoters also took time which delayed disbursement of term
- Inadequate supervision.
- Delay in release of funded and non-funded facility by the banks which in turn delayed the import of needed materials.
- Fortunately, there was no cost overrun even though there was time overrun.
- Once production commenced and the product roll out took place, the initial demand witnessed through advance booking began to dip and cancellation was huge. This despite the product being futuristic. In order to capture the market, the product was priced at Rs. 15, 000/-. Service became an issue since the service personnel were not equipped to deal with technical issues arising from the product. Availability of spares was also a problem. This meant vehicles stranded for want of repairs which also resulted in cancellation.

- This meant severe strain on cash flow since sales were not taking place. The Company was saddled with built up inventory of raw materials and components imported at high cost.
- Company defaulted on term loan and Letter of Credit commitment. Anticipating the demand and lead time required to import materials, Company had ordered stocks and spares for six months.
- Ultimately, after producing 10,000 units, operations ground to a halt and rom Dues of vendors and employees could not be settled and Company was declared a sick unit.

Based on the above information, do an analysis of what went wrong with the Project despite the product being novel with features not heard of in India. Give reasons for your analysis.

From the information given, it is clear that the Project was destined to be a failure from the stage it was conceived. A variety of reasons could be attributed to this-

I. Not much thought and analysis seem to have been given by the promoters while conceiving it. Success of the product elsewhere does not mean that the same will be replicated in India. Indian market is price sensitive and added to this, affordability is a huge factor. The income levels and aspirations of the people were different. They were looking for a low-priced vehicle capable of meeting their daily requirements. Cost of fuel was not a determining factor since petrol prices were low. Locally available vehicles were giving decent mileage and were value for money.

II. Under such circumstances, trying to sell a product, considered to be futuristic and ahead of its times was always going to be difficult.

III. The promoters were well aware that they need to practically import everything from raw materials to components from the parent company at a high cost except the tyres and seats since these cannot be imported. Thus, the beginning itself was flawed.

III. The promoters did not have any previous experience of running an automobile venture and relied on their business knowledge of running other industries. This was a grave mistake since each business has its own challenges and unless one is thorough, they should not venture into unknown territory. The same is true even today and many Companies stick to their core strengths.

IV. Proper due diligence has not been conducted relating to the business-like availability of local materials at reasonable cost, scope for indigenisation, Market survey, availability of senior personnel who has prior knowledge of the product to name a few. Best thing would have been to develop a prototype of the product, do analysis of cost involved in production, test marketing. All this seems to have been given a go by in the enthusiasm of promoters to launch something new without knowing where they are headed for.

V. Inability to put in place a strong Project team consisting of top-notch professionals well versed in project execution who would have ensured that all angles are analysed and appropriate steps taken to remedy the situation. Instead, a loose knit team having no idea of what the product is and no previous experience of executing project was put in place who ended up experimenting at the cost of the Company.

VI. For all its standing in European Market, Peugeot is essentially a car maker and motor cycle manufacturer. They did not have the experience of making a two-wheeler with the capacity of 100 cc before and their attempt to produce and market the product in their country had failed. This aspect seems to have been lost on the promoters. Proper due diligence on this aspect would have alerted the risk to be taken,

VII. Cost of importing raw materials and components should have been considered since it was always going to be high.

VIII. Analysis of cost of production revealed that it is way above what was estimated at the project stage and for each bike produced and sold even cost of raw material was not being recovered. This meant producing bike was always a loss-making proposition. This clearly meant that assumptions made at the project stage were totally way off the mark.

IX. To sum it up, right from the beginning, the project was bound to be a failure, since proper evaluation was not done about the potential risks involved in producing a product which solely depended on imported materials for production at a high cost, overheads, price sensitivity, poor after sales service, in ability to put in place a strong project team, Inadequate due diligence, wrong strategy etc. Mere feature of the product alone does not guarantee success. All factors must combine coupled with proper management. Perhaps, the venture would have been a great success in today's scenario given the perception of people, affordability, fuel efficiency to name a few.

X. This shows how important it is to conceive a project, go through the cycle, analyse all angles, conduct proper due diligence, tie up all resources, estimate correctly before starting a project.

CASE STUDY-2

World Wide Ceramics Limited was formed as a Public Limited Company in early 90's by one of the leading conglomerates of the Country to manufacture Bone China Table ware in collaboration with a leading table ware manufacturer globally known for its high-end brand. The salient features of the project were-

- The promoter of the Company was one of the Companies in the group.
- The promoter Company will hold 76% Equity and the foreign collaborator 24%.

- The Collaboration included provision of technology, drawings, design, erection and commissioning of the plant, providing training to employees on production of high-quality table ware at its facility as well as initial help in marketing the product globally.
- Based on the broad understanding arrived at, collaboration agreement was signed between both the parties.
- Collaboration agreement, among other things provided for-
- Contribution to the equity portion by both the parties in equal tranches such that the entire equity is brought in by the time the project is completed.
- Collaborator will assist in identifying critical machinery required for the project along with equipment like testing, quality lab etc. and render help in procuring the items in a time bound manner.
- Promoter Company will pay technical know-how fee based on milestones achieved.
- Promoter Company will also pay consultancy and design charges for design and assistance in building the plant and erection of machinery.
- Collaborator will place experts and engineers well versed in the industry in factory location. Promoter Company will take care of entire boarding and lodging expenses of the personnel deputed.
- Collaborator to depute its top managerial personnel to oversee production, quality control, and help in developing the expertise of the local personnel.
- The unit was established in Export Processing Zone as 100% Export Oriented Unit and was first of its kind to manufacture high quality table ware matching the standards of Royal Doulton, Wedgewood, Noritake etc. world-renowned name in high premium ceramic table ware.
- According to the prevailing policy applicable to 100% Export Oriented Units, all imports were duty free. Further, units were allowed to sell the finished goods to the extent of 25% in domestic market.
- Promoter Company executed necessary agreement with the Export Processing Zone Authorities post which space was allotted for building the factory and necessary infrastructure.
- The zone had created dedicated zone for export processing unit with all facilities.
- Access to the port was easy since it was located in close proximity.
- Separate Commissioner with dedicated Commissionerate was also established within the vicinity of the zone to ensure speedy clearance.
- The project was to be established with a mix of equity and term loan.
- Commonwealth Development Corporation (CDC) agreed to part fund the project since the collaboration was with UK based Company. The rate of interest was linked to Libor and was low. CDC had an option to exercise the put option where by the loan could be converted to equity.

- The project was to be completed in 15 months with commercial production commencing immediately thereafter.
- The factory will have installed capacity to produce 1 million pieces of table ware ranging from dinner sets, tea sets, ceramic mugs, small kitchen dispensers like salt and pepper. Production to be stepped up in phases and it was estimated that full installed capacity will be utilized in 5 years' time with scope for further expansion.
- Project team drawn from inhouse plus recruited locally was put in place to oversee the execution along with help from overseas consultants.
- Simultaneously, action was initiated to obtain necessary clearances for import of machinery and equipment, other clearances as required from authorities which were easy to come by.
- The Company also entered into marketing agreement with one of the group entities who had dedicated export division for marketing the range of products produced by the group for export purposes.
- Main raw material for production of ceramic table ware is China Clay, Bone, decals, fine powdered gold etc. which needs to be tied up. Plant was to be operated through Gas for burning and moulding the clay since it is cheaper and fuel efficient. Requirement of China Clay was 50 tonnes per month to begin with, Gas-250 tonnes per month, powdered bone 5 tonnes per month, these being major items.
- The detailed project cost was estimated at 30 crores as follows-

Sl.No.	Details	Amount Rs. In cr
1.	Factory Building *	10.00
2.	Plant & Machinery – Imported	5.00
3.	Plant & Machinery- Indigenous	5.00
4.	Lab & Quality Control Equipment	2.00
5.	Admin Block	1.50
6.	Godown & Dispatch & Receiving area	1.00
7.	Miscellaneous Fixed Assets	2.50
8.	Margin money for working capital	0.50
9.	Contingency	2.50
10.	Total	30.00

SL. NO.	SOURCES	AMOUNT- Rs. In crores
1	Term Loan	20.00
2	Equity	10.00
	Total	30.00

*Cost of factory building was on the higher side, since specially designed roof and flooring and atmosphere were required to ensure total cleanliness akin to pharmaceutical industry.

- The project execution got delayed due to variety of reasons like delay in provision of necessary technical drawings, deputation of personnel, appointment of architects and building contractor etc.
- The Project team had to be reconstituted midway since the initial team recruited did not continue mainly due to the fact that they were required to relocate to the project site and were from outside state. This caused delay since fresh team had to be put in place from local sources and did not possess enough experience in executing project of this type.
- Delays were caused in infusion of equity both from the parent company as well as from collaborator side. Delay in availability of funds meant delay in receipt of important machinery and equipment needed to execute the project.
- It may be noted that the proposed unit was located in a different state with the headquarters of the Group in another state. This resulted in improper coordination causing further delay.
- Sanction of funded facility by the institutions and banks was delayed since the project was first of its kind being established in the country and they did not have the back-up data readily available with them to evaluate the project. The credibility of the promoter and standing in the market did help to some extent.
- The Collaborator delayed providing assistance at every stage including infusion of funds committed from their side.
- Net result – Time delay and cost overrun. Meanwhile, Promoter Company was changed in between since the original promoter dropped out due to internal reasons. This meant delay in funding from promoter side plus revamp of the Board.
- Finally, once the project was commissioned, other problems cropped up.
- It came to light that the personnel who represented the collaborator were in fact consultants who used to work for the them at one stage and had no authority to represent them. Nor did they have access to any data. This was a huge blow.
- The promoter company did not put in place a proper project management team.
- Availability of main raw material viz. clay became an issue. Initially, in order to ensure quality of products, it was decided to import clay. Delays caused on account of this meant delay in commissioning the plant.
- Local sources of clay were to be tied up. Availability of good quality clay became an issue. Quantity locally available was not enough and hence had to be sourced from other areas at higher areas.
- Availability of good quality crushed bones was another issue since the major source was located in Hapur- Uttar Pradesh and availability was limited and quality erratic since it was largely produced by un-organised units.

- The promised training of technical personnel did not happen despite repeated requests from the promoter company to the collaborator.
- Personnel recruited for manning critical areas of operation were not from the industry. They had limited knowledge of table ware and had worked in sanitary ware companies which is a different area. This hampered the process and quality to a great extent as the personnel adopted trial & error method to perfect the process with the help of the main overseas person.
- The group Company with whom marketing arrangement was made, had never exported bone China table ware products and hence were handicapped. They had to study the market from scratch and establish customer relationship, convince about the capability and quality of products before orders could be procured.
- The collaborator company reneged on their agreement to help market the product initially sighting some reason or the other and insisted that only a particular design could be sold. This was a ploy to delay the process.
- Meanwhile, production had commenced and a reasonable quality was established. Without market for products, inventory build up happened affecting cash flow. Problem was compounded by the collaborator not bringing in the full portion of equity which in turn affected the remaining portion of Term Loan not released by institutions. Promoter Company had to bridge the gap. Added to this the sanction of working capital facility was delayed. All this combined to put severe pressure on operations for a fledgling company. Thus, permission had to be obtained to sell the output in domestic market which normally, is done at later stages after reasonable exports are done and foreign exchange earned.
- In the meanwhile, coinciding with the annual beer festival in Germany, export order for one million mugs were secured through the sustained efforts of the in-house export house with deadline set for delivery to be done to meet the demand in time for the beer festival. The design was given by the overseas customer which required golden rims to be set on the edge of the mug with appropriate decals. The order was executed with great zeal. It was found upon the consignments arrival that the decals were stuck in reverse direction! Poor inspection at production and dispatch stage marred the reputation of the company. The customer slapped claim for damages to the tune of 1 million dollars and permanently black listed the company.
- The woes were thus compounded.

Based on the above facts, you are required to analyse the possible causes for the problems the Company faced both from implementation & execution angle as well as due diligence angle and suggest measures to prevent such lapses.

Careful analysis of the problems faced by the Company brings out severe deficiencies right from the conceiving stage of the project which spilled over during operations as well resulting in threatening the survival of the Company itself.

This can be explained as follows-

- Project execution requires great deal of ground work to be done. The fact that, the project was promoted by a leading industrial conglomerate does not mean that the project will succeed. All parameters need to be carefully weighed and strategy planned for proper execution at every stage. It is evident there were shortcomings at each stage which compounded the problem.
- It is not clear whether SWOT analysis was done before embarking on the venture. This would have revealed the relative advantages/ disadvantages before decision was taken to go ahead. But the fact that the project was conceived by a large industrial house, gives credence to believe that SWOT analysis would have been done. How effective the analysis was, is a question to be debated upon.
- Lack of proper due diligence from all angles also could have contributed to the problem.
- Bone China Ceramic Table ware industry is dominated by a handful of players even today who between themselves have close to 75% of market share. Products are of premium quality and command huge value and pride.
- To compete and penetrate in such a market requires high calibre team, infrastructure and sustained efforts to succeed and gain traction and market share. This aspect seems to have been lost on the Company.
- The five phases of project have not been followed properly viz. initiation, planning, execution, monitoring and closure.
- A Project to succeed, needs coordination, team which has prior experience of executing projects and has knowledge of regulatory requirements to be taken care of. Besides this time bound execution of the project including tying up all resources required for commencement and marketing of finished product is vital. These aspects have not been taken care of which led to the problem.
- POSSIBLE CAUSES-

  i. The fact that the group ventured into promoting the project without having prior experience of handling such a venture required more deeper analysis including credibility of the collaborator and background of the people representing them. It is evident that proper study of these aspects was not done.

  ii. Conduct of due diligence covering all areas like-

- Technical
- Legal
- Financial

Is very crucial to ensure success of a project. The fact that these areas did not get the attention it deserved is testimony to the outcome.

iii. Putting together a strong project team well versed in timely project execution, having sufficient knowledge of techno commercial aspects, Liasson with concerned local authorities to obtain timely clearances, an eye for utilising the scarce resources mainly finance , monitoring, putting together a well acquainted man power at all levels, training of man power to be ready for operations when plant is commissioned, tying up in advance for raw materials for timely delivery, logistics etc. are non-negotiable. It is evident that not much attention was paid to these aspects and a loose knit team was put in place.

iv. The biggest mistake made was not having prior knowledge of collaborators background and their ability to deliver. When alarm bells started ringing in the form of delay in bringing in their portion of equity, procurement of machinery, reneging on commitment to train man power and marketing, action must have been taken to initiate action to limit the damage done. For a group of the size promoting the company, this is rather hard to digest.

v. The result of not imparting training to key personnel on aspects related to production, quality control, flow to name a few led to disastrous consequence in the form of trial and error, no focus on quality of all items including finished products resulting in consignments getting rejected.

vi. Appointing in house export house to do marketing who had no prior knowledge of the either the product or market was another costly mistake. At least infrastructure in the form of recruiting man power who knew the market, would have helped to some extent.

vii. It is evident that the Agreement executed with the collaborators had lot of loose ends since no action could be initiated despite their background of concealing the facts. They did not have resources to execute the project, no access to manufacturing facility and access to funds. It came to light that they had brought in their equity by convincing investors on the strength of the conglomerate's back ground at a premium when one of the investors blew the whistle. But it was too late by then and damage was done.

viii. To conclude, unless all elements act in unison and proper and thorough study is conducted including due diligence on all aspects, constitute a strong and committed project team consisting of experts from all domain, have a strategic plan in place to seamlessly commence operations, constant monitoring with scope for course correction, no project can succeed. This is a classic case which goes to prove that even the mighty can fail.

CASE STUDY-3

Diamond Hotels & Enterprises Pvt. Ltd. decided to set up a 5* hotel in Central Business District of Bangalore. The promoters of the project were already running a 4* hotel nearby. The hotel had good patronage and occupancy was good due to its proximity to main business district and cricket stadium. Food was one of the high marks of the hotel and combined with these factors, business was good with room occupancy levels touching 70 to 80% on most of the days with some days seeing 100% occupancy. Banqueting & Outdoor catering was also doing good business.

Enthused by the business generated by the 4* hotel the promoters decided to set up the 5* hotel nearby. The area did not have good business class hotel and it made sense to tap the opportunity presented.

Salient features of the proposed 5* hotel project were-

1. The hotel will have 325 rooms spread over 8 floors with all amenities needed for 5* property with an entire floor declared as Non-Smoking area.

2. Categories of rooms to include- Standard/ Executive/ Suites with up graded amenities as per category. All suite rooms will have private drawing and dining rooms/ state of the art amenities including a Jacuzzi and will be located on the top floor.

3. The hotel will have 24 /7 Coffee Shop, Speciality Indian Restaurant, Discotheque with specialized dancing floor, Pan Asian Restaurant and three large banqueting halls including Ball Room capable of accommodating 1000 people at a time. All the outlets will dispense both hard and soft beverages.

4. Lobby Lounge with meeting area and small outlet selling coffee/ snacks/ beverages both soft and hard.

5. Apart from this, the hotel will have a business centre, car rental services, health club, shopping arcade etc.

6. The project will be funded by a mix of equity and term loan. Land will be on lease basis from Trust Board with initial lease for ten years, renewable through mutual consent.

7. There will be commercial block at the back end of the hotel with same 8 floors which will be let out to offices.

8. Plan is to construct the hotel block first followed by commercial block a little later.

9. The entire project is to be completed within a period of 15 months.

10. A project team headed by a hotel industry veteran was put in place to oversee the execution of the project.

11. The total project cost was estimated at Rs. 120 crores as follows-

Sl No.	Particulars	Amount Rs. In Crores
1	Building including Lobby, Rooms, Restaurants, Banquet halls, basement area, kitchen, receiving	38.00

	area, stores, engineering office, housekeeping, back office etc.	
2	Equipment including kitchen equipment, cold storage etc.	15.00
3	Rooms warm shell, restaurants, banqueting including fittings and furniture, Gym, Health club	30.00
4	Electrical Equipment including high speed elevators for guest use, Service Lifts etc.	20.00
5	Generator -800 KVA	5.00
6	Miscellaneous fixed assets, linen, crockery & cutlery, Kitchen cooking equipment, vessels Fire Fighting Equipment, Security Systems, Land Scaping etc.	5.00
7	Contingency – 5%	6.00
8	Margin money for working Capital	1.00
	TOTAL	120.00
	MEANS OF FINANCE	
1	Equity	40.00
2	Term Loan	80.00
	TOTAL	120.00

In the first phase, 250 rooms were to be made ready with balance to be taken up for construction along with the commercial block. Added feature of the hotel was the huge parking lot for guests with three tiers where at a time, 350 cars could be parked. This was a major attraction which drew banqueting easily for major events. since parking is always an issue in Central Business District.

The planned construction got delayed due to –

- Non Availability of funds on time since the lending agencies (Consortium of 3 Banks) took their own time in assessing and sanctioning the Term Loan which delayed disbursement.
- Resultant delay in supply of equipment some of which were imported through EPCG Route with an export obligation.
- The industry requires a plethora of approvals under various regulations which took time.
- Lack of coordination in the execution team which apart from the person heading the team, did not have people who had prior experience in building a hotel, leave alone 5* hotel. They had experience in building housing and commercial projects in which the group was involved.
- However, with money being brought in by promoters, through their own sources, helped in completing the project.
- The Hotel was opened with a soft launch for business just in time for meeting demands of busy season.

- Meanwhile, the hotel put up the team required to man the operations including Head of Departments. This was a difficult task since availability of trained man power was always an issue in hospitality industry. The industry operates on 24/7 basis and guest satisfaction is of paramount importance to survive and sustain.
- To begin with, the occupancy levels were not encouraging both for rooms as well as banqueting which is understandable for a stand-alone property not having the tag of a brand. However, the Aero Show which is a bi- annual event, opened a new window of opportunity and the entire property was over booked for almost a month. Meanwhile, word had spread about the hotel in the market and this helped in bringing in more business from the corporate sector. Banqueting and corporate events also picked up thanks to the high quality of food and beverage as well service. Availability of huge parking facility also helped.
- The hotel began doing well with Average Revenue per room clocking close to Rs. 9000/- per day and occupancy levels remained at healthy 80% on most of the days. Realisation from food and banqueting also was healthy with average cover price being Rs. 800/- per head. The coffee shop of the hotel was big hit with corporate crowd and leisure seekers thanks to innovative menu and quality. Sunday brunch was a big hit with the crowd.
- The average revenue from both rooms / banqueting/ Miscellaneous items were close to Rs. 6. 00 crores per month which was very good for a newly launched hotel property. The fact that, there were no good 5* star hotels in the nearby vicinity helped.
- Buoyed by the business, the promoters decided to venture into expansion plans and decided to put up a resort property. The funds generated from this business were used for this venture.
- Just when things were looking up and momentum was being built, the industry started to see downward trend in business with world economy, mainly USA getting hit with collapse of major financial institutions, industrial slow down etc. This dried up the occupancy levels of rooms and business started going down.
- The fact that, the management did not have a strategy in place to meet the cyclical nature of business coupled with lack of financial discipline did not help.
- The Hotel had not built a strong Finance/ HR/ IT system in place which proved very costly.
- Training system and employee retention policy was not in place. This resulted in exodus of man power including Head of the Departments.
- Delay in payment of suppliers’ dues and employee salary became the norm. This further demoralised the employees and suppliers started to delay supplies of items.
- The problem was compounded with a 5* star deluxe property coming up close to this hotel backed by a huge industrial house known for running several high-class hotels across the country. This hotel offered different standards and amenities and started a price war to grab business since their pockets were deep and they could sustain on low rates for a prolonged period.
- All this affected the business badly. In turn, the hotel started defaulting on loan commitments including interest payments due to fall in revenue.

- The lean patch in the industry which continued well into 4 to 5 years, did not help. Hotel was forced to lower the rates just to stay afloat. This had a cascading effect on Quality of service, procurement of items, refurbishment of guest amenities to name a few.
- Constant churning of man power both at staff and Head of the Department level added to the woes.
- Lack of professionalism and in ability to foresee the warning signals contributed in no small measure to the issues faced.
- The commercial wing, meanwhile, could not be completed since funds were not forthcoming and banks did not want to lend further. The completed portion was seized by persons who had lent money to the promoters in the beginning.
- But in all this, there was a silver lining. Banquets came to the rescue and continued to churn good business helping the hotel to survive even though the inherent problems continue even till this day.

Given the scenario as above, you are required to analyse the reasons for the hotel's decline in business and lay a road map to turn around the operations.

Analysis of the case involving Diamond Hotels & Enterprises Pvt. Ltd throws scenario where, a combination of factors both internal and external contribute to the problems faced which has led to the current position where the hotel is struggling to stay alive.

These factors can be analysed as follows-

1. Vision & Mission- It is clear that the management lacks vision in running the business. If it is for the long haul, then the road map needs to be clearly laid with proper planning and clear-cut strategy to take the business to the next level. It is not enough to do cosmetic changes and hope things will improve. From the time the hotel opened its doors to guests the situation has undergone a sea change-

   - Competition is intense. As many as 800 additional rooms have been added by leading hotel chains in close vicinity to the hotel. They are established brands and automatically take away the business once enjoyed by the hotel. The pandemic had worsened the situation. Travel is done only selectively. Silver lining is, business is looking up again and should touch pre covid levels by the year 2023. Hotel must seize this opportunity and redesign its business to cater to large corporate traveller by fixing the tariff reasonably instead of sticking to old rates. This must be coupled with no compromise on safety standards and reasonable amenities. Business will start flowing in. It is reported that leading hotel chains have started to see good traction with occupancy levels touching 70% on an average. This is a good sign. Banqueting has always been a strong factor in bringing revenue to the hotel. This must be leveraged to the hilt.

- Constant changing and chopping of team especially at HOD level is not good. Continuity is lost and prevents good people from joining the hotel. Professional managers must be given full freedom to run the operations to get the desired result. There is no point in setting targets when operational independence is not given. Trust the team to deliver. Institute proper systems and controls along with monitoring mechanism. Review regularly and do course correction if needed. Extend full support to managers by providing the required resources. Ensure that Guest satisfaction is at the core of everything and towards this, train the staff continuously to the changing requirements. At the same time there should be no compromise on performance standards. Laggards must be identified and removed so that it acts as a deterrent to others.

- Strategy is at the core of any business. One needs to be proactive rather than reactive. Promoters must strategize and plan instead of getting involved in day-to-day operations. SWOT analysis needs to be done often on to stay relevant since it is the fulcrum of Strategic Decision Making. If business goals that involve creating a sustainable competitive advantage over their competitors has to succeed, then SWOT analysis should be part & parcel of the business. The hotel needs to develop effective business strategies that exploit their operational advantages over competitors, while minimizing their disadvantages. This is more so in the hospitality industry, where changes are constant in tune with changing perceptions of the guest who constantly look for innovations in product offering. The pandemic has changed the whole perception of running a business. Guests now look for that 'x' factor which gives them the assurance that their health and wellbeing is protected and safe. The case study reveals that the hotel did not chart course of action through a well-defined process based on long term goals and longer-term vision. Strategic decision making aligns short- term objectives with long term goals. It is necessary to put in place measurable goals, align them to the business and constantly review them to succeed. The brief components of SWOT analysis are-

❖ Building on strengths- Every enterprise has inherent strengths relative to its competitors which come from knowledge, abilities, and resources available to the enterprise.

❖ Minimising weaknesses- Common sources of a Company's weaknesses include ineffective management, insufficient resources, inefficient processes, and obsolete technology, high rental costs, obsolete market research and Cash flow problems, holding too much stock, poor record keeping etc. It is evident that the hotel has lacked in all these areas which has led to the current situation. Being obstinate does not help.

❖ Seizing Opportunities- Potential opportunities can result from identifying an overlooked market segment, changing industry regulations, advancements in technology, and improvements in buyer and supplier relations, loyal customers, high customer demand of the company's services etc. Following these to the tee is absolute sina qua non.

- Counteracting Threats- Any situation that puts a company in an unfavourable position or impedes its efficient operations can be classified as a threat. This can be identified through a macro analysis. Threats can come from anywhere. For example, disgruntled employees, vendors etc, can effectively damage the business by spreading news about the hotel. It is absolutely essential to have a clear-cut strategy to retain the trust of such stakeholders.
- Financial Discipline- No company can hope to sustain and succeed unless absolute discipline is followed in managing the finances. Loose control can lead to unpleasant consequences like in this case. The promoters were well aware of the obligations to meet the commitment of repaying the loans obtained for the project. The first sign of failure is delay in meeting the statutory payments like salary, benefits etc. Next, payment to vendors who are the lifeline of the hotel's operations. If default is made in meeting the obligations to these stake holders, large scale dissatisfaction happens resulting in exodus of good and well trained man power, disruption is supply chain, increased cost of procurement which in turn affects operations resulting in dissatisfied guests. Added to this, failure to meet the repayment obligations of the lenders compounds the problem further. Sources dry up choking business continuity. Realization from operations alone is not enough to sustain. All business must be accepted after properly evaluating the customer and his ability to pay. Outstanding's must be ruthlessly followed. Accountability must be established for collecting the dues.
- Cost Management- This is an area which is non-negotiable. Robust costing systems must be in place which alerts the management of changes and rise in cost of operations. Main costs in hotel are- Man power, Food & Beverages, LLP to name a few. Recipe costing for each item broken into full detail is a must. This enables the hotel to assess cost of producing each item and charge the guest accordingly. Prices of commodities are volatile and these needs to be factored in while costing is done. All overheads must be captured while arriving at pricing decisions. Guests are willing to pay for quality service and food. All cost parameters must be constantly reviewed through proper MIS and monitored. Any change in technology which can help in changing the process resulting in cost reduction must be embraced. Margins are constantly under threat and price elasticity is limited. This must be borne in mind.

- MIS & Budgeting System- No Company can hope to improve its operational efficiency unless it has good MIS and Budgeting System which lends itself to intense scrutiny. A properly developed budgeting system which covers all operating departments and stakeholders is a must. Operating Budgets department wise for the year taking into consideration all factors and covering each area is necessary so that all aspects are covered. This requires high degree of commitment and ability to foresee events which can unfold, like sudden break downs in equipment.

- Factor in all eventualities, contracts like AMC and build the budget. Similarly, revenue forecasting for each area should be done scientifically instead of engaging in guess work. Past performance needs to be analysed thoroughly and build the potential revenue. The Budget must lend itself to course correction if needed midway. Budget for the sake of Budgeting can lead nowhere.

- Equally important is robust MIS System broken into-
- Daily
- Weekly
- Monthly

All operating parameters including revenue, LLP cost, Food cost etc. must be reviewed daily, reasons for deviation established and corrective action initiated. Hotels have a system of daily review meetings where operational matters are discussed. The forum must be utilized to address issues for speedy actions. Monthly MIS must be reviewed by the top management with individual HOD's where actual results are compared with budgets including variance analysis of all parameters are carried out, responsibilities are fixed.

Event wise Profit & Loss account needs to be prepared to find out whether the event conducted has resulted in loss or profit. If it has resulted in loss, reason needs to be analysed including possible wrong pricing and action initiated to ensure lapses do not recur. Estimated Profit & Loss statement needs to be prepared in case of large events to find out the outcome based on pricing before deciding to accept the business. Sometimes, business exigencies will require the management to accept the event. This is best left to the decision of Management. But responsibility is cast on Finance to place the facts before the Management.

- Gestation Period in Hotel Industry- The normal gestation period in hotel industry is five to seven years, more so for standalone properties which is the case here. Such hotels do not have the backing of chains and need to go that extra mile to establish the business. Perseverance and patience is the key. Lenders also must factor in this and adopt an accommodative stance instead of applying the same yard stick. Unfortunately, this aspect is lost on lenders forcing the borrowers to default and complicating the recovery process. The promoters were also responsible for not factoring in this critical aspect. Instead, they were carried away by the buoyancy witnessed in the business and concluded that things are rosy and diverted the funds which proved their undoing. Combining hotel with commercial complex needs careful planning and segregation to succeed. The idea of building a commercial complex was sound given the potential since the location is prime area. But the execution was wrong. Added to this, they wanted to expand their foot print elsewhere before stabilizing this business.

- Robust IT System- Technology is at the forefront today driving business and aiding decision making. Hotels have complex operating modules with each area being unique. Manually managing these complex operations is a difficult proposition. It is necessary to invest in good technology and seamlessly integrate the operations, generate reports with precision, have in built fire walls, security checks, firewalls, accessibility controls, back up procedure, ability to continuously upgrade are a must. Investment in good IT system including hardware will pay rich dividends, eliminate manual intervention and help timely decision making.

About the Author:

Author Name: – CA P.G. SUBRAMANIAN

Fellow member of the Institute of Chartered Accountants of India with forty-five years of experience at senior level across Industry Verticals covering Manufacturing, Service Sector mainly in hospitality industry including CEO of a leading 5* hotel & resort property. Handled senior level roles with responsibility for Finance, Budgets, Costing, MIS, Taxation, Legal & Secretarial, Contracts, Procurement, HR & Admin functions & IT. Post my corporate work, associated with leading firm of Chartered Accountants as Director. Heading Indian Cutting Tool Manufacturers Association as Secretary.

INDUSTRY EXPERIENCE:

Forty-Five years' experience in the areas of –

- Close to thirty years in manufacturing sector heading finance function. Handled core finance including corporate finance, accounts, audit, taxation, budgets, MIS, Costing, Legal & Secretarial, Admin & HR. Responsible for implementing SAP for the entire organization and streamlining IT functions.
- Experience of over fifteen years in looking after operational matters of five-star property, including launching several initiatives aimed at cost reduction, innovative practices in improving the operational efficiency, CRM initiatives, Process improvements, Corporate Governance, Negotiation and Commercial Contracts, training initiatives, Finance, Audit and Budgeting, MIS etc.
- Was till recently President and CEO of a 5* deluxe property which is hotel cum resort. Was fully responsible for Operations/ Finance/ HR/ Admin/ IT/ Procurement/ Contracts/ Cost Control/ Security/ Unit Budget and P&L/ Secretarial and overall, in charge.

EDUCATIONAL QUALIFICATION:

- Commerce Graduate from **UNIVERSITY OF BOMBAY**.
- Fellow member of the Institute of Chartered Accountants of India.
- Member of Expert Committee on Indirect Taxes and Banking & Finance and Corporate Affairs, Tourism & Hospitality Committee of the Bangalore Chamber of Industry & Commerce.
- Member of ASCON Sub Group on MSME & Taxation – CII at All India level.
- Regular speaker at various professional forums including training of professionals.

ACADEMIC EXPERIENCE:

- Involved in revision of Syllabus for CPT/ IPCC-I and IPCC-II – Accounting/ Advanced Accounting for Institute of Chartered Accountants of India.
- Commissioned to prepare case studies relating to Strategic Cost & Financial Management and Risk Management- FINAL – Institute of Chartered Accountants of India.
- Has authored several Articles on Management, Finance, Internal Audit etc;
- Authored book on "Strategic Cost Management & Risk Analysis" – published by the Institute of Chartered Accountants of India- Southern India Regional Council.
- Written book on Project Management & Financial Due Diligence.
- In the process of writing book on Start Ups- 'How far will you Go' slated for publication in June-2023.
- Mentor for startup company under the aegis of Confederation of Indian Industry- CII

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