

## Master Circular

Management of Advances**Clarifications in regard to Assessment of  
Working Capital Limits***[Ref. para 2.7]*

	<b>Issues raised by banks</b>	<b>Clarifications</b>
	(1)	(2)
(i)	Whether banks should sanction working capital limits computed on the basis of a minimum of 20 per cent of the projected annual turnover/output value or whether it is intended that banks should also arrive at the requirement based on the traditional approach of production/processing cycle and thereafter decide the quantum of need-based finance. If the traditional approach is followed the working capital finance arrived at could be either more than or less than 20 per cent. In case it is less than 20 per cent, whether banks should still give 20 per cent ?	The assessment of working capital credit limits should be done both as per projected turnover basis and traditional method. If the credit requirement based on production/ processing cycle is higher than the one assessed on projected turnover basis, the same may be sanctioned as RBI guidelines stipulate bank finance at minimum of 20 per cent of the projected turnover. On the other hand if the assessed credit requirement is lower than the one assessed on projected turnover basis, while the credit limit can be sanctioned at 20 per cent of the projected turnover, actual drawals may be allowed on the basis of drawing power to be determined by banks after excluding unpaid stocks. In the case of Selective Credit Control commodities the drawing power should be determined as indicated in the RBI directive.
(ii)	Whether projected turn over/output value basis 'gross sales'	The projected turnover/output value may be interpreted as projected 'Gross Sales' which will include excise duty also.

	<b>Issues raised by banks</b>	<b>Clarifications</b>
	(1)	(2)
(iii)	Whether the 5 per cent promoter's stake (Net Working Capital) should be reckoned with reference to the projected turnover or with reference to the working capital arrived at based on production/ processing cycle.	In terms of extant guidelines the working capital requirement is to be assessed at 25 per cent of the projected turnover to be shared between the borrower and bank viz. borrower contributing 5% of the turnover as NWC and bank providing finance at a minimum of 20 per cent of the turnover. The above guidelines were framed assuming an average production/processing cycle of 3 months (i.e. working capital would be turned over four times in a year). It is possible that certain industries may have a production cycle shorter/longer 3 months. While in the case of a shorter cycle, the same principle could be applied as it is the intention to make available at least 20 per cent of turnover by way of bank finance. In case the cycle is longer, it is expected that the borrower should bring in proportionately higher stake in relation to his requirement of bank finance. Going by the above principle, at least 1/5th of working capital requirement should be brought in by way of NWC.
(iv)	Whether 5 per cent NWC should be reckoned with reference to turnover or with reference to available long term sources; in other words is the prescribed NWC the minimum amount?	Since the bank finance is only intended to support need-based requirement of a borrower if the available NWC (net long term surplus funds) is more than 5 per cent of the turnover the former should be reckoned for assessing the extent of the bank finance
(v)	Whether drawing power should continue to be regulated through stocks and whether unpaid stocks deducted for arriving at drawing power ?	It is left to the discretion of banks. However, in arriving at drawing power, unpaid stocks are not financed as it would result in double financing. The drawing power should conform to Reserve Bank of India directives in the case of Selective Credit Control commodities
(vi)	Since the present instructions cover traders as well, and most trade is done at market credit, whether the credit limits should be assessed as 20 per cent of the turnover per se and actual drawing regulated through stocks ?	In the case of traders, while bank finance could be assessed at 20 per cent of the projected turnover, the actual drawals should be allowed on the basis of drawing powers to be determined by banks after ensuring that unpaid stocks are excluded. In the case of SCC commodities the RBI directive should be scrupulously followed.