CHAPTER 4
Management Short Term Funds & its analysis.

SYNOPSIS

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The "Working Capital" of a business means that capital which can be changed into cash within an operating cycle. In general, the working capital is Current Assets deducted from Current Liabilities. The remainder is Working Capital which is important for illustrating the liquidity of the business and the credit worthiness of the creditor.

The general movement of a short cycle of Working Capital is shown in Chart 4.1

Chart 4.1 Short cycle of Working Capital.

Capital and loans of sugar producers in Thailand.

Management, when looking for capital and considering the selection of the source of capital, must consider profit. The business normally tries to reduce expenses which occur in the form of the cost price of capital obtained. At the same time, it tries to maintain the level of risk which may occur from the use of capital from that source to remain at an acceptable level.

"Short Cycle Capital" means capital which the business will have to repay within 1 year. The criteria used in considering the first priority as to whether or not one should use a short cycle of capital, is Short Term capital which can be bought for buying assets, which have a short working age or short cycle age.
This is to correspond with the period when such an asset will result in sufficient income for paying debt. It will be seen that if investment in buying every item of the business has been done thoroughly and causes income higher than expenses, (this occurring from the use of assets), the finding of capital which has a period of returning payment which corresponds with a sufficient period to earn income will enable such business to earn profit without any risk. Using short-term capital to buy assets which have a working long age, although more profitable because the cost price of capital is not much compared with income to be received in a long-term period, will be very risky, because the business will have to repay the debt quickly. On the contrary, if long-term capital is used for buying assets, which have a short working age, the business may have no problem in making the repayment, but profit is reduced because the business is responsible for unnecessarily long periods of interest payments, which causes the cost price of capital to become high. In other words, "short cycle capital" may have more than a one year period to return the capital, because for certain short-term capital, the person who seeks capital may be able to make an agreement to repay continuously for more than one year. Sources of capital which sugar producers popularly use are trading documents, an overdraft from a bank, a mortgage of goods with a commercial bank or short-term capital from an exporter.

Trading document.

The business document most popularly used by sugar producers is the "Post-dated Cheque". Sugar producers use post-dated cheques as a tool for finding capital by being a cheque-payer. When buying sugar-cane, the sugar producer will sign a cheque in advance. This is considered a source of capital, because instead of paying cash, they can delay payment.
Overdraft from a bank.

A commercial bank usually provides an overdraft to a customer who has regular deposits with the bank over a long period. Capital obtained from an overdraft is for short-term circulation. An overdraft should be taken once in a while in each year and not be a continuous overdraft for a long period. If the latter is the case, that business would be safer trying to find a long-term source of capital.

The business requesting an overdraft will have to specify the required amount, sufficient to circulate, and prepare a cash budget. The commercial bank after considering cash budget figures, time and the repayment, will approve. In principle, the business will have to deposit money to deduct the overdraft amount before closing the annual account. In practice, the bank normally extends the period until it looks as though capital obtained from an overdraft is a long-term source of capital. The balance sheet of various sugar mills shows that many have a very high overdraft; some high as 90% of the total capital.

In approving the budget or overdraft amount, the commercial bank will consider budgets, movement of cash from the cash budget and implementation and methods of work. The bank will also request more securities or ask another person to guarantee. The bank charge 12%-15% interest a year. If a business is a good customer of the bank, such business will receive the prime interest rate of between 10.5%-12.5% per annum. This changes according to the volume of money in the market.

Commercial Bank Mortgages

Characteristics of mortgaging goods with a commercial bank.

There are 2 characteristics of mortgaging goods with a commercial bank. These are:

a) mortgaging goods stored in a Public Warehouse or the bank’s warehouse. This method of mortgage complies with the law. The mortgaged good are handed to the bank which accepts such mortgage or are handed to a third party, such as a Public Warehouse; and
b) mortgaged goods stored in a Field Warehouse. The goods used for mortgaging are in the owner's warehouse. This does not comply with mortgaging principles. The bank has to sign a Contract to rent the warehouse from the customer, so it appears that the Warehouse is under proprietorship of the bank itself.

Such a mortgage of goods is a big source of loans to an exporter. Banks usually give direct assistance to exporters in 2 ways:

1. **Packing Credit.**

   In certain cases, an exporter requiring capital to procure goods for a Purchase Order may apply to a commercial bank for a loan by delivering a Letter of Credit from the overseas bank, issued to the buyer. The bank uses this as a guarantee, as the exporter has no Letter of Credit at this bank, so he is unable to receive payment for the goods from any other bank. The Letter of Credit which the bank considers receiving must be unable to be withdrawn. In giving such a loan, the administrative policy of each bank determines conditions. After the bank has approved a loan, the bank may request another guarantee. The amount of loan approved by the bank will not exceed 80% of the figure shown in the Letter of Credit. Certain banks normally consider giving loans to big-scale exporters who have been regular bank customers. The budget approved will not exceed 70% of the total amount shown in such Sales Contracts. The exporter, after receiving Packing Credit, has to immediately spend the loan for buying goods for the buyer. After such goods have been placed on the ship and the Bill of Exchange sold to the bank, the bank will deduct the amount from the total amount of loan, as well as charging interest for such loan.

2. **Packing Stock.**

   This category of loan can be effected when an exporter mortgages goods with the bank. This type of loan has a different name in each bank. Certain banks regard it as a loan for export of a certain type of goods, because the exporter normally brings the goods for sale to obtain a loan to buy additional goods. It is a loan for Packing Credit, which uses goods as a guarantee without using a Letter of Credit or Sales Contract. Certain banks call it a “loan by mortgaging goods”, Packing Stock or
Stock Financing, which gives a narrower and clearer meaning. Certain banks call this loan for mortgaging goods a Documentary Bill Discount or Local Bill Discount. The use of Stock Financing by the exporter enables the commercial bank to use such Documentary Bill to Discount, issued by the exporter, and entrusted to a commercial bank, to sell on discount to the Bank of Thailand. This method of Bill Discount will be explained later.

**Finding Short-Term Capital from an exporter and the Bank of Thailand.**

The Bank of Thailand helps the sugar industry by giving assistance to exporters, allowing them to buy a Documentary Bill of Discount from the export of sugar with a Letter of Credit from a commercial bank. The Bank of Thailand charges the commercial bank 5% interest a year and has specified that such commercial bank charges to the exporter must not exceed 7% a year. This Documentary Bill Discount will be valid for up to 180 days. The exporter will have capital to pay the sugar industry for circulating sugar, such as buying sugar cane and various raw materials and paying labour costs and the cost of fuel.

The volume of buying Documentary Bills Discount for the export of sugar in 1994 was as high as 6,300 million baht. During the 9 months from the beginning of each year, it was as high as 4,200 million baht, or approximately 80% of the total export of sugar.

At present, the Bank of Thailand has improved methods to buy Documentary Bills of Discount from the export of sugar to give privileges to the exporter, so it can give full benefit to the sugar mill. When the exporter receives a Letter of Credit from abroad, the exporter brings the Documentary Bill Discount to sell the Letter of Credit of 80% discount of the Letter of credit. It should not exceed 300 baht a sack.

Such Documentary Bill Discount must be valid within 120 days. If the exporter has not completed handing over the sugar according to the volume specified in the Letter of Credit, or the time has not come to hand over the sugar, the Documentary Bill Discount should be issued according to the amount shown in the Bill for handing over the goods at the rate of 80%, according to the value specified in the Letter of Credit. The price should not exceed 300 baht a sack, while the period should not exceed 180 days.
Adding the periods of the Documentary Bill Discount together, the first period for 120 days and the latter period for 180 days, time involved is up to 300 days. To ensure that the money received from the Bank of Thailand is used in the sugar production industry, the Bank of Thailand has specified that the exporter transfer the money received from selling on discount to the sugar mill within 3 days after the date of selling on discount. Interest not exceeding 7% a year is to be charged to the sugar mill.

It is the assistance of the Bank of Thailand and commercial banks to sugar industry exports which enables good results for the cost price of expenses and the circulating capital of such sugar mills. The structure of the source of circulating capital in the sugar industry is:

**Management with cash.**

A sugar producer holds cash in hand to pay for implementing normal work. There are 2 periods of implementation:

1. the opening period for pressing sugar cane, from November to May; and
2. the closing period, from June to October.

The requirement of circulating capital in each period is different. As noted in the previous chapter, the expenses will help sugar producers to implement work smoothly. It will be seen that in operating work by the sugar producer, the business will normally have to pay for implementing work before receiving money from goods sold. These expenses are necessary items which will produce income later. An example is buying sugar cane. This must be bought for production before it is sold to obtain income. The mill will have to give loans of "money for maintaining the plantation" to the sugar-cane planter. The mill charges interest not lower than 12% a year. For certain mills, instead of paying money for maintaining the plantation to small planters, they entrust the money for maintaining the plantation to a "Quota Head" to act as a middle man. The Quota Head contacts the sugar-cane planters and negotiates leases between the sugar-cane planters and the mills. The business still has to pay wages and other factory expenses in cash. After obtaining ready-made goods, the business has to pay further expenses to bring the goods for sale, other than expenses in administering other
work. These items need payment in cash. To ease or eliminate the problem of a cash shortage, the sugar producer should prepare a cash budget, as well as budget for current cash, to determine which period will have a cash flow in and a cash will flow out, to ensure that the in and out cash flows correspond with one another. The majority of sugar mills do not prepare such a budget, which results in erroneous management. Sugar producers should be aware of the selection of sources of capital to obtain the lowest cost price for circulation.

**Management of Cash.**

The Manager has a duty to manage the use of cash in the most efficient manner. The lowest amount of cash by which the business is to be controlled must be maintained so there is no leakage or dishonesty, in receiving cash, or paying cash by distributing work and responsibility, such as spending petty cash or using the cheque system, etc., must be enforced. Managing cash has two aspects:

1. method for accelerating in-coming cash to a quicker one; and
2. method for slowing payment of cash.

**Accelerating receipt of cash.**

Sugar producers have to find methods to manage cash to accelerate in-coming cash and to delay disbursement. Various methods to maintain cash, so that the business can use as much as possible, are:

1. selling in advance to domestic sugar customers. When a merchant wants to buy sugar from the mill, he has to pay approximately 10-15% deposit. The sugar mill will issue a Documentary Bill Discount on how many sacks of sugar have been sold in advance and the price per bag. At the same time, the expiry date of the Documentary Bill must be definite. During this period, the Documentary Bill may be transferred or endorsed to any one word, but by the expiry date, the person who has rights in the Documentary Bill will have to move the sugar out of the warehouse and, at the same time, pay the balance owing. If the sugar is not moved out, the sugar mill will charge the cost of storage or increase interest; and
2. Exporters normally have a long-term contract with an overseas Company. The overseas buyer of sugar will open a Letter of Credit (L/C) to the exporter. After obtaining the L/C, the exporter will bring that L/C to a commercial bank for use as evidence of collateral when applying for a loan. The commercial bank may offer 60-80% according to the amount specified in the L/C. Immediately after obtaining money, the exporter will have to quickly and proportionately allocate this amount to the sugar mills. There are 2big-seal exporters who own many mills in their group. They have to allocate the money obtained to every mill in their group according to the export quota, although sugar will not come from every mill.

**Slowing Disbursements.**

The business should spend money as slowly as possible, to ensure a supply of ready capital. The method for expenditure should be strict and thorough. In buying sugar cane, the mill will have to pay 10% for maintaining the plantation before production begins. The remaining 90% will be paid during the production period after the mill has received the sugar-cane by paying 50% by cash cheque, with the remaining 50% by post-dated cheque. The advantage in issuing a 45 day post-dated cheque is to slow down disbursement without losing the mill’s credit.

Although there is an acceleration of in-coming cash and slowing down of disbursements, this cash management does not popularly specify the lowest amount of cash which a sugar producer should have. If we look at the balance sheet, we notice that there is little cash left, because the majority of money received or spent will use a cheque, which is a bank overdraft.

**Management of Debtors.**

The sugar mills sell the goods for cash in advance by receipt of deposit. There is hardly any sale on credit, so there is little capital and it is not regarded as an important part of managing the circulation of capital. It will not be referred to again.

Sugar is the "goods remaining in stock" of sugar mills which is generally an important asset of business. A lot of capital is used. To not let a sugar producer use too much capital in such goods, the business must learn how to manage goods in stock in an efficient manner.

Goods of general business comprises raw materials and ready-made goods, but for a sugar mill, there will be no sugar-cane, a raw material, left because the mill uses the sugar-cane. The remaining raw material belongs to the sugar planters. The mill has no raw materials as goods in stock. There are some raw materials for production left, such as spare parts and furnace oil. Raw materials which must be used are oil and chemical substances. When calculated as a percentage, it is very little. The only goods in stock to be mentioned are fine grain sugar, raw sugar and molasses.

In managing these goods in stock, it has already been specified before production how much can be sold and production estimated.

Most fine grain white sugar will be sold in advance to wholesale merchants in the country.

An overseas advance sale Contract is made with raw sugar. There are domestic and overseas advance sales for molasses.

A sugar producer with too many goods in stock is left with a risk. From the above analysis, the average number of days within which one can sell the goods out has a trend to decrease. It shows the total sales of business has increased. When there is an increase in goods, there should not be too much risk. In addition, a sugar producer avoids risk by having excess sugar to hand by using future or advanced sales. If an exorbitant amount of sugar is produced and the price drops, the business experiences a loss. To avoid risk, a sugar producer will settle with the buyer by signing a contract to sell sugar in the future at a precise price and precise amount. By so doing, the buyer will have to pay a deposit depending on the amount agreed upon. This method is called "Future Sale". For example, a sugar mill signs a contract with 'A' Company Ltd. that they will sell 100 bags @ 500 baht within 60 days. After 60 days, if
the cost of sugar is reduced to 300 baht, the sugar mill will still sell sugar to "A" Co. Ltd. at 500 baht. If the price of sugar has gone over 500 baht, the mill still has to sell at that price.

Production policy.

Before specifying production policy, we have to learn about the domestic and overseas markets.

The International Sugar Organization (ISO) estimates world sugar requirements and domestic consumption. Last year, Thailand had:

- an export quota of 1.2 million MT;
- an allowance to have sugar in stock of 0.1 million MT;
- domestic consumption of 0.5 million MT; and
- a production aim of 1.8 million MT.

If production of 1.8 million MT of sugar requires 3.0 million MT of sugar-cane and sugar mill 'A' has been allocated 5% production of sugar, the mill will be able to press of 5% of 3.0 million MT sugar-cane equivalent to 150,000 MT.

We may calculate allocation of capacity to produce sugar from the volume of sugar produced within the past 3 years, by averaging or by specifying from the size of the pressing machine.

Selling policy:

- White grain sugar is associated with wholesale merchants.
- Raw sugar depends on export companies. The ISO will try to specify 'Supply' in the world market to correspond with world 'Demand', by allocating an export quota of sugar to the producing country. After it has been able to specify "Supply", it is able to specify the price. If the price decreases, the ISO will reduce the quota of different countries until the price remains at the required level, such as, the price level is 8 baht a pound (lb.). If the ISO reduces the quota of various countries, it will be equivalent to reducing "Supply" in the world market to Q'Q. In this event, the price level will go up to 11 baht a pound (lb.) etc., as seen from the following graph:
Graph 4.1 Specifying sugar price in the world market by showing Demand and Supply line.

- Molasses. A certain portion is exported, while the other portion is sold in-country by calling for bids.

Saying: Management of goods in stock. Although there is an exorbitant amount of goods in stock, there is no risk, both in price and in quality of goods, because all will be sold out. We sell goods in the FIFO system. The first lot of sugar produced will be sold out first, so there will not be any sugar left in stock for too long and the quality will not be degraded.

Since production and selling policy are specified, there is no problem managing the goods in stock as, although there is a voluminous amount of goods, there is no risk. The market requirement has been calculated before production and, with the certainly of a fixed market, there is no risk to goods in stock. There is no control in the production of sugar cane, so if sugar cane produced exceeds requirements, the sugar mills will not buy the excess sugar cane. The result rests on the sugar-cane planters alone.
Sources of funds for sugar producers.

Sources of funds for sugar producers may be classified into 3 implementation periods:

1. The Period before opening machines for pressing sugar cane, around November.

   The capital for circulation will be obtained from:

   (a) packing credit of raw sugar and molasses with a commercial bank. The exporter will get a L/C from overseas and bring this L/C to apply for Packing Credit from a commercial bank, then allocate the money to various sugar mills according to the export quota; and

   (b) future sales of sugar in-country. If the sugar producer finds it necessary to urgently spend money, they will sell in advance to a wholesale merchant at a cheap price, collect the money and deliver the sugar at a later date. If a voluminous amount of sugar is sold, the mill will receive a large amount of money.

2. Period while opening the machine for pressing sugar cane, around December to May.

   The mill obtains circulating capital from:

   a) permanent overdrafts from the bank. When the money is needed, the producer can draw within this specified amount throughout the year; and

   b) an overdraft from the bank by Packing Stock of sugar. The sugar producer will be able to use this amount when he puts mortgaged goods at the bank warehouse. The money can be withdrawn beyond the amount specified by the bank.

3. Period when the machine for pressing of sugar cane is closed: May onwards.

   Circulation capital will come from Future Sales. During this period, the mill will receive the balance of each bag. If sugar costs 450 baht a bag, the sugar producer will receive 50 baht a bag, so, during this period, he receives the remaining 400 baht a bag.

Capital sources for these 3 periods.

A sugar producer sources capital for the first period from Future Sales, as money can be obtained without paying interest. Packing Credit from the
commercial bank has low interest not exceeding 7% and, in certain years when the price of sugar drops, the mill may also obtain a Government subsidy.

**Uses of Fund for circulation.**

The use of circulating capital by a sugar producer may be classified according to necessity in using the fund during the 2 implementation periods. These are:

1. **The period before opening the machines for pressing sugar-cane, around July.**

   There will be requirements for circulating capital, such as:

   a) money for maintaining the plantation. This is approximately 30 baht/MT. It guarantees that the mill will have enough sugar-cane during the pressing season. The mill will pay in about 5-10 baht/MT cash to the agriculturists. The remaining amount is paid by post-dated cheque around January - February of the following year. After the agriculturists have received the post-dated cheque, they immediately sell at a reduced amount to the bank. This is included in the overdraft budget which the sugar producer has received on a permanent basis from the bank; and

   b) payment for the repair of machinery. After the production season or before the pressing of sugar cane season, all machinery normally has to be repaired. During the pressing season, the machinery is continually used for 24 hours, so becomes dilapidated. After the pressing season, the mill has to close to repair the machinery. Sometimes new machinery to replace the old must be bought by installment or by a long-term loan contract. Repairs cost a lot of money.

2. **Period when the mill opens for pressing of sugar cane around December to May.**

   For this period, the circulation capital is used by sugar producers to pay for various expenses in producing sugar, such as the cost of sugar-cane, labor costs and other production expenses such as the cost of water, electricity and research, etc. The highest expense during this period is the cost of sugar cane. The mill will normally pay 50% in cash after deducting the amount for maintaining the plantation, which is paid in advance. The remaining 50% will be paid by 45 day post-dated cheque. During this period, the overdraft with the bank will gradually go up until production is completed. After selling the sugar, the bank overdraft reduces.
Throughout the implementation period there are additional office expenses: salaries, cost of vehicles and entertainment costs etc. which are normally stable expenses.

Receiving to conform with spending of circulation capital.

The receipt and spending of circulating capital corresponds with one another. It begins with the period before the machine for pressing sugar-cane is opened and money for maintaining the plantation is paid to the sugar-cane planters. When the mill owner estimates that there will be a small volume of sugar cane, the owner is willing to pay money for maintaining the plantation up to 20% of the cost of sugar-cane to be certain that there is sufficient sugar-cane to feed into the mill during the production season. This is instead of the usual 10%. When agriculturists plant sugar cane and the mill owner thinks that the volume of sugar cane will exceed requirements, he reduces the money for maintaining the plantation to 10% or lower. If the money for maintaining the plantation payment is too high, the requirement of circulating capital will become higher too. Capital from the future sale of sugar and from the bank overdraft to help efficient implementation of work will be available. The same applies to the case of costs of repair of mill machinery and equipment. The owner normally uses circulation capital from the above two sources. If it is for buying machinery, a long-term source of circulating capital is used because of the high cost of each piece of machinery. It may take many years to cover the cost of buying machinery. If the mill owner uses a short-term source of capital to invest in such a permanent asset, the sugar producer must find money to pay short-term debts within a year, so efficiency ceases and the problem of insufficient money to circulate will arise. This is rarely done in practice. When considering a budget, there might be certain businesses that practise this method, as there is little long-term debt in the budget, in spite the purchase of new machinery every year. This may be due to paying short-term debt by extending the Loan Contract every year. This has a similar characteristic.
to long-term investment capital to invest in a permanent asset. It may also show an error in entering accounts i.e.: the company has entered long-term debt in the same group as short-term debt, which takes more than 1 year of repayment.

As for using circulating capital during the opening period for pressing sugar-cane, the sugar producer will have to pay for the cost of sugar-cane, labor and other expenses. A producer will obtain circulating capital from Packing Credit from the bank (as above) and after producing sugar, the sugar producer may mortgage the sugar (or Packing Stock) with the bank.

The major part of circulating capital of a sugar producer comes from commercial banks. At this latter stage, it appears that commercial banks increasingly control sugar mills by allowing more overdrafts. As long as the bank gives financial assistance, there are not many problems concerning circulating capital management, except that a wrong category of the use of capital can be made. If the bank does not give support, there is the immediate problem of circulating capital. If the bank does not buy the cheque for maintaining the plantation, which the sugar producer pays to the agriculturists, the agriculturists that receive such a cheque will not be able to sell at the reduced rate to any commercial bank, etc.

The Credit System in Sugar Cane Planting

The support money system plays an important role in sugar cane planting. About 42% of the total sugar cane planting credit in Thailand comes from this system. The Banks for Agriculture and Agricultural Cooperatives, commercial banks and the big sugar cane farmers supply the remaining 58% of loans. Not all of these loans are used for investment purposes. Some are used for personal consumption, such as marriage ceremonies, funerals and the like. The prevalence of rituals and festivals in the local community are evidence of this.
Demand for Credit

Better control of the repayment of loans for sugar cane planting is part of the reason why higher credit has been given to the sugar cane farmers compared to that given to other crops. A larger investment is possible in sugar cane farming activities. Sugar cane farmers who do not have a sufficient amount of internal finance have to borrow from external sources through the credit system. The supplier of credit in sugar cane planting is discussed in section 3.

Most of the sugar cane farmers have their own schedule for farming activities, such as land preparation, planting, weeding and harvesting. The schedule normally depends on environmental factors such as rain and location. The sugar cane farmers who live in the same area usually have similar farming activities. The demand for credit tends to be seasonal.

Supply of Credit

There are four main sources of credit in sugar cane planting in Thailand:
1. sugar mills:
2. big sugar cane farmers:
3. the Bank for Agriculture and Agricultural Cooperatives (BAAC); and
4. commercial banks.

Each of these sources shares 15% of the total supply, respectively. The first two sources are informal credit sources. The rest are formal credit sources.

Relatives and friends supply the remaining 6%. The method of providing loans and regulation by each credit source is discussed below.
Summary analysis.

This chapter discusses short and long term capital cycles, types of credit used (post-dated cheques, overdrafts, mortgages and packing stock) and from where these sources of capital are derived during the 3 main implementation periods.

Sources of capital include cash in hand, future sales, packing credit and exporters and the Bank of Thailand through documentary bill of discount. It further discusses the management of cash in hand through production and selling policies and the management of goods in stock. It then discusses the uses of capital during the 3 main implementation periods and emphasises the important role of support money in the sugar cane planting industry.