



# M2i Consulting

Microfinance Management & Investment Advisory

## *Debt Management*

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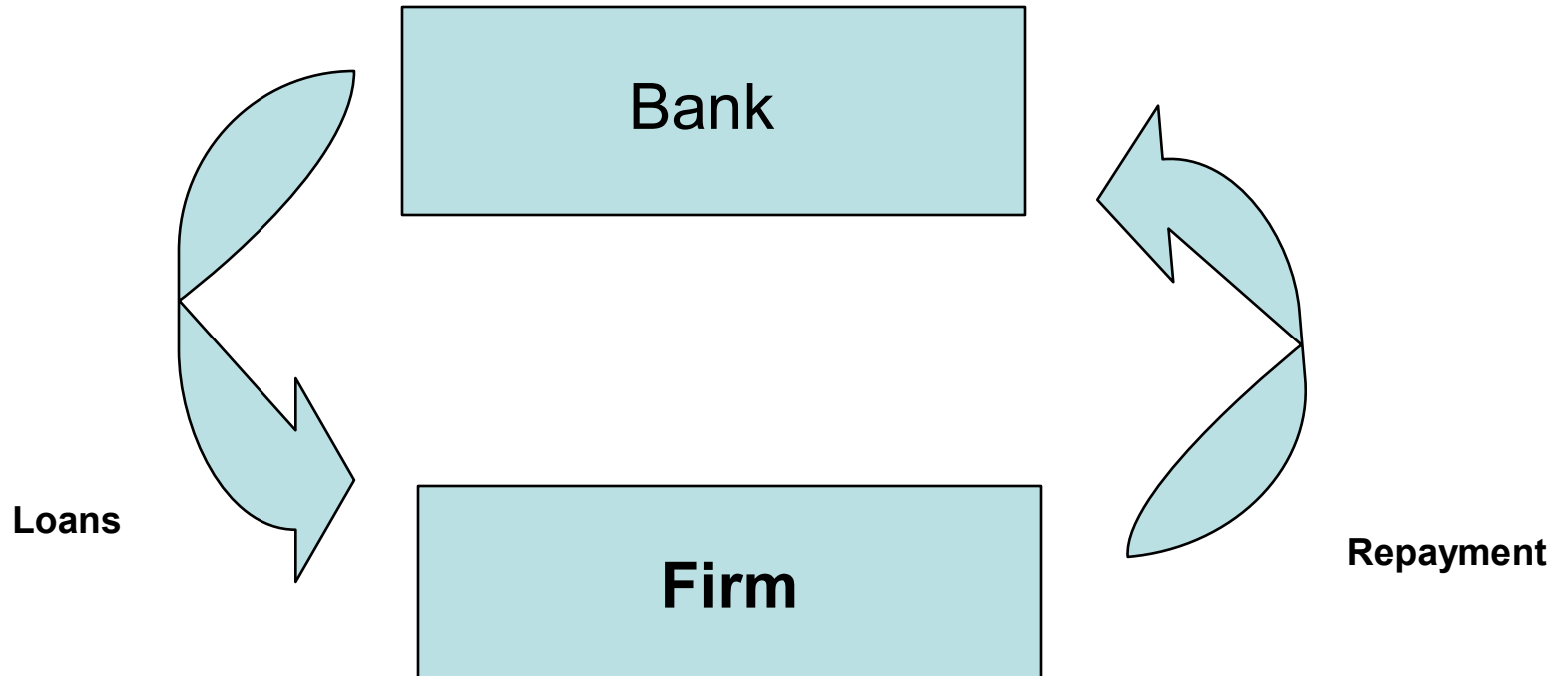
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# What is debt?



**That which is due from one person to another, whether money, goods, or services; that which one person is bound to pay to another, or to perform for his benefit; thing owed; obligation; liability.**

# Flow of Debt



# Components of Debt



- **Principal:** Refers to the original value of the debt
- **Interest:** Refers to the cost of debt

## *For example*

Loan amount Rs 100,000. It is repaid in two installments as follows

**Installment 1:** Principal 50,000 plus interest 500

**Installment 2:** Principal 50,000 plus interest 250.

Outstanding balance is the principal balance remaining to be paid

Principal balance before payment of installment 1 is Rs 100,000

Principal balance after payment of installment 1 is Rs 50,000

Principal balance after payment of installment 2 is 0.



- Expressed as annual percentage eg 12%, 15%, 20%.
- Payable on a reducing balance basis or a flat basis

## **Interest represents**

6. Cost of time value of money
7. Cost of the risk taken by the lender
8. Cost of delivery of the service



## **Reducing Balance**

**Interest payments reduces with each payment.**

If one has taken a loan of Rs10,000 at 12% pa and Rs1,000 is payable each month. In the first month the interest payable will be  $12\%/12$  of Rs10,000 ie Rs100. In the second month if Rs1,000 is repaid the interest will be calculated at Rs9,000 and it will be only Rs90.

## **Flat Basis**

**Interest payment does not reduce with each payment**

If one has taken a loan of Rs10,000 at 12% pa and Rs1,000 is payable each month. In the first month the interest payable will be  $12\%/12$  of Rs10,000 ie Rs100. In the second month also the interest payable will be Rs100.

# Example



## Reducing Balance method (12% pa)

	Outstanding	Repayments		
		Principal	Interest	Total installment
1	10,000	1,000	100	1100
2	9,000	1,000	90	1090
3	8,000	1,000	80	1080
4	7,000	1,000	70	1070
5	6,000	1,000	60	1060
6	5,000	1,000	50	1050
7	4,000	1,000	40	1040
8	3,000	1,000	30	1030
9	2,000	1,000	20	1020
10	1,000	1,000	10	1010
<b>Total</b>		<b>10,000</b>	<b>550</b>	



# Example



## Flat interest basis (12% pa)

		Repayments		
	Outstanding	Principal	Interest	Total installment
1	10,000	1,000	100	1,100
2	9,000	1,000	100	1,100
3	8,000	1,000	100	1,100
4	7,000	1,000	100	1,100
5	6,000	1,000	100	1,100
6	5,000	1,000	100	1,100
7	4,000	1,000	100	1,100
8	3,000	1,000	100	1,100
9	2,000	1,000	100	1,100
10	1,000	1,000	100	1,100
<b>Total</b>		<b>10,000</b>	<b>1,000</b>	

# Equated Monthly Installment



- Mostly followed by the banks for its retail loans
- Usually follows the reducing balance method.
- The monthly installment remains the same for all the months.
- Principal and interest vary from one installment to the other

# Equated Monthly Installment (EMI)



## EMI (21% pa)

	Outstanding	Repayments		
		Principal	Interest	Total installment
1	10,000	924	175	1099
2	9,076	940	159	1099
3	8,136	957	142	1099
4	7,179	973	126	1099
5	6,206	990	109	1099
6	5,215	1,008	91	1099
7	4,208	1,025	74	1099
8	3,182	1,043	56	1099
9	2,139	1,062	37	1099
10	1,077	1,077	22	1099
<b>Total</b>		<b>10,000</b>	<b>990</b>	



# Maintaining repayment schedule



- Building a good credit history is important.
- This ensures that credit facility is continued.
- One needs a systematic approach to maintain repayment schedule