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A Commercial Paper (CP) is an unsecured, short-term debt instrument issued by a corporation, typically for meeting short-term liabilities.

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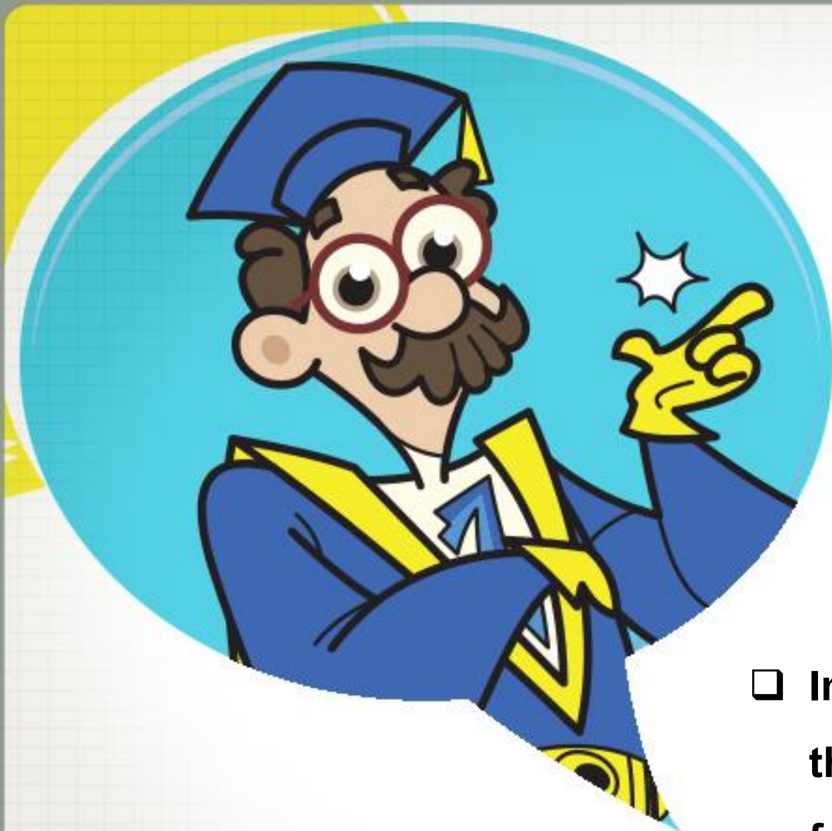

- In this lesson, I will try to *simplify* the concept of ‘Commercial Papers’ for you…

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Understanding Commercial Papers

– By Prof. *Simply* Simple

A Commercial Paper (CP) is

1. a money-market instrument
2. issued by large banks & corporations
3. to garner money from the market
4. to meet short term needs.

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When & why was it introduced in India?

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- It was introduced in India in 1990.
- It was aimed at providing high rated corporates with a borrowing option.
- So while they could borrow from a bank, now with the help of a CP, they could also borrow from the open market.
- Since CP is used to borrow directly from the market, the rate of interest is lesser as compared to the banks.

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Thus…

- **A commercial paper is a lower cost alternative to borrowing from a bank.**
- **However not all organizations are in a position to issue CPs.**
- **Only reputed organizations whose papers have a good rating can borrow directly through CPs and save money.**

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Let's take an example…

- **ABC Group are the owners of a large retail stores.**
- **They want to raise funds from the market to purchase merchandise.**
- **If they go to a bank for a loan, they would have to pay 15% interest on the loan.**
- **But from the open market they could perhaps get the loan at only 10%.**
- **Hence by resorting to an instrument like CP, the organization gains 5%.**

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Therefore…

- **By issuing CPs the organization borrows directly from investors and by-passes the banks.**

- **As a result, it gets to borrow at a lower rate from the market as compared to what the banks would have charged.**

- **This process is also called Financial Disintermediation *or in other words* getting rid of the mediator.**

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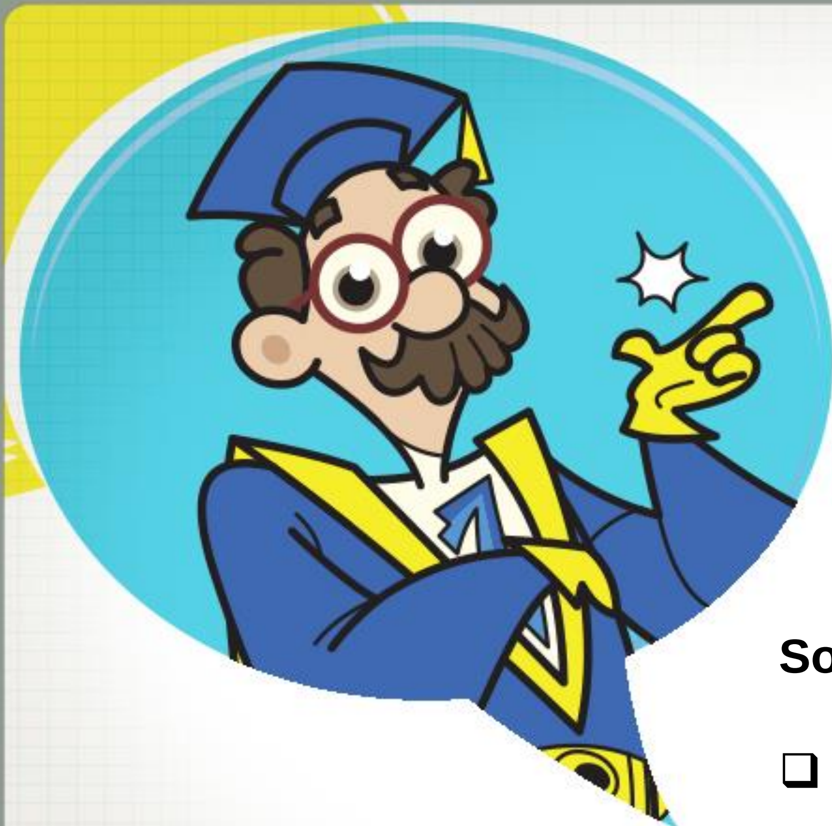

So who is eligible to issue CPs?

- ❑ **Corporates**
- ❑ **Primary dealers**
- ❑ **Financial Institutions (FIs)**

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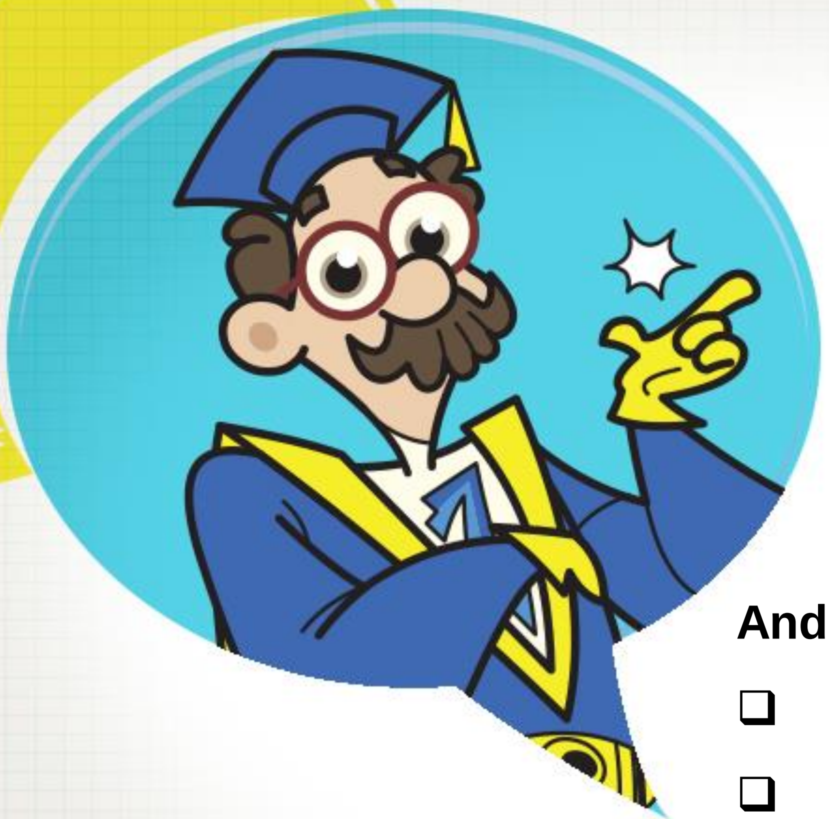

And who can invest in CPs?

- ❑ **Individuals**
- ❑ **Banking companies**
- ❑ **Non-Resident Indians (NRIs) and**
- ❑ **Foreign Institutional Investors (FIIs) etc.**

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For what maturity periods are CPs issued?

CPs can be issued for maturities between a minimum of 15 days and a maximum of up to one year from the date of issue.

Therefore it is used to fund the working capital or current requirements of organizations.

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Some other things

to remember about CPs…

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To Sum Up

- **A major benefit of a CP is that it does not need to be registered with the Securities and Exchange Board of India (SEBI) as long as it matures before nine months (270 days).**

- **However, one important point to note is that the borrowed amount can only be used to fulfill current requirements. It is not meant be used for purchase of fixed assets, such as a new plant.**

If you have understood

CPs, let me tell you what

Treasury Bills are…

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- Treasury Bills or T- Bills are exactly the same as CPs.
- Except that while CPs are issued by corporates, T- Bills are issued by the Government for financing its working capital needs.

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To Sum Up

- **What: A Commercial Paper (CP) is an unsecured money market instrument issued by a corporation or bank in the form of a promissory note.**
- **Why: It provides the organization a borrowing option other than a bank.**
- **When: CPs are issued or sold when an organization needs to borrow money for its short term needs.**
- **How: Once a business becomes established, it can issue CPs after having them rated.**

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Hope you have now understood

the concept of

Commercial Papers

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