

BAILOUT PACKAGE

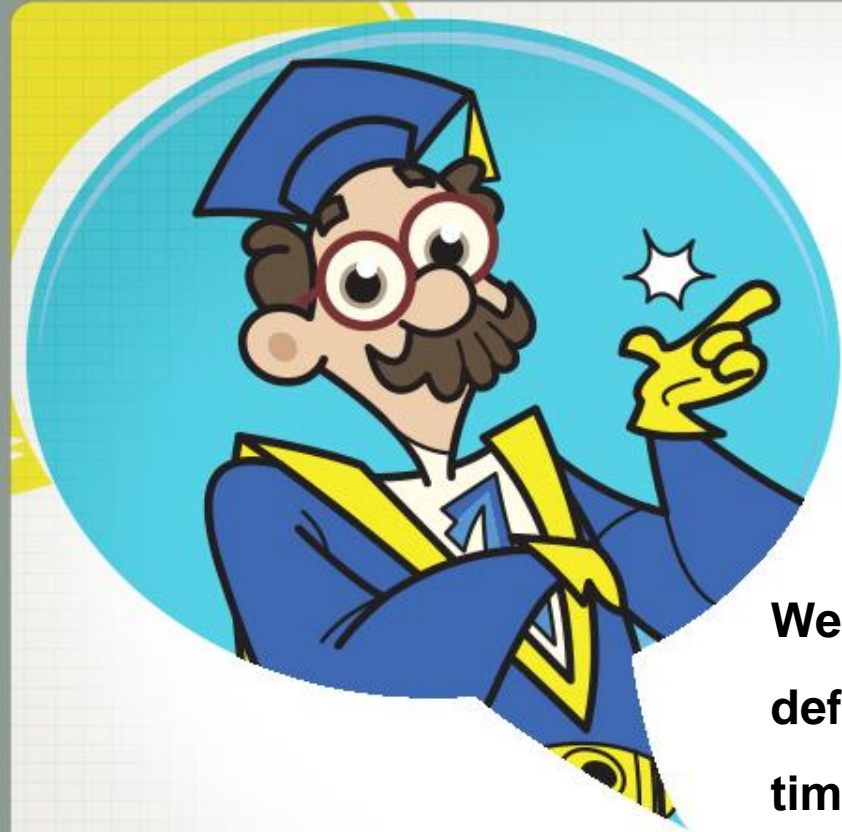


vEcoSys

Understanding a Typical Bailout Package



BAILOUT PACKAGE



We keep hearing about companies defaulting on their debt from time to time. This is followed by “Bail Out” requests. What are “Bail Outs” all about?

Let’s try and discover



BAILOUT PACKAGE

The bailout package is nothing but creating a fund which will provide money to the debt ridden company.

This kind of a fund is usually constructed with the help of government to provide the company a chance to repay its debts



BAILOUT PACKAGE

With the help of this fund the debt ridden company gets a chance to reform its processes so that it can manage its debt obligations smoothly.

In a sense it is taking a new loan to pay for the old loan.

So what is the big idea?

Why is this done?



BAILOUT PACKAGE

If this bailout package was not put together, there are chances that the company would default.

A default leads to panic selling by investors of the shares and bonds of the defaulting company.

This is not desirable because the company's abilities to raise resources to run their business gets adversely impacted.



BAILOUT PACKAGE

Thus the idea of creating the fund is to provide a lifeline to the company for the time being so that it uses the money and time to reform its processes and brings down its costs to enable it to get into a position whereby it can pay off its debt.

In a sense it gives the company time and chance to heal the situation



BAILOUT PACKAGE

To draw a parallel tank of a car whose fuel has drained out in the middle of a highway.

There is no petrol pump in the vicinity and the place is desolate. The passengers are in a fix because if nobody comes to their rescue they'll all die from starvation.



BAILOUT PACKAGE

Now all of a sudden a truck passes by.

The passengers request for fuel.

The truck driver is gracious to lend them fuel.

But there is a problem.

The fuel that he has is not of the grade that the car needs



BAILOUT PACKAGE

The car driver realizes that this is his only chance to survive to see another day.

If he uses this fuel, the car will certainly travel some distance up to the nearest city but his engine would get damaged.

But he has no other option.

If they remain stranded they all will die.

At least if the car reaches the city, the engine can be repaired for the onward journey



BAILOUT PACKAGE

So the car uses the truck fuel. Reaches the city and goes to the garage immediately.

The engine due to running on truck fuel has got damaged. However the mechanic is able to bring it back into good condition and the car moves on its onward journey after paying off the mechanic.

Thus although the car got back on the road, there was a price that was paid by way of repairs to the engine



BAILOUT PACKAGE

Please note that because of the lifeline that the car got in the middle of nowhere it got a chance to get back into shape

Even if there was some cost involved in getting the car in order it was well worth the effort as the benefits of saving the passengers and the car was much more crucial



BAILOUT PACKAGE

Now the bail out package should be seen in this context.

If one allowed the company to default, not only the company but even investors would get adversely affected.

By providing the company a lifeline, it may be possible for the company to put its house in order and pay back its debts

So the company is like the car and the investors are like the passengers who too stand to get into problem if the company fails



BAILOUT PACKAGE

Also, just as the car owner had to spend some money in repairing his engine due to the usage of truck fuel instead of car fuel, the company which seeks a bail out too pays a price by way of a downgrade that its bonds receive and perhaps a fall in its share prices.

In short this company's borrowing power in the open market gets adversely affected and this is the cost that the company has to pay for the bail out



BAILOUT PACKAGE

This is the reason why everything possible should be done to prevent the company from filing for bankruptcy

The bail out package may be an additional loan to service a previous loan. However this loan gives time and chance to the company to set its house in order under guidance of those who are providing the loan



BAILOUT PACKAGE

For a company to set its house in order, it has to reform its business plan in such a way that while its revenue does not get impacted, its costs come down.



BAILOUT PACKAGE

The reformed business plan has to be thus managed in an astute manner to ensure that the overall profits of the company goes up by smartly managing the cost structure. This would enable the company to pay off its debt obligations



BAILOUT PACKAGE

This will require every employee to make some personal sacrifice. For example they may have to agree to take a pay cut if need be for the overall betterment of the organization

Employees usually do not like this and hence do not cooperate with their leaders' directions.

Hence astute handling is a prerequisite in such cases



BAILOUT PACKAGE

In this manner just as the car got repaired back into good health one expects the company to recover and payoff its debts gradually.

If the company does not comply with the reform plan the situation of bankruptcy will repeat itself

Therefore it becomes very vital for the company to manage its operations in a very disciplined manner so that it keeps costs under control



BAILOUT PACKAGE



Hope this explanation has given you an idea of how bail out packages are intended to work

Hope this story has clarified the role of a bailout package



Thinking of Investment

Contact

vEcoSys



DISCLAIMER

The views expressed in this lesson are for information purposes only and do not construe to be any investment, legal or taxation advice. The lesson is a conceptual representation and may not include several nuances that are associated and vital. The purpose of this lesson is to clarify the basics of the concept so that readers at large can relate and thereby take more interest in the product / concept. In a nutshell, Professor Simply Simple lessons should be seen from the perspective of it being a primer on financial concepts. The contents are topical in nature and held true at the time of creation of the lesson. This is not indicative of future market trends, nor is vEcoSys IMF Pvt. Ltd. attempting to predict the same. Reprinting any part of this material will be at your own risk. vEcoSys IMF Pvt. Ltd. will not be liable for the consequences of such action.

**Mutual Fund investments are subject to market risks,
read all scheme related documents carefully.**

