



# BUSINESS NEWS



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## BANKING CASE STUDY- BORROWING ABOVE YOUR CAPACITY!!!

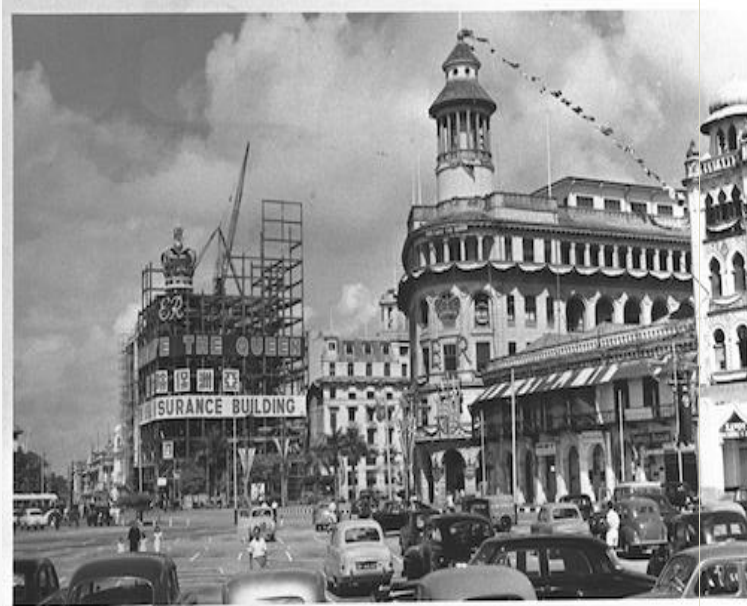


### By: S. Khugan

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### THE CASE STUDY...

This particular case is way back in 2003. Now this case is something that jolted us in the financial consultancy line as the facts didn't add up at first but by the time we could analyze the problem it was too late and had led to several millions of losses for all sides.



Always Understand the consequences of your actions when it comes to **DEBTS!!!**

**THE FIRST STEP TO TAKING CONTROL OF YOUR MONEY...IS TO STOP BORROWING.....**

## The Case in Hand...

Let me begin by giving you the scenario! The company was established in 1953 and was currently a third generation company. The company started by the original promoter in 1951 and incorporated the company under a sole proprietorship in 1953 and then changed the registration into a partnership in 1962 and incorporated a Private Limited company in 1976.

The promoter started the company with a humble RM100.00 and had built the company to a multimillion dollar corporation by the time we were hired to consult them in 2003. At the time of our appointment the company's monthly turnover was between RM 2.5-3 Million monthly and recorded a yearly turnover of approximately 32 Million a year.

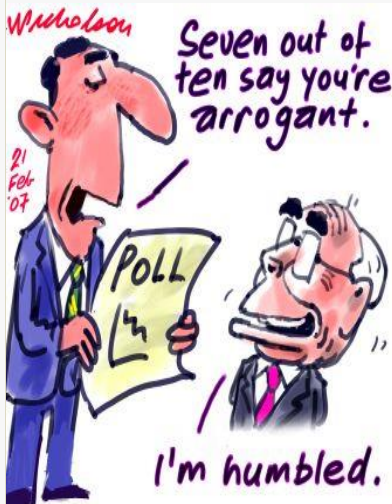
At that time their liabilities was at bare minimal, as the company was run by the original promoters son and daughter in law who were very conservative in their thinking, as they were the second generation owners of the company. However in 2001 the company's Managing Director was their 26 year old son who had taken over the reigns of the company from his father and mother who were still in the company but left it to him for daily operations.

Now this young man had fantastic ideas and wanted to initiate a massive expansion program for the company, in which time we were appointed to consult on these plans, when we crunched the numbers and took in the risk factors it was an amazing plan to implement.

By 2005 the company had three subsidiaries with the average turnover of RM 1.2 Million -1.5 Million per month with a profit margin of minimum 32%. Please note at this juncture the company was still self financed without any further borrowings from the financial institutions.

By the end of 2005, The Managing Director came up with a plan to go international as now he was being scouted by several International companies who wanted to work with him and the company. In order for this second phase of expansion the company needed a rather substantial capital injection.

So the company applied for several loans from different banks and as you can imagine with the excellent track record the banks were more than pleased to extend credit to this company. The company started growing exponentially after each injection and the company started opening other subsidiaries.



The problem was that all of a sudden we could see a unexpected change in the directors of the company, I am sure that you would be assuming that it was from the 26 year old who was now 29 of course, but actually it was from the second generation directors his parents. As they never knew how to value their company and now all of a sudden with the rapid flash of cash, Arrogance started building up and suddenly the subsidiaries were given to Son-in-laws and cousins and relatives to run who had no experience in the business what so ever neither the practice in logical thinking as well.

Each director of the subsidiaries were given a Mercedes E230 as a company car, some were given Mercedes 2 door coupes. Suddenly the Managing Director thought what the heck and bought a Ferrari after all he was the Managing Director and all of a sudden a Barabus was beneath him.

Money was being splurged on useless things against our advice; turnover started decreasing as the focus on the company was now dwindling. The operations were actually managed by some of the dedicated staff who have been working in the company for over 20 years.





The management of the company started taking trips for long periods of time without rhyme or reason, business was suffering and no one was bothered but a handful of us. At the Annual General Meeting of 2006 we provided a full report on the actual status of the company and the losses that the company had suffered over the last fiscal year.

The shocking news was that they decided to terminate the staff who were actually keeping the company afloat, all because they had questioned the expenses of the directors of the subsidiaries and it was an ego trip as who were they to question family. Taking this into account we put in our resignation as their corporate consultants, however they refused to accept and agreed to not go through with the earlier terminations.

As we had formed a friendship we retracted our resignation, however things started to get worse in the next few months as they started terminating the said employees one by one based on various accusations. With every unlawful termination the company opened itself to law suit after law suit.



On September 2006 we had no choice but to officially resign as their Corporate Consultants as the problems were becoming so huge that we could not concentrate on other clients as they were taking up the bulk of our time with unproductive works.

By April of 2007 the condition of the company had worsened to an extent that some subsidiaries were just having a skeletal crew as hardly any works were being done on the premises. By this time the Managing Director was hardly to be seen in office or in any other business outlet of theirs.

Family problems started increasing as now everyone wanted a Ferrari and shares in the company, divorced in laws were suing for right of ownership, relatives started fighting among themselves as to who had a bigger car or allowance, etc...

March 2007 a banker friend of mine called and said that the company had put in an application for a rather huge loan and wanted to know my opinion. I had given him my two cents and told him that they should reconsider or at least slash the amount by about 60%. He calls me up three days later and says that his management is pushing for the approval as it was a good company and it was out of his hands.



I left it at that, till I was called for lunch by one of the terminated employees of one of the most productive subsidiaries on May 23<sup>rd</sup> 2007 and she asked me to follow her to the factory and to my surprise it was operated by 3 people with absolutely no production. Now this factory under this particular employee was running a production line of 50 people with 2 shifts and generating a sales turnover of over RM 1.5-1.8Million per month. She was in tears as she could not bear to see all her work gone to waste as I am sure those of you reading would agree that generating such a turnover with that limited workers was a great deed indeed.

That was it till somewhere in mid August 2007 I was called to have lunch with the Managing Director at his favorite hotel in KL, I still remember it was a

Friday afternoon. We talked and he kept on saying how sorry he was for the way the company was run and that they should have listened to us and whether we would consider coming back to consult them and so forth, as we had become good friends by then or as I thought so, we caught up on a lot of old times and left hugging each other saying our goodbyes at almost quarter to 7pm.

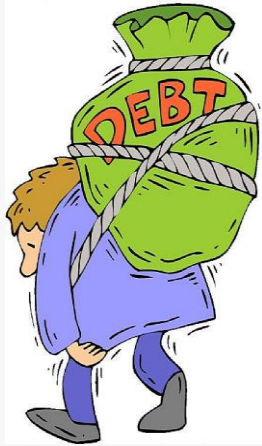
Honestly after that I had actually given thought to should we consult them again, but after weighing the pros and cons and how much business we had to loose in order to get their company matters in order I had decided not to do so, though with a heavy heart.

The weekend passed by as usual and on that Monday at 9.30am I received a call from my banker friend that had approved this company loan in March of 2007, he sounded frantic and asked me to come over to the main factory in KL. Thinking that there was a major accident or something I rushed to the site and was caught unaware of what I was witnessing....



The company was sealed in RED TAPE and there were cranes and Lorry's in the factory site and guys with guns and machetes walking around inside the factory area while all the well dressed people who definitely looked liked bankers were outside the fence not given permission to go in.

They were ripping the roof of the buildings and using the cranes to extract the machinery's that were bolted to the ground and loaded them onto the Lorries that were parked there. We were in a state of shock as to what was happening. After calmly talking to some of the bosses who were in the factory area did we get the actual picture of what was happening there?



**It seemed that the management of the company to sustain their lifestyle had borrowed over RM 12 Million** from various money lenders and when they could not service the high interest payments overnight the entire family along with their extended family disappeared, apparently out of the country for good with whatever money they had taken from all sources.

In retaliation they the Money Lenders were extracting anything that they could salvage as repayment and the banks were left with huge bad debts. I have not heard from anyone from that family at all for the last 8 years, I assume that the last lunch I had with the Managing Director was in fact a courteous goodbye. Needless to say I was not happy but that's how the winds blow....

**THE MORAL OF THE STORY :** In my last post we examined why successful businesses are not bankable today, well the short version is that Financial Institutions have been hit badly by cases such as this, however I do share your opinions that this one case which was ruled by human factors. Perhaps banks should also learn that not everything comes from the examinations of documentations only as the one unpredictable factor is always the Human factor.

So the next time you feel that the Financial Institutions are trying to make your life difficult it is because they want to be very thorough in evaluating the financing proposal, so this is where understanding your business needs and submitting a precise application is very crucial to the future of your business.

I sincerely hope that this case study has given you some insight of the workings and concerns of a Financial Institution as well as an insight as to what to avoid in your business for the future....



***Till My Next Post....Please have a Profitable Week Ahead and Best Regards Always!!!***

**S. KHUGAN  
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