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FINANCING OF BUSINESS

You must have seen a doctor busy in running his clinic, a shopkeeper selling groceries, or a tailor busy in stitching clothes. They all are pursuing their occupations or doing business to earn their livelihood. To become successful in their occupation or business all of them need some amount of funds (money) to buy the required materials, tools and equipments. The doctor has to purchase medical equipments and furniture to run his clinic, the shopkeeper has to buy groceries, the tailor has to purchase sewing machine, threads and other stitching materials for his work. Thus, any type of business or occupation requires money at every stages of its operation. Now, the question arises from where do the businessmen gather the required amount of money? Are they able to manage with their own money to start and run their business? Obviously, it is difficult and in case of large business, it is ruled out. So we have to know what are the various options available to them to arrange the required amount of funds (also called capital). In this lesson, we shall try to find out the answer to such questions.

OBJECTIVES

After studying this lesson, you will be able to:

- state the meaning of business finance;
- explain the need and importance of business finance;
- identify the different types of business finance;
- explain the various methods of raising short-term finance;
- suggest various types of securities required to obtain bank credit and
- describe the various methods of raising long term finance.

15.1 BUSINESS FINANCE

We all know that every business requires some amount of money to start and run the business. Whether it is a small business or large, manufacturing or trading or transportation business, money is an essential requirement for every activity. Money required for any activity is known as finance. So the term 'business finance' refers to the money required for business purposes and the ways by which it is raised. Thus, it involves procurement and utilisation of funds so that business firms will be able to carry out their operations effectively and efficiently.

You know that a business unit cannot move a single step without sufficient amount of finance. But before discussing the importance of finance, let us learn in detail as to why does the business need funds.

Every business needs funds mainly for the following purposes:

1. **To purchase fixed assets :** Every type of business needs some fixed assets like land and building, furniture, machinery etc. A large amount of money is required for purchase of these assets.

2. **To meet day-to-day expenses :** After establishment of a business, funds are needed to carry out day-to-day operations e.g., purchase of raw materials, payment of rent and taxes, telephone and electricity bills, wages and salaries, etc.

3. **To fund business growth :** Growth of business may include expansion of existing line of business as well as adding new lines. To finance such growth, one needs more funds.

4. **To bridge the time gap between production and sales :** The amount spent on production is realised only when sales are made. Normally, there is a time gap between production and sales and also between sales and realisation of cash. Hence, during this interval, expenses continue to be incurred, for which funds are required.

5. **To meet contingencies :** Funds are always required to meet the ups and downs of business and for some unforeseen problems. Suppose, a manufacturer anticipates shortage of raw materials after a period, then he would like to stock the raw materials in large quantity. But he will be able to do so only if sufficient money is available with him.

6. **To avail of business opportunities :** Funds are also required to avail of business opportunities. Suppose a company wants to submit a tender for which some amount of money is required to be deposited along with the application. In case of non-availability of funds it would not be possible for the company to submit the tender. Take another example. When a stockist offers special discount on large amount of purchase of any particular material then a manufacturer can avail of such offer, only if he has adequate funds to buy it.

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15.2 IMPORTANCE OF BUSINESS FINANCE

Finance is the most important requirement of every business and it is considered as life-line of the business. Inadequate finance poses many problems and may bring an end to the life of the business. The importance of finance has considerably increased in modern days due to following reasons in addition to the usual need:

(a) **Need for Large Scale Operation :** Now-a-days business activities are generally undertaken on a large scale. The products of any country are now freely and easily available in other countries. The entire world has become a big market. So to survive in the business world the businessman has to expand the horizon of his activities and function on large scale. This expansion of business always demands more funds.

(b) **Use of Modern Technology :** Use of latest technology in the process of production as well as distribution has become imperative for every business now-a-days. To meet the competition, production process now demands use of modern machinery, equipments and tools. Hence, there is a greater need for finance to meet the challenge of the world's markets successfully.

(c) **Promotion of sales :** In this era of competition lot of money is to be spent on activities for promoting sales. This involves advertisement, personal selling, use of sales promotional schemes, providing after sales service and free home delivery, etc. which need huge amount of funds.

15.3 TYPES OF BUSINESS FINANCE

You have learnt that in every business activity money is an important as well as essential component. Now let us see the nature and types of financial requirement of the business enterprises.

The type and amount of funds required usually differs from one business to another. For instance, if the size of business is large, the amount of funds required will also be large. Likewise, the financial requirements are more in manufacturing business as compared to trading business. The business needs funds for longer period to be invested in fixed assets like land and building, machinery etc. Sometimes, the business also needs funds to be invested for shorter period. So based on the period for which the funds are required, the business finance is classified into three categories.

(a) Short-term Finance;

(b) Medium-term Finance; and

(c) Long-term Finance;

Let us now learn about each of them in detail.

Short-term Finance

Funds required to meet day-to-day expenses are known as short-term finance. This is required for purchase of raw materials, payment of wages, rent, insurance, electricity and water bills, etc. The short-term finance is required for a period of one year or less. This financial requirement for short period is also known as working capital requirement or circulating capital requirement. It may be noted that a part of the working capital requirement is of a long-term nature, as certain minimum amount of funds are always kept to meet the requirement of stock and regular day-to-day expenses.

Medium-term Finance

Medium-term finance is utilised for all such purposes where investments are required for more than one year but less than five years. Amount required to fund modernisation and renovation, special promotional programmes etc. fall in this category.

Long-term Finance

The amount of funds required by a business for more than five years is called long-term finance. Generally this type of finance is required for the purchase of fixed assets like land and building, plant and machinery, furniture etc. The long-term finance is also known as fixed capital as such need in fact is, of a permanent nature.

Types of Finance	*Period of Repayment*	*Purpose*
Short-term	Less than a year	Purchase of raw materials, payment of wages, rent, insurance etc.
Medium-term	One year to five years	Expenditure on modernisation, renovation, heavy advertising etc.
Long-term	More than five years	Purchase of land and building, plant and machineries, etc.

Every organisation need different types of finance i.e., long-term, medium-term as well as short-term. But the combination in which these are used differ from one business to another. For example, steel industry requires more long-term finance to be invested in land and building and machinery as compared to the manufacturing of leather goods or plastic buckets. Similarly, for manufacturing hosiery items, requirement of short-term finance would be more than that of long-term finance.

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Concepts of fixed and working capitals

You are aware that the capital of a business is invested in different types of assets like land and building, furniture, machines, raw material, stock of finished goods etc. Some of these assets are used over a long period of time and hence are generally of a permanent nature. Fixed capital refers to the total value of assets in a business, which are of durable nature and used in a business over a considerable period of time. It comprises assets like land, building, machinery, furniture etc. The capital invested in these assets is fixed in the sense that these are required for permanent use in business and not for sale.

Working capital consists of those assets which are either in the form of cash or can easily be converted into cash, e.g., cash and bank balances, debtors, bills receivable, stock, etc. These assets are also known as current assets. Working capital is needed for day-to-day operations of the business. However, a part of working capital is required at all times to maintain minimum level of stock and cash to pay wages and salaries etc. This part of working capital is called 'permanent' working capital.

INTEXT QUESTIONS 15.1

1. List the various needs of the business for which funds are required.
2. Give examples of specific expenditures for which funds will be required for the following terms/time periods.
   (a) Short-term
   (b) Medium-term
   (c) Long-term

15.4 SOURCES OF FINANCE

Having learnt about the need, importance and types of financial requirements, now we must know from where the businessmen get the required amount of funds to meet the short-term, medium term and long term requirements. Who provides them the required amount? Let us learn about the various sources from which the businessmen generally arrange money for business purposes.

Broadly speaking, there are two main categories of sources from which the businessmen can get the required funds for their business. These are : (1) internal sources; and (2) external sources. You know that to start a business the businessman either invests his own money or borrows from outsiders or uses both the sources. When the businessman invests his own money (called owner's capital), and retains a part of the profits earned in the business it constitute the internal sources of finance. It is an integral part of every business organisation and it is cost effective. But, this source has its own limitations. Hence the business houses have to resort to the external sources of finance. The various external sources from where businessmen can get the finance include, friends and relatives, banks and other financial institutions, moneylenders, capital market, manufacturers and producers, customers, foreign financial institutions and agencies, etc.

It is observed that the scope of raising funds also depends upon the nature and form of business organisation. For example, a sole proprietorship form of business organisation has very limited sources from which it can arrange funds for the business. These are:

(a) Own Savings
(b) Friends and Relatives
(c) Moneylenders
(d) Commercial Banks
(e) Finance Companies
(f) Manufactures and Suppliers
(g) Retained Profits

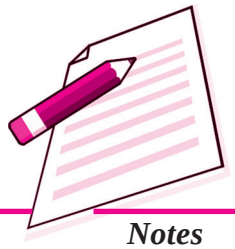
The same sources of financing are also available in case of partnership firms. In both sole proprietorship and partnership form of business organisation, long term capital is generally provided by the owners themselves by way of investing their own savings and retaining a part of the profits generated by the business and the rest of the above sources are mostly used for their short-term financial needs. However, in case of companies, the following are the usual sources of finance.

(a) Capital Market
(b) Financial Institutions
(c) Public Deposits
(d) Commercial Banks
(e) Leasing Companies
(f) Investment Trusts
(g) Retained Profits.

We shall learn in detail about these sources in the next chapter.

15.5 METHODS OF RAISING SHORT-TERM FINANCE

There are a number of methods used for raising short-term finance. These are :



1. **Trade Credit :** Trade credit refers to credit granted to manufacturers and traders by the suppliers of raw material, finished goods, components, etc. Usually business enterprises buy goods on 30 to 90 days credit. This means that the goods are delivered but payments are not made until the expiry of the period of credit. This type of credit does not make the funds available in cash but it facilitates purchases without making immediate payment which amounts to funding it by suppliers. This is a very popular source of short term finance.

2. **Bank Credit :** Commercial banks usually provide short-term finance to business firms, which is known as bank credit. When bank credit is granted, the borrower gets a right to draw the amount of credit as and when needed. Bank credit may be granted in any of the following ways:

   (a) **Loans and Advances :** When a certain amount of money is advanced by a bank repayable after a specified period, it is known as bank loan. Such advance is credited to a separate loan account and the borrower has to pay interest on the whole amount of loan irrespective of the amount of loan actually drawn. Usually loans are granted against security of assets.

   (b) **Cash Credit :** It is an arrangement whereby banks allow the borrower to withdraw money upto a specified limit. This limit is known as cash credit limit. This facility is granted against the security of goods in stock or promissory notes or other marketable securities like government bonds. Under this arrangement, the borrower can draw, repay and again draw the amount within the sanctioned limit. Interest is charged only on the amount actually withdrawn and not on the amount of entire limit.

   (c) **Bank Overdraft :** When a bank allows its depositors or account holders to withdraw money in excess of the balance in his current deposit account upto a specified limit, it is known as overdraft facility. This limit is granted purely on the basis of credit-worthiness of the borrower. Interest is charged only on the overdrawn money. Rate of interest in case of bank overdraft is less than the rate charged under cash credit.

   (d) **Discounting of Bill :** Banks also give advance money by discounting bill of exchange. When a bill of exchange is presented before the bank for encashment, bank credits the amount to customer's account after deducting some discount. The amount of discount is charged on the basis of the interest for the period of bill. On maturity of the bill, the payment is received by the bank from the drawee.

Distinction between Cash Credit and Bank Overdraft

(i) Cash credit is an arrangement of credit granted by a bank to a firm. The firm may or may not have an account with the bank. Overdraft is granted to an accountholder purely on the basis of his credit-worthiness. Credit worthiness is decided by the financial soundness of past dealings of the customer with the bank.

(ii) In case of cash credit, the amount of credit is placed in a separate account of the borrower. Overdraft limit is generally granted to an existing account of the customer.

(iii) The amount of credit in case of cash credit depends upon the value of securities offered. But overdraft limit is decided on the average balance in the customers account.

(iv) Overdraft is granted without the security of any assets. But for cash credit, security of tangible assets is an essential requirement.

3. **Factoring :** Factoring is a method of raising short-term finance for the business in which the business can take advance money from the bank against the amount to be realised from the debtors. By this method, the firm shifts the responsibility of collecting the outstanding amount from the debtors on payment of a specified charge. Here the business gets the money in advance without waiting for due date. Also it saves the effort of collecting the debts.

4. **Customers' Advances :** Sometimes businessmen insist their customers make some advance payment. It is generally asked when the value of order is quite large or goods ordered are very costly. Customers' advance represents a part of the payment towards sale price of the product(s), which will be delivered at a later date. Customers generally agree to make advance payment when such goods are not easily available in the market or there is an urgent need of any goods. A firm can meet its short-term requirements with the help of customers' advances.

5. **Installment Credit :** In business, credit that is granted on condition of its repayment at regular intervals, or installments, over a specified period of time. Installment credit is the means by which most durable goods such as automobilies and large home appliances are bought by individuals. The purchaser usually is advanced the goods after making an initial fractional payment called a down payment. If the purchaser defaults on his payments at some point, all previous payments are forfeited to the seller, who may also taken possession of the goods.

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6. **Loans from Unorganised Sectors :** In addition to the above methods of raising funds, the businessmen always have the option to take the money from the unorganised sector like loans from the moneylender (called indigenous bankers), friends and relatives. To meet the short-term and urgent need of business, money can be obtained from them either on personal security or on security of tangible assets and personal properties. Since the interest charged on loans from unorganised sector is normally very high, the businessmen are not very keen to avail of loan from this source.

7. **Inter Corporate Deposits (ICDs) :** Deposits made by one company with another company for a short term are termed as Inter Corporate Deposits. It is a type of unsecured debt. It is arranged by a broker. This is a form of short term finance. This source of finance is free from legal formalities. ICDs are kept secret and are not disclosed to the public. The interest payable depends on the amount and period of deposit. There is no organised market for exchanging these deposits.

Types of ICDs

Following are the different types of inter corporate deposits:

(a) **Call Deposits :** Call deposits can be withdrawn by the lender by giving a one day notice. The rate of interest on such deposits is 10 % p.a.

(b) **Three Months Deposits :** These ICDs are for a period of three months. The rate of interest on these deposits is 12% p.a.

(c) **Six Months Deposits :** These ICDs are for a period of 6 months. The rate of interest on these deposits is 15% p.a.

15.6 TYPES OF SECURITY REQUIRED FOR OBTAINING BANK CREDIT

You have learnt that loans and advances are granted by the banks on the basis of some security, which will ensure the bank for safe return of its money. This security may be personal security of the borrower as well as on the security of some assets, besides the standing of the firm. Thus, securities offered against bank credit may be of two types:

(1) Personal security (2) Security of assets

Personal security means the credit-worthiness of the borrower. Banks judge the credit-worthiness of the borrower on the basis of his financial soundness and past dealings with the bank, and then sanction the amount. When the banks ask for security of assets, the following are generally accepted as security for extending short-term finance.

(a) **Moveable Goods :** Stock of raw materials and finished goods are accepted by banks as security against bank credit. In case of non-payment, these goods are sold and money is recovered by banks.

(b) **Shares :** Shares that are quoted on a recognised stock exchange are accepted as security against bank credit. The borrower is required to assign his share holding in favour of the bank.

(c) **Documents of Title to Goods :** Bill of Lading, Railway Receipts (RR), Goods Receipt (GR), Warehouse warrant are various documents which are recognised as documents of title to goods. To secure credit from bank, the borrower may deposit any of these documents with bank after duly endorsing the same in favour of the bank. This enables the bank to deal with the goods in case of default in repayment.

(d) **Fixed Deposit Receipts :** It is a receipt issued by bank as evidence of fixed deposit made by the customer. Banks grant loan on the security of this receipt. Banks normally grant loan upto 90% of the value of such receipts.

(e) **Life Insurance Policies :** Banks extend credit on the basis of life insurance policy upto the amount of surrender value of such receipts.

(f) **Jewellery or Precious Metals :** This type of security may be offered to borrow money for private as well as for business purposes. Sole proprietary concerns sometimes offer jewellery or other precious metals to obtain credit.

(g) **Other Securities :** Besides the assets and documents mentioned above, banks also accept National Savings Certificate (NSC), Kisan Vikas Patra (KVP), Government Bonds for grant of short-term credit.

INTEXT QUESTIONS 15.2

I. Give specific examples of the following kinds of assets that may be given as security for obtaining bank credit:

(a) Document of title to goods

(b) Moveable goods

(c) Jewellery or precious metals

II. Which type of bank credit is being referred to here:

(a) Accountholder is allowed to withdraw an amount in excess of the balance in his current account in the bank.

(b) The bank advances money against a document, after deducting some discount.

(c) Interest is charged on the amount actually withdrawn, and not on the entire amount sanctioned.

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(d) The amount is credited to a separate account by the bank and interest is paid by the borrower on the whole of this amount, irrespective of the amount actually drawn.

III. Multiple choice Questions.

(i) Name the deposit arranged by one company with another company for a short term.

(a) Fixed deposit (b) Inter corporate deposits

(c) Owned deposit (d) Borrowed deposits

After knowing the various methods of raising short-term finance let us now learn about the methods of raising long-term finance.

15.7 SMALL BUSINESS

Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 has classified enterprises as follows :

1. Manufacturing Enterprises

   a) Micro Enterprise : A unit with an investment up to Rs. 25 lakh.

   b) Small Enterprise : A unit with an investment above Rs. 25 lakh and upto Rs. 5 crore.

   c) Medium Enterprise : A unit with an investment above Rs. 5 crore and upto Rs. 10 crore.

2. Service Enterprises

   a) Micro Enterprise : A unit with an investment up to Rs. 10 lakh.

   b) Small Enterprise : A unit with an investment above Rs. 10 lakh and up to Rs. 2 crore.

   c) Medium enterprise : A unit with an investment above Rs. 2 crore and up to Rs. 5 crore.

15.7.1 Role of Small Business in India

Small Scale Industries are small in size but constitute 95% of the industrial units in India. They contribute 45% of the total exports from India. They are helpful in the following ways :

1. **Employment :** As Small Scale Industries are laboure-intensive, they provide employment to a large number of people.

2. **Supply Variety of Products :** SSIs supply variety of products like mass consumption goods, readymade garments, stationery items, detergents, leather, plastic and rubber products, processed foods and vegetables, wood and steel furniture, safety matches etc. Some sophisticated items like electric and electronic goods such as TV, Calculator, agricultural tools etc. and handloom and handicraft products are made by SSIs.

3. **Balance Regional Development :** SSIs use single technologies and depend on locally available resources (material, labour etc.). This enables it to start its unit anywhere in the country.

4. **Opportunity for Entrepreneurship :** SSIs provide opportunity for entrepreneurship. These units can be started with little capital so talented and skilled people can have their own business units.

5. **Low Cost of Production :** SSIs use locally available resources which are less expensive. Therefore, establishment and running cost of small industries are less.

6. **Capture New Business Opportunities :** Due to the small size of the organisations, quick decisions can be taken by SSI units. This enables them to capture new business opportunities.

7. **Customised Production :** SSI units manufacture products according to the needs of customers. They manufacture products according to the specifications provided by consumers.

15.7.2 Role of Small Business in Rural India

Earlier rural people used to engage only in agriculture. With the formation of SSI Units many rural people started setting up agro-based rural industries.

Traditional artisans and persons engaged in cottage and rural industries get a good employment opportunity because of SSI unit. This prevented migration of rural population to urban areas in search of jobs.

In SSI units, labour intensive techniques are used. Therefore, it helped to remove the problem of poverty and unemployment. At the same time, SSIs help to utilise the rural potential to the maximum, thus, helping the country in a balanced regional development.

15.8 METHODS OF RAISING LONG TERM FINANCE

You have already learnt about the purpose for which long-term finance is required by the business. In small organisations the long-term finances are generally provided by the owners. But for large organisations like joint stock companies there are various options available to raise the long term finance. Followings are the most commonly used methods of long-term finance.

(i) Issue of Shares

(ii) Issue of Debentures

(iii) Loans from financial institutions

(iv) Public Deposits

(v) Retention of Profit

(vi) Lease financing

(vii) Foreign Investment

Let us now discuss about these in detail.

15.8.1 Issue of Shares

Share is the smallest unit into which the total capital of the company is divided. For example, when a company decides to raise Rs. 50 crores of capital from the public by issuing shares, then it can divide its capital into units of a definite value, say Rs. 10/- or Rs. 100/- each. these individual units are called as its share. After deciding the value of each share and number of shares to be issued, the company then invites the public to buy the shares. The investing public then buy the shares as per their capabilities. The investors who have purchased the shares or invested money in the shares are called the shareholders. They get dividend as return on their investment.

You know that investors are of different habits and temperaments. Some want to take lesser risk and are interested in a regular income. While others are ready to take greater risk in anticipation of huge profits in future. In order to tap the savings of different types of people, a company can issue two types of shares, viz. (a) Equity Shares, and (b) Preference shares.

(a) Equity Shares

Equity shares are shares, which do not enjoy any preferential right in the matter of claim of dividend or repayment of capital. The equity shareholders get dividend only after making the payment of dividends on preference shares. There is no fixed rate of dividend for equity shareholders. The rate of dividend depends upon the surplus profits. In case there are good profits, the company pays dividend to the equity shareholders at a higher rate. Again in case of winding up of a company, the equity share capital is refunded only after refunding the claims of others. In fact they are regarded as the owners of the company who exercise their authority through the voting rights they enjoy. The money raised by issuing such shares is known as equity share capital. It is also called as ownership capital or owners' fund.

Merits of Equity Shares

From Shareholders point of view

- The equity shareholders are the owners of the company.
- It is suitable for those who want to take risk for higher return.
- The value of equity shares goes up in the stock market with the increase in profits of the concern.
- Equity shares can be easily sold in the stock market.
- The liability is limited to the nominal value of shares.
- Equity shareholders have a say in the management of a company as they are conferred with voting rights.

From Management point of view

- A company can raise capital by issuing equity shares without creating any charge on its fixed assets.
- The capital raised by issuing equity shares is not required to be paid back during the lifetime of the company. It will be paid back only when the company is winding up.
- There is no binding on the company to pay dividend on equity shares. The company may declare dividend only if there are enough profits.
- If a company raises more capital by issuing equity shares, it leads to greater confidence among the creditors.

Limitations of Equity Shares

From Shareholders point of view

- Equity shareholders get dividend only when the company earns sufficient profits. The decision to declare dividend lies with the Board of Directors of the company.
- There is high speculation in equity shares. This is particularly so in the time of boom when profitability of the companies is high.
- Equity shareholders bear a very high degree of risk. In case of losses they do not get dividend, and in case of winding up of a company, they are the last to get the refund of their money invested. Equity shares actually swim and sink with the fate of the company.

From Management point of view

- It requires more formalities and procedural delay to raise funds by issuing equity shares. Also the cost of raising capital through equity share is more as compared to debt.

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- As the equity shareholders carry voting rights, groups are formed to garner the votes and grab the control of the company. This may lead to conflict of interests, which is harmful for the smooth functioning of a company.

(b) Preference Shares

Preference Shares are those shares, which carry preferential rights in respect of dividend and return of capital. Before any dividend is paid to the equity shares, the dividend at a fixed rate must be paid on the preference shares. However, this dividend is payable only if there are profits. Again at the time of winding up, the holder of the preference shares will get the return of their capital before anything is paid to the equity shareholders. The holders of the preference shares do not have any voting right. So, they cannot take part in the management of the company. It is not compulsory on the part of the company to issue preference shares.

Types of Preference Share

A company has the option to issue different types of preference share. Let us see what are the different types of preference share a company can issue.

(i) **Convertible and Non-convertible Preference Share :** The preference shares which can be converted into equity shares after a specified period of time are known as convertible preference share. Otherwise, it is known as non-convertible preference share.

(ii) **Cumulative and Non-cumulative Preference Share :** In vumulative preference shares, the unpaid dividends are accumulated and carried forward for payment in future years. On the other hand, in non-cumulative preference share, the dividend is not accumulated if it is not paid out of the current year's profit.

(iii) **Participating and Non-participating Preference Share :** Participating preference shares have a right to share the profit after making payment of divided at a predecided rate to the equity shares. The non-participating preference shares do not enjoy such a right.

(iv) **Redeemable and Irredeemable Preference Share :** Preference shares having a fixed date of maturity are called as redeemable preference shares. Here, the company undertakes to return the amount to the preference shareholders immediately after the expiry of a fixed period. Where the amount of the preference shares is refunded only at the time of liquidation, are known an irredeemable preference shares.

Difference between equity shares and preference shares

We have already learnt the meaning and features of equity and preference shares. Now let us find out the differences between these two.

Basis of difference	Equity shares	Preference Shares
(i) Choice	It is compulsory to issue these shares.	It is not compulsory to issue these shares.
(ii) Payment of dividend	Dividend is paid on these shares only after paying dividend on preference shares.	Dividend is paid on these shares in preference to the equity shares.
(iii) Return of capital	In case of winding up of the company the equity share capital is refunded only after the refund of preference share capital.	In case of winding up of the company the capital is refunded in preference over the equity shares.
(iv) Voting Right	The equity shareholders enjoy voting rights.	The preference shareholders do not have voting rights.
(v) Accumulation of Dividend	The dividends on equity shares are not accumulated and therefore, cannot be carried forward.	The unpaid dividends are accumulated and are carried forward to the future years in case of cumulative preference shares.

It may be noted that the companies have to follow a prescribed procedure for issue of shares as per the Companies Act and the guidelines issued by Securities and Exchange Board of India (SEBI).

You learnt about equity shares and preference shares. Now let us learn about debentures.

15.8.2 Issue of Debentures

The companies can raise long term funds by issuing debentures that carry assured rate of return for investors in the form of a fixed rate of interest. It is known as debt capital or borrowed capital of the company. The debenture is a written acknowledgement of money borrowed. It specifies the terms and conditions, such as rate of interest, time of repayment, security offered, etc. These are offered to the public to subscribe in the same manner as is done in the case of shares.

The debentureholders are the creditors of the company and are entitled to get interest irrespective of profit earned by the company. They do not have any voting right. So they do not interfere in the day-to-day management of the business. Ordinarily, debentures are fully secured. In case the company fails to pay interest on debentures or repay the principal amount, the debentureholders can recover it from sale of its assets.

Merits of Debentures

(a) Debentures are secured loans. On winding up of the company, they are repayable before making any payment to the equity and preference shareholders.

(b) The debentureholders get assured return irrespective of profit.

(c) Issue of debentures enables the company to provide high return to equity shareholders when the earnings of the company are good. This is called Trading on Equity.

(d) Debentureholders have no right either to vote or take part in the management of the company. So by issuing debentures the company raises the additional capital without diluting the control over its management.

(e) Interest paid on debentures is treated as an expense and is charged to the profits of the company. The company thus, saves income tax.

Limitations of Debentures

(a) If the earnings of the company are uncertain and unpredictable, issue of debentures may pose serious problems due to fixed obligation to pay interest and repay the principal. So, when the company expects good and stable income, then only it should issue debentures.

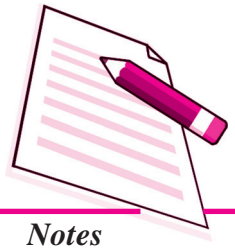
(b) The company, which issues debentures, creates a charge on its assets in favour of debentureholders. So a company not having enough fixed assets cannot borrow money by issuing debentures.

(c) The assets of the company once mortgaged cannot be used for further borrowing. So, issue of debentures reduces the borrowing capacity of the company.

Trading on Equity

Trading on Equity refers to the use of high debt for ensuring higher returns for the equity shareholders. This is workable when the profitability is high and the rate of return on investment of funds is higher than the rate of interest to be paid on the borrowed money. Let us take an example. Suppose Rs. 5 crores is required to be invested on a project that may give 20% return per annum. If the management decides to raise Rs. 2.50 crores by issuing equity shares of Rs. 10 each and Rs. 2.5 crores by issuing 10% debentures, then the shareholders will get a return of 30% on their funds. Let us the see calculation.

Total earnings	Rs. 1,00,00,000
Interest on debenture @10%	Rs. 25,00,000
Earning after paying interest	Rs. 75,00,000



Notes

$$\text{Return on Equity Share Capital} = \frac{75,00,000}{2,50,00,000} \times 100 = 30\%$$

Now if the company decides to raise 80% by debt and only 20% by shares (Rs. 4 crores by 10% debentures and Rs. 1 crore by shares), the return on equity share capital will be calculated as follows:

Total earnings	Rs. 1,00,00,000
Interest on debenture @10%	Rs. 40,00,000
Earning after paying interest	Rs. 60,00,000

$$\text{Return on Equity Share Capital} = \frac{60,00,000}{1,00,00,000} \times 100 = 60\%$$

We can see that with the use of higher proportion of debt the rate of return on equity capital has simply doubled. At the same time, it is also associated with high risk that, if the profitability declines to less than 10%, we shall still have to pay 10% on debentures. This will reduce the return on equity share capital to less than even 10%.

Types of Debentures

Debentures may be classified as:

(i) **Redeemable and Irredeemable Debentures :** The debentures which are repayable on a specified date, are called redeemable debentures. On the other hand, there is no fixed time by which the company is bound to pay back the money in case of irredeemable debentures. These debentureholders cannot demand to get back their money as long as the company does not make any default in payment of interest. So these debentures are also called perpetual debentures.

(ii) **Convertible and Non-convertible Debentures :** The holders of convertible debentures are given the option to convert their debentures into equity shares. But incase of non-convertible debentures the company does not give any such option.

(iii) **Secured and Unsecured Debentures :** Secured debentures are issued with a charge on the assets of the company as security. This charge may be fixed i.e., on specified asset, or it may be floating. Secured debentures are also known as mortgaged debentures. On the other hand, unsecured debentures are issued with merely a promise of payment without having any charge on any assets as security. So these debentures are also known as naked or simple debentures. Now-a-days debentures are invariably issued as secured debentured.

Notes

(iv) Registered and Bearer Debentures : For registered debentures the issuing company maintains a record of the debentureholders. Any sale or transfer of such debentures must be registered with the company. On the other hand, bearer debentures are just like negotiable instruments and transferable by mere delivery. The company keeps no record of such debenture-holders. Interest coupons are attached to them and anybody can produce the coupon to get the interest.

After having some idea about shares and debentures let us find out the difference between them.

Difference between Shares and Debenture

Basis	*Shares*	*Debentures*
1. Status	Shareholders are the owners of the company. They provide ownership capital which is not refundable unless the company is liquidated.	Debentureholders are the creditors of the company. They provide loans generally for a fixed period, which are to be paid back.
2. Nature of return on investment	Shareholders get dividends. Its amount is not fixed as it depends on the profit of the company.	Interest is paid on debentures at a fixed rate. Interest is payable even if the company is running at a loss.
3. Rights	Shareholders are the real owners of the company. They have the right to vote and determine the policies of the company.	Debentureholders do not have the right to attend meetings of the company. So they have no say in the management of the company.
4. Security	No security is required to issue shares.	Generally debentures are secured. So, sufficient fixed assets are required when debentures are to be issued.
5. Order of repayment	Share capital is paid back only after paying the debentureholders and creditors.	Debentureholders have the priority of repayment over shareholders.
6. Risk	Risk is high due to uncertainty of returns.	Little risk due to certainty of return.

INTEXT QUESTIONS 15.3

I. Complete the following chart that compares equity shares and preference shares:

Basis of Difference	*Equity shares*	*Preference shares*
(1) Payment of dividend on shares	Dividend paid after paying dividend on preference shares	(a) ……... ……
(2) Return of capital on winding up of company	(b) …… …… …….....	Capital is refunded in preference over the equity shares.
(3) Voting rights	(c) …… …….....	Do not carry voting rights
(4) Accumulation of Dividend	Dividend is not accumulated and therefore cannot be carried forward	(d) ……... …… ……

II. Some of the features of the different methods of raising long-term capital are given below. Identify the features that relate to equity shares, preference shares and debentures.

(i) In case of winding up of the company, the capital is refunded after payment of debentures but before payment to equity shareholders.

(ii) Their holders are creditors of the company for a fixed period.

(iii) Their holders are the owners of the company and enjoy voting rights.

(iv) They bear high degree of risk-in case of losses they do not get dividend and in case of winding up of the company, they are the last to get refund of their invested money.

(v) Their holders have no say in the management of the company and they do not have the right to attend the company's meetings.

Notes

III. Mention the difference between shares and Debentures, on the basis of the criteria listed below:

Basis	Shares	Debentures
1. Status		
2. Rights		
3. Security		
4. Risk		

IV. Multiple Choice Questions :

i. Name the types of manufacturing industry in which Rs. 50 lakhs have been invested.

a) Micro Enterprise b) Small Enterprise

c) Tiny Units d) None of the above

ii. Identify the service industry which have investment of Rs. 20 lakh.

a) Micro Enterprise b) Small Enterprise

c) Tiny Units d) None of the above

iii. A service enterprise with an investment of Rs. 3 crore is called a :

a) Micro Enterprise b) Small Enterprise

c) Medium Enterprise d) None of the above

15.8.3 Loan from Special Financial Institutions (SFI)

After independence a large number of financial institutions have been established in India with the primary objective to provide medium and long-term financial assistance to industrial enterprises. Institutions like Industrial Finance Corporation of India (IFCIs), Industrial Reconstruction Bank of India, State Financial Corporation (SFCs), State Industrial Development Corporation (SIDCs), have been established to provide financial support to set up new enterprises as well expansion and modernisation of the existing enterprises.

These financial institutions grant loans for a maximum period of 25 years. These loans are covered by mortgage of companies property and/or hypothecation of stocks shares etc. The major benefit derived from such loans are :

(i) The rate of interest payable is lower than the market rate and

(ii) The amount of loan is large.

However, it involves a number of legal and technical formalities and also the negotiation period is usually long. The financial institutions often nominate one or two directors to have some degree of control over the utilisation of funds and the functioning of the company.

15.8.4 Borrowing From Commercial Banks

Traditionally, commercial banks in India were not granting long-term loans. They were granting loans only for a short period not extending beyond one year. But recently they have started giving loans for a period of 3 to 5 years. Normally they give term loans for one or two years. The period is extended at intervals and in some cases loan is given directly for 3 to 5 years. Commercial banks provide long-term finance to small-scale units in the priority sector.

Merits

The merits of long-term borrowing from banks are as follows:

1. It is a flexible source of finance as loan amount can be increased as per the business need and can be returned in advance when funds are not needed.
2. Banks keep the financial operations of their clients secret.
3. Time and cost involved are lower as compared to issue of shares, debentures etc.
4. Banks do not interfere in the internal affairs of the borrowing concern.
5. Loans can be paid back in easy installments.
6. In case of small-scale industries and industries in villages and backward areas, the interest charged is very low.

Limitations

Following are the limitations of long term borrowing from commercial banks:

1. Banks require personal guarantee or pledge of assets while granting loans. So the business cannot raise further loans on these assets. Thus, it reduces the borrowing capacity of the borrowers.
2. In case the short-term loans are extended again and again, there is always uncertainty about their continuity.
3. Too many formalities are to be fulfilled for getting term loans from banks. These formalities make the borrowings from banks time consuming and inconvenient.

Notes

15.8.5 Public Deposits

It is a very old method of finance practised in India. When commercial banks were not there, people used to deposit their savings with business concerns of good repute. Even today it is a very popular and convenient method of raising short and medium term finance. Under this method companies can raise funds by inviting their shareholders, employees and the general public to deposit their savings with the company. To attract the public, the company usually offers a higher rate of interest than the interest on bank deposit. The period for which companies accept public deposits ranges between six months to 36 months.

Procedure of raising funds through Public Deposits

When an organisation wants to raise funds through public deposits it gives an advertisement in the newspapers. The advertisement highlights the achievements and future prospects of the undertaking and invites the investors to deposit their savings with it. It declares the rate of interest, which may vary depending upon the period for which money is deposited. It also declares the time and mode of payment of interest and the repayment of deposits. Normally they appoint some local firms to act as brokers and help them in providing service to the depositors.

Keeping in view the malpractices of certain companies, such as non-payment of interest for years together and not refunding the money, the Government has framed certain rules and made certain amendments in the Companies Act for their security. The maximum rate of interest and brokerage payable are decided by the Reserve Bank of India. The amount of deposit should not exceed 25% of the paid up capital and general reserves. The company is also required to maintain a Register of Depositors containing all particulars as to public deposits.

Merits

Following are the merits of public deposits.

1. **Simple and easy :** The method of borrowing money through public deposit is very simple. It does not require many legal formalities. It has to be advertised in the newspapers and a receipt is to be issued.

2. **No charge on assets :** Public deposits are not secured. They do not have any charge on the fixed assets of the company.

3. **Economical :** Expenses incurred on borrowing through public deposits are much less than expenses of other methods like issue of shares and debentures.

4. **Flexibility :** Public deposits bring flexibility in the capital structure of the company. These can be raised when needed and refunded when not required.

Limitations

Following are the limitations of public deposits.

1. **Uncertainty :** A concern should be of high repute and have a high credit rating to attract public to deposit their savings. There may be sudden withdrawals of deposits, which may create financial problems. Depositors are regarded as fair weather friends.

2. **Insecurity :** Public deposits do not have any charge on the assets of the concern. It may not always be safe to deposit savings with companies particularly those, which are not very sound financially.

3. **Limits on the amount raised :** There are limits on the amount that can be raised through public deposits.

15.8.6 Retention of Profit

Like an individual, companies also set aside a part of their profits to meet future requirements of capital. The portion of the profits, which is not distributed among the shareholders but is retained and reinvested in business, is called retained earnings or ploughing back of profits. As per Indian Companies Act 1956, companies are required to transfer a part of their profits in reserves like General Reserve, Debenture Redemption Reserve and Dividend Equalisation Reserve etc. These reserves can be used to meet long-term financial requirements like purchase of fixed assets, renovation and modernisations etc. This method of financing long-term financial requirement is also called as Retention of Profit.

Merits

Following are the benefits of retention of profit.

1. **Cheap Source of Capital :** No expenses are incurred when capital is available from this source. There is no obligation on the part of the company either to pay interest or pay back the money. It can safely be used for expansion and modernisation of business.

2. **Financial Stability :** A company which has enough reserves can face ups and downs in business. Such companies can continue with their business even in depression, thus building up its goodwill.

3. **Benefits to the Shareholders :** Shareholders are assured of a stable dividend. When the company does not earn enough profit it can draw upon its reserves for payment of dividends. Not only that their holding size can improve with issue of bonus shares. Due to reserves, there is capital appreciation, i.e., the value of shares may go up in the share market.

Notes

Limitations

Following are the limitations of retention of profit:

1. **High Profit Required :** This method of financing is possible only when the company earns huge profits and that too for many years.
2. **Dissatisfaction Among Shareholders :** Accumulation of profits often leads to low dividend payment by companies. Not only that, the companies may not utilise it for issue of bonus shares to avoid higher dividend payment. This may create dissatisfaction among the shareholders.
3. **Mis-management of Funds :** Capital accumulated through retained earnings encourages management to be less careful with utilisation of funds which may lead to low profitability. It is not in the long run interest of the shareholders.

15.8.7 Lease Financing

Lease is a contract whereby one can use the assets of the other with due permission of the owner on payment of rent without purchasing them. The owner of the asset is called 'lessor' and the user is called lessee. The period of use is called the lease period after which the lessee may opt for purchase of the asset.

So leasing is an arrangement that enables a business enterprise to use and exercise complete control over the assets without owning it. The owner gets rent in return and at any time as per the terms of the contract he can cancel the agreement. This system helps the business to use the plants and machinery and other fixed assets for a long period of time without investing a large amount of money in purchasing them. At the end of the lease period the asset goes back to the owner. The owner of the assets also has the option of selling it to the user at a reduced price. Sometimes the user company may request the leasing company to purchase its existing assets and allow them to use the same assets on lease basis. This enables the company to save the long-term funds that can be utilised for other purposes. This is known as 'sale and lease back' system.

15.8.8 Foreign Investment

Funds for the business can also be raised from foreign sources by means of Foreign Direct Investment (FDI). It can be obtained by collaborating with the foreign companies. It enables the Indian companies to secure equity capital through subscription of foreign collaborators to their share capital.

The companies can also take loan from International Financial Institutions like The World Bank and International Finance Corporation either directly or by way of refinancing.

The sale of shares to the persons of Indian origin and nationality, living abroad (Non-Resident Indians or NRIs) is another method of raising long-term funds of business. A non-resident Indian or a company controlled by non-resident Indians can invest within the prescribed limits of the paid up capital of an Indian company.

15.8.9 Global Depository Receipt

The issue of Global Depository Receipts (GDRs) and American Depository Receipts (ADRs) are different methods of raising funds from foreign sources. Under this method the shares of Indian companies are issued in the forms of depository receipts (Global or American) that are traded on the foreign markets.

Under GDR, shares of the company are first converted into depository receipts by an international banks. These depository receipts are denominated in US dollars. Then these depository receipts are offered for sale globally through foreign stock exchanges. The holder of GDRs are entitled for dividend just like shareholders. But they do not enjoy the the voting rights. many Indian companies like ICICI, Wipro etc. have raised foreign capital through issue of GDRs.

The depository receipts which are issued by a USA Bank for trading only in American Stock markets are known as American Depository Receipts (ADR). The ADRs are issued only to the American citizens.

INTEXT QUESTIONS 15.4

I. Give the full form of the following abbreviations:

(a) IFCI
(b) SFC
(c) SIDC
(d) GDR
(e) FDI
(f) ADR

II. Which method of long-term financing, Public Deposit or Retention of Profits, are being referred to, in each of the following statements:

(a) Management is less careful about funds utilization by this method.

(b) To raise funds through this method, an advertisement is generally given through the newspapers.

(c) They offers flexibility and the funds can be refunded when not required.

(d) They offer benefit to shareholders as company may draw upon them to pay dividend to them.

(e) No obligation on the company to pay interest on it or repay the money.

III. (a) How are funds raised through lease financing? Explain briefly, in your own words.

(b) List any two limitations of long-term borrowings from Commercial Banks.

Notes

WHAT YOU HAVE LEARNT

- Every business requires money to start and run the business. 'Business finance' refers to the money required for business purpose and the ways by which it is raised.
- Every business needs funds to purchase fixed assets to meet its day-to-day expenses, to fund business growth, bridge the time gap between production and sales, to meet contingencies and to avail of business opportunities.
- The importance of finance has considerably increased in modern times due to need for large-scale operation, use of modern technology and promotion of sales.
- Based on the period for which the funds are required, business finance is classified as:

  (a) Short-term finance (for a period of less than one year)

  (b) Medium-term finance (for one year to five years)

  (c) Long-term finance (for more than five years).
- There are two sources of raising the required funds by the business (i) internal sources – owner's capital, retained earnings, and (ii) external source-friends and relatives, banks, other financial institutions, money lenders, capital market, etc.
- Methods of raising short-term finance:

  1. Trade Credit
  2. Bank Credit – loans and advances, cash credit, bank overdraft, discounting of bills.
  3. Factoring
  4. Customers' advances
  5. Installment credit
  6. Loans for unorganised sectors
  7. Inter Coorporate Deposits

- The loans and advances are granted by the banks by taking some security that will ensure the bank about safe return of its money. Securities offered against bank credit may be of two types:

  (i) Personal security

  (ii) Security of assets like moveable goods, shares and stock, documents of title to goods, fixed deposit receipts, Life insurance policies, jewellery or precious metals etc.

- Small business in India is helpful by providing employment, supply variety of products, balanced regional growth, opportunity for entrepreneurship etc.

- The methods of raising long term finance are:

  (i) Issue of shares – Share is the smallest unit into which the total capital of the company is divided. There are mainly two types of shares.

  (a) Equity shares : They are shares which do not enjoy any preferential right in the matter of payment of dividend or repayment of capital. The equity shareholders get dividend only after making the payment of dividends on preference shares. There is no fixed rate of dividend for equity shareholders.

  (b) Preference shares : They carry preferential rights in respect of dividend and return of capital. The rate of dividend on preference shares is fixed.

  The different types of preference shares that a company can issue are:

  - Convertible and non-convertible preference shares
  - Cumulative and non-cumulative preference shares
  - Participating and non-participating preference shares, and
  - Redeemable and irredeemable Preference shares.

  (ii) Issue of Debentures : The companies also raise funds through debentures, which carry an assured rate of return for the investors. in the form of a fixed rate of interest. Debenture holders are the creditors of the company and are entitled to get interest irrespective of profit earned by the company. They do not have any voting right.

  (iii) Loan from Special Financial Institutions (SFI)

  (iv) Borrowings from Commercial Banks

  (v) Public Deposits

(vi) Retained Earnings

(vii) Lease Financing

(viii) Foreign Investment

(ix) Global Depository Receipts.

KEY TERMS

ADR	Bank Credit	Bank Overdraft
Capital Market	Cash Credit	Customer's Advance
Debenture	Discounting of Bill	Dividend
Equity Share	Factoring	Foreign Direct Investment
GDR	Internal Financing	Investment Trust
Lease	Long-term Finance	Medium-term Finance
Ploughing Back of Profits	Preference Share	Public Deposit
Retained Earnings	Share	Short-term Finance
Special Financial Institutions	Trade Credit	Trading on Equity
Working Capital	ICDs	

TERMINAL EXERCISE

Very Short Answer Type Questions

1. What is meant by 'Discounting of Bill'?
2. What is Trading on Equity?
3. What is meant by lease financing?
4. State the meaning of 'sale and lease back' system.
5. State the meaning of 'Preference shares'.
6. Define a Small Scale Enterprise as per 'MSMED Act, 2006.
7. Mention any two roles of small business in India.

Short Answer Type Questions

8. Distinguish between GDR and ADR.

9. 'Finance is considered as the life-line of the business, especially in the modern day'. Give reasons for the same.
10. What do you mean by ICDs?
11. Enumerate different types of ICDs.
12. Define a Small Scale Enterprise as per 'MSMED Act, 2006'.
13. Mention any five roles of small business in India.
14. Explain any two ways in which a business enterprise can obtain Bank Credit.
15. Give two merits and two limitations of equity shares, from the point of view of the management.
16. Explain the four types of preference shares that a company can issue.

Long Answer Type Questions

17. What are 'Debentures'? Describe three merits and three limitations of debentures as a source of long-term finance for a company.
18. Differentiate between 'Shares' and 'Debentures' as sources of long-term finance.
19. What is meant by Special Financial Institutions (SFIs)? Explain two merits and two demerits of taking loans from SFIs as a source of long-term funds.
20. Briefly explain the different types of ICDs.
21. Describe the significance of small business in rural India.
22. Explain the main purposes for which business needs funds.
23. Write explanatory notes on:

    (a) Retention of Profits; and (b) Public Deposits,

    as methods of Long-term finance.

ANSWERS TO INTEXT QUESTIONS

15.1 I. (a) To purchase fixed assets
(b) To meet day-to-day expenses
(c) To fund business growth
(d) To bridge time gap between production and sales.
(e) To meet contingencies
(f) To avail of business opportunities.

II. (a) (i) purchase of raw material
(ii) payment of electricity bill (or any other suitable example)

Notes

(b) (i) modernisation and renovation
(ii) special promotional programmes (or any other suitable example)

(c) (i) purchase of land and building
(ii) purchase of furniture (or any other suitable example)

15.2 I. (a) Bill of Lading, Railway Receipts, Warehouse Warrant etc.
(b) Stock of raw material like leather, chemicals etc. or finished goods like industrial machinery, leather shoes etc. (or any other suitable examples).
(c) Gold Bangles, Diamond Necklace, Silver ware (or any other suitable examples).

II. (a) Bank Overdraft (b) Discounting of Bill
(c) Cash Credit (d) Loans and Advances.

III. (i) b

15.3 I. (a) Dividend is paid on these shares in preference to the equity shares.
(b) Share capital refunded only after the refund of preference share capital.
(c) Shareholders enjoy voting rights.
(d) Unpaid dividends are accumulated and are carried forward to the future years, in case of cumulative preference shares.

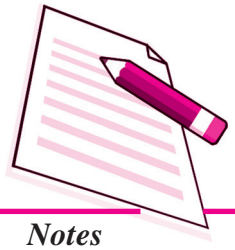
II. (i) Preference shares (ii) Debentures
(iii) Equity shares (iv) Equity shares
(v) Debentures

III.

Basis	*Shares*	*Debentures*
1. Status	Owners of the company	Creditors of the company.
2. Rights	Right to vote and determine policies of the company.	No right to attend company's meetings. No say in company's manage ment.
3. Security	Not required	Generally secured. So suf ficient fixed assets required to issue debentures.
4. Risk	High	Little risk

IV. (i) b (ii) b (iii) c

15.4 I. (a) Industrial Finance Corporation of India
(b) State Financial Corporation



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(c) State Industrial Development Corporation
(d) Global Depository Receipt
(e) Foreign Direct Investment
(f) American Depository Receipt

II. (a) Retained Earnings (b) Public Deposit
(c) Public Deposit (e) Retained Earnings
(f) Retained Earnings.

DO AND LEARN

Visit the branches of any two banks in your locality and find out from them about the various ways in which they provide finance to business enterprises. Find out about the types of securities the banks accept for such finance.

ROLE PLAY

Imran had started his garment business as a sole proprietor, with a capital of Rs. 25,000/-. Now, after two years, he has decided to form a company to run his expanding business. He approaches a financial consultant, Ms. Jyoti, to find out about the various sources from which he can obtain funds for a long term period for his company. Following is an extract from the conversation that took place between Imran and Jyoti, at Jyoti's office:

Imran : So ma'am, what are the ways in which I can get funds for the long-term, to meet the needs of my expanding business?

Jyoti : Mr. Imran, in today's times, you have a wide choice of financing options available to you. I would suggest you to weight the pros and cons of each of them and only then decide the source most suitable for the specific needs of your business.

Imran : Oh! It would be wonderful if you could throw some light on the various sources, since I do not know much about all this.

Jyoti : Yes, surely. The first one that comes to my mind is by approaching the capital market. This can be done in three ways-through issue of equity shares, preference shares and debentures.

Imran : Wait, wait. One by one please can you tell me about equity shares first.

Now, continue the conversation between these two people. You may take on Jyoti's part and ask one of your friends to play the role of Imran.

Through this role play, you can have fun and revise the various sources of long-term finance. Enjoy yourself.

Notes

16

SOURCES OF LONG-TERM FINANCE

In the previous lesson you learnt about the various methods of raising long-term finance. Normally the methods of raising finance are also termed as the sources of finance. But, as a matter of fact the methods refer only to the forms in which the funds are raised, and hence may or may not include the sources from, or through which the funds are raised. Hence, we must also have an idea about the sources of finance. You will recall that the various sources of long-term finance had been duly identified in the previous lesson. We shall now learn in detail about those sources.

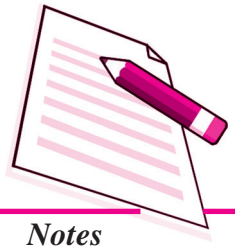
OBJECTIVES

After studying this lesson, you will be able to:

- identify the various sources of long-term finance;
- explain the meaning and importance of capital market;
- identify the special financial institutions in India;
- describe the nature and role of special financial institutions;
- explain the concept of mutual funds;
- describe the role of leasing companies;
- identify the foreign sources of long-term finance and
- explain the importance of retained earnings as a source of long-term finance.

16.1 SOURCES OF LONG-TERM FINANCE

The sources of long-term finance refer to the institutions or agencies from, or through which finance for a long period can be procured. As stated earlier, in case of sole



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proprietary concerns and partnership firms, long-term funds are generally provided by the owners themselves and by the retained profits. But, in case of companies whose financial requirement is rather large, the following are the sources from, or through which long-term funds are raised.

(a) Capital Market
(b) Special Financial Institutions
(c) Mutual Funds
(d) Leasing Companies
(e) Foreign Sources
(f) Retained Earnings

16.2 CAPITAL MARKET

Capital market refers to the organisation and the mechanism through which the companies, other institutions and the government raise long-term funds. So it constitutes all long-term borrowings from banks and financial institutions, borrowings from foreign markets and raising of capital by issuing various securities such as shares debentures, bonds, etc. For trading of securities there are two different segments in capital market. One is primary market and the other is, secondary market. The primary market deals with new/fresh issue of securities and is, therefore, known as **new issue market**. The secondary market on the other hand, provides a place for purchase and sale of existing securities and is known as **stock market** or **stock exchange**.

The new issue market primarily consists of the arrangements, which facilitate the procurement of long-term finance by the companies in the form of shares, debentures and bonds. The companies usually issue those securities at the initial stages of their formation and so also later on for expansion and/or modernization of their activities. However, the selling of securities is not an easy task, as the companies have to fulfill various legal requirements and decide upon the appropriate timing and the method of issue. Hence, they seek assistance of various intermediaries such as merchant bankers, underwriters, stock brokers etc. to look after all these aspects. All these intermediaries form an integral part of the primary market.

The secondary market (stock exchange) is an association or organisation or a body of individuals established for the purpose of assisting, regulating and controlling the business of buying, selling and dealing in securities. It may be noted that it is called a secondary market because only the securities already issued can be traded on the floor of the stock exchange. This market is open only to its members, most of whom are brokers acting as agents of the buyers and sellers of securities. The main functions of this market lie in providing liquidity (ready encashment) to securities and safety in dealings. It is because of the availability of such facilities that people are ready to invest in securities. We shall learn more about the capital market in lesson no. 18.

Notes

16.3 SPECIAL FINANCIAL INSTITUTIONS (SFI)

A number of special financial institutions have been set up by the central and state governments to provide long-term finance to the business organisations. They also offer support services in launching of the new enterprises and so also for expansion and modernisation of existing enterprises. Some of the important ones are Industrial Finance Corporation of India (IFCI), Industrial Investment Bank of India (IIBI), Industrial Credit and Investment Corporation of India (ICICI), Industrial Development Bank of India (IDBI), Infrastructure Development Finance Company Ltd. (IDFC), Small Industries Development Bank of India (SIDBI), State Industrial Development Corporations (SIDCs), and State Financial Corporations (SFCs), etc. Since these institutions provide developmental finance, they are also known as **Development Banks** or **Development Financial Institutions (DFI)**. Besides these development banks there are a few other financial institutions such as life Insurance Corporation of India (LIC), General Insurance Corporation of India (GIC) and Unit Trust of India (UTI) which provide long-term finance to companies and subscribe to their share and debentures. The main functions of these institutions are:

(i) to grant loans for a longer period to industrial establishment;

(ii) to help the establishment of business units that require large amount of funds and have long gestation period;

(iii) to provide support for the speedy development of the economy in general and backward regions in particular;

(iv) to offer specialized services operating in the areas of promotion, project assistance, technical assistance services and training and development of entrepreneurs and

(v) to provide technical and professional management services and help in identification, evaluation and execution of new projects.

INTEXT QUESTIONS 16.1

1. Distinguish between new issue market and stock exchange. (Give one point)

2. Give the full form of the following abbreviation.

   (a) DFI

   (b) IIBI

   (c) SIDBI

   (d) SFI

   (e) IFCI

Let us have a brief idea about some of the Special Financial Institutions.

1. **Industrial Finance Corporation of India (IFCI) :** It is the oldest SFI set up in 1948 with the primary objective of providing long-term and medium-term finance to large industrial enterprises. It provides financial assistance for setting up of new industrial enterprises and for expansion or diversification of activities. It also provides support to modernisation and renovation of plant and equipment in existing industrial units. It can grant loan or subscribe to debentures issued by companies repayable in not more than 25 years. It can also guarantee loans raised from other sources or debentures issued to the public, and take up underwriting of the public issue of shares and debentures by companies. For ensuring greater flexibility to meet the needs of the changing financial system IFCI now stands transformed to IFCI Ltd. with effect from 1 June 1993.

2. **Industrial Credit and Investment Corporation of India (ICICI) :** It was set up in 1955 for providing long-term loans to companies for a period upto 15 years and subscribe to their shares and debentures. However, the proprietary and partnership firms were also entitled to secure loans from ICICI. Like IFCI, the ICICI also guarantees loans raised by companies from other sources besides underwriting their issue of shares and debentures. Foreign currency loans can also be secured by companies from ICICI. In the context of the emerging competitive scenario in the finance sector, ICICI has merged with ICICI Bank Ltd., with effect from 3 May 2002. Consequent upon the merger, the ICICI group's financing and banking operations have been integrated into a single full service banking company.

3. **Industrial Development Bank of India (IDBI) :** It was set up in 1964 as a subsidiary of Reserve Bank of India for providing financial assistance to all types of industrial enterprises without any restriction on the type of finance and the amount of funds. It could also refinance loans granted by other financial institutions and offer guarantees for the loans raised from the capital market or scheduled banks. It also discounts and rediscounts the commercial bills of exchange and undertakes underwriting of the public issues. IDBI, like ICICI, has also transformed into a commercial bank and has been retitled as IDBI Ltd. with effect from 1 October 2004 with IDBI Bank merged into it.

4. **Industrial Investment Bank of India (IIBI) :** The erstwhile Industrial Reconstruction Bank of India (IRBI), an institution which was set up for rehabilitation of small units has been reconstituted in 1997 as Industrial Investment Bank of India. It is a full fledged all purpose development bank with adequate operational flexibility and autonomy. After the reconstruction its focus has changed from rehabilitation finance to development banking.

Notes

5. **Small Industries Development Bank of India (SIDBI) :** It was set up in 1990 as a principal financial institution for the promotion, financing and development of small-scale industrial enterprises. It is an apex institution of all the banks providing credit facility to small-scale industries in our country. It offers refinancing of bills, rediscounting of bills, and several other support services to Small Scale Industries (SSI). It undertakes a wide range of promotional and development activities for improving the inherent strength of SSI units and creating avenues for the economic development of the rural poor.

6. **State Financial Corporations (SFCs) :** In order to provide financial assistance to all types of industrial enterprises (proprietary and partnership firms as well as companies) most of the states of our country have set up SFCs. The primary objective of these corporations is to accelerate the pace of industrial development in their respective states. SFCs provide finance in the form of long-term loans or through subscription of debentures, offer guarantee to loans raised from other sources and take up underwriting of public issues of shares and debentures made by companies. However, they cannot directly subscribe to the shares issued by the companies. The SFC (Amendment) Act, 2000 has provided greater flexibility to SFCs to cope with the changing economic and financial environment of the country.

7. **State Industrial Development Corporations (SIDCs) :** These corporations were set up in 1960s and early 1970s by most state governments for promotion and development of medium and large-scale industries in their respective states. In addition to providing financial assistance to industrial units, they also undertake a variety of promotional activities. They also implement the various incentive schemes of the central and state governments.

8. **Other Financial Institutions :** Apart from the above special financial institutions, there are a few other organizations, which act as important source of long-term finance. These are:

   (a) ***Life Insurance Corporation of India (LIC) :*** It was set up in 1956 on nationalisation of life insurance business in India. Primarily it carries on the business of life insurance and deploys the funds in accordance with national priorities and objectives. It invests mainly in government securities and shares, debentures and bonds of companies. It also extends financial assistance to banks and other institutions for social development and infrastructure facilities. It also underwrites new issues of shares and grant loans to the corporate sectors. Its performance with regard to assistance to corporate sector has been significant both in terms of sanctions and disbursements.

(b) ***General Insurance Corporation of India (GIC) :*** It was established in 1973 on nationalization of general insurance business in India. Like LIC, its investment priority is socially oriented sectors of the economy, and invests its funds in government securities and shares and debentures of companies. It also provides term loans and underwriting facility to new and existing industrial undertakings.

(c) ***Unit Trust of India (UTI) :*** It was set up in 1964 as an investment trust with capital of Rs. 5 crore subscribed by Reserve Rank of India, LIC, State Bank of India and other financial institutions. It has been playing an important role in mobilizing the savings of the community through sale of units under various schemes (most well known being US-64 and master shares) and channalising them into corporate investments. It has also been extending financial assistance to the companies by way of term loans, bills rediscounting, equipment leasing and hire purchase financing.

(d) ***Export and Import Bank of India (EXIM Bank) :*** The Export and Import Bank of India was set up in January, 1982 to take over the operations of international finance wing of the IDBI and act as an apex institutions in the field of financing foreign trade. The main functions of the Bank are: (i) financing of export and import of goods and services; (ii) granting deferred payment credit for medium and long term duration; (iii) providing loans to Indian parties to enable them to contribute to share capital of joint ventures in foreign countries and; (iv) extending refinance facilities to commercial banks in respect of export credit. Recently it has introduced production equipment finance programme under which it provides rupee term finance to export oriented units for acquisition of equipment. Apart from these, the Exim Bank also undertakes merchant banking and development banking functions as considered necessary to finance promotional activities and providing counseling services to persons engaged in export-import business.

(e) ***Venture Capital Institutions :*** Venture Capital is a form of equity finance designed specially for funding high risk and high reward projects of young entrepreneurs. It helps them to turn their research and development projects into commercial ventures by providing them the initial capital and managerial assistance. The initial capital is provided in the form of equity participation through direct purchase of the shares and debentures of the enterprise set up for the purpose. The institutions providing venture capital also actively participate in the management of the entrepreneurs' business. By actively involving and supporting the enterprises, they are able to protect and enhance the value of their investment.

Notes

The development of venture capital institutions is of recent origin in India. The concept was formally introduced in 1986-87 when the Government announced the creation of a venture fund to be operated by IDBI. It was followed by ICICI, IFCI and two public sector banks (State Bank of India and Canara Bank) who set up separate companies for the purpose. Some state government controlled development financial institutions viz., Gujarat Industrial Investment Corporation and Andhra Pradesh State Corporation also promoted their venture capital companies. In 1992-93, SIDBI also set up a venture capital fund for providing financial assistance for innovative ventures in small-scale sector.

INTEXT QUESTIONS 16.2

1. State the meaning of Venture Capital
2. Mention the year in which following financial institutions were established.
   (a) IIBI
   (b) LIC
   (c) EXIM Bank
   (d) GIC
   (e) SIDBI

16.4 BANKS

In the previous lesson you learnt that commercial banks usually provide short-term finance to business firms in the form of loans and advances, cash credit, overdraft etc. But now-a-days, most of the commercial banks have also started term lending (long and medium term) and providing need based finance of different time periods to firms of all sizes. Consistent with the policy of liberalization, the banks have been allowed to evolve their own methods of assessing financial needs of the borrowers and extend them the term loans for larger size and longer periods. Some of the banks have also started their industrial branches to finance exclusively to industrial enterprises. Thus, the commercial banks also now act as an important source of medium term and long term finance for the business.

You know that a large number of cooperative banks are now operating in our country. These banks have the license from the RBI to operate like commercial banks. They also some times provide long-term finances to small and medium scale cooperative industrial units like Sugar factories, food-processing units etc.

16.5 NON-BANKING FINANCIAL COMPANIES (NBFCS)

You must have heard about various housing finance companies, investment companies, vehicle finance companies etc. operating in private sectors different parts of our country. These companies are categories under Non-Banking Financial Companies, because they perform the twin functions of accepting deposits from the public and providing loans. However they are not regarded as banking companies as they do not carry on the normal banking activities. They raise funds from the public by offering attractive rate of interest and give loans mainly to the wholesale and retail traders, small-scale industries and self-employed persons. The loans granted by these finance companies are generally unsecured and the interest charged by them ranges between 24 to 36 percent per annum. Besides giving loans and advances, the NBFCs also have purchase and discount hundis, undertaken merchant banking, housing finance, lease financing, hire purchase business etc. In our country, NBFCs have emerged as an important financial intermediary due to simplified loan sanction procedure, attractive rate of return on deposits, flexibility and timeliness in meeting the credit needs of the customers.

16.6 MUTUAL FUNDS

Mutual fund refers to a fund established in the form of a trust by a sponsor to raise money through one or more schemes for investing in securities. It is a special type of investment institution, which acts as an investment intermediary that collects or pools the savings of a large number of investors and invests them in a fairly large and well diversified portfolio of sound investments. This minimizes their risk and ensures good returns to the investors. Thus, they act as an investment agency for small investors and a good source for long-term finance for the business.

16.6.1 Features of Mutual Funds

The essential features of mutual funds are as follows:

1. It is a trust into which a number of investors invest their money in the form of units to form a large pool of funds.
2. The amount is invested in securities by the managers of the fund.
3. The amount is invested in different securities of reputed companies to ensure definite and regular income. Thus, it helps in minimizing the risk.
4. The mutual fund schemes often have the advantages of high return, easy liquidity, safety and tax benefits to the investors.
5. The net income received on the investments of the fund is distributed over the units held.
6. The managers of the fund are obliged to redeem the units on demand or on the expiry of a specified period.

Notes

16.6.2 Types of Mutual Funds

Keeping in view the investment objectives of the investors the mutual funds usually have a large variety of schemes such as equity fund, debt fund, balanced fund, growth fund, income fund, liquid fund, tax saver fund, index fund and so on. These schemes are broadly classified into two categories as follows:

(a) **Open Ended Funds :** These funds have no fixed corpus and period. Such fund continuously offer units for sale and is ready to buy back the units surrendered. In other words, investors are free to buy from, or sell to, the trust any number of units at any point of time at prices which are linked to the net asset value (NAV) of the units.

(b) **Close Ended Funds :** In case of these funds, subscriptions from the investors are collected during a specified time period and have a fixed corpus. Not only that, the investors cannot redeem their units till the specified maturity date. However, to provide liquidity, these are listed on the stock exchange and the investors can purchase and sell through the brokers at the market price without any difficulty.

It may be noted that Unit Trust of India was the first mutual fund started in India as early as 1964. Later, LIC, GIC and some nationalised banks also launched their mutual funds with high degree of success. However, during post liberalisation era, many private sector mutual funds have entered the fray. To mention a few, these are: Birla Sun Life, HDFC, HSBC, ICICI Prudential, DSP Merrill Lynch, DBS Chola Mutual Fund.

INTEXT QUESTIONS 16.3

1. Mention the source of finance of NBFCs.
2. What is Net Asset Value?
3. List the advantages of Mutual funds.

16.7 LEASING COMPANIES

You learnt about leasing arrangement as a method of long-term finance in the previous unit. This method has become quite common among the manufacturing companies. Leasing facility is usually provided through the mediation of leasing companies who buy the required plant and machinery from its manufacturer and lease it to the company that needs it for a specified period on payment of an annual rent.

For this purpose a proper lease agreement is made between the lessor (leasing company) and lessee (the company hiring the asset). Such agreement usually provides for the purchase of the machinery by the lessee at the end of the lease period at a mutually agreed and specified price. It may be noted that the ownership remains with the leasing company during the lease period.

Sometimes, a company, to meet its financial requirements, may sell its own existing fixed asset (machinery or building) to a leasing company at the current market price on the condition that the leasing company shall lease the asset back to selling company for a specified period. Such an arrangement is known as 'Sell and Lease Back'. The company in such arrangement gets the funds without having to part with the possession of the asset involved which it continues to use on payment of annual rent for the lease.

It may be noted that in any type of leasing agreement, the lease rent includes an element of interest besides the expenses and profits of the leasing company. In fact, the leasing company must earn a reasonable return on its investment in lease asset.

The leasing business in India was started, in seventies when the first leasing company of India was promoted by Chitambaram Group in 1973 in Chennai. The Twentieth Century Finance Company and four other finance companies joined the fray during eighties. Now their number is very large and leasing has emerged as an important source. It is very helpful for the small and medium sized undertakings, which have limited financial resources.

16.8 FOREIGN SOURCES

Foreign Sources also play an important part in meeting the long-term financial needs of the business in India. These usually take the form of (1) external borrowings; (2) foreign investments and; (3) deposits from NRIs. Let us have a brief idea about these sources.

1. **External Borrowings :** These include loans obtained at concessional rates of interest with long maturity period and commercial borrowings. The major sources of concessional loans have been the International Monetary Fund (IMF), Aid India Consortium (AIC), Asian Development Bank (ADB), World Bank (International Bank for Reconstruction and Development) and International Financial Corporation. The World Bank grants loans for specific industrial projects of high priority and given either directly to an industrial concern or through a government agency. The International Finance Corporation, an affiliate of the World Bank, grants loans to industrial units for a period of 8 to 10 years. Such loans do not require government guarantee.

   As for the external commercial borrowings, their major sources have been the export credit agencies like US Exim Bank, the Japanese Exim Bank, Export Credit and Guarantee Corporation of U.K. and other government and multilateral agencies. The external commercial borrowings are permitted by the government as an important source of finance for Indian firms for the expansion investments.

Notes

2. **Foreign Investments :** The foreign investments in our country are generally done in the form of foreign direct investment (FDI) or through foreign collaborations. The foreign direct investment usually refers to the subscription by the foreigners to shares and debentures of the Indian Companies. This is also known as portfolio investment and covers their subscription to ADRs, GDRs and FCCBs (Foreign Currency Convertible Bonds).

   Alternatively, some companies are formed with the specified purpose of operating in India or the multinationals can set up their subsidiary or branch in India. As for the foreign collaborations, these can be of financial collaborations involving foreign companies participation in equity capital of an existing or new undertaking. The technical collaborations are by way of supply of technical knowledge, patents and machineries. To start with, the technical collaborations had been the more popular form in the past. But during the post liberalisation phase, shift from technical collaborations to financial collaborations is noticed in our country.

   It may be noted that the government has been very successful in attracting more foreign investment in the post liberalisation era. It is because the Government of India now permits automatic approval of foreign investment upto 51% equity in 34 industries and a special board (Foreign Investment Promotion Board) has been set up to process cases not covered by automatic approvals. The main advantage of foreign investment is that generally the foreign investor also brings with him the technical expertise and the modern machinery. The disadvantage, however, is that a large part of profits are transferred to the foreign investors.

3. **Non-resident Indians (NRIs) : Y**ou are aware that the persons of Indian origin (PIO) living abroad commonly known as Non-Resident Indians (NRIs) constitute an important source of long-term finance for industries in India. The most common form of their contribution is in the form of deposits under Foreign Currency Non-Resident Account (FCNRA) and Non-Resident (External) Rupee Account (NRERA). It is worth noting that the share of NRI deposits in the total foreign capital flows (net) was 26.7% during the year 2001-02. However, like external borrowing, NRI deposits are high cost source of external finance and are fair weather friends. Hence, too much dependence on NRI deposits is not a right policy. It may be noted that they are also permitted to subscribe to the shares and debentures of the companies in India, and have the option of selling them and take back the amount. This constitutes an integral part of foreign direct investment.

16.9 RETAINED EARNINGS

You know that retained earnings refer to the undistributed profits of companies which is usually kept in the form of general reserve. Primarily, it is a hedge against low profits in future and is used for the issue of bonus shares by the company. But, in effect, it acts

as an important source of long-term finance for the companies with Zero cost of capital. The retained profits can be used for expansion and modernization programmes by the companies. The amount of retained earnings is determined by the quantum of profits, the dividend payout policy followed by the management, the legal provisions for dividend payment, and the rate of corporate taxes etc.

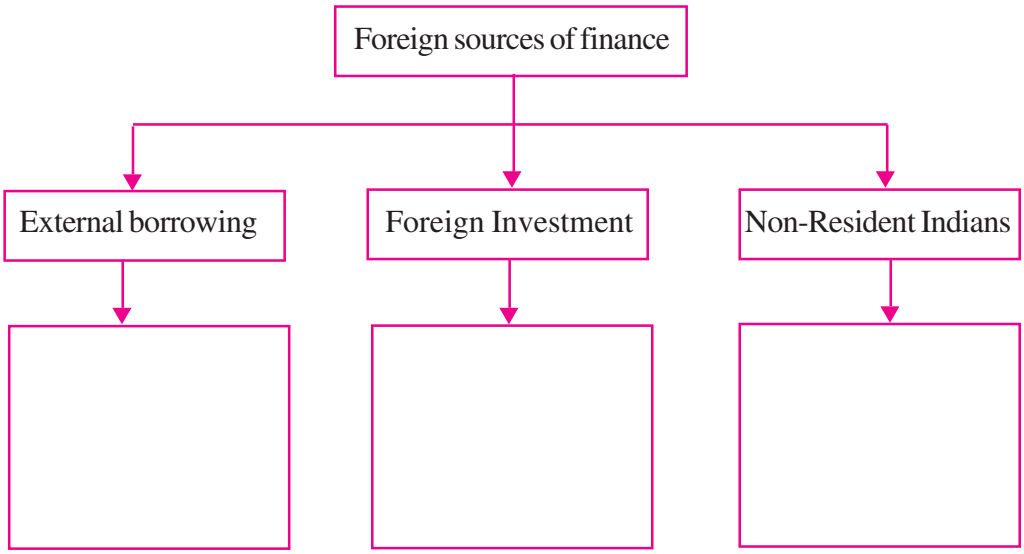
It is an internal source, which does not involve any cost of floatation and the uncertainties of external financing. In fact, it is regarded as the most dependable source of long-term finance. It also strengthens the firm's equity base, which enables to borrow at better terms and conditions. The main drawbacks of this source are (a) it is fully dependent on the accuracy of profits; and (b) possibility of reckless use of funds by the management.

INTEXT QUESTIONS 16.4

1. Name the two parties of lease agreement.
2. Categorise the following under three headings of foreign sources of finance.

   (a) ADB (b) ADR (c) FCNRA (d) AIC

   (e) PIO (f) NRERA (g) FCCB



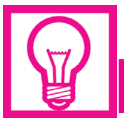
WHAT YOU HAVE LEARNT

- The institutions or agencies from or through which finance for a Long period is obtained are termed as sources of long-term finance. Capital market, special financial institution, banks, non-banking financial companies, retained earnings and foreign investment and external borrowings are the main sources of long-term finances for companies.

Notes

Sources of Long-term Finance

- The companies raise long-term funds by issuing shares and debentures through securities market. This market is divided into two parts – (a) new issue market, in which new securities are issued; and (b) stock exchange, in which existing securities are traded.
- To provide long-term finance and other support services to industrial enterprise, special financial institution (SFI) have been set up by central and state governments some of the important SFIs are IFCI, ICICI, IIBI, IDBI, SIDBI, SFCs, SIDCs etc. Besides these SFIs, there are few other financial institutions such as LIC, GIC, UTI, etc EXIM Bank, Venture Capital Institutions also provide long-term finance and other support to business enterprises.
- Commercial banks and Co-operative banks also provide long and medium finance to enterprises.
- There are number of Finance Companies operating in private sectors who accept deposits form the public and give Long-term loans to business enterprises. These companies are know a Non-Banking Financial Companies. Because of their simplified loan sanction procedure, flexibility and quick services, NBFCs have emerged as an important source of finance.
- Mutual Funds act as an investment intermediary that collects the savings of a large number of investors and invest them in big companies. This minimises the risk of the investors and ensures them good return. To attract the investors. Mutual fund companies offer different schemes which are categoried under open ended schemes and close ended schemes.
- The leasing companies also extend long term support in the form of providing plants and machineries, building, land etc. on rent basis. The business firms can avail this facility without blocking huge capital in buying the assets.
- Foreign sources take the form of (a) External borrowings; (b) Foreign investments; and (c) Non-resident Indians.
- The undistributed profits of the company which is kept for future use constitute a major source of long-term finance. It does not involve any cost of floatation and it strengthens the firm's equity base.



KEY TERMS

Capital Market	Leasing	New Issue Market
Retained Earnings	Stock exchange	Development Finance Corporation
Special Financial Institutions	NRI	Venture Capital
Corpus	NBFCs	Net Asset Value
Mutual Funds		

TERMINAL EXERCISE

Very Short Answer Type Questions

1. What is meant by Stock Market?
2. Name any two special financial institutions.
3. Mention any two features of Mutual Funds.
4. Distinguish between Open ended and close ended types of Mutual Funds.
5. State the meaning of 'Foreign Direct Investment'.

Short Answer Type Questions

6. State any two functions of EXIM bank.
7. What are the main functions of special financial institutions?State.
8. Explain, how LIC of India provides support to business sectors in solving long-term requirement of funds.
9. Explain the role of NBFCs in providing long-term finance.
10. Mention the merits and demerits of 'Retained Earnings' as a source of long-term finance.

Long Answer Type Questions

11. Explain 'Capital Market' as a source of Long-term finance.
12. Name any three special financial institutions and state their objectives.
13. Describe the role of venture capital institutions in providing long term finance to business.
14. What is meant by 'Mutual Funds'? Explain its features in brief.
15. Describe 'External borrowings' as a form of getting funds from foreign sources.

ANSWERS TO INTEXT QUESTIONS

16.1

1. In new issue market deals with new issue of securities, where as in stock exchange existing securities are traded.

2. (a) Development Financial Institutions
   (b) Industrial Investment Bank of India
   (c) Small Industries Development Bank of India
   (d) Special Financial Institutions
   (e) Industrial Finance Corporation of India

Notes

16.2 1. Venture capital is a form of equity finance designed specially for funding high risk and high reward projects of young entrepreneurs.

2. (a) 1997 (b) 1956 (c) 1982
(d) 1973 (e) 1990

16.3 1. Public Deposits

2. The price at which a unit of mutual fund is bought and sold

3. (a) High return (b) Easy liquidity
(c) Safety (d) Tax benefits

16.4 1. (a) Lessor (b) Lessee

2.

- Foreign sources of Finance
  - External borrowings
    - ADB
    - AIC
  - Foreign Investment
    - ADR
    - FCCB
  - Non-Resident Indians
    - FCNRA
    - PIO
    - NRERA

DO AND LEARN

You are required to collect the following information from the newspaper and record the same.

(a) Name of the Mutual Fund Companies (at least 5 to 10 companies)

(b) The schemes issued

(c) Whether open end or closed end.

(d) Value of the unit (Market Price)

(e) Any other information you can

ROLE PLAY

The Chamber of Commerce of your town has organised a discussion on the 'Long-term need of finance'. Your friend Madan, who runs a big readymade garments shop, is a member of that Chamber of Commerce. Knowing that you are a student of Business Studies he has suggested your name to be an expert to deliver a lecture on "Role of Special Financial Institutions in providing long-term finance". You are required to prepare your lecture and present it first before your friends.