CHAPTER-VII

SOURCES OF FINANCE
(A) SHORT-TERM CAPITAL

The subject of capital procurement policies may be approached in several different ways. For example, they may be studied from the standpoint of internal versus external sources and debt versus equity financing, or they may be viewed in respect to the length of time that the capital remains in use by the firm before it is returned to the supplier. The later method is generally preferred because the approach it represents is familiar to both the supplier and user. From the standpoint of the user, financial managers have specific uses for short, intermediate and long term capital and develop definite policies with regard to the time the capital is used. Suppliers on the other hand, tend to specialize in either long- or short- term capital; to illustrate, banks, commercial finance companies and certain government agencies specialize in relatively short-term capital.

There are several disadvantages to this approach, the more important ones being the following. First, each category tends to merge into the next; that is, short-term loans may really be long-term loans because of prearranged contract between the supplier and user. This arrangement is specially prevalent among small business, for reasons to be explained later. Secondly, no clear line of demarcation exists between the various categories. One financial institution may classify all long-term loans as intermediate-term capital, and yet some may be for a 5 year period and other may have 10 to 20 year maturity.

The format of short-term capital is divided into three basic sections. First the relative importance of short-term credit for the small company is reviewed. Second, in the light of the significance of this form of financing for the small firm, an extensive presentation is offered regarding the relevant factors for determining the appropriate balance between short-term and long-term debt capital. Third, the sources providing short-term credit for the small company are presented.

THE IMPORTANCE OF SHORT-TERM CAPITAL FOR SMALL BUSINESS

Short-term financing plays a vital role in the financing of assets, regardless of the size of the firm. However, this source is of particular significance to the small business. Having limited access to the capital markets, the smaller company has to place greater
reliance upon short-term sources, particularly trade credit and short-term bank credit. In contrast, the large corporations, while utilizing trade credit extensively, employ short-term bank loans as a means for providing greater flexibility if the need arises. Thus, for the large business entity, the importance of short-term bank credit comes in the form of increased discretion rather than as a result of the volume. The smaller organization has no such option. If after maximizing its use of trade credit additional funds are required, the smaller company, for the most part, must approach the banker for additional money. Finally, the small concern’s inability to enter the long-term public markets places additional burden upon short-term financing. Thus, the small firm is restricted in its availability to long-term sources of financing. Accordingly, the significance of short-term funds takes on an extra dimension for the small organization.¹

The foregoing scarcity in long-term debt for the small enterprise has existed for several reasons. In the past bankers were interested primarily in “self-liquidating” loans, not considering the nature of banking to be compatible with the extension of credit for extended periods of time. However, recently bankers have altered this philosophy, providing intermediate-term loans to businesses yet, in spite of this trend, the bank loan officer remains hesitant to offer long-term capital to the small concern. Possibly one reason for these reluctance stems from the possibility of a death of key executive within the small business, thereby threatening the entire continuity of the organization. While insurance may partially counter this loss, in many instances no amount of money will offset the loss of the leader in the small firm.

FACTORS INFLUENCING THE DECISION BETWEEN SHORT-TERM AND LONG-TERM DEBT

In determining the financing policies of the firm two underlying questions must be resolved:²

(1) What is the optimal debt-equity relationship, and (2) What should be the composition in terms of short-term and long-term maturities? In this chapter, we are going to assume that the debt-equity mix has been ascertained, with the remaining question to be addressed being the determination of the debt-maturity structure. As
already said, the smaller firms use larger proportions of short-term debt relative to the long-term liabilities. In this regard, any attempt to analyse the differences between small and large firms with respect to debt maturity structures should be done in the context of a general presentation of the key factors having an impact upon the decision. These determinants may be segmented into two categories: - (1) the advantages and disadvantages of the two respective choices without regard to firm characteristics and (2) the relevant factors coming to bear upon the decision when viewed strictly from the individual company’s perspective

**Advantages of Short-Term Debit**

With respect to the advantages of short-term credit two considerations generally favour employing short-term credit, these being cost and flexibility.

1. **Cost Difference**: The cost advantage does not unequivocally align with either short-term or long-term securities. Yet, a strong tendency has been proven for short-term indebtedness to have an advantage in terms of cost.

2. **Flexibility**: If the fund requirements for the business are partially cyclical in nature, management should not finance these short-term needs through long-term debt. Cyclical variations in assets requirements are encountered by short-term debt.

**Reasons for using long-term Debt**

In the figure 7.1 given on the next page, three advantages are cited for using long-term debt. Although the effect would not be felt uniformly, these factors should have an impact upon any deliberation regarding the firm’s debt-maturity structure. These three motivations for preferring long-term maturities are explained next.
The cost advantage varies between short and long-term debt, depending upon the economic conditions. However, the cost of short-term debt has usually been the cheaper source of financing.

Figure 7.1: Analysis of Debt-Maturity Composition.
(i) **Reduced Interest Rate Risk**

As already noted the expected interest rate for short-term financing has historically been less than the equivalent figure for long-term debt. However short-term rates are subject to a significantly larger degree of variability. Hence, if a company finances extensively with obligations having short-term maturities, a concomitant condition to be expected is a greater volatility over time in the interest expense for a given amount of debt. Consequently, the company's earning per share will be subject to larger variance, to which most managers and investors have a strong aversion. For this reason, long-term debt affords greater stability in earnings available to the owners. Whether this reduction in interest rate risk by employing long-term securities is attractive to the proprietors of the small organization is dependent on their attitudes toward the risk-return trade off in that the reduction of the variability in interest costs typically comes only with an increase in the expected interest charges.

(ii) **Loan Renegotiation**

In addition to the risk of volatile interest expenses, a firm relying heavily upon short-term debt also faces the necessity of frequent renegotiations of its loans. This episode carries with it considerable uncertainty for the firm, not only in terms of the new interest rate but also in potential restrictions included in the terms of the loan or, at the extreme, the denial of the credit for a subsequent period. The last concern, the lender's decision not to continue with the firm, usually need not be a concern, provided a recession and/or a discontinuity of the company's prosperity does not develop. If, however, problem areas arise that result in a reduction in earnings, the creditor will scrutinize closely the merits of the situation in deciding whether or not to grant the loan.

The difficulty arising from the inability to renegotiate on equivalently favorable terms or from the rejection of the loan proposal affects any firm, large or small. However, the problem has been more pervasive over the years for a small firm that does not have access to the capital markets.
The General Rise in the Interest Rates

A final reason clearly favouring the issuance of long-term debt vis-a-vis short-term liabilities is the general long-term pattern of rising interest rates. Yet, due to the general rise in interest rates since 1945, a firm borrowing money at a stated per cent for a 20 year period would normally pay greater amounts of interest in the earlier years but would have a cost advantage in later periods. In summary, the immediate cost advantage from short-term borrowing may be offset by greater costs in later years.

Firm Characteristics and the Debt-Maturity Structure

A number of firm characteristics could be identified as impacting the decision between short- and long-term debt, with three key determinants being (1) the business risk of the operation, (2) the existing asset structure, and (3) the company size and maturity.

The level of business risk: Business risk has been defined as the variability of the firm’s return on assets. This type of uncertainty is a function of the industry within which the business operates and the amount of fixed operating expenses incurred by the operation. If the industry is highly competitive and/or particularly sensitive to changes in the economy, the company’s sales will be subject to wide fluctuations. Furthermore, if the organization is characterised by a high degree of operating leverage, the relative variability in earnings before interest and taxes is further magnified, thereby increasing the firm’s business risk.

If the company’s ownership attempts to maintain a “reasonable” level of business risk has to be recognised in arriving at the debt maturity structure decision. From the company’s perspective, the greater the proportion of short-term debt relative to the concern’s total debt, the greater the risk of insolvency. Thus, all else being constant, as business risk increases, the financing by short-term credit should be reduced. In summary, if enterprise functions in a highly competitive industry, or an industry noted for its volatility, and/or the firm’s operating leverage is substantial, short-term financing should be curtailed. If, on the other hand, these conditions are moderate, management has greater discretion in its employment of short-term debt.
Existing asset structure: As mentioned previously, the nature of the assets being financed has to enter into the determination of the “optimal” debt composition. The rationale cited earlier for distinguishing between secular and temporary investments. In a similar context, but from the creditor’s perspective, the type of assets controls the financial terms to be offered. If the nature of the business is service or retail oriented, which normally requires larger investments in working capital as opposed to capital expenditure, long-term debt arrangements are not so readily available. For the lender, these current assets simply do not offer the collateral necessary for long-term protection. At the other extreme, capital-intensive firms by their nature have to rely more heavily upon long-term financing due to the necessity for synchronizing cash inflows and outflows.4

Company size and maturity: The size and maturity of a firm have a definite impact upon the company’s financing strategy. For the new small business long-term debt funds are primarily available by mortgaging real estate, acquiring equipment through installment purchases, and/or by arranging for “off-balance-sheet” financing through long-term leases. When these funds are depleted, short-term credit represents the only remaining origin for debt funds. Hence, for the relatively short-term, management’s discretion between long- and short-term financing is not so great as that observed for the larger and more mature corporation. For this reason, small firms normally are compelled to depend on the closer-maturing obligations. This “compulsory” reliance upon short-term debt, oftentimes by necessity, places the small firm in a greater financial risk posture. This risk is further compounded when we realise that small firms also employ more financial leverage than do their large counterparts. Thus, when viewed from the total capital structure, the small firm’s heavy indulgence in short-term liabilities is quite significant and has a direct impact in increasing the operation’s financial risk.5

Attention is now directed toward the possible sources for the small firm in acquiring short-term capital.

SOURCES OF SHORT-TERM CREDIT

Sources of short-term capital may be segmented into two categories: (1) credit available from suppliers in the form of trade credit, and (2) debt provided by financial institutions.
Trade Credit

Trade credit is characteristically different from other forms of short-term credit in that this source is not associated with a financial institution. However, this fact should not minimize the significance of trade credit as a primary source of financing. Specifically, on the average, approximately one-third of a firm’s current liabilities comes from trade credit. These payables are all the more important when viewed from the perspective of the small-scale industries.

Financial Industries as supplier of short-term Credit

The volume of short-term credit supplied by financial institutions fluctuates more widely than does the volume supplied by trade credit. Although banks are the largest group of financial institutions supplying short-term credit, other financial institutions also play a major role in this type of lending.

(B) INTERMEDIATE FINANCING

In the preceding section we were concerned with short-term financing; that is, credit that is rapid or renewed within one year from the date of the loan. In this section we shall deal with intermediate credit, which may be defined as credit extended for periods longer than one year but not long enough to be classified as long-term credit. Although intermediate credit is secured in many different ways and evidenced by various types of credit instruments, its major sources are term loans and leasing. The relative importance of leasing and term loans in small-scale industries is not available, but it is believed that both are major sources of financing, more so in long-term than in short-term debt, and certainly deserving of consideration by the managers of small scale industries.6

THE NATURE OF TERM LOANS

The term loan as we know it today is a relatively new type of credit-granting device, even though it has been employed in principle for many years in the form of extended and renewed short-term loans. Maturities of term loans depend to a great degree on the financial institution granting the credit; for example, the greatest majority of the loans made by banks have maturates between 1 and 5 years. The smaller firms
receive the shorter maturities, whereas the larger firms receive the longer terms. Life insurance and pension funds tend to grant longer-terms 5 to 15 years- but they, too, give shorter terms to smaller companies.

As the title implies, the term loan is repayable over the life of the loan. As a general rule, the payments include the interest, and the amount remains constant over the life of the loan. Occasionally, the firm is able to have a balloon payment at the end of the loan’s life.

Banks generally require some type of collateral from their borrowers, and this is especially true for small-scale industries. The collateral may include personal assets such as stock and bonds as well as real property such as machinery and equipment. Occasionally the firm is required to secure the loan with real estate.

In the majority of cases, the interest rates charged on term loans are higher than those charged on short-term loans to the same borrower. Moreover, the rate can either (1) remain constant over the life of the loan or (2) move directly with the prime-lending rate. In addition to the interest charge the lender may also charge a service to cover such items as legal and credit analysis costs.

Interest on term loans may be charged either on the original amount or on the outstanding amount of the loan. If charged on the outstanding amount, the rupee amount of interest declines as the loan is repaid. If charged on the original amount, the interest rate is higher.

TERM LOANS AS A FINANCE DEVICE

Although term loans are employed for many valid reasons, they may create some operational problems under certain conditions. First, the use of term loans may “disturb” a firm’s optimal capital structure, which could adversely affect earnings on equity and cost of capital.

As the term loan is paid off from earnings, the return on equity as well as risk decrease. The reduction in risk would have a tendency to cause the value of the firm to increase, but this increase in value may be offset by a decline in the return on equity. It
should also be noted that after the term loan is repaid (out of equity) the firm's
debt/equity ratio is smaller than it was when the loan was undertaken. In other words, the
firm's capital is no longer at its optimum, thus causing a permanent decline in the firm's
return of equity and more than likely the value of the firm as well.\footnote{7}

A term loan can avoid distorting return on equity and value if it is not very large
relative to other debt and if installments are paid with debt rather than equity capital. This
is not to suggest that term loans should be avoided; rather, it suggests that care should be
exercised when term loans are used in the financing process.

The term loan does have certain advantages. First, it permits flexibility in that the
terms of the loan can be tailored to fit the needs of the small-scale industries. Second,
small-scale industries do not have access to the capital markets, and term loans are a
fairly good substitute for long-term securities. Even, if there is access to the capital
markets, term loans may be obtained much more quickly and possibly more cheaply than
publicly issued bonds.

Sources of Term Loans

Principal suppliers of term loans are commercial banks, small Industries
Development Bank of India, State Financial corporations, National Small Industries
Corporation and State Industrial Development corporations, etc.

NATURE AND IMPORTANCE OF LEASING

Leasing as a method of procuring assets is probably the most significant
development that has taken place in the field of finance during the past three decades.
Originally the emphasis was on real estate leasing, but during the past several years' firms
have been able to lease almost any type of fixed asset. Although there are no figures
measuring the amount of leased equipment presently in use, we may safely conclude that
lease financing is one of the major methods of external financing being used by many
industries. Although a firm would probably never lease all its fixed assets, there is a
definite trend toward owing less and leasing more. It is difficult to say whether the
increased importance of leasing is a result of the financial officer's desire to conserve
funds or whether it results from increased effort on the part of the leasing companies.
Prior to discussing the pros and cons of lease financing, we should examine briefly the two principle techniques of leasing, which are (1) leasing rather than purchasing the asset and (2) the sale and leaseback of an asset that has been previously acquired and financed out of the firm's own funds. In general there are two types of leases: Operating leases and financial leases.

Operating leases may be canceled with prior notice. This means that the lease is not bound for a lengthy period of time and the lessor carries the responsibility of ownership. Usually the lessor maintains and insures the asset. The type of assets covered by this type of lease includes computers, copying machines and telephone services. An important characteristic is that the cost of the asset is usually not fully optimized. The financial lease on the other hand, is noncancelable lease of a fully amortized asset that the lease normally maintains and services. The lease payment usually covers the cost of the asset plus a return that covers the cost and required return of the lessor. The lease usually includes an option for the lessee to purchase the asset at the end of the lease period for its fair market value. To arrive at the cost of the lease, the lessor only has to divide the cost of the equipment by the PVIFA (Present value interest factor for the period of time that the lease is to run).8

The sale and lease back arrangement involves nothing more than transferring the title of an asset owned by a firm to another party in exchange for a price that reflects the market value of an asset, following which the asset is leased by the original owner. The net effect of the transaction is for the original owner to “trade” a fixed asset for a current asset. The new owner and lessor expect to receive the cost of the asset plus an acceptable return.9

As stated sale and leaseback financing is the sale of an asset previously acquired and financed out of the firm’s own funds to another party, from whom it is then, leased back on a long-term basis. Although it is difficult to say precisely why this method of financing has increased in importance during the past several years, the change may be attributable to the growth of financial institutions and their effort to find attractive investments. Also, this technique allows firms to convert long-term investments in fixed assets to current assets.
The following advantages, which accrue to both financial institutions and business firms, reveal some of the reasons this particular technique has enjoyed such success during the past several years. The advantages for the financial institutions are several. First, it is able to obtain a higher yield from such an arrangement than it could by holding high-grade bonds.

Second, it is generally conceded that the lessor is in a relatively safe position since the types of firms that enter into these agreements have relatively small amounts of debt outstanding. In the event of insolvency the lessor is not in a strong position as a general creditor since the lessee can obtain legal relief from rental obligations; however, until insolvency occurs, the lessor is in a very strong position since the asset involved is of such character that the lessee cannot operate without it.

Third, in many cases the asset will have a value at the expiration of the lease. This offers the investor several courses of action. First, the lessor may allow the firm to repurchase the property at the amortized value. Since tax problems may result from such a course of action, however many firms refuse to grant options to repurchase the property. Second, the investor may sell the property and pay a capital gain tax, or third, the lessee may renew the lease at the going market rate, which means that the investor receives an even higher rate of return.

Two advantages often accrue to lessee. The first involves the release of capital funds for current use. If a firm can sell its fixed asset and reinvest the funds in current assets it may improve its return on investment in two ways: First, the funds will be invested in assets that turn over faster; therefore, in the long run their return will be higher than if the funds had been invested in assets with a slow turnover. Second, if the firm raises needed capital from equity sources at a time when the cost of equity capital is high, the earning power of each share will be divided; therefore, it will benefit the firm more to raise the necessary funds by selling its fixed assets. Second, the major advantage of the sale and leaseback technique is that, under certain conditions the firm can experience a definite tax saving.
OPERATING AND FINANCIAL LEASES

Operating leases are vitally important to small-scale industries since this may be the only way in which they can obtain the use of the asset in question. While this is an important subject, we will focus on the financial lease.

First and foremost, the small-scale industry owners should be aware of the contents of the financial lease contract. In the majority of cases the contract includes the following:

(1) The term of the lease (during which time the lease is noncancelable);
(2) Periodic rental payments, which include the cost of the equipment plus a return on the lessor’s investment;
(3) Cost of maintenance, taxes, insurance and so on; and
(4) A renewable clause.

Advantages and Disadvantages of Financial Leases

An examination of the literature in the field of lease financing reveals that there is no unanimity of opinion about the advantages and disadvantages of lease financing. Therefore, we shall list those advantages that have not been seriously questioned and follow them those that have been set forth and discussed and discredited.

The following advantages of financial leases currently acknowledged as being valid:

1. Permit a lessee to obtain the use of property that cannot be acquired in any other way.
2. Provide facilities that are needed only temporarily.
3. Avoid the risk of obsolescence.
4. Relieve the user of maintenance, service and administrative problems.
5. Provide an additional source of financing.
6. Give the lessee flexibility.

Advantages are obvious, as these do not require individual explanations. It should be pointed out however, that under certain conditions it is possible to question one or
more of them. In the past, various attempts have been made to establish the beneficiality of four alleged advantages, although recent literature has discredited them. The more important of these are that leasing (1) frees working capital, (2) yields a tax saving (3) improves the lessee’s apparent financial position, and (4) spares management the need to review capital expenditures.

The most frequently mentioned disadvantages of leasing are (1) high cost; (2) loss of residual values; (3) the possibility that a premium will be demanded for vital equipment unless adequate care is taken when the lease is negotiated; (4) inadequate evaluation due to habitual leasing; (5) the lack of accumulation of equity, which could have some adverse effects on future financing; and (6) the possibility that control of the facility may be lost at the end of the lease period.

The validity of each of these disadvantages depends on the alternatives and the care exercised when negotiating the lease agreement. To illustrate, the cost of a lease may or may not exceed the cost of alternative sources. There are several elements that determine whether a lease is more “expensive” than the alternative sources; these include the tax rate, the repayment schedule, the depreciation method used, and the rate of interest charged on the balance of the investment.

SOURCES OF LEASE FUNDS

Funds to finance leases are obtained from several important sources, chiefly the following: independent leasing companies, banks, Small Industries Development Bank of India, State Financial Corporations, State Industrial Development Corporations & National Small Industries Corporation etc.

(C) LONG-TERM FINANCING

The source of finance has to be decided with reference to the period for which the funds are required. Fixed capital or long-term funds must be raised in such a manner that the enterprise will have uninterrupted use of such funds for a sufficiently long period. Long-term finance is required for investment in fixed assets like land and buildings, plant and machinery, furniture and fixtures, etc. It is generally required and raised for ten years. The important sources of long-term finance are:
(I) Issue of shares.
(II) Issue of debenture
(III) Loans from financial institutions
(IV) Ploughing back of profits (for existing concerns).

(I) **Issue of Shares**

Issue of shares is the most important method of raising long-term finance. Shares are the ownership securities. Share capital or capital stock constitutes the ownership funds of a company. Funds raised through the proceeds of share issues provide a financial floor to the capital structure of a company. The share capital of a company is divided into units or portions of equal value. Each unit represents a part in the total capital. It is known as a 'share' and the value mentioned against it is called face value or par value. A share may thus be defined as a part of the share capital representing a shareholder’s interest in the company. Under Section 86 of the companies Act, 1956, a public company limited by shares can issue two types of shares viz., equity shares and preference shares. A private company, which is not a subsidiary of a public company, can also issue deferred shares.

(a) **Equity Shares**

Equity shares or ordinary shares are those shares, which carry no preferential right in the payment of dividend or repayment of capital. They represent the primary security of a company and constitute the cornerstone of a company’s financial structure. Equity shares are issued first but paid in last of all claimants. Equity shareholders sink and swim with the company, as there is no guarantee of dividend and repayment of capital. Equity shareholders get dividend only after the dividend on preference shares and interest on debentures have been paid. At time of winding up, equity shares can be paid back only after all other claims have been paid.

Equity shareholders bear maximum risk and, therefore, they can control the affairs of the company. They have full voting rights. They elect the directors and formulate policies of the company in the general meetings.
(b) Preference Shares

According to section 85(1) of the companies Act, 1956 a preference share is a share which carries preferential rights as to the payment of dividend at a fixed rate and as to the repayment of Capital. Thus, preferential shareholders enjoy two preferential rights over equity shares. Firstly, they are entitled to receive dividend prior to the payment of dividend on equity shares. Secondly, at the time of winding up of the company the preference share capital is paid prior to the repayment of equity share capital. Preference shareholders have limited voting rights i.e. they can vote only on matters which affect them directly. Preference shares are of the following types:

1. Cumulative and Non-Cumulative;
2. Participating and Non-participating;
3. Redeemable and Irredeemable;
4. Convertible and Nonconvertible;

(II) Issue of Debentures

Debentures or bonds are creditorship securities representing long-term indebtedness of a company. A debenture is an acknowledgement of debt by a company. It is an instrument in writing under which a company agrees to pay a fixed rate of interest at periodical intervals and to repay the loan at the expiry of the stipulated period. A debenture has been defined as "A document under the company's seal, which provides for the payment of a principal sum and interest thereon at regular intervals, which is usually secured by a fixed or floating charge on the company's property or undertaking and which acknowledge a loan to the company."

Debenture holders are creditors of the company. They have no voting rights but their claims rank prior to equity shareholders and preference shareholders. Their exact rights depend upon the nature of debentures they hold. Debentures can be of the following types:

1. Secured and Unsecured Debentures.
2. Registered and Bearer Debentures.
3. Redeemable and Irredeemable Debentures
4. Convertible and Non-Convertible Debentures
Comparative Evaluation of Equity Shares, Preference Shares and Debentures

In the same course of financial planning, one of the important decisions to be made is the choice of securities to be issued. This decision requires a comparative evaluation of various types of securities. Often a company may choose all the securities. In order to determine the suitability of shares and debentures for a company, the following factors should be taken into consideration:

(i) **Cost**: Equity shares are a costlier source of finance than preference shares and debentures. Equity shareholders expect a higher return to compensate them for the higher risk, which they bear. Debenture interest is deductible from profits for income-tax purpose.

(ii) **Period of Finance**: Equity shares provide permanent finance for the lifetime of the company. Preference shares and debentures provide long-term and medium-term finance. Funds received through these securities can be paid back whenever the company desires.

(iii) **Risk and Return**: Return on equity shares depends upon the profits and involves no fixed burden on the company. Issue of equity shares involves no risk of insolvency even if the company fails to earn sufficient profits. But dividend on preference shares and interest on debentures represent a fixed burden on the company. If the earnings are constantly insufficient, company may have to go into liquidation. Interest on debentures is a charge on profits.

(iv) **Trading on Equity**: If a company issues only equity shares, there is no scope for trading on equity. Use of non-participating preference shares and non-convertible debentures help to increase the return to equity shareholders.

(v) **Control on Management**: Equity shareholders have full voting rights in the meeting of a company. Therefore, issue of equity shares may dilute the control of company’s affairs. Preference shares and debentures carry limited or no voting rights. When the company does not want to diffuse control, it is likely to raise further capital by issuing preference shares and debentures.
(vi) **Capacity to borrow:** The issue of equity shares increases the capacity of a company to borrow funds as its credit worthiness is increased. But issue of debentures reduces the company's capacity to borrow funds. Issue of preference shares has no significant effect on the borrowing capacity and credit worthiness of the company.

(vii) **Flexibility of Financial Structure:** Equity shares provide freedom for the issue of other securities, but make the capital structure rigid as equity capital cannot be paid back in the normal course of business. Preference shares and debentures can be redeemed and, therefore, help to bring elasticity in the financial structure of the company.

(III) **Institutional Financing**

Traditionally, the role of commercial banks in the field of long-term finance to industry has been negligible. Therefore, the Government has set up a number of special financial institutions in the country to provide long-term finance to business enterprises. These institutions or development banks have become a major source of finance for floatation of new concerns as well as for the modernization and expansion of the existing concerns. They provide finance both in the form of equity and debt. These institutions are not simply financial institutions. They also provide promotional, technical and managerial services. They take initiative in locating and filling gaps in the country's industrial structure. Small-scale Industrial Sector raises working credit and term capital required by it from commercial banks, co-operative banks, regional rural banks and state financial corporations. The banking system provides mainly working capital and the State Financial Corporation mainly investment capital. Assistance is also available to the small-scale industrial sector from the National Small Industries Corporation (NSIC) at national level and the State Small Industries Development Corporation (SSIDC's) at state level in the form of supply of machinery on hire purchase basis. The Small Industries Development Bank of India (SIDBI), the National Bank for Agriculture and Rural Development (NABARD) and the Industrial Reconstruction Bank of India (IRBI) provide refinance facilities to banks and financial corporations for financing small-scale industrial
sector. The credit provided by banks to small-scale industrial sector is treated as credit to "Priority Sector."

**SOURCE OF FUNDS**

- Industrial Development Bank of India
- Industrial Finance Corporation of India
- ICICI
- Industrial Reconstruction Bank of India
- LIC
- UTI
- GIC
- State Financial Corporations
- State Industrial Development Corpn.
- Commercial Bank
- HDFC
- HUDCO
- Risk Capital Foundation
- Shipping Development Fund Committee
- Export Import Bank of India
- NABARD
- SIDBI
- Foreign Collaborations
Institutional agencies grant financial assistance to small-scale industries for:

1. Participating in equity capital;
2. Acquisition of fixed assets by way of term loans; and

(IV) Ploughing Back of Profits

Retained earnings or ploughing back of profits refers to the process of reinvestment of the earnings year after year. Well-established companies commonly use retained earnings or undistributed profits to finance their business need. This method is also known as "self financing" because it is an internal source of finance. Retained earnings are a popular source of finance for modernization and expansion programmes. Such earnings can also be used to redeem old debts and to meet working capital requirements.

The amount of retained earnings in a company depends on several factors. Generally, more are the net profits of a company; greater is the capacity to plough back profits. Secondly, dividend policy of the company determines the extent to which profits can be retained for investment in business. A company which follows a policy of paying liberal and regular dividend every year may not be able to retain as much profits as a company following a conservative dividend policy. Thirdly, the age of the company affects the practice of self-financing. New companies generally do not retain many profits due to their desire to satisfy the shareholders.

On the other hand, an old company may distribute only a small part of the profits among shareholders and may retain the major part for ploughing back. Lastly, the future plans of the company regarding modernization and expansion also have an influence on retained earnings.

All these sources of finance are not available to all the small units. Much would depend on the status, character and the period of time the units have been in operation.

MAIN SOURCE OF SHORT-TERM CAPITAL IN SMALL-SCALE INDUSTRIES

Working Capital is the major reason most firms seek short-term loans. It’s worth noting explicitly that short-term financing is always debt of one form or another. Sources of short-term financing can be divided into two categories:
1. Spontaneous financing consisting of accounts payable and accruals, and
2. Short-term borrowings

**Spontaneous Financing:** Spontaneous financing consist of accounts payable and accruals. We will consider accruals first.

**Accruals:** Accruals arise because firms receive services continually, but make payments at fixed intervals. By paying employees at the end of a week or at the end of the month, as the case may be, the firm obtains free financing, since employees do not charge interest on these “forced loans”. Similarly, taxes are paid quarterly, rather than daily, which is other source of free finance. In other words, accruals provide a modest financing advantage, but they are not a policy issue.

**Accounts payable—Trade credit:** The very existence of small firms often depends on the availability of trade credit. Many firms would never have gotten started at all if suppliers had insisted on receiving cash upon delivery. The buying firm receives the goods and is expected to pay for them at a specified latter date. Effectively, the selling company lends the buyer the purchase price without interest, from the time the goods are shipped until the payment is made. The practice is called extending trade credit to the customer.

There is typically no security and very little contractual support for trade credit. The contract between the parties is limited to the terms written on the buyer’s purchase and seller’s invoice.

Trade credit is an attractive source of financing because it is free. However, it typically is not extended for very long period of time.

**Short-term Borrowings**

The second major component of short-term finance is borrowing, from individuals, from other firms or from financial institutions, especially banks. Borrowings differ from spontaneous sources in several important respects:

1. Short-term borrowing is planned and negotiated; it does not fluctuate spontaneously with sales.
2. In the case of borrowings, the firm actually receives money rather than supplies, or the services of employees, in advance of payments.

3. Typically, an individual borrowing transaction tends to be larger than its trade credit counterpart.

4. Borrowing always has an explicit cost.

**Table 7.1**

<table>
<thead>
<tr>
<th>Name of Industry</th>
<th>Commercial Banks</th>
<th>Other Financial Institutions</th>
<th>Friends/Relatives or Money Lenders</th>
<th>Total No.</th>
<th>Total %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Garments</td>
<td>75 100.0</td>
<td>-</td>
<td>-</td>
<td>75 93.7</td>
<td>80</td>
</tr>
<tr>
<td>2. Auto-parts</td>
<td>30 88.2</td>
<td>-</td>
<td>4 11.8</td>
<td>34 85.0</td>
<td>40</td>
</tr>
<tr>
<td>3. Electronics</td>
<td>50 100.0</td>
<td>-</td>
<td>12 16.7</td>
<td>62 92.0</td>
<td>78</td>
</tr>
<tr>
<td>4. Metal Products</td>
<td>60 83.3</td>
<td>-</td>
<td>-</td>
<td>50 89.3</td>
<td>56</td>
</tr>
<tr>
<td>5. Rubber &amp; Plastics</td>
<td>50 100.0</td>
<td>-</td>
<td>-</td>
<td>50 89.3</td>
<td>56</td>
</tr>
<tr>
<td>6. Others</td>
<td>74 92.5</td>
<td>-</td>
<td>6 7.5</td>
<td>80 93.0</td>
<td>86</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>339 93.9</strong></td>
<td>-</td>
<td><strong>22 6.1</strong></td>
<td><strong>361 90.3</strong></td>
<td><strong>400</strong></td>
</tr>
</tbody>
</table>

*Note: May be using more than one source, but we have considered only the main source.*

As discussed earlier, short-term financing plays a vital role in the financing of assets, regardless of the size of the firm. However, this source is of particular significance to the small business. Having limited access to the capital markets, the smaller company has to place greater reliance upon short-term sources, particularly trade credit and short-term bank credit. In small firms, after maximizing its use of trade credit additional funds are required, the smaller company, for the most part, approaches the banker for additional money. Table 7.1 shows that 90.3 per cent small-scale industries depend on short-term borrowings for their short-term needs of finance. Out of them 93.9 per cent small-scale industries, approach commercial banks for short-term loans. In Garments, Electronics, and Rubber and Plastics industries 100 per cent units, which required short-term finance from outside, have taken short-term loans from banks. On the other hand in Others industry, Auto-part’s industry, and Metal product industry 92.5 per cent, 88.2 per cent and 83.3 per cent units respectively are using bank as a source of short-term financing. Table
also shows that only 6.1 per cent industries have taken short-term loans from friends and relatives out of 90.3 per cent small-scale industries.

So, on the basis of above analysis we can say that commercial banks play the most significant role in providing working capital finance. Financial institutions have not provided short-term loans to any unit, because financial institutions do not provide finance for working capital.

MAIN SOURCE OF TERM LOANS IN SMALL-SCALE INDUSTRIES

For several reasons, the somewhat comprehensive criteria which are applied to term loan applications from medium and large-scale industries cannot be used in respect of term-loan proposal from small-scale industries. Small scale industries find it difficult to secure adequate finance from institutional sources even for their working capital requirements because of their own inherent limitations, on the one hand and the generally high standards applied by the lending institutions to borrowers, on the other. Organized credit institutions have generally been wary of lending to small-scale industries because, in their eyes, they are generally a poor risk. By and large, small units have a low capital turn over ratio as a result of which the available block capital security is inadequate in relation to a given level of production; their markets are somewhat narrow, the prospects for business frequently uncertain, and their rate of mortality is rather high. Banks, therefore, find it difficult to access their credit worthiness.

Difficulties in Procuring Institutional Finance

Small-scale industries are generally not regarded as sufficient credit-worthy because they are not able to satisfy the criteria lay down by lenders. The grant of medium and long term loans involves not only an assessment by the lending agencies of the credit-worthiness of the borrowers and the securities offered by them, but also an observance of rules and regulation governing such advances. The financial position of a borrowing concern should be fairly sound and should show profit or should have the prospects of proving its earning capacity, if financial assistance is granted; the equipment and technical processes employed in the production of goods and services should be efficiently; the unit concerned should have an assured market or should produce items
which are required by big industries; and the borrowing concern should be owned by men of integrity and business standing.

The institutions, which normally respond to some extent to the needs of small-scale industries, are smaller banks, whose field of activity is restricted to a small area. These banks are often managed by a local men to, unlike the branch agents of big banks, are able to develop informal relationship with the small industries. In view of their personal contact with customers, local banks are better able to adopt a flexible attitude and expeditiously dispose of the applications for loans. However, the resources of these banks are limited; and unless bigger banks take a promotional view in the initial stages and extend the much needed to small industries, the latter would be forced to borrow from non institutional lenders, the disadvantage of which need no elaboration here. As a consequence, they would fail to raise their standard of operations, which alone can help them to develop and become credit worthy. On their part, the small-scale industrialist should appreciate the fact that banks have to operate on business principles and cannot lower their lending standards to any appreciable extent in order to meet their financial needs. They should, therefore, make earnest efforts to meet the requirements of lending.

Table 7.2

<table>
<thead>
<tr>
<th>Name of Industry</th>
<th>Commercial Banks</th>
<th>Other Financial Institutions</th>
<th>Friends/Relatives or Money Lenders</th>
<th>Total No.</th>
<th>Total %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>%</td>
<td>No.</td>
<td>%</td>
<td>No.</td>
</tr>
<tr>
<td>1. Garments</td>
<td>34</td>
<td>70.8</td>
<td>7</td>
<td>14.6</td>
<td>7</td>
</tr>
<tr>
<td>2. Auto-parts</td>
<td>22</td>
<td>73.3</td>
<td>5</td>
<td>16.7</td>
<td>3</td>
</tr>
<tr>
<td>3. Electronics</td>
<td>30</td>
<td>75.0</td>
<td>4</td>
<td>15.0</td>
<td>6</td>
</tr>
<tr>
<td>4. Metal Products</td>
<td>43</td>
<td>78.2</td>
<td>3</td>
<td>5.4</td>
<td>9</td>
</tr>
<tr>
<td>5. Rubber &amp; Plastics</td>
<td>34</td>
<td>77.3</td>
<td>3</td>
<td>6.8</td>
<td>7</td>
</tr>
<tr>
<td>6. Others</td>
<td>54</td>
<td>73.0</td>
<td>7</td>
<td>9.4</td>
<td>13</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>217</td>
<td>74.6</td>
<td>29</td>
<td>10.0</td>
<td>45</td>
</tr>
</tbody>
</table>

*Note: May be using more than one source, but we have considered only the main source.*

Table 7.2 shows that 72.7 per cent small-scale industries have taken term loans for investment in plant and equipment, land and building or permanent addition to current
assets. Out of them 74.6 per cent industries due to the problems face by small scale industries in taking term loans from financial institutions as discussed in detail above, have taken long term and medium-term loans from commercial banks. Only the bigger units which could fulfill the stringent terms and conditions of financial institutions have taken loans from these institutions and their percentage is just 10. Remaining 15.4 per cent industries have taken loans from non-financial institutions (friends, relatives and moneylenders). In small-scale industries bank financing is most popular. Banks also grant loans for medium or long terms after taking security of land or building or against the security of plant and machinery to be purchased from the loan amount. So, the smaller units, which cannot provide any security, do not get term loans from commercial banks. In that case their needs are fulfilled by non-financial institutions.

Out of these 74.6 per cent industries which have taken term loans from commercial banks. In Metal products industry maximum 78.2 per cent units have taken loans from banks. The main reason for it is large number of small units in this industry. As said earlier small units cannot fulfill the stringent terms and conditions of financial institutions. In Rubber and Plastics industry the position is almost same and 77.3 per cent units have taken loans from banks. In Electronics industry 75 per cent units, followed by Auto-parts industry 73.3 per cent units, Others industry 73 per cent units and Garments industry 70.8 per cent units have taken term loans from banks.

As far as loan taken from other financial institution is concerned only (10 per cent) the big units have taken loans from them. In Auto-parts industry maximum 16.7 per cent units closely followed by Electronic and Garments industry where 15 per cent and 14.6 per cent units have taken term loans from other financial institutions. In remaining industries just 5 to 9.4 per cent units have taken loans from them.

In small-scale industry friends/relatives or moneylenders also play an important role in providing term loans? In a case when banks or other financial institutions refuse to grant term loans the only source for small firms is friends/relatives or moneylenders. Normally they charge high rate of interest but they help the small firms in crisis. It is clear from the table that in Others industry 17.6 per cent units closely followed by Metal Products industry 16.4 per cent units have used this source for term loan. In Rubber &
Plastics industry, Electronics industry and Garments industry also 15.9 per cent, 15 per cent and 14.6 per cent respectively have taken term loans from friends/relatives or moneylenders.

In small sector rest 27.3 per cent industries are not using any term loans. In this category both type of units are there: one who are financially sound and amount invested in fixed assets is not significant and other who had taken term loans but repaid already. In smaller units the requirements of working capital in comparison to fixed capital are more. So, small units have arranged fixed capital themselves without taking the help of outsiders.

**LONG-TERM FINANCING IN SMALL-SCALE INDUSTRIES**

Every firm requires funds for investment in the form of fixed capital and working capital. While estimating the need for funds, the period for which they are required is also to be ascertained. It is the period of finance, which determines the source or sources of finance to be tapped and method of financing to be used. Raising permanent capital for the expansion of an enterprise is not accomplished with ease, particularly for the small-scale industries. In general, the small firm is thought to incur higher cost for its funds as well as a greater limitation in terms of diversity of sources. While determining the preferred means for meeting the financing requirements of the firm a number of basic principles should be followed. Prior to investigating the type of funds, the key question would “should the company finance with long-term or short-term source?” The answer to this question would depend on the type of assets being financed, permanent or temporary assets. All permanent assets should be financed with either long-term debt or equity financing, and the remaining current assets should be sponsored by short-term sources.

Having determined the need for long-term financing, a number of matters must be recognized in ascertaining which source of funds should be drawn upon. Such as (i) Trade on the equity; (ii) the capital structure mix, (iii) the ability to cover fixed financing charges, and (iv) Relative cost.
Several non-financial factors come into play in determining the financial packages; the chief ones are: (1) debt may be the only source available to the small-scale industries regardless of cost, (2) debt does not disturb the voting position of existing shareholders, and (3) financial flexibility may not be possible when equity securities are employed.

The management of small firm should consider a number of key elements in finally deciding upon the choice between debt and equity.

Various sources of finance may be grouped under two heads, namely (i) Owners’ Funds and (ii) Borrowed Funds. Ownership funds include capital contributed by the shareholders and profits re-invested in the business. Borrowed funds are raised by way of loans and credit from the public, banks, financial institutions, etc.

The owners’ funds in small-scale industries, owing to their nature of organisation and limited access of the owners to the market are in short supply. The table 7.2 (discussed earlier) shows that 72.7 per cent small units have taken term loans for expansion, modernization or even for establishment from banks, financial institutions or non-financial institutions. Here, we will discuss the percentage of owners’ funds in the total capital and the percentage of loan capital in the total capital in small-scale industries in Haryana. Before discussing the position of these two kinds capital, we would like to make it clear that here the meaning of total capital is owners’ funds plus long-term borrowed capital. In the total capital we have not included short-term capital because while calculating Debt-equity ratio in the chapter Financial Leverage and Capital structure, we have included short-term capital in the External Equities - both long-term and short-term loans. In the Owners’ Funds we have included Equity capital and retained earnings. Now, we will discuss with the help of two tables (7.3 and 7.4) the percentage of Owners’ Funds and long-term loans used by small-scale industries for fulfilling long-term needs.
Table 7.3
PROPRIETARY RATIOS IN SMALL-SCALE INDUSTRIES IN HARYANA

<table>
<thead>
<tr>
<th>Name of Industry</th>
<th>0-24%</th>
<th>25-49%</th>
<th>50-74%</th>
<th>75-99%</th>
<th>100%</th>
<th>Total No.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>%</td>
<td>No.</td>
<td>%</td>
<td>No.</td>
<td>%</td>
</tr>
<tr>
<td>1. Garments</td>
<td>10</td>
<td>12.5</td>
<td>16</td>
<td>20.0</td>
<td>6</td>
<td>7.5</td>
</tr>
<tr>
<td>2. Auto-parts</td>
<td>8</td>
<td>20.0</td>
<td>16</td>
<td>40.0</td>
<td>2</td>
<td>5.0</td>
</tr>
<tr>
<td>3. Electronics</td>
<td>18</td>
<td>30.0</td>
<td>4</td>
<td>6.7</td>
<td>4</td>
<td>6.7</td>
</tr>
<tr>
<td>4. Metal Products</td>
<td>17</td>
<td>21.8</td>
<td>22</td>
<td>28.2</td>
<td>8</td>
<td>10.2</td>
</tr>
<tr>
<td>5. Rubber &amp; Plastics</td>
<td>23</td>
<td>41.0</td>
<td>2</td>
<td>3.6</td>
<td>3</td>
<td>5.4</td>
</tr>
<tr>
<td>6. Others</td>
<td>30</td>
<td>34.9</td>
<td>18</td>
<td>20.9</td>
<td>8</td>
<td>9.3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>106</strong></td>
<td>26.5</td>
<td><strong>84</strong></td>
<td>21.0</td>
<td><strong>31</strong></td>
<td>7.7</td>
</tr>
</tbody>
</table>

Note: Equity = Equity Capital + Retained earnings.

Table 7.3 shows various categories of small-scale industries according to the use of equity capital (Owners' Funds) for long-term financing. For the purpose of analysis we have divided them into two categories. Firstly, the units, which are using 50-100 per cent owners', funds (52.5 per cent) and secondly, the units which are using 0-49 per cent per cent owners’ funds (47.5 per cent). In the first category 27.3 per cent units are using 100 per cent owners’ funds for long-term financing. In it there are mainly small units which require less amount of fixed assets or capital as well as those old big units which has taken loan capital but have repaid them and presently having no loan capital. In this category the maximum percentage is of Garments industry 40 per cent followed by Electronics industry 33.3 per cent, Metal Products industry 29.5 per cent, and Auto-parts industry 25 per cent, which are using only Owners’ Funds for long-term. Next 17.5 per cent small-scale industries are using more than 74 per cent but less than 100 per cent owners’ funds of total capital. In this range of industries maximum percentage, 28.6 belongs to Rubber & Plastics industry followed by Others industry 20.9 per cent, Garments industry 20 per cent. In Auto-parts industry, Metal Products industry and Electronics industry 10-13 per cent units are using 74-99 per cent owners’ funds of total capital. In the first category rest 7.7 per cent of small-scale industries are using less than 75 per cent owners’ funds of the total capital. In this category, the percentage of different industries varies from 5 to 10.3 per cent according to the nature of the industry.

In the second category of industries using 0-49 per cent of owners’ funds 21 per cent of industries are using 25 per cent to 49 per cent owners’ funds and 26.5 per cent are
using less than 25 per cent owners funds for long term financing. In this, mainly bigger units, expanding units, and units, who require heavy investment in plant & machinery as well as financially weak units, which mainly depend on loan capital, are there. In the category using 25-49 per cent owners’ funds the maximum percentage is of Auto-parts industry 40 followed by Metal Products industry, 28.2 per cent, Others industry 20.9 per cent and Garments industry 20 per cent. The percentage of Rubber and Plastics industry and Electronics industry is just 3.6 and 6.7 respectively. The reason for more percentages in Auto-parts and Metal Products industries is the heavy investment required in plant and machinery. In the category using less than 25 per cent equity the maximum percentage is of Rubber & Plastics industry 41 per cent, followed by Others industry 34.9 per cent. It means that they mainly depend on outsiders for long term financing. The reasons are same as explained above. In Rubber and Plastics industry, the financial position of smaller units is weak and the owners’ have invested 0 to 24 per cent capital. In Electronics industry 30 per cent, in Metal Products industry 21.8 per cent, in Auto-parts industry 20 per cent, and in Garments industry 12.5 per cent units are using less than 25 per cent owners’ capital. These are mainly bigger units, which require heavy investment in fixed assets. So, the owners are providing only less than 25 per cent of the total capital.

Table 7.4

<table>
<thead>
<tr>
<th>Name of Industry</th>
<th>0% No.</th>
<th>0% %</th>
<th>1-25% No.</th>
<th>1-25% %</th>
<th>26-50% No.</th>
<th>26-50% %</th>
<th>51-75% No.</th>
<th>51-75% %</th>
<th>Above 75% No.</th>
<th>Above 75% %</th>
<th>Total No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Garments</td>
<td>32</td>
<td>40.0</td>
<td>16</td>
<td>20.0</td>
<td>6</td>
<td>7.5</td>
<td>16</td>
<td>20.0</td>
<td>10</td>
<td>12.5</td>
<td>80</td>
</tr>
<tr>
<td>2. Auto-parts</td>
<td>10</td>
<td>25.0</td>
<td>4</td>
<td>10.0</td>
<td>2</td>
<td>5.0</td>
<td>16</td>
<td>40.0</td>
<td>8</td>
<td>20.0</td>
<td>40</td>
</tr>
<tr>
<td>3. Electronics</td>
<td>20</td>
<td>33.3</td>
<td>8</td>
<td>13.3</td>
<td>4</td>
<td>6.7</td>
<td>10</td>
<td>16.7</td>
<td>18</td>
<td>30.0</td>
<td>60</td>
</tr>
<tr>
<td>4. Metal Products</td>
<td>23</td>
<td>29.5</td>
<td>8</td>
<td>10.3</td>
<td>8</td>
<td>10.2</td>
<td>22</td>
<td>28.2</td>
<td>17</td>
<td>21.8</td>
<td>78</td>
</tr>
<tr>
<td>5. Rubber &amp; Plastics</td>
<td>12</td>
<td>21.4</td>
<td>16</td>
<td>28.6</td>
<td>3</td>
<td>5.4</td>
<td>2</td>
<td>3.6</td>
<td>23</td>
<td>41.0</td>
<td>56</td>
</tr>
<tr>
<td>6. Others</td>
<td>12</td>
<td>14.0</td>
<td>18</td>
<td>20.9</td>
<td>8</td>
<td>9.3</td>
<td>18</td>
<td>20.9</td>
<td>30</td>
<td>34.9</td>
<td>86</td>
</tr>
<tr>
<td>Total</td>
<td>109</td>
<td>27.3</td>
<td>70</td>
<td>17.5</td>
<td>31</td>
<td>7.7</td>
<td>84</td>
<td>21.0</td>
<td>106</td>
<td>26.5</td>
<td>400</td>
</tr>
</tbody>
</table>

*Note: Intermediate Loans + Long-Term Loans.*

Table 7.4 shows the percentages of loan capital taken by small-scale industries as well as the percentages of different industries according to loan capital used by them. We
can divide them into two categories for the purpose of analysis, first, using 50 per cent or less loan capital of the total capital, and second, using more than 50 per cent loan capital. Now, we will discuss first category in which 52.5 per cent units are there. Out of 52.5 per cent units, 27.3 per cent are using no loan capital. Majority of them is comparatively smaller units requiring fewer amounts for plant and machinery. The aforesaid 27.3 per cent units also include financially sound units as well as the old units, which have repaid the loan amount. Next are 17.5 per cent units which have taken long-term loans but the amount is less than 26 per cent. This category of units depends mainly on owner’s funds for long-term financing. Rest 7.7 per cent small-scale industries are using 26 to 50 per cent loan capitals. In this category, the units are of moderate size where owners and outsiders are equally contributing for long-term financing. In this first category of units using 50 per cent or less loan capital of the total capital maximum percentage is of Garments industry 67.5 per cent, followed by Rubber and Plastics industry 55.4 per cent, Electronics industry 53.3 per cent, Metal Product industry 50 per cent, Others industry 44.2 per cent and Auto-parts industry 40 per cent which are using loan capital 50 per cent or less. This category includes mainly small units or less capital intensive units. On the second category where more than 50 per cent loan capital is used for long-term financing, 21 per cent units in the small sector are using more than 50 per cent but less than 76 per cent loan capital of the total capital. In this 21 per cent category of units the maximum number is of Auto-parts industry 40 per cent, followed by Metal Products industry 28.2 per cent, Others industry 20.9 per cent, Garments industry 20 per cent, Electronics industry 16.7 per cent and Rubber and Plastics 3.6 per cent. The reason of Auto-parts industry having maximum percentage in using 51 to 75 per cent loan capitals is the heavy investment in fixed assets due to new technology and comparatively the big size of the units. In 26.5 per cent small-scale industries which are using more than 75 per cent outsiders’ funds, the maximum percentage, 35.9 per cent belongs to Metal products industry closely followed by Others industry 34.9 per cent. In Metal Products industry bigger units using costly plant and machinery and smaller units which are not financially sound have taken more than 75 per cent loan of the total capital. In Other industry capital intensive units are using more than 3/4th-loan capital. In Garments industry least 12.5 per cent units are using more than 75 per cent loan capital. All these units are the one using modern technology for production. 20 to 30 per cent of Auto-parts, Rubber & Plastics
and Electronics industries are using more than 75 per cent outsiders’ funds out of total capital.

**Summing Up**

In small-scale industries after maximising its use of trade credit, for additional funds, most of the industries, approaches commercial banks for short-term borrowings. Commercial banks play the most significant role in providing working capital finance to small industries because financial institutions do not provided finance for working capital. Two-third industries in small sector have taken term loans for investment in plant & machinery, land and building or permanent addition to current assets. Out of them again two-third small industries have approached commercial banks for term loans due to stringent terms and conditions of financial institutions for granting term loans. And only one-tenth of them have taken loans from these financial institutions. Remaining industries have taken term loans from non-financial institutions. The owners’ funds in small-scale industries, owing to their nature of organisation and limited access of the owners to the market, are in short supply. Approximately one-fifth industries are using more than two-third owners’ funds out of the total capital used in the business for long-term. And in 47.5% industries more than half of the total capital is contributed by outsiders. In small sector only one-fourth industries solely depend on owners’ funds for long-term investment and these are financially sound as well as the old units, which have repaid the loan amount.
REFERENCES


