CHAPTER III
In the preceding chapter we have dealt with the concept of capital, capital structure and other related issues (including sources of capital in brief) to get the conceptual background of the study founded. In the present chapter it is intended to examine the sources of capital, the stepping stone of capital mix, in greater detail in the context of Indian Corporate Sector. Sources of capital here refer to the origins providing the investible funds to the Corporate Sector of India to cater to its needs for operation of the business. In fact, funds as such, originate from a bunch of sources broadly divided into two classes, viz. external and internal. External sources connote the sources which are outside the firm. The examples of such sources are an individual, Government, other firm, bank, financial institution—contribution to the total capital of a firm by way of subscribing to securities like shares, debentures/bonds or by way of advancing direct loan and deposit. External sources, again, may be of indigenous or foreign nature. Moreover, the fund received from such sources may be divided into ownership fund and creditorship fund. Share capital constitutes the ownership fund, while the rest form the creditorship fund, because the shareholders are the owners of the business and the providers of the rest are the creditors thereof. Ownership fund is also called variable risk or charge-bearing and dearer fund, while creditorship fund is recognised as the
fixed risk or charge-bearing and cheaper fund. Ownership funds are of long-term nature, while creditorship funds may be of both long-term and short-term nature. On the other hand, internal source denotes the source which is within the business. That is, the funds generated out of business operation and ploughed back is identified as internal fund. The funds coming under this category are reserves & surplus, provisions, proposed dividend, and bonus shares, etc. Internal funds may also be long-term or short-term. The fund received from bonus issue, reserves & surplus belongs to the first category, while proposed dividend falls under the second one. Provisions may belong to both. Provision for depreciation, etc. which serves the firm for long comes to the former category but provision for taxation payable within a short period forms the short-term internal fund. However, internal sources are variable risk or charge-bearing and hence dearer fund like equity share capital. It also constitutes a part of ownership fund though a few items like provision for tax do not belong to the owners.

The gravity of a source, however, in the capital structure varies from case to case, time to time depending upon the sector, to which the firm belongs and nature, size, stage of operation, earning capacity, etc. of the business as discussed in the previous chapter. The sources of PvEs unlike that of PEs are broad-based. PEs are usually financed by the Government itself out of State Coffer. Of course, now-a-days PEs are being allowed, rather made bound, to collect funds from
the market. As to sources of PE-capital, a lot of discussion has already been made in the previous chapter. None the less its reiteration is felt pertinent in the running chapter. PEs get their funds either from budgetary appropriation of the Government or the Government can set up a Government Company in conformity with the provisions of Joint Stock Companies Act or a statutory corporation through special enactment, which may itself undertake the task of procuring funds either by issuing its own shares or bonds, or by floating Government loans through it to the general public. Such a practice was followed in case of nationalised industries in U.K. that came into existence between 1945 and 1949. Another method that may be adopted for initial capital is the creation of special development fund for the purpose, though India has not been found to do it. Flow of funds from State Coffer for providing initial capital to PEs may take diverse forms, viz., outright grant, interest-bearing, repayable or non-repayable loans and dividend-paying share capital. It may also be provided with redeemable or convertible preference share capital. If special institutions are set up, the fund emanating therefrom comes usually in the form of loan. Government may exercise the aforesaid techniques either in isolation or by a combination of them taking any one or more of them. A Government Company can also raise debt capital from the market when it has been able to earn confidence among the investing public. This is why it is usually a non-starter. Various sources of capital may be examined in the following
lines.

**SHARE CAPITAL**

The amount of money subscribed by the shareholders in a company is known as share capital\(^4\), i.e., the shareholders' fund excluding retained earnings in the form of reserves & surplus goes by the name of share capital. The memorandum of association of a company in its capital clause contains the amount of share capital with which the company is to be registered and indicates its division into shares of a fixed amount under section 13(4) of the Joint Stock Companies Act, 1956.

Share implies the definite portion of the company's capital. Subject to provisions of the article of association, share is a transferable property. It is the documentary evidence of proprietary relationship between the holder and the company. U/s 2(46) of the Companies Act, 1956 'share means share in the share capital of a company and includes stock except where a distinction between stock and share is expressed or implied'. Mainly two types of shares, equity and preference, are issued by a public limited company U/s 86 of the said Companies Act, 1956.

**EQUITY SHARE**

Section 85(2) of the Companies Act, 1956 states, 'equity share capital means, with reference to any company limited by shares, whether formed before or after the commencement of this Act, all share capital which is not preference share
capital'. Equity shares are the variable charge-securities. In other words, the equityholders have only a residual claim on the earnings that remain after payment of all including operating expenses, interest on loan, taxes and preference share dividend. In fact, the equityholders are the real owners of the company holding the eventual risk. Even in the event of liquidation of the company, they are the last receivers. It has got no maturity date. It is a permanent security of the company. An equityholder can liquidate it only by way of sale or transfer. Thus, it is non-refundable in nature. So, it is the costliest source of fund forming the permanent financial base of a company. A value, known as par value, attached to the share, is borne by the memorandum of association of the company. It is also known as face value of the share bearing the holder's interest in, as well as the liability to, the company. It may have a book value purporting the fund available to equityholders divided by the number of equity shares. Again, particularly in case of Pves, it may have another value known as market value or exchange value. Obviously, it is the stock exchange price at which transactions take place.

Equity shares equip the holders with the right to vote for election of the members to the board of directors, the organ, through which they exercise and retain control over the management of the company. Moreover, equityholders have the privilege to subscribe to further issue of shares, usually
at prices lower than market price subject to the approval of the CCI. This right is referred to as preemptive right and such issues are known as right issues. In case of PvEs equity shares are subscribed by the public widely in case of public limited companies and privately in case of private limited companies. In case of PEs, on the other hand, such shares are usually subscribed by the Government itself, though in law there is no bar to the public-participation which the Government has not pursued as a general policy, despite repeated recommendations by the Estimate Committee in its 16th report (1st Lok Sabha), 19th report (2nd Lok Sabha) and by the Krishnamenon Committee, etc. suggesting for public-participation in PEs, at least, to the extent of 25 per cent. It may be recalled, only in a few Government Companies public-participation in equity share capital was allowed. It goes without saying that the Rao-Government has proposed for divestment of 20 per cent equities in some selected PEs through 1991-92 central budget. Employees' participation in equities, both in PEs and PvEs, may also take place. A survey showed that on 31.5.65. out of 100 companies, only in the 6 companies, employees' participation had taken place. The Government has taken two schemes to encourage employees' participation in the equity capital of their companies. In the first scheme (Employees' Stock Option Scheme), the stock issue is linked to savings of employees while in the second scheme, companies have to reserve 5 per cent of their total public and right issues of shares for preferential allotment to the employees.
By the very name it signifies a share, the holding of which associates the holder with the preferential right to get dividend and/or principal over equity shareholders u/s 85 of the Joint Stock Companies Act. The dividend may be a fixed amount or an amount calculated at a fixed rate. It may be recalled that it is a hybrid security due to the co-existence of the features of both equity shares and debt. As the rate of dividend is fixed, it helps trading on equity, it is less risk-bearing than equity, it enjoys priority over equity and usually it does not offer voting rights— as such, it resembles debt. On the other hand, as it is not any contractual obligation, the return paid on it goes by the name of dividend, its non-payment does not lead to insolvency and it is not tax deductible, i.e., it is not a charge against profit, therefore, it does not entail any tax benefit—it takes after equity share. Incidentally, it may be stated that when a company has utilised its debt capacity, it can finance further with this source as preference capacity is distinct from a debt capacity.

Preference share capital may be of different types:
(i) Cumulative or non-cumulative. (ii) Redeemable or irredeemable. (iii) Participating or non-participating. (iv) Convertible or non-convertible.

(i) When the terms and conditions so provide that the holder
of the preference share would be entitled to arrear dividend, the preference share concerned is called cumulative preference share, i.e., when the unpaid dividend accumulates for payment in future, such preference share is a cumulative preference share and when it does not, it is a non-cumulative preference share.

(ii) Again, when preference share is required to be redeemed after expiry of a stipulated period of time, it is a redeemable preference share, when it is not so required, it is an irredeemable preference share.

(iii) When a preference share holder is allowed to participate in the residual surplus with the equity holders, it is a case of participating preference share and when it is not so allowed, it is a non-participating preference share.

(iv) When a preference share is issued on attaching convertibility clause and it is allowed to be converted after 3-5 years into an equity share, such preference share is called convertible preference share and when such conversion is not allowed it is non-convertible preference share. Incidentally, it may be mentioned that the Government has introduced 10% cumulative convertible preference share, a new instrument, of Rs.100 each convertible between the end of 3 years and 5 years subject to the approval of CCI, issuable at 1:1 ratio at the most with equity. It can be enlisted in one or more stock exchanges. It should be treated as equity during
calculation of D/E ratio. The ratio of 1:3 between preference capital and equity capital does not apply to this instrument. It combines the feature of a fixed rate of return as in the case of preference shares with the flexibility of equity. Its introduction is for the purpose of setting up of new projects, expanding or diversifying existing projects and raising funds for capital expenditure, modernisation or for working capital needs. However, a few companies have issued such preference shares as yet.

BONUS SHARE

The payment of dividend in the form of shares in lieu of cash usually in the event of cash deficiency by the company is known as bonus issue. Bonus may also be issued to make partly paid shares fully paid. It is, actually, a process of capitalisation of undistributed reserves & surplus and is not a separate form of share. Only the existing equityholders are entitled to have such shares. Any company, Government or Non-Government, can issue such shares. In practice, Non-Government companies are excel in issuing the same. Such shares can be issued provided the articles of association of the company so provides, the company has sufficient undistributed profits and the Company Law Board (CLB) and the Controller of Capital Issues (CCI) so approve. The sources of bonus issue as enunciated in the guidelines issued in February 1947 are general reserves, free reserves, credit balance of profit
and loss account, capital profits and reserves, debenture redemption reserves, share premium account and capital redemption reserves. Out of the above sources, the last two are not allowed to be utilised for making partly paid shares fully paid. Additional guidelines issued on 18.8.81 by the Government may be put up in the following lines.

A resolution in the general meeting has to be taken to enhance the limit for authorised capital if the existing limit is likely to be superseded by the paid-up capital following the bonus issue.

A resolution enabling the board of directors to issue such shares and earmarking the proposed rate of dividend for the next year should also be taken prior to the submission of a prayer for the approval of CCI.

The permission to issue such shares will be given only to capitalise real profits and share premium.

No bonus share shall be issued out of profits on revaluation of fixed assets.

The residual reserve will be 40 per cent of the increased capital and the residual reserve test would take account of development rebate reserve and investment allowance reserve along with free reserves.

Bonus cannot be issued without offering dividend to shareholders.

30 per cent of gross profit, the average of last three years' gross profits, must not be less than the 10 per cent of increased capital.
There must be a gap of at least 36 months between two consecutive bonus issues.

No bonus share can be issued before converting partly paid shares into fully paid shares.

No permission for issue of bonus share will be given unless & until the legal payments of the employees, such as gratuity, provident fund, etc., are paid off.

The permission from the financial institution standing as loan fund suppliers should be taken prior to issue of bonus share.

Bonus and rights, if issued simultaneously, bonus issue should get prior permission.

It can never exceed paid-up capital and the like.

**DEBENTURE**

A debenture is a document containing an acknowledgement of indebtedness of the company, plus the terms and conditions regarding rate of interest, date of maturity, etc. Non-Government companies raise most of its loan capital through the issue of such debentures and other long-term bonds. The holders as such, are known as debentureholders who are the creditors of the company. They are entitled to a fixed rate of interest and repayment of the principal. They have a first claim of repayment of the principal amount in the event of liquidation. Also the interest on debenture is a charge against profit, hence it is tax deductible. Thus, it
is a very important source of capital for a company. Deben-
ture has been defined u/s 2(12) of the Companies Act, 1956
as, 'Debenture includes debenture stock, bonds and any other
securities of a company whether constituting a charge on the
assets of the company or not'. Like preference share, it is
also classified on the basis of redeemability, convertibility,
priority of repayment, redemption procedure, registration,
security offered, guarantee offered, subordination, etc.

Debentures repayable either in a single instalment at the
end of a certain period or through periodical instalments du-
ring the said period are called redeemable debentures and
when the debentures are perpetual in nature, being repayable
only at the time of liquidation of the company, such deben-
tures are known as irredeemable debentures.

The debentures which can be converted at the option of the
holder into equity shares of the company is recognised as
convertible debentures. Terms of conversion and rights there-
of are borne in the debenture certificate. Conversely, the
debentures that cannot be converted into equity shares are
called non-convertible debentures. Most of the debentures
belong to this class. In India, it became very popular in 80s
in the PVEs due to financial prospect and tax advantage
attached to it\textsuperscript{12}.

Some debentures may prevail over the others in respect of
repayment as same asset stands as security against the both.
The former is called first mortgage debentures and the latter
is called second mortgage debentures.
Redemption procedure may vary from case to case. Some may be redeemed by periodical sinking fund payments, while some may be paid off in a single instalment. The debentures redeemed by periodical sinking fund payments (fixed/variable) to the trustees of debentureholders are sinking fund debentures. As such, each debenture is paid by instalments, while there are some others known as serial debentures which are also redeemed by periodical instalments in the sense that in this case a portion of total such debentures issued matures periodically according to their serial numbers and accordingly the said debentures are redeemed in full.

Again, some debentures may be registered and some may be un­registered (bearer). Registered debentures are those in respect of which the name, address of the holders are entered in the register maintained by the company. Such debentures are transferable only through transfer-deed like share-transfer. Unregistered debentures are those for transfer of which, no transfer-deed is required as in this case no register is maintained by the company to enter the names and whereabouts of the holders. Such debentures can be transferred merely by delivery like negotiable instruments.

Besides, debentures may be secured or unsecured. Debentures secured by a mortgage (lien) on the asset of the company are secured debentures. The mortgage asset is known as collateral. Such asset may be specific (fixed) or general (floating), while debentures against which there is no mortgaged asset of the company standing as security are unsecured/necked/
simple debentures. It is the earning power of the company that is the only security to the holders of such debentures. Only well-established and credit-worthy companies, quite naturally, can issue such debentures.

Moreover, debentures may or may not be covered with guarantee. Debentures guaranteed by some third party, usually bank or Government, in respect of the payment of interest and repayment of principal are guaranteed debentures. Further, some debentures may be subordinated by the others in terms of redemption. The debentures that rank for payment behind all unsecured debts in the event of liquidation of the company are subordinated debentures.

In addition, there may have restrictions on participation in the issue of some debentures. As such, debentures kept reserve for existing Indian debentureholders are called rights debentures, such debentures are issued to raise long-term working capital of the firms. Again, debentures may publicly or privately be placed. It is privately placed with a single institutional investor or a small group of investors with a view to avoiding underwriters' interference and other cumbersome procedures.

**CHANGING TREND OF POPULARITY OF DEBENTURE**

Upto the late seventies, it had a limited popularity in corporate capital structure when most of the financial requirements of the companies were met by inter-corporate investments. Apart from the fear of loss of credit from banks
reluctant to offer credit to a company having debenture in its financial structure, the managerial and financial integration of corporate firms due to managing agency system also acted as a hurdle to the issue of debenture. Moreover, it did not have much appeal to the speculative-minded investors who preferred to invest in equities. Besides, its market was confined to institutional investors and investment companies. Furthermore, most of the issues were of high denominations aggravating the situation, i.e., confining the market only to the big investors. Terms were also not attractive. Adequate services of trustees were also not available, nor its secondary market was developed. The companies had limited facilities of issue and of underwriting-houses to help in issue and conversion. Its demand was adversely affected due to the competition with Government securities and preference shares.

Recent developments in eighties were due to several favourable factors. It is issued in attractive terms. Proper safeguards for the holders have been provided. Trustee services are also made available. The issue-houses and underwriting-agencies have emerged to create the market for debentures. Relaxation of statutory restrictions on the institutional investors resulted in an increase in their investment portfolios with respect to debentures. In addition, unlike equity capital, it is tax deductible leading to a reduction in cost of capital. In 1978, the Government of India formulated a
set of guidelines on the issue of 11% rights debentures upto ₹.250 lakhs by public limited companies to meet the long-term working capital needs. The initial response was fairly satisfactory. Even a few issues of some good firms were over-subscribed. However, for this or that reason euphoria was short-lived. In October 1980, the Government formulated another set of guidelines for the issue of public debentures by public limited companies to meet the long-term needs for working capital and modernisation, expansion/diversification of projects. Obviously, its market was not confined to the shareholders only. Besides, it did not impose any maximum limit like ₹.250 lakhs. The relaxation of debt-equity ratio from 1:1 to 2:1 was a commandable feature of such (1980) guidelines. The maturity period reduced from 12 years to 7 years was another step in the right direction.

Interest was raised to 12 per cent, further to 13.5 per cent in February, 1981. In April 1982, the guidelines were further revised by making a distinction between convertible and non-convertible debentures in respect of ceiling on the rate of interest. For convertible debentures, the existing rate of 13.5 per cent was maintained, while the rate of interest for non-convertible debentures was raised to 15 per cent. A premium of 5 per cent of the face value of debentures might be allowed at the time of redemption. The face value of debentures should ordinarily be ₹.100. The issue should ordinarily be underwritten unless exempted by the CCI. The shares of the
company concerned should be listed in stock exchanges. The market price of the company's equity share must have been at or above face value during last 6 months. The revised guidelines in September 1984 further encouraged both the PvEs and PEs to issue secured convertible and non-convertible debentures. Accordingly, some provisions were incorporated de novo. In case of non-convertible debentures, a company might have the option of getting the debentures converted into equity fully with the approval of, and at such a price as might be determined by, the CCI. The D/E ratio may be allowed to exceed 2:1 for capital intensive projects. The non-convertible debentures should normally be listed in the stock exchanges unless privately placed with bank, financial institution, etc. under CCI's approval to remove institutional threat of conversion. Only secured debentures would be permitted to be issued to the public. Simultaneous issue of shares and debentures would also be permissible. The provision regarding listing of shares would not apply to PEs provided the fair value of its shares was equal to, or more than, the face value and such PEs had declared dividend in the previous year. Linked-issue of shares and debentures might be permitted only in cases where the interest rate of non-convertible debentures was not more than the maximum rate prescribed for convertible ones. Simultaneous issue of (convertible/non-convertible) debentures and equity might be permitted if the investors were free to subscribe to any or both.
Case for Convertible Debentures

Conversion facility imparts a measure of flexibility to the capital structure. It can be issued at a time when the non-convertible/straight debenture is not likely to have a good investment appeal. Its rate of interest is also lower than that of non-convertible ones. Cheaper is the source for financing growth of the company. It enables management to widen equity base indirectly. It is, in fact, deferred equity. Besides, it offers tax advantage until it is got converted. It enables a company to sell future issues of equity at a price higher than that at which its equity shares may be selling when the convertible debentures are issued. From investors' viewpoint, it involves low risk, high yield and potential capital appreciation. The credit for making it popular with the public goes largely to TELCO that made the first ever largest convertible debenture issue of Rs. 47 crores in October, 1980. On the other hand, Hindusthan Development Corporation holds record for the extent of oversubscription of such debentures. Its public offer was Rs. 75 lakhs made in 1981 (May) and the offer was oversubscribed by 73 times. However, its popularity has shown a descending trend as against an ascending trend of popularity of non-convertible debentures.

Dominance of Non-convertible Debentures

The overwhelming popularity of such debentures has been made
possible by the aggressive publicity organised by the merchant banking houses. The financial institutions are also giving a good support subscribing even upto 50 per cent of the total issue. The buy-back arrangements enable the issuing companies to create and maintain confidence of the investors. The bought-back debentures are bought away by financial institutions like LICI, UTI, GICI, etc. and its subsidiaries. To push up the demand, the companies offer a choice of two schemes, cumulative interest payment and non-cumulative interest payment to pacify the different tastes of different investors. The redemption at a premium of 5 per cent of the face value after 7 years has added fuel to the flame, i.e., increased its popularity further. Its superiority over public deposits may be construed in terms of interest rate of 15 per cent irrespective of the period of holding; 5 per cent premium on redemption; higher liquidity due to listing on stock exchanges; possibility of upward review of interest rate in accordance with Government guidelines; buy-back provision making investment like money at call; full security and exemption from tax deduction at source upto Rs.1000 of interest income just like interest on fixed deposits. As a result, a secondary market for such debentures has blossomed. The annual reports of RBI for 1983-84 and 1987-88 together provide an interesting information as to the race between convertible debentures and non-convertible ones during the said period which may be depicted in Table 3.1.
TABLE 3.1
CAPITAL ISSUES BY PRIVATE CORPORATE SECTOR

<table>
<thead>
<tr>
<th>Security</th>
<th>YEAR</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Equity Share</td>
<td>270.30</td>
<td>353.86</td>
<td>999.30</td>
<td>1092.00</td>
</tr>
<tr>
<td></td>
<td>(37)</td>
<td>(44)</td>
<td>(39)P</td>
<td>(62)N</td>
</tr>
<tr>
<td>B. Preference Share</td>
<td>2.05</td>
<td>2.39</td>
<td>0.7</td>
<td>6.9</td>
</tr>
<tr>
<td></td>
<td>(-)</td>
<td>(-)</td>
<td>(-)</td>
<td>(-)</td>
</tr>
<tr>
<td>C. Debenture :</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Convertible</td>
<td>288.95</td>
<td>30.49</td>
<td>1082.10</td>
<td>511.60</td>
</tr>
<tr>
<td></td>
<td>(40)</td>
<td>(4)</td>
<td>(42)</td>
<td>(29)</td>
</tr>
<tr>
<td>b. Non-Convertible</td>
<td>171.05</td>
<td>422.47</td>
<td>478.10</td>
<td>138.50</td>
</tr>
<tr>
<td></td>
<td>(23)</td>
<td>(52)</td>
<td>(18)</td>
<td>(8)</td>
</tr>
<tr>
<td>Sub-total (a+b)</td>
<td>460.00</td>
<td>452.96</td>
<td>1560.20</td>
<td>650.10</td>
</tr>
<tr>
<td></td>
<td>(63)</td>
<td>(56)</td>
<td>(60)</td>
<td>(37)</td>
</tr>
<tr>
<td>Total (A+B+C)</td>
<td>732.35</td>
<td>809.21</td>
<td>2560.20</td>
<td>1749.00</td>
</tr>
<tr>
<td></td>
<td>(100)</td>
<td>(100)</td>
<td>(100)</td>
<td>(100)</td>
</tr>
</tbody>
</table>

(Figures in parenthesis signify percentage to total)

* Excludes bonus shares
** Includes one large issue of Rs.500 crores
*** Provisional
P Includes share premium to the extent of 1
N Includes share premium to the extent of 25


On analysis of Table 3.1 it appears that out of the total capital issues in 1982-83, 1983-84, 1986-87 and 1987-88 the convertible debentures shared 40 per cent, 4 per cent,
42 per cent and 29 per cent respectively thus, clearly showing a fluctuating trend, while non-convertible debentures constituted 23 per cent, 52 per cent, 18 per cent and 8 per cent respectively also exhibiting a fluctuating trend during the first three years and a declining cum even trend during the last two years. It is distinct that the two instruments highlighted a keen competition during the period under reference. It is further observed that the proportion of debenture in total capital issued during the years, viz., 1982-83, 1983-84, and 1986-87 was around 0.60. But in 1987-88 it declined radically to 0.37. Another interesting fact is that the importance of convertible and non-convertible debentures changed constantly in a peculiar manner, i.e., when one increased, the other decreased, as indicated before. It may further be noted that the debenture played a significant role in the capital issues of non-Government companies during the said period.

PUBLIC BONDS

The Finance Minister in his budget speech on 28.2.86 said, 'The core of the problem is simply that internal generation (of resources) in Public Sector Enterprises is not measuring up to the task of financing a plan of the size that is essential for our development'. The Government, it may be recalled, has been emphasising the need for the PE - self-financing as far as possible. For 1986-87, the budgetary
support to PEs was less than 3 per cent over the revised budget estimates of 1985-86, as against (11 to 22) per cent annual increase during the last decade (70s)\(^1\). The Government's philosophy of asking PEs to fend for themselves has, among others, led to their going to the capital market for raising loans. Accordingly, in 1986 three PEs, viz., the Indian Telephone Industry Ltd. (ITI), National Thermal Power Corporation (NTPC) and Rural Electrification Corporation Ltd. (REC), for the first time issued bonds without any Government guarantee (first two for Rs.100 crores each and the third for Rs.65 crores) at 14% per annum with tax benefits and transfer of title facilities, both of which are not available in PVES - bonds/debentures. In July 1986, the Government allowed PEs to issue 10% tax free bonds which are also exempted from wealth tax without any limit and are transferable by endorsement and delivery like the 14% bonds. The bonds of NTPC, ITI, REC were oversubscribed to the extent of Rs.63 crores, Rs.16 crores and Rs.19 crores respectively and all the firms were allowed to retain the oversubscribed funds. Later in 1986, National Hydropower Corporation, Neyveli Lignite Corporation, Mahanagar Telephone Nigam, Railways and NTPC went to the capital market to raise loans through 14% or 10% tax-free bonds to the extent of Rs.150 crores, Rs.50 crores, Rs.150 crores, Rs.250 crores and Rs.100 crores respectively. Most of the issues were oversubscribed. The commercial banks, and other financial units considered 10% tax-free bonds to be very much attractive. However, the floatation cost of these
bonds were very high. For example, NTPC spent ₹3.5 crores for raising ₹1.63 crores including oversubscribed amount of ₹0.63 crores. Moreover, the loss of income of the Exchequer for exemption of income tax and wealth tax in connection with the issue of such bonds is no less important.

**TERM LOANS**

A term loan is a contract under which a borrower agrees to make a series of interest and principal payments on specific dates to a lender. Most of the term loans are amortised, i.e., paid off in equal instalments over the career of loan. Its maturities may vary from 2 to 30 years but generally it varies from 3 to 15 years. It is usually supplied by banks, financial institutions (like IDBI, IFCI, UTI, ICICI, LIC, SFCS, etc.), Government, public, other firms, etc. In India banks usually provide short-term loan for one year and medium-term loan for more than 1 year but less than 5 years, while special financial institutions provide long-term loan for a term of five years or more. The institutional loans were originally meant for PvEs. But with the change in Government policy in 1969 allowing PEs to enjoy such source and authorising the financial institutions as such to entertain PEs too at par with PvEs, more and more aids have been flowing from such institutions to the PEs. Incidentally, it may be mentioned that as on 31-3-85 the amount of such loan to PEs stood at ₹0.834 crores including ₹0.42 crores to IISCO, a subsidiary
of SAIL. It cannot be gainsaid that the leading financial institutions convert such loans to equity, which is not viewed favourably by the firm concerned 21.

PUBLIC DEPOSITS

Deposits accepted directly from the members of the public against a fixed rate of interest usually higher than that allowed by the banks to attract the public against no security. Again, this rate is lower than that charged by the banks enabling the firm to reap the advantage of lower rate of interest. Once it has been a dominant feature of the capital structure of Cotton and Textile Mills, Bombay. Subsequently, it has gradually inundated capital market of the country to such an extent that warranted its proper regulation and the Reserve Bank of India ultimately was compelled to regulate its quantum in 1964. Thereafter, the Government of India also amended Companies Act in 1974 to take regulatory steps. U/s 58A of the said Act of 1974 as well as under Companies (Acceptance of Deposits) Rules, 1975, amended on 30.3.78 22 restrictions have been imposed on the payment of interest beyond 15 per cent and on the borrowings beyond 25 per cent of equity paid-up capital plus free reserves. Nowadays, on the strength of Companies (Acceptance of Deposits) Rules, 1975, amended in 1978 and the budget speech (June, 1980) of the Finance Minister granting the PEs' access to public deposits, Government Companies too have been utilising public
deposits since 1980-81 both under cumulative and non-cumulative schemes at the maximum rate of 14\(\frac{1}{2}\) per cent for a period not exceeding three years. However, only 20 Central PEs and some State PEs have been allowed to accept it. Upto 1983 the public deposit in PEs exceeded the amount of \text{\textcurrency{433,000,000}}.\textsuperscript{23}

To guard the interest of depositors adequately the following further amendments were made in the Companies Amendment Act of 1988 (Sec. 58A)\textsuperscript{24}: (a) It is compulsory to repay the deposits in terms of acceptance in due date, if not renewed by the depositors, (b) In case of default the aggrieved depositor may appeal to Company Law Board (CLB) for relief, (c) CLB, by its order including extension of time for repayment on condition, is to grant relief and (d) Non-compliance will attract penalty. Thus, the reliance on civil suit has been waived. The benefit depends largely on the activeness of CLB. However, all these measures will help introducing a simplified and non-cumbersome procedure. As a result, the capital market will be strengthened.

**GOVERNMENT LOAN**

Government provides loan capital to both PEs and PvEs. In case of PvEs it stands as a very negligible source, while in case of PEs it usually forms 100 per cent of equity capital. The rate of interest, as may be recalled, varies in accordance with the period for which the loan has been given and the bank rate and yields on Government securities as well, which
again varies from time to time, from firm to firm. As may again be recalled, sometimes PEs are provided mostly with Government loan finance.

**GOVERNMENT GRANTS/SUBSIDIES**

Sometimes a PE is started with an outright non-repayable grant-in-aid, in which case any profit that it makes after making its various commitments or a proportion of such profits is paid into the treasury. Sometimes it is offered to PEs to meet specific losses. For example\(^\text{25}\), Indian Airlines received ₹.12 crores till 31.3.84 to make good of the losses due to running some routes on Government direction. In the revised budget estimate of 1984-85 the Government subsidies for food and fertiliser were ₹.1100 crores and ₹.1632 crores respectively and an 'interest subsidy' for 8 Central PEs led to ₹.499 crores including ₹.139 crores for SAIL.

**INTER-CORPORATE LOAN**

This is also a source of finance of long-term nature when a company invests its surplus funds in another companies. It becomes compulsory for the establishment of joint sector companies (in collaboration with foreign companies, leading financial institutions, etc.). It leads to financial integration emerging many a benefit.
LEASING

It is an 'off balance-sheet financing' as neither the assets nor the liabilities under lease contract appear in the balance sheet of lessee company. Leasing refers to a contractual agreement allowing the lessee to use the asset of the lessee for a specific period of time in lieu of a specified payment (rent). The title of the asset does not pass on the lessee. Thus, the actual objective of having a loan or equity fund to acquire and use an asset is fulfilled through leasing process. So, it constitutes to be a component of capital structure of a company. Lease agreement may be of different types. Some may be renewable, while some may even offer a purchase option to the lessee. However, lease may be financial or operating. A financial lease is akin to instalment credit. It is a method of acquisition of an asset without making any payment for it and where lessee acts more or less as a financial institution. In other words, it is a means of financing the use rather than the ownership of an asset over the major portion of its useful life; the selection of equipment is a lessee's function. Here rentals cover the full cost of the equipment plus interest factor and the lessor's profit. In operating lease, on the other hand, leasing company purchases the equipment to lease it out to the lessee at a term and cost which does not cover interest and profit of the lessor. Computers are generally leased under operating lease system.

In India, hire purchase financing has been in vogue for
several decades but leasing was restricted till recently to different kinds of real estate. Since 1983 it has been permeating in the field of finance. To encourage the healthy growth of financial leasing of equipment policy, guidelines have been modulated and issued regarding the role of commercial banks, raising of public deposits, capital issues and import of capital goods. In India, financial lease has developed as an important supplementary source of equipment finance. Banks and financial institutions have been taking greater interest in its promotion. In the case of expansion, modernisation, diversification or acquisition of balancing equipments, lease finance would be most ideal as the payment of rental is required from the month following the month of acquisition of the equipment. Besides, the rentals are allowable expenditure for tax purposes. The state of equipment leasing business (as on 31.3.86) may be conceived from Table 3.2.

From Table 3.2 it is distinct that as on 31.3.86 the number of companies engaged in leasing business were 470 of which (i) equipment leasing companies alone were 339 & (ii) other financial companies doing leasing business were 131 having lease assets of Rs.239.55 crores and Rs.181.49 crores respectively. Incidentally, as on 31.3.87 ICICI alone sanctioned and disbursed a sum of Rs.187.7 crores and Rs.84.3 crores respectively towards leasing. Total resources raised during 1986-87 by Non-Government public limited companies stood at
### Table 3.2

**Equipment Leasing Business on 31.3.86**

<table>
<thead>
<tr>
<th>Type of leasing companies</th>
<th>No. of companies</th>
<th>Net owned funds</th>
<th>Regulated deposits</th>
<th>Bank borrowings</th>
<th>Debenture</th>
<th>Others</th>
<th>Total</th>
<th>Aggregate resources</th>
<th>Lease assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment leasing companies</td>
<td>339</td>
<td>81.4</td>
<td>38.28</td>
<td>47.88</td>
<td>57.56</td>
<td>19.77</td>
<td>163.49</td>
<td>244.63</td>
<td>239.55</td>
</tr>
<tr>
<td>Other financial companies doing business</td>
<td>131</td>
<td>303.57</td>
<td>209.21</td>
<td>295.74</td>
<td>18.81</td>
<td>1896.07</td>
<td>2419.83</td>
<td>2723.40</td>
<td>181.49</td>
</tr>
</tbody>
</table>

(Figures are provisional)

Rs.2434.2 crores. Thus, it appears that leasing, as an alter-
native source of finance, has a wide potentiality. As such,
we may also tune with S. Honda - 'Life is based on seeing,
listening and experimenting, but experimenting is the most
important.'26.

**RETAINED EARNINGS**

It is the general practice of each company not to divide the
whole divisible profit as dividend among the shareholders. A
part thereof is retained in the business to plough it back
to finance its growth. This increases the amount of its capi-
tal. It is named as retained earnings. It stems its root from
business operation. It appears in the balance sheet in any
one or more forms, such as profit and loss a/c (Cr.), gene-
ral reserve or other reserve and provision a/cs. This fund
belongs to equityholders. This process of financing is known
as internal or self-financing of investment. However, the
factors that govern its availability are volume of EBIT or
ROI, volume and rate of interest on loan, dividend policy of
the company, Government policy, general environment in the
economy, managerial attitude and efficiency, etc. It is a
popular form of fund in a business because it is readily
available requiring observance of no procedure; it involves
no floatation cost or any other form of actual cost; no imme-
diate pressure is there to pay return on it; it is a perma-
nent source of capital and no question of repayment is there;
it does not bring about any dilution in control of the company; maintenance of a dividend equalisation reserve helps maintaining a stable dividend policy as well; it increases the credit-worthyness by broadening the equity-base; it boosts up the management morale in taking up expansion programmes; it increases the operating efficiency by making up the depletion, deficiency and obsolescence; it helps maintaining the liquidity of funds; it may be used gainfully to retire debentures; the business failures for the paucity of funds may be averted with the aid of this component; it has got enough flexibility in the sense that the management may retain at one time and pay off at another in concurrence with the situation; neither any restrictive provisions nor any controlling clause of conversion it does attach to.

In case of PEs where all the shares are held by the Government the entire amount of earnings may be retained. Unfortunately, most of the PEs are not managed profitably for various reasons. Otherwise, much of the funds would have originated from retained earnings. Yet, internal source of finance including, of course, depreciation provision of large volume on enormous fixed investment, has proved to be an important source of funds to PEs. Incidentally, in financial management depreciation provision is considered to be a single largest source of internal funds. Its importance cannot be ignored. Dr. Mukherjee\(^2\) shows that it is as high as 78 per cent of total internal source. This source is equally
available for both the PEs and PvEs. The ratio of internal and external sources of funds in both the sectors during 1984-87 may pertinently be perused from Table 3.3 once again though the position of internal & external finance in PEs & PvEs have already been noted in preceding chapter.

**TABLE 3.3**

**THE EXTENT OF INTERNAL AND EXTERNAL CAPITAL BOTH IN PEs AND PvEs DURING 1984-87**

<table>
<thead>
<tr>
<th>Source</th>
<th>1984-85</th>
<th>1985-86</th>
<th>1986-87</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal Capital*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PEs</td>
<td>18</td>
<td>20</td>
<td>20</td>
<td>19.3</td>
</tr>
<tr>
<td>PvEs</td>
<td>32</td>
<td>36</td>
<td>34</td>
<td>34</td>
</tr>
<tr>
<td>External Capital**</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PEs</td>
<td>82</td>
<td>80</td>
<td>80</td>
<td>80.7</td>
</tr>
<tr>
<td>PvEs</td>
<td>68</td>
<td>64</td>
<td>66</td>
<td>66</td>
</tr>
</tbody>
</table>

* Includes Reserves & Surplus only.

** Includes Share Capital & Long-term Debt only.


It appears from Table 3.3 that the dependence of PEs during 1984-87 on internal source is very low, 19.3 per cent on an average, compared to that of PvEs, 34 per cent on an average, partly due to low profitability which, again, is the result
of operational inefficiency on the one hand and unsound financial management on the other. In other words, the dependence of PEs on external financing is well-pronounced. That is, it is 80.7 per cent of total sources as against 76.7 per cent during 1961-79, observed by Challam & Dakshinmurthy. It becomes pertinent to peruse the nature of dependence of PEs on Government Exchequer, i.e., what share of external finance of PEs is borne by the Government. To assess the said dependence it is necessary to examine the share of Government in PEs' loan fund only as usually cent per cent of equity capital of PEs is provided by Government. As such, examination of Table 3.4 may be resorted to.

**TABLE 3.4**

**OUTSTANDING LOAN TO CENTRAL PES DURING 1981-83**

<table>
<thead>
<tr>
<th>Source</th>
<th>1981-82</th>
<th>1982-83</th>
<th>Average % age</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rs.</td>
<td>% age</td>
<td>Rs.</td>
</tr>
<tr>
<td>Government</td>
<td>8044</td>
<td>41</td>
<td>8829</td>
</tr>
<tr>
<td>Bank (including cash credit)</td>
<td>5506</td>
<td>28</td>
<td>6742</td>
</tr>
<tr>
<td>Foreign</td>
<td>995</td>
<td>5</td>
<td>1975</td>
</tr>
<tr>
<td>Others</td>
<td>5303</td>
<td>26</td>
<td>4397</td>
</tr>
<tr>
<td>Total</td>
<td>19848</td>
<td>100</td>
<td>21943</td>
</tr>
</tbody>
</table>

It transpires from Table 3.4 that Government provided, on an average, 40.5 per cent of the Central PEs' loan fund and ranked first during 1981-83. It indicates that, out of the total external fund of PEs, Government provided around 70 per cent as cent per cent of the total share capital of PEs is usually supplied by the Government. The Table further highlights that bank loan ranked second providing 29.5 per cent, on an average, of the loan fund of PEs during the period under reference, because working capital requirements are mostly met out of bank loans. With the increasing working capital needs, the bank loans have gained momentum. In deed, the Government policy of providing working capital loans only in case of the refusal by banks and financial institutions for poor financial performance added problem to PEs. Thus, the lending from Government and Semi-Government agencies as well remains the main source of financing in PEs.

The governance of external source dominated by debt finance, as may be recalled from Table 2.9 in chapter II would affect the profitability of PEs prejudicially.

The nature of composition of internal fund of Central PEs during 1979-84 may be examined from Table 3.5 in this context. It appears from Table 3.5 that the Central PEs generated funds for investment during 1979-84 ranging between ₹.808.69 crores in 1979-80 and ₹.2830.80 crores in 1983-84. Again, it is apparent from the foot of the Table that 146 Central PEs generated ₹.11372 crores in 1990-91 indicating a rising trend.
TABLE 3.5

INTERNAL RESOURCE GENERATION IN CENTRAL PEs* DURING 1979-84

(Rs. in crores)

<table>
<thead>
<tr>
<th>Source</th>
<th>YEAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation</td>
<td>616.82</td>
</tr>
<tr>
<td>DRE written off</td>
<td>76.13</td>
</tr>
<tr>
<td>Retained profits</td>
<td>336.96</td>
</tr>
<tr>
<td>Total</td>
<td>1029.91</td>
</tr>
<tr>
<td>Loans repaid</td>
<td>221.22</td>
</tr>
<tr>
<td>Net reinvestible funds</td>
<td>808.69</td>
</tr>
</tbody>
</table>

* 146 running Central PEs generated Rs.11372 crores in 1990-91 vide The Economic Times dated 28.2.92, p.16.

Source: PE Survey.

Moreover, the internal resources of Central PEs are composed of depreciation provision, deferred revenue expenditure (DRE) written off and retained earnings. It is also observed that depreciation provision contributed a commandable share thereof.

Now, we may follow, pertinently, Table 3.6 to form an idea about the broad-based nature of sources of finance of PVEs.
### TABLE 3.6

**SOURCES OF FINANCE OF PVES DURING PLAN PERIODS UPTO 4TH PLAN**

<table>
<thead>
<tr>
<th>Source</th>
<th>PLAN(S)</th>
<th></th>
<th></th>
<th>Annual</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1st</td>
<td>2nd</td>
<td>3rd</td>
<td>4th</td>
<td></td>
</tr>
<tr>
<td><strong>A. Internal Sources:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Depreciation</td>
<td>30.4</td>
<td>24.5</td>
<td>30.5</td>
<td>31.2</td>
<td>28.2</td>
</tr>
<tr>
<td>2. Retained Profits</td>
<td>24.2</td>
<td>17.5</td>
<td>17.4</td>
<td>13.4</td>
<td>19.0</td>
</tr>
<tr>
<td>3. Tax Provision</td>
<td>3.4</td>
<td>2.7</td>
<td>1.2</td>
<td>0.8</td>
<td>2.6</td>
</tr>
<tr>
<td><strong>B. External Sources:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Paid-up Capital</td>
<td>7.4</td>
<td>10.4</td>
<td>7.6</td>
<td>5.7</td>
<td>2.4</td>
</tr>
<tr>
<td>5. Borrowings</td>
<td>21.4</td>
<td>28.9</td>
<td>28.4</td>
<td>33.6</td>
<td>17.5</td>
</tr>
<tr>
<td>a. Banks</td>
<td>6.3</td>
<td>16.4</td>
<td>18.8</td>
<td>19.1</td>
<td>11.6</td>
</tr>
<tr>
<td>b. Fin. Institutions</td>
<td>-</td>
<td>0.8</td>
<td>1.0</td>
<td>4.9</td>
<td>0.3</td>
</tr>
<tr>
<td>c. Government</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.5</td>
</tr>
<tr>
<td>d. Others</td>
<td>15.1</td>
<td>11.7</td>
<td>8.6</td>
<td>9.6</td>
<td>5.7</td>
</tr>
<tr>
<td>6. Trade Credits</td>
<td>13.2</td>
<td>15.5</td>
<td>14.9</td>
<td>16.9</td>
<td>13.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: The Economic Times dated 11.2.81 reproduced in the thesis of Dr. Mukherjee (p.160).

Table 3.6 stretches out that unlike PEs, PVs husbandise quite a good number of sources of finance including preference share capital, bonus share capital, forfeited shares sandwiched therein. It merits particular attention that Government share in PV-E-capital is wellnigh insignificant, if not nil.
From the discussion made so far in the chapter, it may be summed up that the Indian Corporate Sector procures funds from a host of sources. The sources of PvEs are much more broad-based than that of PEs which traditionally depend more on State Coffer. Of course, PEs may be allowed to undertake capital-finding either by issuing its shares or bonds or by floating Government loans to the public. Unlike PEs, PvEs exploit preference share capital, forfeited share capital, etc. In general different sources of capital are share capital including equity, bonus, rights and preference; retained earnings including reserves & surplus and depreciation provision; debenture; public bonds; public deposits; term-loans from banks, financial institutions; inter-corporate loan; Government loan and grants; leasing and the like.

Equityholders are the eventual risk-bearers & recipients either in regular course or in case of liquidation, hence equity is the costliest security. Again, it is a permanent security of the company. Its holder can liquidate it only by way of transfer or sale. Equityholders are the real owners of the company. They have right to vote for election of the members to the board of directors, right to subscribe to fresh issue of shares at comparatively lower prices. In case of PvEs equities are subscribed by the public, while in case of PEs these are traditionally subscribed by the Government though in law there is no bar to public participation which, the Government has not pursued as a general
policy despite repeated recommendations by the Estimate Committee, etc. As such, participation by employees may also take place in both the cases of PEs and PvEs, though it has rarely happened. Bonus share refers to the payment of dividend in the form of shares in exchange for cash indicating capitalisation of undistributed profits. Of course, it involves compliance of certain rules considered in this study. It goes without saying that PvEs are adept in issuing bonus shares. Preference share is a share, the holding of which associates the holder with preferential right as to receipt of dividend and principal as well. The dividend may be a fixed amount or an amount calculated at a fixed rate. Thus, it's a hybrid security fostering the features of both equity and debt. Preference capital notably may be cumulative or non-cumulative, redeemable or irredeemable, participating or non-participating, convertible or non-convertible, cumulative convertible (a new instrument). Debenture, a creditor-ship fund, includes debenture stock, bonds and other securities of a company forming a charge on the assets of the company or not. It carries a fixed rate of interest. It may also be of different types. It is exclusively used by PvEs. Its popularity has increased after late 70s. A race between convertible and non-convertible debenture issues during 80s has been noted. Being goaded by the circumstances, in 1986, some PEs have been compelled to issue public bonds to raise loan from the market. As regards term loans, it has been found that various financial institutions, banks, etc. supply
such loans for a period ranging from 3 to 30 years. It can be enjoyed by PEs & PvEs both. Public deposits are also considered to be a rising source. Various measures taken to save the depositors have also been dealt with. Also taken up Government loan, grant that are generally enjoyed by the PEs. Leasing, an 'off balance-sheet financing', its types, prospects have also been taken into account. As to internal source, it is observed that it offers a good number of benefits to a firm. On examination of different Tables it is deduced that PEs depend more on external fund provided mostly by the Government in the form of debt, while in case of PvEs internal source contributes a considerable share and for external funds they depend on public (market-supply). Also noted that unsound capital mix of PEs resulted in lower internal capital generation. With the background built up in this chapter and in the preceding chapters, we may proceed to the ensuing chapter, the pivotal one, to deal with the analysis of capital mix and profitability of SAIL vis-a-vis TISCO with the aid of tools and techniques that would be decided therein.
REFERENCES


5. Brigham, E.F., op.cit., p.582.


7. The Economic Times, Cal., dt. 25.7.91.


14. Ibid.

15. Ibid.

16. Ibid., p.432.

17. Ibid., p.436.


19. Ibid.


