CHAPTER X
(a) LONG TERM AND SHORT TERM SOURCES OF FUNDS:

Long term and short term sources of funds are provided by the financial Institution and Banks.

Following are the financial Institutions which provide long term finance to the industries:-

1 - INDUSTRIAL FINANCE CORPORATION OF INDIA (IFCI)

IFCI was set up in 1948 under an Act of Parliament with the main object of "Making medium and long-term credit more readily available to industrial concerns in India particularly in circumstances where normally banking accommodation is inappropriate or recourse to Capital Issue methods is impracticable". Today, IFCI has emerged as a prominent development bank in the country assuming lot of promotional activities and playing the role of a development bank besides making outstanding contribution to the growth of the capital market in India. The capital market
activities of the Corporation includes participation in the equity of companies either by way of underwriting or through direct subscription. The IFCI promoted the Investment Information & Credit Rating Agency of India (ICRA), which started functioning in 1991 to provide credit rating services to the Corporate sector.

2 - INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA (ICICI)

ICICI was incorporated in 1955 as a company under the Companies Act and has been empowered under its Memorandum of Association to undertake and discharge the usual functions of an industrial development finance company, i.e., to provide medium and long-term loans, making investment in shares or debentures by underwriting and direct subscription, besides other financial and promotional activities. Apart from providing direct assistance to project implementation, ICICI is actively engaged in entrepreneurial promotional activities, and is also providing merchant banking services.
3 - LIFE INSURANCE CORPORATION OF INDIA (LIC)

The LIC was established under the Life Insurance Corporation Act, 1956, on nationalisation of life insurance business in India. Although LIC is a specialised statutory body in insurance business, it has over the years emerged as a prominent investment institution playing an important role in the capital market of India. It invests in shares of promising industrial enterprises, grants loans on mortgage of fixed assets, underwrites new issues, and makes traditional investment in share capital of public companies and in other gilt-edged Government securities.

4 - UNIT TRUST OF INDIA (UTI)

UTI was established under Unit Trust of India Act, 1963 with the main objective of providing the facility of equity investment to savers, particularly those belonging to the medium and small income groups. It channelises these savings into productive activities by investing its funds in the shares and debentures of Industrial undertakings. UTI underwrites public issues of equity shares, preference shares and debentures.
The Industrial Reconstruction Corporation of India came into existence in 1971 in order to provide financial assistance to sick and closed industries for industries for rehabilitation and reconstruction. The corporation has been reconstituted on March 20, 1985 as Indian Reconstruction Bank of India, as the principal credit and reconstruction agency in the country for revival of sick and closed industrial units. IRBI extended loans and advances to industrial concerns, underwrites stocks, shares, bonds and debentures, and guarantees loans/deferred payments. Its range of activities includes services like provision of infrastructural facilities, consultancy, managerial and merchant banking and making available machinery and another equipment on lease or hire purchase basis.

In line with the policy of Government of India for promoting and strengthening small and village industries, and
in achieving this sectors' full potential in industrial production, employment generation and exports, the Small Industries Development Bank of India (SIDBI) was established in April, 1990 by the IDBI. SIDBI is the principal financial institution for promoting, financing and developing small scale industries and co-ordinating the functions of other institution engaged in similar activities.

SIDBI provides direct assistance to encourage ancillaries (or) sub-contracting units to undertake technology upgradation and modernisation programmes. A special refinance scheme was set up for acquisition of computers and accessories by small scale industries. SIDBI also helps in improving managerial capabilities in the small scale sector. SIDBI provides promotional services viz. developing a special cadre of trained professionals for the sector, promoting rural entrepreneurship, technology upgradation (or) modernisation of existing units, strengthening of ancillaries and bringing about qualitative changes so as to improve the competitive strength of the small scale sector.
It is an apex financial institution established under the Industrial Development Bank of India Act, 1964 as a subsidiary of Reserve Bank of India aimed at coordinating, in conformity with national priorities, the working of the various institutions engaged in financing, promoting or developing industry for assisting the development of such institutions, and for providing credit and other facilities for the development industry.

The Government set up the General Insurance Corporation in 1971 to take over the management of the General Insurance Business in India, as a prelude to its nationalisation in 1973. GIC is committed to deploy a major part of its resources to socially oriented sectors and also provides considerable assistance to industry, by way of term loans,
direct subscriptions to share capital and debentures, and underwriting of issues.

The above are the all India financial Institution. There are also State level financial Institutions which also provides loan to the industries are –

STATE FINANCIAL CORPORATIONS (SFCs)
STATE INDUSTRIAL AND INVESTMENT CORPORATION (SIICS)

SFCs have been set up in almost all the states in the country. The beginning was made by Tamil Nadu Industrial Investment Corporation Ltd. (TIIC) in 1949, followed by enactment by the Parliament of the legislation State Financial Corporations Act, 1951. The contribution of SFCs in the industrial development of the country is significant. The activities inter alia include granting of loans and underwriting services. The Corporations are also subscribing to the equity capital and debentures of industrial concerns.
Project requiring assistance upto Rs.60 lacs are assisted by SFCs and where requirements exceed Rs.60 lacs but are below Rs.90 lacs. The SIICs extend assistance either by themselves or in collaboration with SFCs. The State Industrial Development Corporations and or State Industrial Promotion Corporations are mainly concerned with the development of Industrial Estates and Providing Industrial Plots or Sheds on outright sale or on deferred payment basis.

These Institutions are mainly provided assistance for development of Industrial estates and providing industrial plots or sheds.

IFCI has the objection of providing long term finances and issuing guarantees to the industrial sector including public and private enterprises. It also operates soft loan schemes and provides Risk Capital Assistance.

State level financial Corporation had the main objective of helping the development of small Scale Units in respecting units.

The State Industrial and Investment Corporation and State Industrial Development Corporation help promotion and
development of medium and large sized projects by contributing to Equity Capital and providing term loans, with special emphasis on backward areas development.

IDBI is the apex financial institution extending refinance assistance to the other development banks and supervising their operation. At present in India approx. 40-50 development banks are working under the supervision of IDBI.

ICICI has been specialising in providing term loan in foreign currencies, extending underwriting assistance and issuing guarantees. It also grants Rupee loans and has a Merchant Banking Cell giving specialised services in project planning and formulation.

IDBI participates in providing term loans for projects. On a consortium basis extends refinance facilities to the State Level Corporations, and operates bill discounting and technical development fund schemes. It also helps the State Level Corporations in augmenting their resources by subscribing to their bonds and debentures. About 45% of IDBI’s assistance flows by way of refinance assistance to
SFC’s, SIDC’s and Commercial banks, a major portion being through re-discounting of bills. In addition, it also operates, Soft Loan Scheme and extends seed Capital Assistance.

The UTI, LIC, GIC, are also in the business of assisting industrial projects through on a limited scale. They mainly participate in consortium arrangements for providing equity support and underwriting assistance and to a lesser extension granting term loans. The IRBI specialises in providing rehabilitation assistance to sick units. The SIDBI takes care of needs of Small Scale Sector.

The Commercial banks are mainly providing of working capital funds. Now they are also providing term loans and underwriting equity capital. They are also entering the areas of Merchant Banking.

Types of assistance in the form of long term and short term provided by the above financial institution are as under:-

(i) Rupee Term Loan
(ii) Foreign Currency Term Loan
(iii) Underwriting of Equity Capital, Debenture Bonds.

(iv) Direct Subscription or Capital.

(v) Guaranteeing loans raised by industrial concerns from different sources including Commercial Banks and extending guarantees in respect of deferred payments by importers.

(vi) Bills Rediscounting.

(vii) Operation of Technical Development Fund

(viii) Soft Loan Schemes

(ix) Equipment Financing

(x) Lease Financing

(xi) Seed Capital Assistance

(xii) Risk Capital Assistance.

Presently Lease financing business has assumed prominence and ICICI extends lease assistance on large
scale. IFCI and several commercial banks are also actively involved in lease financing and hire purchase transaction.

SIDBI provides resources support to and refinance loans and advances extended by primary lending institution to industries on Small Scale Sector, undertakes discounting and rediscounting of bills arising from sale of machinery, extends seed capital and soft loan assistance under National Equity Fund.

(b) REQUIREMENT OF FINANCES:

Project cost have been financed through Promoter's contribution and long term and short term finances from financial institution and Banks. The requirement of finances broadly cover the following aspects:

(i) Debt Equity Ratio
(ii) Promoter's Contribution
(iii) Security Margin
(iv) Debt Service Capacity.

DEBT EQUITY RATIO

A debt equity ratio of 3:1 for Small Scale Units and 2:1 for other medium sized units. Large Projects exceeding investment Rs.3 Crore come under non-finance category and debt equity ratio decided in each case to cash basis by Central Financial Institution.

PROMOTERS CONTRIBUTION:

Promoters contribution is a function of the Debt Equity Ratio. Besides their own contribution, promoters can organise their part of capital through contribution from friends and relatives. 25% to 50% of equity Capital come directly from the group of promoters themselves.

For project of backward areas, depending on the category of backwardness, the promoters contribution norms are fixed as 12.5%, 17.5% and 20% of the cost of project for A B C category areas respectively.
Promoters contribution on Private Limited Companies — The entire capital is to be brought in or arranged by the private promoters.

Promoters contribution in Public Limited Companies — Here promoters contribution decided as per norms of Debt Equity ratio is to be further financed through promoters own contribution & Public Issue in the ratio 40% to 60%.

Let us consider an example —

| Project cost  | 300 lac |
| Debt Equity Ratio | 2:1 |
| Debt            | 200 lac |
| Equity          | 100 lac |

The company is called upon to issue 60% of its capital to the public. The means of Financing can be —

<table>
<thead>
<tr>
<th>Rs./Lac</th>
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<tbody>
<tr>
<td>Promoters Capital 40%</td>
</tr>
<tr>
<td>Public Issue 60%</td>
</tr>
<tr>
<td>Equity Capital</td>
</tr>
<tr>
<td>Loan</td>
</tr>
</tbody>
</table>

300.00
SECURITY MARGIN:

The project cost includes outlays on tangible as well as intangible assets. The financing of intangible assets is not done by most financial institutions. It is the entire responsibility of the promoters. Even in respect of tangible assets, the financial institution consider financing 80 to 85% such assets.

Security Margin calculated as -Tangible Assets - Term Loan/Tangible Assets. A margin of 20% is normally expected. The security margin has a significant influence on the debt equity ratio, depending on the nature of the project and the composition of tangible and intangible assets.

Debt Services Coverage Ratio (DSCR)

The DSCR has to be ascertained after the preparation of the cost of production statement and the cash flow projections. The profitability and cash flow projection have to be fixed up of the various critical assumptions relating to the project construction and operating cost.
DSCR indicates the repayment capacity of the project.

The financial institution expect the DSCR to be around 1.5 where the net cash accruals are substantial and DSCR is high. The instalment repayment amounts may be enhanced, which will have the effect of reducing the period of loan.

In highly profitable projects showing high DSCR if loan repayment can be effected within 5 years the loan does not qualify for refinance which would also be inclined to charge higher rate of interest.

The above four ratios comprising debt equity promoters contribution, security margin and debt service coverage ratio are closely interlinked and exert major influence to the extent of resource that the promoter will have to find by way of promoter’s contribution.
In the capital structure of a company the main sources of finance are the owners' funds and the borrowed capital. The owners' funds come in the shape of their contributions made voluntarily known as shares which are of two main types viz., the equity shares and preference shares. New issue of share capital of a limited company shall have capital of only three types viz. equity share capital, preference share capital and cumulative convertible preference shares. The borrowed funds which come in the shape of long, short or medium term loans or debentures or bonds are mainly secured loans. There is another type of borrowed capital known as public deposits which remain unsecured and carry higher risk for investors.

All these above types of elements of capital structure are the sources of company finance and the same are discussed below in detail.
1 - Equity Shares

"Ordinary shares as a whole are usually referred to as equities. Equity in this sense means that which remains after the rights of creditors, and mortgages are cleared. The equity in a company is the value of assets remaining after creditors, debentures and loan stock holders and preference shareholders have been paid what they are entitled to"*

It is in the above sense that equity share capital is interpreted as the funds owned by the owners of the company, split in pre-determined portions. The equity share holders are entitled to be repaid their capital in a winding up or reduction of capital only after preference shareholders have been paid off. They are thus the residual claimants against the assets and income of the corporation. They are entitled to dividend as per the rates approved and declared by the Board of Directors of the company when the company is earning profits.

Equity share capital in the company's capital structure devolves some basis advantages viz, it provides on a
permanent basis the funds to the company without any
obligation to return the amount. Secondly the company is
under no obligation to declare dividends. The equity holders
carry voting rights on members of issues affecting the
constitution, existence and functioning of the company. They
have the rights against ultra vires act of the company,
pre-emptive right to buy additional issues of shares in
proportion to their existing holdings right to be informed
about the affairs of the company, right to transfer shares
and rights on liquidation. Equity shareholders have a
residual claim over the assets of the firm in the event of
liquidation. The meaning of equity share capital becomes more
clear in comparison to meaning of preference share capital
as given in the Companies Act, 1956, which defines the equity
share capital as one which is not preference share capital.

"Preference share capital" means, with reference to any
company limited by shares, that part of the share capital
of the company which fulfils both the following
requirements, namely:

(a) That as respects dividends, it carries or
will carry a preferential rights to be paid
fixed amount.
(b) That as respects capital, it carries or will carry a preferential right to be repaid the amount of the capital paid-up or deemed to have been paid-up, whether or not there is a preferential right to the payment of either or both of the following amounts, namely:

(i) any money remaining unpaid, in respect of the amounts specified in clause (a), up to the date of the winding up or repayment of capital; and

(ii) any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

(2) RIGHT ISSUE

A rights offer is an offer of a company's shares to its existing shareholders. It gives them the first opportunity to purchase a new issue of shares. As per the terms of the offer, each existing shareholder has the right to be allotted
certain number of shares upon payment of the asking price. The number of shares he is offered is determined by the percentage of his existing share ownership in relation to the total number of company shares; he is offered a similar percentage of the new shares to be issued i.e. if the shareholder takes up the offer he will maintain his existing percentage ownership of the company.

Section 81 of the Companies Act, 1956 regulates further issue of capital and gives the shareholders a pre-emptive right of subscribing to such shares issued after the expiry of two years from the formation of a company or one year from the date of the first allotment, whichever is earlier. It is because of this pre-emptive right that these shares are called 'right shares'. The shareholders have the right of renunciation of the shares offered to them in favour of any other person, unless the company's articles otherwise provide.

3 - Debentures and Bonds:

The companies Act, 1956, defines debentures as "including debentures stock, bonds and any other securities
of a company whether constituting a charge on the assets of the company or not". The terms debentures and bonds are interchangeable, and represent loan component in the capital structure of the company. Providers of debenture capital are known as debenture holders. They are creditors of the company and have no right in the company except for payment of interest on their loans and repayment of the loans in accordance with the terms and conditions on which they are issued. The company can raise money against issues of debentures as authorised under its Memorandum of Association and Articles of Association.

Debenture stock is the consolidated mass of debenture capital for the sake of convenience. Debenture stock differs from debentures in form rather than in substance.
The different classes of debentures are shown in the following chart:

<table>
<thead>
<tr>
<th>Nature</th>
<th>Type</th>
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<tbody>
<tr>
<td>Security</td>
<td>Unsecured/Naked Debentures,</td>
</tr>
<tr>
<td></td>
<td>Secured Debentures,</td>
</tr>
<tr>
<td></td>
<td>convertible Debentures Partially</td>
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<tr>
<td></td>
<td>Convertible Debentures.</td>
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<tr>
<td>Debentures</td>
<td>Repayment</td>
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<tr>
<td>of Capital</td>
<td>Redeemable Debentures</td>
</tr>
<tr>
<td></td>
<td>Irredeemable Debentures.</td>
</tr>
<tr>
<td>Transfer</td>
<td>Bearer Debentures</td>
</tr>
<tr>
<td></td>
<td>Registered Debentures.</td>
</tr>
</tbody>
</table>

Debentures may be secured or unsecured and companies frequently issue both kinds of debentures. Secured debentures bear charge on certain assets of the company viz. both existing and future, upon which the debenture holders may look in the event of default on interest payment/repayment of loan instalment. Unsecured debenture holders, on the other hand, are entitled to repayment equally with ordinary creditors of the company in the event of winding up secured debenture holders are secured creditors and rank in priority for their repayments vis-a-vis
unsecured creditors. In the event of liquidation the unsecured debenture holders rank after secured debentures/loans equally with general creditors and before share capital. Trustees are appointed for unsecured loan stock in the same way as for secured debenture stock but they hold no assets and simply watch the interests of stockholders particularly with regard to restrictions on borrowings which are included in the terms of issue of debentures.

4 - Company Deposits

The term deposit has been defined in Section 58A of the Companies Act, 1956, as any deposit of money with and includes any amount borrowed by a company but shall not include such categories of amount as may be prescribed in consultation with RBI.

Now-a-days public deposits are a prominent source of finance to the companies. Non-banking companies and even big group of companies resort to acceptance of finance from public owing to number of advantages available like -
(1) Funds are available at low cost.

(2) There is no need to provide security.

(3) Process is very simple and no restrictive covenants are involved.

(4) Restrictions put by the RBI on financial institutions to advance, to prevent hoarding and black marketing leads the companies to accept deposits from the public.

(5) Tax deductibility of interest paid on deposits.

**Benefits to the Depositors.**

(i) High rate of interest

(ii) Maturity period is relatively short.

The Companies (Acceptance of Deposit) Rules, 1975 require the companies to comply with the following for accepting deposits:
(1) Limit upto which deposit can be accepted.

(2) Maximum interest and brokerage payable, on deposits,

(3) Maintenance of liquid assets.

(4) Issue of advertisement of statement in lieu of advertisement.

(5) Form to be supplied by the company.

(6) Receipt to be issued for deposit.

(7) Register of deposits,

(8) Return to be filed with Registrar.

(9) Penalties for defalcation,

5 - Term Loan from Financial Institutions and Banks

The bulk of term finance required by large and medium industry is provided by term lending institutions which include all India Institutions viz. Industrial Development Bank of India (IDBI), Industrial Finance Corporation of
India, (IFCI), Industrial Credit and Investment Corporation of India (ICICI), Industrial Reconstruction Bank of India (IRBI), Small Industries Development Bank of India (SIDBI), etc.

Financial institutions channel the funds mobilised by them into productive avenues. They make available funds in bigger lots to needy industrial sector. These institutions act as conduits through which scattered savings are aggregated and put to productive channels. Besides, financial institutions help in allocation of funds between different industries and different sectors of the economy in consonance with the priorities laid down in the plans. They provide finance to those industries which seek to make a strong base for accelerating the pace of industrialisation and foster fast economic development. Today, financial institutions are an instrument in developing the back-ward areas through rapid industrialisation by providing long term finance on concessional rates and help entrepreneurs in selection of projects and make available technical know-how at cheaper rates.

The term loans from financial institutions and banks is a syndicated activity. For big projects financial
institutions provide finance on a consortium basis and commercial banks also join them where 'gap' is left in financing arrangements of the project costs.

6 - Exchange Risk Administration Scheme (ERAS)

The Exchange Risk Administration Scheme was announced on 1st April 1989 by three All India Financial Institutions viz IDBI, IFCI, ICICI with a extending a measure of protection to borrower's of foreign currency loans against exchange risk through the instrumentality of fund known as Exchange Risk Administration Fund. Initially the scheme will be in operation for a period of two years. If the scheme is terminated thereafter, the disbursement already covered under the scheme will continue to get the benefit of the scheme of the entire duration of the loans.

Under this scheme maximum amount that could be eligible for coverage was not to exceed US $60 million, per company as a whole. For the execution of loan agreements, a composite cost is chargeable per annum with a bank. The
Timing of fixation of bank was to be related to the date of execution of the loan agreement and not to the timing of disbursement of the instalments against the sanctioned loan assistance.

7 - Term loans and Commercial Banks.

Commercial banks play a significant role in providing term loans in India although until recently these banks were devoted to providing only short-term financial assistance to the corporate sector. Commercial banks mainly concentrate on providing working capital finance to corporate industrial units within the limits as prescribed by the Reserve Bank of India. Nevertheless, they participate in providing working capital term loan and working capital limits in the syndicate form. They provide term loan to industries in consortium with financial institutions. A bulk of the bank credit has been provided to meet working capital needs of corporate enterprises. Short-term loans for working capital purposes account for about three fourth (3/4th) of the total banking credit facilities. Among short term loan, cash credit and over-draft facilities have been important. Term loan only represents 10% of the total bank credit to industry.
In international financial market the borrower from one country may seek lenders in other countries in specific currency which need not be of the participant country. In international financial market, the availability of foreign currency is assured under four main systems -

(a) Euro currency market;
(b) Export credit facilities
(c) Bond issues; and
(d) Financial institutions.

Euro currency market - Here funds are made available as loans through syndicated Eurocredits/instruments known as Floating Rate Notes FRNS. Interest rates vary every 3 to 6 months based on London - Interbank offered-Rate. Syndicated Euro Currency bank loan has developed into one of the most important instruments for international lending. Syndicated Euro credit is available through instruments viz. Term Loan and Revolving Line Facility.
Export Credit Facilities are made available by several countries through an institutional framework in which EXIM Banks play a prominent role. EXIM Bank of India is playing a significant role in financing exports and other offshore deals.

9 - Syndicated Eurocurrency Loans.

The Eurocurrency market refers to the availability of a particular currency in the international financial market outside the home country of that currency. For example, the Eurodollar market refers to the financial market for US dollars in England, France, West Germany, Hong Kong and other financial centres outside the US. The Eurodollar borrowing may be evidenced by issue of commercial paper in the form of promissory notes, or by subscription to bond/debentures or it may be syndicate loans type.
10 - OTHER FINANCIAL INSTITUTIONS:

Besides the above financial institutions, long term loan is provided by other financial and investment institutions namely SFCs, SIDCs, LIC, UTI and GIC.

SFCs have been established under State Financial Corporation Act, 1951 throughout India in all the States and provide financial assistance inter alia by way of long-term loan in small magnitude either solely or jointly with All-India term lending institutions. The constitution and organisation of SFCs resemble to the one of IFCI.

LIC, UTI, and GIC are investment organisations by they participate in term lending in consortium loans grantees by All India Financial Institutions like IDBI, IFCI, ICICI, IRBI, etc.