A. A. V. PATEL JR. COLLEGE

SYJC - Excellence Program

Synopsis

Sub- - Secretarial Practice

Topic 2 - Sources of business finance.

HSC Weightage :- 28 marks.

2.3 Sources of Business Finance

(A) External Sources (outside the firm)

(B) Internal Sources (within the firm)

External & Internal Sources further classified as

(a) Long Term Sources

(b) Short Term Sources

Sources of Finance.

- Long Term
  - Owned Capital
    - Shares
      - Equity Shares
      - Preference Shares
    - Retained Earnings
  - Borrowed capital
    - i) Debentures
    - ii) Bonds
    - iii) Loans from Institutions
    - iv) Loans from banks
- Short Term
  - i) Public Deposit
  - ii) Bank Credit
  - iii) Trade Credit
  - iv) Loan from Directors
  - v) Advances from customers
  - vi) Native money lenders
  - vii) Government assistance

2.4 Methods of Raising finance

(A) Shares
- → Equity shares
- → Preference Shares

(B) Retained Profits
(C) ① Debentures
② Bonds
(D) Public Deposits
(E) Loan from Financial Institutions
(F) Loan from commercial Banks
(G) Trade Credit
(H) Discounting of Bill of Exchange
(I) GDR & ADR.

(A) SHARES

According to Companies Act 1956, "Share means a share in the share capital of a company and includes the stock where a distinction between stock and shares is expressed or implied."

Features :-
1. Smallest Unit
2. Ownership
3. Distinct number
4. Movable property
5. Share Certificate
6. Value expressed in terms of money.
   ⓐ Face Value ⓑ Issue Value
   ⓒ Market Value.
7. Dividend
8. Types → ⓐ Equity Shares ⓑ Preference Shares

Kinds of shares

(I) Equity shares :- Oridary Shares.
According to Companies Act 1956, "those shares which are not preference shares" are equity shares.
Real Risk Bearers. Its a Risk capital.
Equity share holders are Residual Claimants.

Features :-

1) Permanent Capital
2) Fluctuating Dividend
3) No preferential Rights
4) Rights
5) Control
6) Risk
7) Residual Claimants
8) Face Value
9) Market Value
10) Bonus and Right Issue.
11) No charge on assets.

Types of Equity Shares

- Equity shares with normal voting rights
- Equity Shares with differential voting rights.

(II) Preference Shares :- Occupy on 'In Between' position in the capital structure.

Features :-

1) Preferential Dividend
2) Prior repayment of capital
3) Fixed return

4) Nature of capital
5) Market Value
6) Voting right
7) Risk
8) face Value
9) Not entitled for Right or Bonus Issue.

Types of Preference Shares.

- Cumulative & Non-cumulative
- Participating & Non-Participating
- convertible & Non-convertible
- Redeemable & Non-Redeemable.

(B) RETAINED PROFITS

Earnings of the company which are retained in the business.

Determinants :-

1) Total earnings of the company.
2) Taxation policy.
3) Dividend policy
4) Government control.

(C) (1) DEBENTURES

Tophan Defines, "a debenture is a document given by a company as evidence of debt to the holder, usually arising out of loan and most commonly secured by charge."

Debentureholder is creditor of the company. Debenture is a transferable instrument issued in the form of 'Debenture Certificate.'

Features :-

1) Promise
2) Face Value
3) Time of payment
4) Interest
5) Assurance of repayment
6) Parties :- (a) Company
   (b) Trustee
   (c) Debenture holders
7) Rights of debentureholders
8) Terms of issue of debentures.
9) Security
10) Listing

TYPES OF DEBENTURES

- On the basis of Security
  - Secured Debentures
  - Unsecured Debentures
- On the basis of transfer
  - Registered Debentures
  - Bearer Debenture
- On the basis of repayment
  - Redeemable Debentures
  - Irredeemable Debentures
- On the basis of conversion
  - Convertible Debentures
  - non-convertible Debentures

(c) (2) <u>BONDS</u> :- It is a debt security. Bond holder is creditor of the company. The amount of interest is paid on bond.

Features of Bonds :-

1) Nature of finance
2) Status of Investor
3) Return on bonds
4) Repayment

Types of Bonds.

Based on Coupon

1) Fixed rate bonds
2) Floating rate bonds
3) Zero coupon bonds
4) Deep Discount bonds
5) Inflation-indexed bonds.

Based on Option

① Bonds with call option
② Bonds with put option

Based on Redemption

① Single Redemption
② Amortising Bonds.

(D) PUBLIC DEPOSITS

It is an important source of financing short term requirement of company. Companies generally receive public deposits for the period ranging from 6 months to 36 months. The rate of interest is higher than commercial banks. The company issue 'Deposit Receipt' to depositors. The term of deposit is mentioned in the 'Deposit Receipt'.

Rules and Regulations :-
1) Ceiling on deposits
2) Maturity of Deposits
3) Interest on deposits
4) Register of deposits
5) Status of Deposit holder.

(E) LOAN FROM FINANCIAL INSTITUTIONS

The Government of India established special financial institutions for providing industrial finance.

Financial Institutions

Development Banks	Financial Institutions	Investment Institutions	State level Institutions
1. IDBI	1. RCTC	1. LIC	1. SFC
2. IFCI	2. TDICI	2. UTI	2. SIDC.
3. ICICI	3. TFCI	3. GIC	
4. SIDBI			
5. IRBI			

Importance of Institutional financing
1) To develop sound capital market
2) To mobilize financial resources
3) Capital formation
4) Planned economy
5) Financing small business
6) Foreign exchange need
7) Government taxation policy
8) Rate of Interest.

(F) LOANS FROM COMMERCIAL BANKS

Types of bank credit

1) Overdraft - For current Accountholders
2) Cash Credit - against pledge or hypothecation
3) Cash Loans

(G) TRADE CREDIT

It is a short term financing to business. Manufacturers, wholesalers and suppliers are called 'Trade creditors.' They sell tangible goods to other business concerns on the basis of future payment. i.e. deffered payment. Credit is extended by these business concerns with an intention to increase their sales.

(H) DISCOUNTING OF BILL OF EXCHANGE

- Instrument of credit.

The seller gets a definite promise in writing from buyer, for paying the amount on a specific date.

(I) GLOBAL DEPOSITORY RECEIPT (GDR) & AMERICAN DEPOSITORY RECEIPT (ADR)

IndianCompanies, which can not list their shares directly on foreign stock exchange, get listed on these stock exchanges indirectly using GDR and ADR.

Advantages - Text Book pg. no. 41.