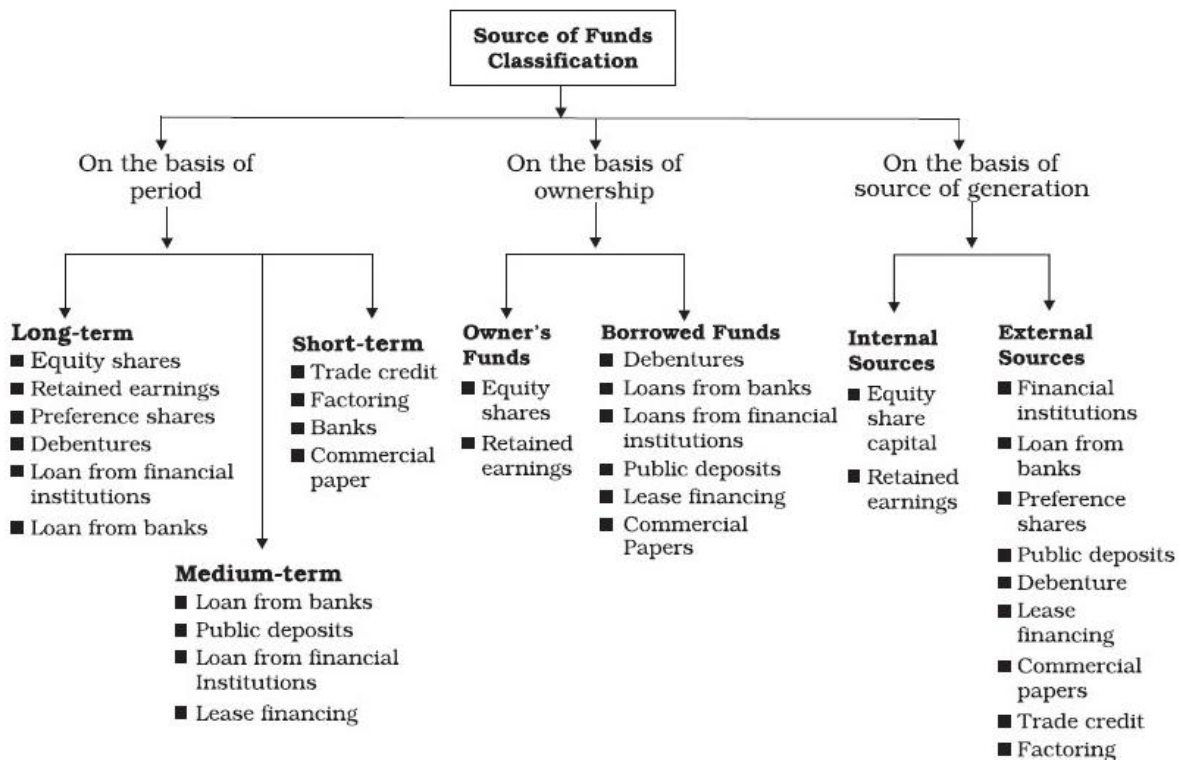


Sources of Finance

Finance holds the key to all business activities. No business activity can ever be pursued without financial support. Finance is necessary throughout the activities of promotion, organisation and regular operations of business. All functions of business are ultimately dependent on finance.

The Finance needed by business organisation is termed as 'Capital'. Every business organisation needs certain capital for its activities. A joint stock company, which is a modern form of business organisation and being a large undertaking, requires huge capital for business. This huge capital collection or capital formation has special significance in the management of joint stock company.

Capital formation is a process of collection of capital from various sources according to financial plan of company.

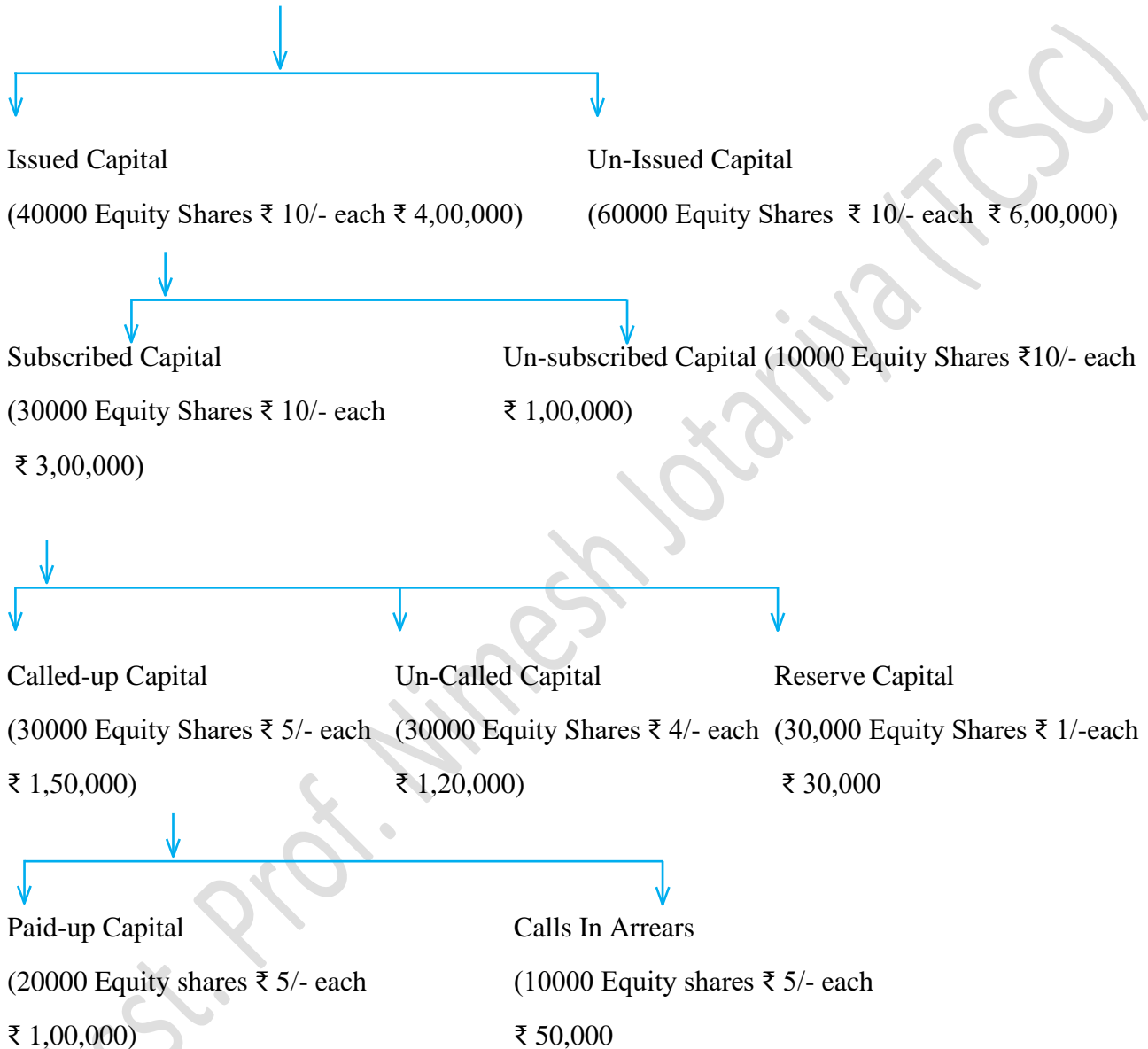


CLASSIFICATION OF SHARE CAPITAL:

Share capital refers to the capital made up of Equity Shares and Preference Shares. Usually, in share capital, the proportion of Equity shares is more than Preference shares.

Share Capital can be classified as –

Authorised or Nominal or Registered Capital (1,00,000 Equity Shares ₹ 10/- each ₹ 10,00,000)



Shares

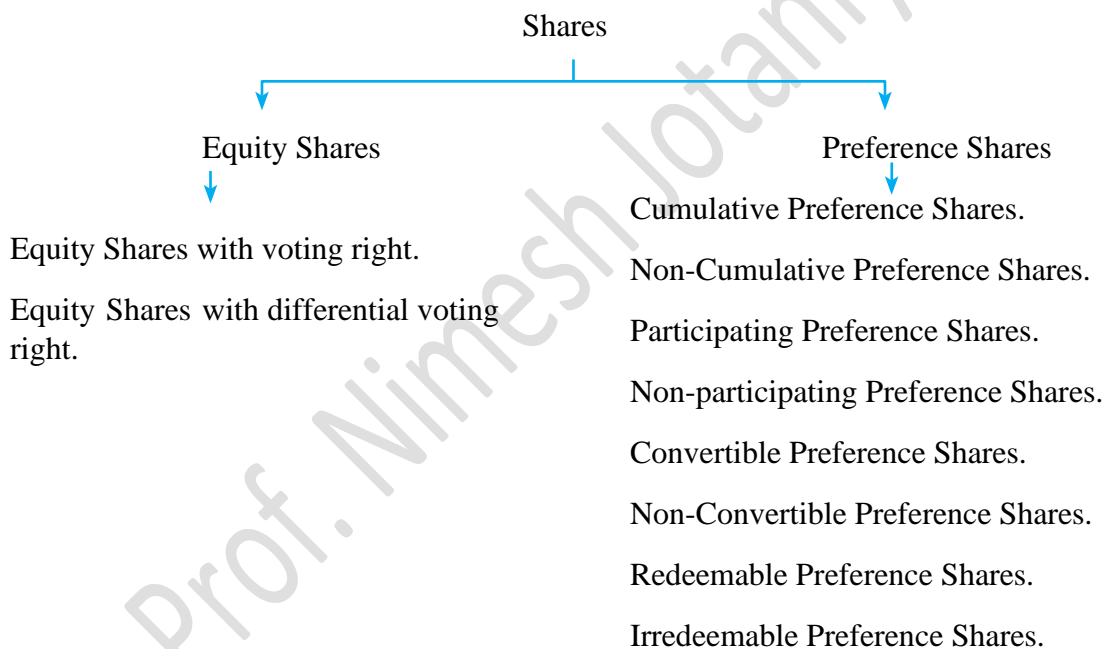
The term share is defined by Section 2 (84) of the Companies Act 2013, 'Share means a share in the share capital of a company and includes stock'.

Share is a unit by which the share capital is divided. The total capital of company is divided into small parts and each part is called share and the value of each part / unit is known as face value. Share is a small unit of capital of a company. It facilitates the public to subscribe to the capital in smaller amount.

A person can purchase any number of shares as he wishes. A person who purchases shares of a company is known as a shareholder or a member of that company.

Kinds of Shares (As per Section 43 of the Companies Act 2013)

A company can issue different types of shares depending upon right to control, income and risk. The following chart shows different kinds of shares.



Equity Shares: Equity shares are also known as ordinary shares.

Companies Act defines equity shares as ‘those shares which are not preference shares’.

The above definition reveals that:

The equity shares do not enjoy preference for dividend.

The equity shares do not have priority for repayment of capital at the time of winding up of the company.

Equity shares are fundamental source of financing business activities. Equity shareholders own the company and bear ultimate risk associated with the ownership. After paying claims of all other investors the remaining funds belong to equity shareholders. Thus equity shareholders are ‘residual claimants’ of the income and assets.

Equity shareholders do not carry any fixed commitment of dividend. They are paid dividend at the rate recommended by Board of Directors. If there is no profit, no dividend will be payable. Similarly if there is less profit, lesser dividend will be paid. Thus the fortune of equity shareholders is tied up with the ups and downs of the company. If the company is successful, they enjoy great financial rewards and if the company fails, the risk falls mainly on them. It is exactly because of this position equity share capital is known as ‘venture capital’ or ‘risk capital’. The owners of equity shares are real risk bearers.

Features of Equity Shares:

Permanent Capital: Equity shares are irredeemable shares. The amount received from equity shares is not refundable by the company during its life time. Equity shares become refundable only in the event of winding up of the company or company decides to buyback shares. Thus equity share capital is long term and permanent capital of the company.

Fluctuating Dividend: Equity shares do not have a fixed rate of dividend. The rate of dividend depends upon amount of profit earned by company. If company earns more profit, dividend is paid at higher rate. On the other hand if there is insufficient profit or loss, Board of Directors may postpone the payment of dividend. Equity shareholders cannot compel them to declare and pay dividend. The income of equity shares is uncertain and irregular. The equity shares get dividend at fluctuating rate.

Rights: Equity Shareholders enjoy certain rights :

Right to vote: It is the basic right of equity shareholders through which they elect directors, alter Memorandum and Articles of Association, etc.

Right to share in profit: It is an important right of equity shareholders. They have right to share in profit, when distributed as dividend. If the company is successful and makes handsome profit, they have advantage of getting large dividend.

Right to inspect books: Equity shareholders have right to inspect statutory books of their company.

Right to transfer shares: The equity shareholders enjoy the right to transfer shares as per the procedure laid down in the Articles of Association.

No preferential right: Equity shareholders do not enjoy preferential right in respect of payment of dividend. They are paid dividend only after dividend on preference shares has been paid.

Controlling power: The control of company is vested with the equity shareholders. They are often described as ‘real masters’ of the company. It is because they enjoy exclusive voting rights. The Act

provides the right to cast vote in proportion to share holding. They can exercise their voting right by proxies, without even attending meeting in person.

Risk: Equity shareholders bear maximum risk in the company. They are described as 'shock absorbers' when company has financial crisis.

Residual claimant: Equity shareholders as owners are residual claimants to all earnings after expenses, taxes, etc. are paid. A residual claim means the last claim on the earnings of company. Although equity shareholders come last, they have advantage of receiving entire earnings that is left over.

No charge on assets: The equity shares do not create any charge over assets of the company.

Bonus Issue: Bonus shares are issued as gift to equity shareholders. These shares are issued free of cost to existing equity shareholders. These are issued out of accumulated profits. Bonus shares are issued in proportion to the shares held. Thus capital investment of (ordinary) equity shareholder tends to grow on its own. This benefit is available only to the equity shareholder.

Right Issue: When a company needs more funds for expansion purpose and raises further capital by issue of shares, the existing equity shareholders may be given priority to get newly offered shares. This is called 'Right Issue'. The shares are offered to equity shareholder first, in proportion to their existing shareholding.

Face Value: The face value of equity shares is low. It can be generally ₹ 10 per share or even ₹ 1 per share.

Market Value: Market value of equity shares fluctuates according to the demand and supply of these shares. The demand and supply of equity shares depend on profits earned and dividend declared. When a company earns huge profit, market value of its shares increases.

Types of Equity Shares:

The equity share can be of two types:

Equity shares with normal voting right: Voting right of such equity holders is in proportion to his share holdings.

Equity shares with differential voting right: Such equity holders shall have varying rights regarding dividend, voting or otherwise in accordance with Rule 4 of Companies (Share Capital and Debentures) Rules 2014.

Preference Shares:

As the name indicates, these shares have certain preferential rights distinct from those attached to equity shares.

The shares which carry following preferential rights are termed as preference shares :

A preferential right as to payment of dividend during the life time of company.

A preferential right as to the return of capital in the event of winding up of company.

The holder of preference share have a prior right to receive fixed rate of dividend before any dividend is paid to equity shares. The rate of dividend is prescribed at the time of issue.

Normally preference shares do not carry any voting power. They have voting right only on matters which affect their interest, such as selling of undertaking or changing rights of preference shares, etc. or they get voting rights if dividend remains unpaid.

The preference shareholders are co-owners of the company but not controllers. These shares are purchased by cautious investors who are interested in safety of investment and who want steady returns on investments.

Features of Preference Shares:

Preference for dividend: Preference shares have the first charge on the distributable amount of annual net profit. The dividend is payable to preference shareholders before it is paid to equity shareholders.

Preference for repayment of capital: Preference shareholders have a preference over equity shareholders in respect of return of capital when the company is liquidated. It saves preference shareholders from capital losses.

Fixed Return: These shares carry dividend at fixed rate. The rate of dividend is pre-determined at the time of issue. It may be in the form of fixed sum or may be calculated at fixed rate. The preference shareholders are entitled to dividend which can be paid only out of profits.

Nature of Capital: Preference shares do not provide permanent share capital. They are redeemed after certain period of time. A company cannot issue irredeemable preference shares.

Market Value: The market value of preference share does not change as the rate of dividend payable to them is fixed. The capital appreciation is considered to be low as compared with equity shares.

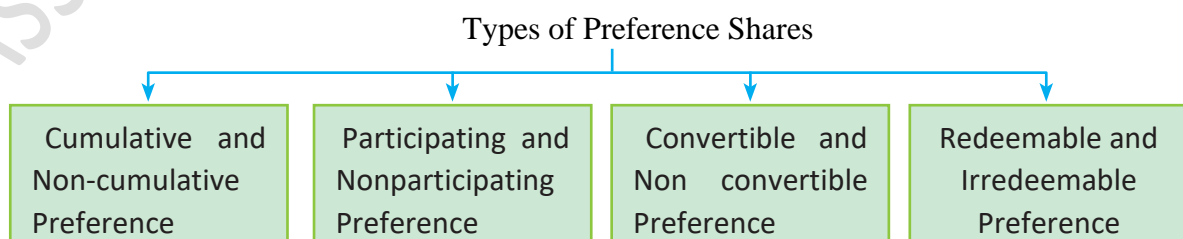
Voting rights: The preference shares do not have normal voting rights. They do not enjoy right of control on the affairs of the company.

Risk: The investors who are cautious, generally purchase preference shares. Safety of capital and steady return on investment are advantages attached with preference shares. These shares are boon for shareholders during depression period when interest rate is continuously falling.

Face Value: Face value of preference shares is relatively higher than equity shares. They are normally issued at a face value of Rs. 100/-.

Rights or Bonus Issue: Preference shareholders are not entitled for Rights or Bonus issues.

Nature of Investor: Preference shares attract moderate type of investors. Investors who are conservative, cautious, interested in safety of capital and who want steady return on investment generally purchase preference shares.



Cumulative Preference Shares: Cumulative Preference Shares are those shares on which dividend goes on accumulating until it is fully paid. This means, if the dividend is not paid in one or more years due to inadequate profits, then this unpaid dividend gets accumulated. This accumulated dividend is

paid when company performs well. The arrears of dividend are paid before making payment to equity shareholders.

Non-cumulative Preference Shares: Dividend on these shares does not get accumulated. This means, the dividend on shares can be paid only out of profits of that year. The right to claim dividend will lapse, if company does not make profit in that particular year. If dividend is not paid in any year, it is lost forever.

Participating Preference Shares: The holders of these shares are entitled to participate in surplus profit besides preferential dividend. The surplus profit which remains after the dividend has been paid to equity shareholders, up to certain limit, is distributed to preference shareholders.

Non-participating Preference Shares: The preference shares are deemed to be non-participating, if there is no clear provision in the Articles of Association. These shareholders are entitled to fixed rate of dividend, prescribed at the time of issue.

Convertible Preference Shares: The holders of these shares have a right to convert their preference shares into equity shares. The conversion takes place within a certain fixed period.

Non-convertible Preference Shares: These shares cannot be converted into equity shares.

Redeemable Preference Shares: Shares which can be redeemed after certain fixed period of time are called redeemable preference shares. A company limited by shares, if authorised by Articles of Association, issues redeemable preference shares. Such shares must be fully paid. These shares are redeemed out of divisible profit only or out of fresh issue of shares made for this purpose.

Irredeemable Preference Shares: Shares which are not redeemable i.e. payable only on winding up of the company are called irredeemable preference shares. As per Section 55(1) of the Companies Act 2013, a company cannot issue irredeemable preference shares.

Retained Earnings:

Business organisations are subject to variation in earnings. It would be a wise decision to keep aside a part of earning during a period of high profit. A prudent company does not distribute the entire profit earned among shareholders. A part of profit is retained by company in the form of reserve fund. These reserves are the retained earnings of the company. The sum total of retained earnings gets accumulated over the years. This accumulated profits are reinvested in the business rather than distributed as dividend.

"The process of accumulating corporate profits and their utilisation in business is called retained earnings."

In simple words, a part of net profit, which is not distributed to shareholders as dividend is retained by company in the form of 'Reserve Fund'. Company converts its reserves into 'bonus share capital' and capitalise its profit. This capitalisation of profit by issue of bonus shares is known as ploughing back of profit or self financing. Bonus shares are issued free of cost to the existing equity shareholders out of the retained earnings.

The Management can convert retained earnings into permanent share capital by issuing bonus shares. It is an important source of raising long term capital. It is simple and cheapest method of raising finance. It is used by established companies. It is an internal source of finance.

Determinants of retained earnings:

Total earnings of company: If there is ample profit, company can save and retain some parts of profit. More the earnings, a company can save more. Attitude of top management also determines the amount of retained earnings.

Taxation Policy: The taxation policy of government is also an important determinant of corporate savings. If the taxes levied are at high rates, company cannot save much of the profits in the form of reserves.

Dividend Policy: It is a policy of Board of Directors in regards to distribution of profits. A conservative dividend policy is needed for having good accumulation of profit. But this policy affects shareholders as they get dividend at a lower rate.

Government Control: A government is regulatory body of economic system of the country. It's policies, rules and regulations ensures that the companies work as per its regulations. Company has to formulate it's dividend policy in accordance with the rules and regulations framed by the Government.

Asst. Prof. Nimesh Jotaniya (FCS)

SOURCES OF BORROWED CAPITAL

Only owned capital is not sufficient to carry on all business activities of a joint stock company. A company needs borrowed capital to supplement its owned capital.

Every trading company is entitled to borrow money. However, it is a normal practice to have an express provision in the Memorandum of Association, enabling a company to borrow money. Memorandum authorises company to exercise borrowing powers whereas Articles of Association provides as to how and by whom these powers shall be exercised. The power to borrow money is normally exercised by Board of Directors of the company.

The capital may be borrowed for short, medium or long term requirement. It is better to raise borrowed capital at a later stage of company's business, when company want to expand or diversify its business and it requires additional capital. This additional capital can be raised by : a) issue of debentures b) Accepting deposits c) bonds d) Loans from commercial banks and Financial institutions, etc. Interest is paid on borrowed capital. It is paid at fixed rate. Borrowed capital is repayable after a specific period of time.

Debentures

Debentures are one of the principal sources of raising borrowed capital to meet long and medium term financial needs. Over the years debentures have occupied a significant position in the financial structure of the companies.

The term debenture has come from the latin word 'debere' which means to 'owe'. The term debenture has not been defined clearly under Companies Act.

Palmer defines : "A debenture as an instrument under seal evidencing debt, the essence of it being admission of indebtedness."

Features

Promise: Debenture is a promise by company that it owes specified sum of money to holder of the debenture.

Face Value: The face value of debenture normally carries high denomination. It is ₹ 100 or in multiples of ₹ 100.

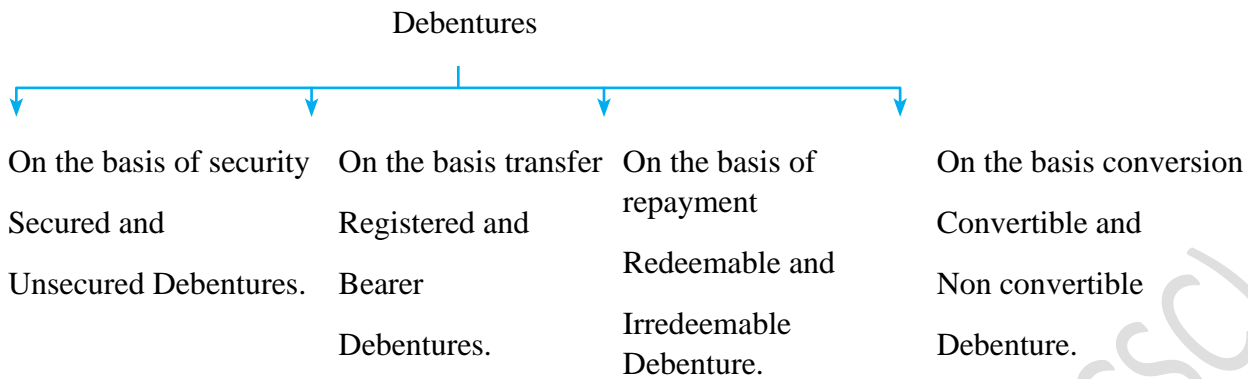
Time of Repayment: Debentures are issued with the due date stated in the debenture certificate. The principal amount of debenture is repaid on maturity date.

Priority of Repayment: Debentureholders have a priority in repayment of debenture capital over the other claimants of company.

Assurance of Repayment: Debenture constitutes a long term debt. They carry an assurance of repayment on due date.

Interest: A fixed rate of interest is agreed upon and is paid periodically in case of debentures. Payment of interest is a fixed liability of the company. It must be paid by company irrespective of the fact, whether the company makes profit or not.

Types of Debentures



Secured debentures: The debentures can be secured. The property of company may be charged as security for loan. The security may be for some particular asset (fixed charge) or it may be the asset in general (floating charge). The debentures are secured through 'Trust Deed'.

Unsecured debentures: These are the debentures that have no security. The issue of unsecured debentures is now prohibited by the Companies Act, 2013.

Registered Debentures: Registered debentures are those debentures on which the name of holders are recorded. A company maintains 'Register of Debentureholders' in which the name, address and particulars of holdings of debentureholders are entered. The transfer of registered debentures requires the execution of regular transfer deed.

Bearer Debentures: Name of holders are not recorded on the bearer debentures. Their names do not appear on the 'Register of Debentureholders'. Such debentures are transferable by mere delivery. Payment of interest is made by means of coupons attached to debenture certificate.

Redeemable Debentures: Debentures are mostly redeemable i.e. Payable at the end of some fixed period, as mentioned on the debenture certificate. Repayment can be made at fixed date at the end of specific period or by instalment during the life time of the company. The provision of repayment is normally made in 'Trust Deed'.

Irredeemable Debentures: These kind of debentures are not repayable during life time of the company. They are repayable only after the liquidation of the company, or when there is breach of any condition or when some contingency arises.

Convertible Debentures: Convertible debentures give right to holder to convert them into equity shares after a specific period of time. Such right is mentioned in the debenture certificate. The issue of convertible debenture must be approved by special resolution in general meeting before they are issued to public. These debentures are advantageous for the holder. Because of this conversion right, convertible debentureholder is entitled to equity shares at a rate lower than market value.

Non-convertible Debentures: Non-convertible debentures are not convertible into equity shares on maturity. These debentures are redeemed on maturity date. These debentures suffer from the disadvantage that there is no appreciation in value.

Bond

Bond is a debt security. It is a formal contract to repay borrowed money with interest. Bond is a loan. The holder of bond is a lender to the institution. He is a creditor of the company. He gets fixed rate of interest. All bonds have maturity date and is paid in cash at certain date in future.

According to Webster Dictionary, 'A bond is an interest bearing certificate issued by the government or business firm, promising to pay the holder a specific sum at a specified date.'

Thus a company borrows money and issues bonds as an evidence of debt. Interest is payable on bonds at fixed interval or on maturity of bonds.

Features

Nature of Finance: It is a debt Finance. It provides long term finance. The bonds can be issued for longer period i.e. 5 years, 10 years, 25 years, 50 years.

Status of bondholder: The bondholders are creditors. Since they are creditors and non-owners they are not entitled to participate in general meeting. They have no voting right and hence no participation in the management.

Return on bonds: The bondholder gets a fixed rate of interest. It is payable at regular interval or on the maturity of bond.

Repayment: Bonds have specific maturity date on when the principal amount is repaid.

American Depository Receipt (ADR) and Global Depository Receipt (GDR)

In India, the shares of public company are listed and traded on various stock exchanges like Bombay Stock Exchange (BSE) and National Stock Exchange (NSE).

With adoption of free economic policy and due to globalization some of the Indian company's shares are also listed and traded on foreign stock exchanges like New York Stock Exchange (NYSE) or National Association of Securities Dealer Automated Quotation (NASDAQ). To list shares on these stock exchanges, company has to comply with policies of those stock exchanges. The policies of these stock exchanges are different than the policies of Indian Stock Exchanges. Therefore, those Indian companies which can not list their shares directly on foreign stock exchanges, get listed indirectly using ADR and GDR.

ADR and GDR are Dollar/Euro denominated instrument traded in USA and Europe Stock Exchanges.

Indian Company issues shares to an intermediary called 'Depository'. Bank of New York, Citigroup etc. act as foreign Depository Bank. This Depository bank issues ADR and GDR to investors against these shares. The ADR / GDR represent fixed number of shares. These ADR / GDR are then sold to people in foreign country. The ADR / GDR are traded like regular shares. They are listed on stock exchanges. The prices fluctuate depending on demand and supply.

Both ADR and GDR are depository receipts, but only difference is the location where they are traded. If the Depository Receipt is traded in USA, it is called American Depository Receipts (ADR) and if it is traded in a country other than USA is called Global Depository Receipts (GDR).

Non-Resident Indians (NRI) and Foreign nationals can invest their money in India by purchasing ADR and GDR. They can buy ADR / GDR using their regular equity trading Account.

The company pays dividend in home currency to the depository bank and the depository bank converts it into the currency of investor and pays dividend.

The exchanges on which GDR is traded are as follows :

London stock exchange.

Luxembourg Stock exchange.

NASDAQ Dubai.

Singapore Stock exchange.

Hongkong Stock exchange.

Commercial Banks

There are number of sources of financing short and medium term business requirements. Among these, commercial bank constitute the most predominant source. Commercial banks play significant role in corporate financing in India. Commercial banks, by introducing variety of deposit schemes tailored to individual depositor's need, mop up savings of people and make use of these savings to meet varied requirements of corporate enterprises.

Commercial banks assist corporate enterprises -

By Granting term loans to companies.

By subscribing to shares and debentures of companies.

By underwriting the issue of securities of the Company.

Commercial banks also play an important role in providing short term finance. They have become primary source of financing working capital of the business. In India, primary source of financing working capital are bank credit and trade credit.

Banks have introduced many innovative schemes for disbursement of credit. They are as follows :

Overdraft: A company having current account with bank is allowed overdraft facility. The borrower can withdraw funds as and when needed. He is allowed to overdraw on his current account, up to the credit limit which is sanctioned by bank. Within this stipulated limit any number of drawings are permitted. Repayments can be made whenever required during the time period. The interest is determined on the basis of actual amount withdrawn.

Cash Credit: It is also an important and popular form of financial aid. This form of credit is operated in same manner as overdraft facility. The borrower can withdraw amount from his cash credit account up to a stipulated limit based on security margin. Cash credit is given against pledge or hypothecation of goods or by providing alternative securities. Interest is charged on outstanding amount borrowed and not on the credit limit sanctioned.

Cash loans: Under this, the total amount of loan is credited by bank to the borrowers account. Interest is payable on actual balance outstanding.

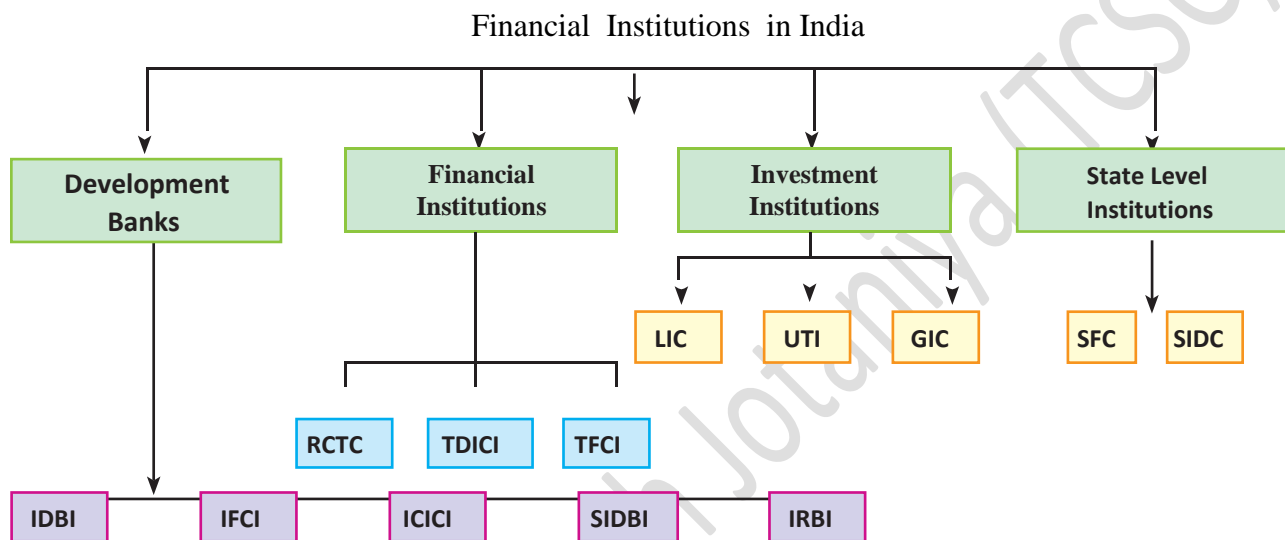
Discounting bills of exchange: The drawer of the bill i.e. (seller) can receive money from drawee (i.e. buyer) on due date or after the due date. Drawer can receive money before due date by discounting the bill with the bank. This is nothing but selling the bill to the bank. The bank gives money to drawer

less than the face value of the bill. Thus bill of exchange are trade bills. They are accepted by bank and cash is advanced against them.

Financial Institutions

First industrial policy was declared in 1948 for rapid industrial development in the country. The Central Government and State Government have established special financial institutions for providing industrial finance. These institutions provide medium and long term finance. The assistance of these institutions has become important for new companies as well as going concerns.

Financial Institutions are classified into four categories as follows.



Development Banks

Industrial Development Bank of India (IDBI).

Industrial Finance Corporation of India Ltd. (IFCI)

Industrial Credit and Investment Corporation of India (ICICI)

Small Industries Development Bank of India (SIDBI)

Industrial Reconstruction Bank of India (IRBI)

Financial Institutions

Risk Capital and Technology Finance Corporation Ltd. (RCTC)

Technology Development and Information Company of India Ltd. (TDICI)

Tourism Finance Corporation of India Ltd. (TFCI)

Investment Institutions

Life Insurance Corporation of India (LIC)

Unit Trust of India (UTI)

General Insurance Corporation of India (GIC)

State Level Institutions

State Finance Corporations (SFC)

State Industrial Development Corporation (SIDC)

Above mentioned institutions provide financial assistance in the following forms :

To provide term lending facilities.

To subscribe to shares and debentures.

To underwrite the issue of securities.

To lend money.

To guarantee term loans raised by company.

Trade Credit

No business can be run without 'credit'. Credit is the soul of business. Trade credit financing is major source of short term financing.

Manufacturers, wholesalers and suppliers of goods or materials are called 'trade creditors'. They sell tangible goods to other business concerns on the basis of deferred payment i.e. future payment credit is extended by these business concerns with an intention to increase their sales. The business firm extends credit, also because of custom that has been built up overtime.

Trade credit is not cash loan. It results from a credit sale of goods / services, which has to be paid at a future date after the sale takes place. In other words, when goods are delivered by supplier to a customer and the payment is made after some time, it is called as trade credit.

Hire Purchase

Hire Purchase is one of the most commonly used modes of financing for acquiring various assets. It aids by spreading the huge cost of an asset over a longer period of time. Thus, it frees a lot of capital to be directed to other important purposes.

In case of hire purchase, the buyer pays for an article in periodical instalments but becomes the owner of the article only after the final instalment is paid. Till the final instalment is paid, the seller remains the owner of the article. However, the buyer gets the possession of the article immediately and can start using it. Also, the buyer has to pay interest in addition to the purchase price on the outstanding amount. If the buyer fails to pay any instalment, the seller can take away (repossess) the article.

Hire Purchase – Terminologies

HIRE PURCHASE AGREEMENT: The Purchaser/hirer and the vendor enter into a written agreement known as Hire Purchase Agreement under Hire Purchase Act,1972, which contains the following details:

Hire purchaser/Hirer – A person who purchase asset on H.P. basis, also known as Hirer.

Hire Vendor – A person who sale assets on H.P. basis

Cash price – Original cost of Asset or Price at which asset can be purchase without instalments

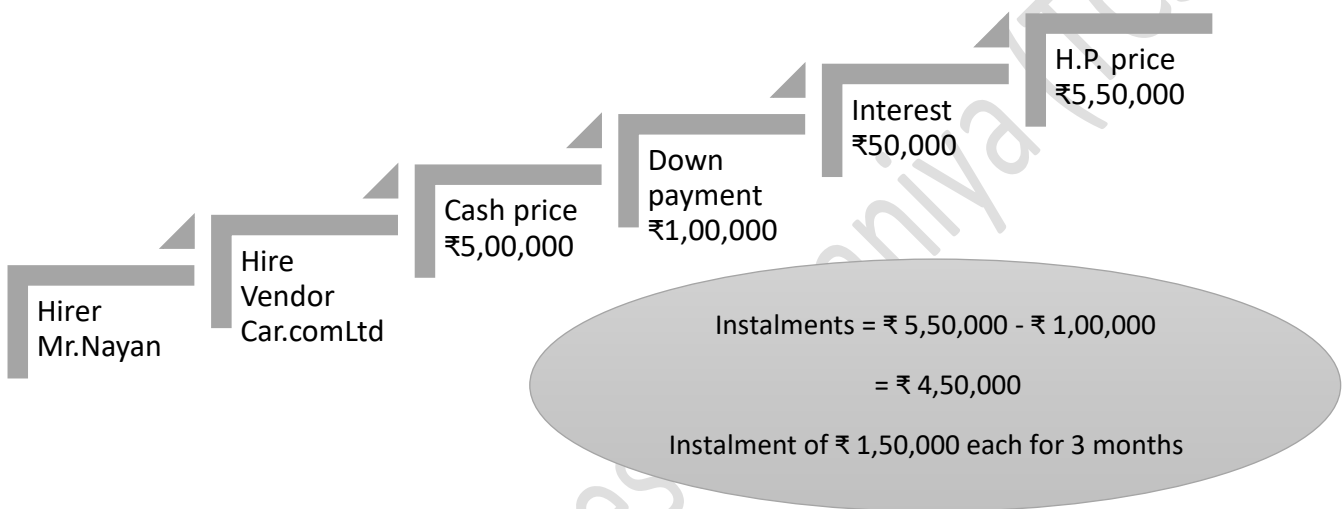
Down Payment – Initial amount to be paid on agreement

Interest – Specific rate of Interest to be charged on balance amount ,Interest charged by vendor on Cash price of Asset

H.P. Price = Cash Price + Interest

Instalments = H.P. price – Down payment. Balance amount after paying down payment is divided in to equal instalments, which can be Monthly, Quarterly, half yearly or yearly.

For eg. Mr. Nayan purchase motor car from Cars.com Ltd on Hire purchase basis, the price of car is ₹5,00,000 and Mr. Nayan has to pay ₹1,00,000 at the time of signing the agreement and balance in 3 equal instalments. Car.com ltd. Will charge 12% interest p.a. which comes to ₹50,000.



Lease Finance

Lease financing is a contractual agreement between the owner of the assets (lessor) and user of the assets (lessee), whereby the owner permits the user to economically use the asset on the payment of periodical amount which is in the form of lease rent for a specific period of time. The title of goods remains with the owner (lessor) of the asset. It is the most important source of long term financing.

Lease financing is the source of payment which comes when the owner of assets (lessor) ready to provide their assets to another person in exchange of that lessor provides some agreed payment. In this way, the lessor leases the assets for a period of time on rent and lesser gets funds from the lessor. The periodical payment made by the lessee to the lessor is called the lease rental.

Under lease financing, the lessee is given the right to use the asset but the ownership lies with the lessor and at the end of the lease contract, the asset is returned to the lessor or an option is given to the lessee either to purchase the asset or to renew the lease agreement.

Purpose of Leasing

Benefits of Taxes

The tax benefit is availed to both the parties, i.e. Lessor and Lessee. Lessor, being the owner of the asset, can claim depreciation as an expense in his books and therefore get the tax benefit. On the other hand, the lessee can claim the MLPs i.e. lease rentals as an expense and achieve tax benefit in a similar way.

Avoid Ownership and thereby Avoiding Risks of Ownership

Ownership is avoided to avoid the investment of money into the asset. It indirectly keeps the leverage low and hence opportunities of borrowing money remain open for the business. A Lease is an off-balance sheet item.

Advantages

- A lease contract is often worked over a longer period than a bank loan
- Cash Flow for business, especially a start-up will not be affected by massive outlay for Capital Expenditure.
- Lease payments are tax deductible business expense
- It is easier to get leasing finance with poor credit rating
- Leasing terms are lower than using another form of capital financing

Disadvantages

- Relatively high cost of lease.
- More burden with interest rates decline in market.
- Miscellaneous expenses are owned by lessee.
- No capital gains when asset prices are poorer.

Financial Lease V/s Operating Lease

| Financial Lease | Operating Lease |
|--|---|
| 1. A Commercial contract in which lessor lets the lessee to use an asset in lieu of periodical payments for usually long period of time. | 1. A Commercial contract in which lessor lets the lessee to use an asset in lieu of periodical payments for usually Short period of time. |
| 2. The ownership is transferred to the lessee. | 2. The ownership remains with lessor. |
| 3. The contract is called loan agreement. | 3. The contract is called rental agreement. |
| 4. The lessee would need to take care and maintain the asset. | 4. The lessor would need to take care and maintain the asset. |
| 5. The risk of obsolescence lies on the part of lessee. | 5. The risk of obsolescence lies on the part of lessor. |
| 6. It is also termed as Full – payout lease. | 6. It is termed as Service lease |
| 7. For eg. Hiring Taxi | 7. For eg. Aircrafts, Buildings, Railway wagons. |

Commercial Papers

Commercial paper is an unsecured, short period debt tool issued by a company, usually for the finance and inventories and temporary liabilities. The maturities in this paper do not last longer than 270 days. These papers are like a promissory note allotted at a huge cost and exchangeable between the All-India Financial Institutions (FIs) and Primary Dealers (PDs).

Most of the commercial paper investors are from the banking sector, individuals, corporate and incorporated companies, Non-Resident Indians (NRIs) and Foreign Institutional Investors (FIIs), etc. However, FII can only invest according to the limit outlined by the Securities and Exchange Board of India (SEBI)

In India, commercial paper is a short-term unsecured promissory note issued by the Primary Dealers (PDs) and the All-India Financial Institutions (FIs) for a short period of 90 days to 364 days.

Commercial Paper in India

On 27th March 1989, commercial paper in India was introduced by RBI in the Indian money market. It was initially recommended by Vaghul working Group on the basis of the following points.

- The registration of commercial papers should only be granted to companies having Rs. 5 cores and above net worth with excellent dividend payment record.
- The market should follow the CAS discipline. The RBI should manage the paper amount, entry of the market, and total quantum which can be upgraded in a year.
- No limitation on the commercial paper market apart from the least size of the note. However, the size of one issue and each lot should not be less than Rs. 1 crore and Rs. 5 lakhs respectively.
- It should be eliminated from the provision of insecure advances in the state of banks.
- The paper can be made in terms of interest or at a discount rate to face value.
- It should not be compelled to stamp duty while issuing and transferring.

Types of Commercial Paper

According to the Uniform Commercial Code (UCC), commercial papers are divided into four different types.

Draft – It is written guidance by an individual to another and to pay a stipulated sum to a third party.

Check – It is a unique draft where the drawee is a bank.

Note – Here, an individual is promised to pay another individual or bank a particular amount.

Certificates of Deposit – In this type, a bank confirms the receipt of deposit.

According to security, there are two types of commercial papers

Unsecured Commercial Papers – These are traditional papers and allotted without any security.

Secured Commercial Papers – It is also known as Asset-Backed Commercial Papers (ABCP) and assured by other financial assets.

Advantages of Commercial Paper

Contributes Funds – It contributes extra funds as the cost of the paper to the issuing company is cheaper than the loans of the commercial bank.

Flexible – It has a high liquidity value and flexible maturity range giving it extra flexibility.

Reliable – It is highly reliable and does not have any limiting condition.

Save Money – On commercial paper, companies can save extra cash and earn a good return.

Lasting Source of Funds – Maturity range can be customised according to the firm's requirement, and matured papers can be paid by selling the new commercial paper.

Venture Capital Financing

Entrepreneurs need investments for their start-up companies. The investments or the capital that these entrepreneurs receive from wealthy investors is called Venture Capital and the investors are called Venture Capitalists.

VC firms reduce the risk of investments by co-investing with other VC firms. Usually, there will be the main investor called the 'lead investor' and other investors will be called 'followers'.

How does Venture Capital Fund work?

- Venture Capital Fund is made up of investments from wealthy individuals or companies who give their money to a VC firm to manage their investment portfolios for them and to invest in high-risk start-ups in exchange for equity.
- The basic idea is to invest in a company's balance sheet and infrastructure.
- Venture Capitalist nurtures the idea of an entrepreneur for a short period of time and exits with the help of an investment banker.
- In a start-up company, VC will receive an equity partnership in exchange for investments in the start-up company.
- VC's receive liquidation preference, it means in the worst-case scenario where the company fails, VCs are given the first claim to all the company's assets and technology. It also offers voting rights over key decisions like Initial Public Offer (IPO) or even sale of the company.

Advantages of Venture Capital

1. Banks usually prefer to finance a new business which has hard assets. In the current information-based economy, new start-ups hardly have any hard asset. Venture Capitalists step in under these circumstances.
2. They can provide more insights into the market.
3. Can help in strategy formulation.
4. Can help in developing strategic networks

Merchant Banking

Merchant Banking is a combination of Banking and consultancy services. It provides consultancy to its clients for financial, marketing, managerial and legal matters. Consultancy means to provide advice, guidance, and service for a fee. It helps a businessman to start a business. It helps to raise (collect) finance. They help to expand and modernize the business. It helps in the restructuring of business. This helps to revive sick business units. It also helps companies to register, buy and sell shares at the stock exchange.

Merchant Bank is defined as “A Merchant Bank could be best defined as a financial institution conducting money market activities and lending, underwriting and financial advice, and investment services whose organization is characterized by a high proportion of professional staff able to approach problems in an innovative manner and to make and implement decisions rapidly.”

It is skill-based activities and involves serving every financial need of every client. It requires a focused skill-base to provide for the requirements of the client. SEBI has made the quality of manpower as one of the criteria for registration as the merchant banker. These skills should not be concentrated in issue management and underwriting alone, which may hurt business.

Merchant bankers can turn to any of the activities mentioned above depending upon resources, such as capital, foreign tie-ups for overseas activities and skills. The depth and sophistication in merchant banking business are improving since the avenues for participating in capital market activities have widened from issue management and underwriting to private placement, bought out deals (BODS), buy-back of shares, mergers, and takeovers.

Functions of Merchant Banking Organization:

1] Portfolio Management:

Merchant banks provide advisory services to institutional investors, on account of investment decisions. They trade in securities, on behalf of the clients, to provide the portfolio management services.

2] Raising funds for clients:

Merchant banking organization assists the clients in raising funds from the domestic and international market, by issuing securities like shares, debentures, etc., which can be deployed for starting a new project or business or expansion activities.

3] Promotional Activities:

One of the most important activities of merchant banking is the promotion of a business enterprise, during its initial stage, right from conceiving the idea of obtaining government approval. There is some organization, which even provides financial and technical assistance to the business enterprise.

4] Loan Syndication:

Loan Syndication means service provided by the merchant bankers, in raising credit from banks and financial institutions, to finance the project cost or working capital of the client's project, also termed as project finance service.

5] Leasing Services:

Merchant Banking organizations render leasing services to their customers. There are some banks which maintain venture capital funds to help entrepreneurs.