LAW AND ECONOMICS IN CONTEMPORARY INDIA: AN INTER-DISCIPLINARY APPROACH

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Abstract

In contemporary scenario the inter-section between law and economics gained considerable attention due to the inception of antitrust law in the field of corporate world, or else before that company form of business had always been considered as black box. However, now this intersection is applicable in other fields of study such as issues related with property, acquisition, contract and crime etc.

Law and Economics play a significant role in the corporate world. Law is a social engineering whereas the economics is financial engineering. As far as the Corporate Finance is concerned the economics is indispensable, hence the economics deals with the best utilization of resources and also while raising the Corporate Finance since the finance is life-blood of any corporation. The Financial manager while taking decisions with regard to raising capital will always keep in mind the economic perspective of profit maximization and wealth maximization. The Manager must select the most appropriate method of financing the corporation by taking in to consideration of cost to capital. One of the main functions of the Financial Manager is to raise funds for corporation by way of equity and debit by taking into consideration of the principles of economics i.e. best utilization of funds. The balance between debt and equity is also required to be maintained as per the requirements of the company. The ratio between debt and equity 2:1 is ideal and it is proved in maximum number of cases even though there is no statutory provision in this regard. The next function is to allocation of funds as per the requirement depending upon the size of the company.

In keeping into consideration the above objectives, the researchers wish to throw some light on the concept and principles of economics relating to law and corporate finance. The researchers focus on the objectives of corporate finance such as profit maximization and wealth maximization. Further concentrates on corporate fund raising such as equity and debt

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by striking the balance between debt and equity through taking into consideration the economic perspective. Finally, the researches link the law and economics to corporate finance.

Keywords: *Corporate, Economic, Debt, Equity, Constitution*

INTRODUCTION

Corporate Finance plays an important role in raising finance for any company in an economic way which leads to maximization of profit and wealth. It takes care of decisions such as finance, investment and dividend decisions. The primary goals of Corporate Finance are "*profit maximization and wealth maximization*". Profit maximization is the traditional method whereas the wealth maximization is the modern approach which takes care of all stakeholders. Finance is considered as life blood of business organization because it carries oxygen. The financial manager should strike a balance between equity and debt with an ideal thinking of 1: 2 ratios. If the debt is more than 2, the creditors will feel insecure of their money which they lent to the company; therefore, it is ideal to maintain the balance between equity and debt which suits for the corporation. In fact, there is no hard and fast rule to maintain the ratio of debt and equity still the some of the researches reveal that the ratio between equity and debt is 1:2 is appreciable. When it looks on economic perspective of corporate finance, it focuses mainly on risk and return. The cost of capital which includes both equity and debt, they are paid dividends and interest respectively. The economic perspective will be successful when company earns more income than it pays to the equity shareholders by way of dividends, interest in respect of debenture holders and other creditors such as suppliers, financial institutions and banks. The decisions of the Financial Manager also have an impact on the company's economic perspective. The ultimate objective of the corporation is 'wealth maximization' which is the basic concept of economics.

OBJECTIVES OF CORPORATE FINANCE

William Taminobelema Nyeduko rightly said that "*Money is the life blood of any business entity*". Every Corporation requires finance to run the business with a view to achieve the objectives for which it has been incorporated. Finance is required for procuring the Capital Assets and to meet the working capital needed to carry out the production and sales cycle. The Manager must then select the most appropriate method of financing it. The working capital management plays a key role in the company's long term success, without the oil of working capital; the engine of the fixed assets will not function. The working capital management requires a clear specification of the objectives to be achieved. The two main objectives of working capital management are to increase the profitability of the company and to unsure that it has significant liquidity to meet short term obligations as they fall due and so continue in business. Profitability is related to the goal of shareholder's wealth maximization, so investment in current assets should be made only if an acceptable return is obtained. While liquidity is needed for a company to continue in business, a company may choose to hold more cash than is needed for operational or transaction needs.

Working capital needs to consider the nature of the business of the company since different companies will have different requirements of working capital. A manufacture company needs to invest heavily in spare parts and components might be owed large amounts of money by its customers. Working capital policies will also need to reflect the credit policies of the company's close competitors since it would be foolish to lose business because of an unfavourable comparison of terms of trade. Short term finance include overdraft, short term bank loans and trade credit with repayment to be made in the near future. Financial Manger is one of the key managerial persons in a company; generally, the Chief Financial Officer acts as Financial Manager in a company and takes care of financial decisions and capital budgeting of a Corporation. The main functions of financial manager are: Raising Funds, Profit planning, Understanding Capital Market and Providing financial advice and supply.

CONSTITUTIONAL PERSPECTIVE OF CORPORATE FINANCE

Constitution is basic document of the law of the land; it is also known as fundamental document of the nation. Kelson observed that the Indian Constitution is ground norm i.e. fundamental rule of the country; hence whatever law is made that should be in line with the Constitution. There are certain provisions that are made in the 7^{th} Schedule (Art 246) in which three lists are there, they are furnished below:

1. List-I Union list having 97 items
2. List-II State list having 66 items
3. List-III Concurrent list having 47 items.

Items nos. pertaining to Corporate Law with special reference to finance, commerce and business are 35, 36, 37, 38, 41, 42, 43, 44, 45, 46, 47, 48, 52, 85 and 86

THE STRUCTURE OF THE FINANCIAL SYSTEM

It is divided in to two categories such as Organized and Unorganized sectors. The Organized financial system consists of Banking system, Money market, financial instructions. The Unorganized financial system consists of money lenders, indigenous bankers, lending pawn brokers, land lords, traders etc. The RBI controls organized sector whereas in case of unorganized sector there is no direct control by RBI.

FINANCIAL SYSTEM VIS-À-VIS CORPORATE SECTOR

Industrialization is sine quo non for economic progress. In the past independence era, the base of the industrial structure has been broadened. In this, the corporate sector has been in the lead. More importantly “finance is the life blood of industry”. The corporate sector depends on the financial system for various reasons such as:

- Risk Capital: It is an important source of raising the promoter’s contribution; financial institutions provide venture/seed capital to corporate entities.
- Equity: A good equity base ensures the financial health of a unit. It provides flexibility, favourable financial leverage and increases its debt raising capacity. There is no hard and fast rule regarding debt and equity but the ideal ratio between Debt and Equity is 2:1. The debt and equity ratio is also a measure of investor leverage.
- Debt: Long and short term capital; financial institutions are generally the major lenders of borrowed funds of the corporate sector.

CORPORATE FUND RAISING

Corporation raises money for its needs by issue of securities and borrowing money (Equity and Debt). There are two methods that the Indian companies adapt while procuring funds for its business purpose i.e. Public offer and Private placement. The public offer covers the initial public offering for the first time by the public company which may be fresh issue or offer for sale. Whereas the further public offering for listed companies may be fresh or offer for sale. Hence the Initial Public Offer is that when the share of a company are sold for the first time.

THE CORPORATE DEBT FINANCING

When the company raises money for working capital or capital expenditures by selling debt instruments such as debentures and bonds, in addition to that the companies borrow money from Banks and Financial Institutions on fixed rate of interest based on creation of charge fixed or floating. Debenture is a medium to long term debt instrument issued by large companies to borrow money at a fixed rate of interest. It is a certificate of loan and it does not become share capital, hence it is a debt capital. According to section 2(30) of the Companies

Act 2013, Debenture includes, "*debenture stock, bond or any other instrument of the company evidencing a debt, whether constituting a charge on the assets of the company or not*."

Advantages of Debentures

- It does not dilute the interest of equity
- Interest paid on Debentures is tax deductible
- Cost of debenture lower than equity or preference
- Issue of debenture is an advantage during time of inflation

EQUITY v. DEBT

Equity is the ownership of company by the shareholders who have subscribed their capital by way of taking share of the company. The Equity shareholders are the real owners of the company in fact and they have voting rights in the meetings. In the case of *LIC of India* v. *Escorts Ltd. & Others*[1] it has been observed that, "*the common rights of shareholders such as voting power, ownership, the right to transfer ownership, dividends, the right to inspect corporate documents, and the right to sue for wrongful acts*." The debt of the company is borrowed capital which has taken especially from Banks and financial institutions include debt obligations and funds owed to different vendors, workers and loan providers of the company. Bonds and Debentures of the company come under the debt finance that is also known as creditors of the company.

DISTINCTION BETWEEN DEBENTURE HOLDER AND EQUITY SHARE HOLDER

Debenture holder is creditor of the company whereas equity share holder is owner of the company. The debenture can be redeemed of returned during tenure whereas the equity is paid on liquidation of the company. The debenture holder is paid prior to the equity share holder who is paid at the end of company i.e. winding up of company. The debenture holder is paid interest whether profit is there or not whereas the equity shareholder is paid dividends out of profits only, if no profits no dividends. Debenture holders do not have voting rights whereas the equity holders have voting rights.

[1] AIR 1986 SC 1370

ECONOMIC PERSPECTIVE OF CORPORATE FINANCE

Economics plays a very important role in the economy of nation which deals with utilization of funds with limited means. It is the study of scarcity and tells us that how people should use resources in a profitable way to maximize the profit of the company. Economics often involves in the area like wealth and finance as well best utilization of funds to reach the primary goal of shareholder's wealth maximization, but not all about money. It shoulders the responsibility on Finance Manager (CEO) of the Corporation to raise the capital with low cost than income which the company earns through its operation. When the company raises its capital through equity or debt, it should take care of pros and cons corporate finance. The company should always fetch the income more than the expenditure to meet the cost of the capital and declare the dividends as well.