IV. VERY LONG ANSWER TYPE QUESTIONS

Question 1. Explain the concept of IDBI (its full form, establishment year, purpose, objectives, and functions).

Answer:

IDBI	Industrial Development Bank of India
LOGO	IDBI
Established/ Set up	IDBI was set up in July 1964 as a wholly owned subsidiary of the Reserve Bank of India.
Purpose	The purpose was to enable the new institution to benefit from the financial support and experience of RBI.
Ownership transferred	Before 16th February, it was delinked from RBI in 1976 and was made an autonomous corporation. In February 1976, the ownership of IDBI was transferred to Government of India. After the transfer of its ownership, IDBI became the main institution, through which the institutes engaged in finance and made an autonomous corporation.
Government's shareholding	Government's shareholding in IDBI stands at 72.14%.
Objectives	To serve as the apex institution for term finance for industry in India. Its objectives include: 1. Co-ordination, regulation and supervision of the working of other financial institutions such as IFCI, ICICI, UTI, LIC, Commercial Banks and SFCs. 2. Supplementing the resources of other financial institutions and thereby widening the scope of their assistance. 3. Planning, promotion and development of key industries and diversifications of industrial growth. 4. Devising and enforcing a system of industrial growth that conforms to national priorities.
Functions	1. The IDBI has been established to perform the following functions – To grant loans and advances to: (*i*) IFCI, SFCs. (*ii*) Any other financial institution by way of refinancing of loans repayable within 25 years. (*iii*) To grant loans and advances to scheduled banks or state co-operative banks by way of refinancing of loans granted which are repayable in 15 years. (*iv*) To grant loans and advances to all above mentioned institutions of industrial concerns for exports. (*v*) any industrial concern. 2. To discount or rediscount bills of industrial concerns. (*i*) To underwrite or to subscribe to shares or debentures of industrial concerns. (*ii*) To subscribe or to purchase stock, shares, bonds and debentures of other financial institutions. 3. To provide consultancy and merchant banking services in or outside India. 4. To provide technical, legal, marketing and administrative assistance to any industrial concern or person for promotion, management or expansion of any industry. 5. Planning, promoting and developing industries to fill up gaps in the industrial structure in India. 6. To act as trustee for the holders of debentures or other securities.

Question 2. What is 'venture capital'? Explain the mode of raising funds.

Answer: The term 'venture capital' is defined as a equity by which an investor supports an entrepreneur talent with finance and business skills to exploit market opportunities and thus obtain a longterm market gains. These are investors and investment companies whose specialty is financing new, high potential, high-technology oriented entrepreneurial ventures.

The mode of raising funds through venture capitalists:

1. They are more interested in financing ventures which are in their second or third stage of development .
2. They often provide initial equity investment to start up a business such ventures can be of software, biotechnology, high-potential ventures, high-technology ventures or are

venture having high potential prospects and returns expected.
3. Venture capitalists look for a high rate of return. Thus, they want equity, or some share of ownership in return for their capital.
4. They are willing to take the higher risk of losing their capital for a chance of profit from the business's success.
5. The venture capitalist sells his or her percentage of the business to either another investor or back to the entrepreneur after specific number of years association or when he finds returns lowering down.
6. Mostly small business approach to venture capitalists when they want to start or grow a business but couldn't persuade banks to lend money.
7. These investors have a deep insight about the fields in which they make their investment, but they behave like more or less as non-working partners do not interfere in the management of the enterprise but protect them at initial stage by keeping good contact with them.
8. Venture capitalists are more careful while investing in any venture as they know that investment is highly illiquid. It means it is not subject to repayment on demand.

Question 3. When is it appropriate to use financial institutions as a source of financing?
Answer: Financing, an enterprise-whether large or small is a critical element for success in business. Financing is the use and manipulation of money. Raising money for a business is one aspect of financing.
All new entrepreneurs most of the time face difficult problems to arrange start up finance.
While finance is a life blood of the business and is needed throughout the life of business, the new entrepreneur faces significant difficulties in acquiring capital at start-up.

1. The entrepreneur needs to consider all possible sources of capital and select the one that will provide the needed funds at minimal.
2. Different sources of funds are used at various stages in the growth and development of the venture.
3. If an entrepreneur cannot personally supply the necessary amount of money, another option is 'OTHER PEOPLE'S MONEY (OPM)'. It means before seeking outside financing; an entrepreneur should first explore all methods of internal financing and the other external financing and if it suits an entrepreneur he can go for financial institutions as a sources of financing.
4. Institutional finance refers to institutional financing.
5. Sources of finance to Industry, other than commercial banks. These institutions are established by the Central/State Government, aiming at:
   (a) Promoting the industrial development of a country.
   (b) Providing both owned capital and land capital for long and medium term requirements.
   (c) Supplement the traditional financial agencies like commercial banks.
   (d) To encourage setting up of industries in backward areas.
   (e) To provide technical assistance to industrial units.
   (f) To develop investment markets.

Question 4. On the basis of duration, classify the sources of finance.
Answer: Sources of finances can be classified on the basis of duration

Sources of long-term Finance	Sources of short-term Finance
There are numbers of sources of long-term finance which are listed below: Venture capital • Debentures – • Share issues – • Owners savings: • Bank loans — medium or long term loans • Leasing	There are a number of sources of short-term finance which are listed below: 1. Trade credit 2. Bank credit – Loans and advances – Cash credit – Overdraft – Discounting of bills 3. Customers' advances 4. Instalment credit 5. Loans from co-operatives

Methods of Raising Capital: A company may raise funds for different purposes depending on the time periods ranging from very short to fairly long duration. The total amount of financial needs of a company depends on the nature and size of the business. The scope of raising funds depends on the sources from which funds may be available. The business forms of sole proprietor and partnership have limited opportunities for raising funds. They can finance their business by the following means:

1. Investment of own savings
2. Raising loans from friends and relatives
3. Arranging advances from commercial banks
4. Borrowing from finance companies.

Question 5. Companies can raise finance by a number of methods. What are the methods to raise long-term and medium-term capital finance?
Answer:
Issue of Shares: It is the most important method. The liability of shareholders is limited to the face value of shares, and they are also easily transferable. A private company cannot invite the general public to subscribe for its share capital and its shares are also not freely transferable. But for public limited companies there are no such restrictions. There are two types of shares:

1. Equity shares: The rate of dividend on these shares depends on the profits available and the discretion of directors. Hence, there is no fixed burden on the company. Each share carries one vote.
2. Preference shares: Dividend is payable on these shares at a fixed rate and is payable only if there are profits. Hence, there is no compulsory burden on the company's finances. Such shares do not give voting rights.

Issue of Debentures: Companies generally have powers to borrow and raise loans by issuing debentures. The rate of interest payable on debentures is fixed at the time of issue and are recovered by a charge on the property or assets of the company, which provide the necessary security for payment- The company is liable to pay interest even if there are no profits. Debentures are mostly issued to finance the long-term requirements of business and do not carry any voting rights.
Loans from Financial Institutions: Long-term and medium-term loans can be secured by companies from financial institutions like the Industrial Finance Corporation of India, Industrial ; Credit and Investment Corporation of India (ICICI), State level Industrial Development Corporations, etc. These financial institutions grant loans for a maximum period of 25 years against approved schemes or projects. Loans agreed to be sanctioned must be covered by securities by way of mortgage of the company's property or assignment of stocks, shares, gold, etc.
Loans from Commercial Banks: Medium-term loans can be raised by companies from commercial banks against the security of properties and assets. Funds required for modernisation and renovation of assets can be borrowed from banks. This method of financing does not require any legal formality except that of creating a mortgage on the assets.

Public Deposits: Companies often raise funds by inviting their shareholders, employees and the general public to deposit their savings with the company. The Companies Act permits such deposits to be received for a period up to 3 years at a time. Public deposits can be raised by companies to meet their medium-term as well as short-term financial needs. The increasing popularity of public deposits is due to:

1. The rate of interest the companies have to pay on them is lower than the interest on bank loans.
2. These are easier methods of mobilising funds than banks, especially during periods of credit squeeze.
3. They are unsecured.
4. Unlike commercial banks,the company does not need to satisfy credit-worthiness for securing loans.

Reinvestment of Profits: Profitable companies do not generally distribute the whole amount of profits as dividend but, transfer certain proportion to reserves. This may be regarded as reinvestment of profits or ploughing back of profits. As these retained profits actually belong to the shareholders of the company, these are treated as a part of ownership capital. Retention of profits is a sort of self financing of business. The reserves built up over the years by ploughing back of profits may be utilised by the company for the following purposes:

1. Expansion of the undertaking
2. Replacement of obsolete assets and modernisation.
3. Meeting permanent or special working capital requirement.
4. Redemption of old debts.
5. It enables the company to adopt a stable dividend policy.

Question 6. “Public issue is the most popular method of raising capital these days by the entrepreneurs.” Explain its benefit and drawbacks.
Answer: Meaning of Public Issues: This involves raising of funds directly from the public through the issue of prospectus. When an entrepreneur decides to go public and become a public company, he/ she tends to be in advantageous position because of reaping the following benefits: Access to capital or raising funds:

1. An entrepreneur stands to gain by going public in access to capital.
2. Generally, the capital is paid off at the liquidation of a company or not to be repaid immediately and does not involve an interest charge.
3. The only reward the IPO investors seek is an appreciation of their investment by getting dividends.

Entrepreneur can use the capital raised for a variety of purposes including:

1. growth and expansion,
2. retiring existing debt,
3. corporate marketing and development,
4. acquisition capital.

Other advantages:

1. Mergers and acquisitions: Public stock of a company can be used for businesses to grow through acquisitions.
2. Higher valuations: Public companies are typically valued more than private companies.
3. Benchmark trading price: The trading price of a public company’s stock serves as a benchmark of the offer price of other securities.
4. Capital formation: Raising capital later is typically easier

because of the extra liquidity for the investors.

5. Incentives: Stock options and stock incentives can be very helpful in attracting employees.
6. Reduced business requirements: While an underwritten initial public offering requires significant earnings, the lack of earnings does not keep a private company from going public.
7. Less dilution: There is less dilution of ownership control compared to an IPO.
8. Liquidity: A public company provides liquidity for management, minority shareholders, and investors.
9. Prestige: Added prestige and visibility with customers, suppliers, as well as the financial community.

Question 7. State the limitations of Public Issues.
Answer: The various limitations/obligations' are as follows:

1. Increasing accountability to public shareholders.
2. Need to maintain dividend and profit growth trends.
3. Becoming more vulnerable to an unwelcome takeover.
4. Need to observe and adhere strictly to the rules and regulations by governing bodies.
5. Increasing costs in complying with higher level of reporting requirements.
6. Relinquishing some control of the company following the public offering.
7. Suffering a loss of privacy as a result of media interest.

Question 8. Explain the features of Stock Exchanges.
Answer: Following are the features of stock exchange—:

1. Association of persons: It is an association of persons or body of individuals which may be registered or unregistered.
2. Recognition from central government: It is an organized market. It requires recognition from the Central Government.
3. Market for securities: It is a market, where securities of corporate bodies, government and semi-government bodies are bought and sold.
4. Deals in second hand securities: It deals with shares, debenture, bonds and such securities already issued by the companies. In short, it deals with existing or second hand securities and hence it is called secondary market.
5. Regulates trade in securities: It does not buy or sell any securities on its own account. It merely provides the necessary infrastructure and facilities to its members and brokers who trade in securities. It regulates the trade activities so as to ensure free and fair trade.
6. Allow dealings only in listed securities: It always maintain an official list of securities that could be purchased and sold on its floor.
7. Transactions effected only through members: All the transactions in securities at the stock exchange are effected only through its authorized brokers and members. No outsiders or direct investors are allowed to enter in the trading circles of the stock exchange.
8. Working as per rules: Buying and selling transactions in securities at the stock exchange are governed by the rules and regulations of stock exchange as well as SEBI Guidelines. No deviation from the rules and guidelines is allowed in any case.
9. Specific location: It is a particular market place where authorized brokers come together daily (i.e. on working days) on the floor of market called trading circles and conduct trading activities. The price of different securities traded are shown on electronic boards. After the working hours market is closed. All the working of stock exchange is conducted and

controlled through computers and electronic system.
10. Financial barometers: Stock exchanges are the financial barometers and development indicators of national economy of the country. Industrial growth and stability is reflected in the index of stock exchange.

Question 9. Who are called as “Angel Investors”? Explain the features of “Angel Investors”.
Answer:
Business angel or informal investor or an angel investor, is an affluent individual who provides capital for a business start¬up and early stage companies having a high-risk, high-return matrix usually in exchange for convertible debt or ownership equity.
Features of Angel Investors: Providing start-up finance to the needy who want to start a small own business. The main people involved to provide funds are “friends and family”, (it can be seed funding and formal venture capital). But raising of funds cannot be more than a few thousands from friends and family, even the venture capitalist are least interested to make investments. Thus, angel investments is a common second round of financing for high-growth start-ups or early stage companies.

1. Most angel investors are current or retired executives, business owners or high net worth individuals who have the knowledge, expertise, and funds that help start-ups match up to industry standards.
2. They bear extremely high risk and are usually subject to dilution from future investment rounds.
3. They expect a very high return on investment.
4. Apart from investing funds, most angels provide proactive advice, guidance, industry connections and mentoring start-ups in its early days.
5. Their objective is to create great companies by providing value creation, and simultaneously helping investors realize a high return on investments.
6. They have a sharp inclination to keep abreast of current developments in a particular business arena, mentoring another generation of entrepreneurs by making use of their vast experience.

Question 10. When and how to seek Venture Capital Finance?
Answer: Entrepreneurs can typically seek venture capital to assist at any of the following four stages in the company’s development:
(i) Early stage financing this stage includes:
(a) Seed capital
(b) Pre-start up and start up
(c) Second-round financing

(a) Seed capital finance:

- It refers to the capital required by an entrepreneur for conducting research at pre-commercialization stage.
- During this stage, the entrepreneur has to convince the investor (VC) why his idea/product is worthwhile.
- The investor will investigate into the technical and the economical feasibility of the idea.
- In some cases, there is some.sort of prototype of the idea/product that is not fully developed or tested.
- As the risk element at this stage is very high, investor (VC) may deny to assist if he does not see any potential in the idea.
- Entrepreneur’s ability, technological skills and competencies are required to match with the market opportunities so as to successfully convince about product/idea’s feasibility to the venture capitalist.

(b) Start up finance:

- If the idea/product/process is qualified for further investigation and/or investment, the process will go to the second stage; this is also called the start-up stage.
- A business plan is presented by the entrepreneur to the VC firm. A management team is being formed to run the venture.
- If the company has a board of directors, a person from the VC firms will take seats at the board of directors.
- While the organisation is being set up, the idea/product gets its form.
- The prototype is being developed and fully tested.
- Sometimes, clients are being attracted for initial sales. The management-team stablishes a feasible production line to produce the product.
- The VC firm monitors the feasibility of the product and the capability of the management-team from the board of directors.

(c) Second-round financing:

- At this stage, the time comes the idea has been transformed into a product and is being produced and sold.
- This is the first encounter with the rest of the market, the competitors and attempt is to squeeze in the market and get some market share from the competitors.
- The entrepreneur, at this stage, needs assistance from the Venture Capitalist for expansion, modernization, diversification so that the economies of scale and stability could be attained.

(ii) Last stage financing/bridge/pre-public stage: In general, this is the last stage of the venture capital financing process. The main goal of this stage is for the venture to go public so that investors can exit the venture with a profit commensurate with the risk they have taken.
At this stage, the venture achieves a certain amount of market share. This gives the venture some opportunities for example:

- Merger with other companies.
- Keeping new competitors away from the market.
- Eliminate competitors.
- Development capital.

Question 11. When was SEBI established? What are the main aims of SEBI?
Answer:

1. SEBI was officially established by The Government of India in the year 1988 and given statutory powers in 1992 with SEBI Act, 1992 being passed by the Indian Parliament.
2. SEBI has it's Headquarter at the business district of Bandra Kurla Complex in Mumbai, and has Northem, Eastern, Southern and Western Regional Offices in New Delhi, Kolkata, Chennai and Ahmedabad respectively.
3. Initially, SEBI was a non-statutory body without any statutory power. However, in the year of 1995, SEBI was given additional statutory powers by the Government of India through an amendment to the Securities and Exchange Board of India Act, 1992. In April, 1998 the SEBI was constituted as the regulator of capital markets in India under a resolution-of the Government of India.
   SEBI's Establishment: SEBI was established as a supervising and regulatory body to curb certain malpractices and to promote the Securities Markets in India.

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