CHAPTER 2

Sources of Capital

SECTION - I
Long-term Sources of Capital

A Introduction

The sources from which capital are procured for a period of more than five years are called Long-term sources of capital. But at present, a redical change has been taken place of this concept. At present, the sources from which capital is procured for a period of more than one year are called Long-term sources. In this chapter, we shall discuss about different Long-term sources of capital.

B Preference Share Capital

Preference shares are those shares which carry two preferential rights as to receive dividend at a fixed rate before any dividend is paid on Equity shares and to return of capital at the time of liquidation of the company before equity shareholders. The capital which is collected by the sale of this type of shares is called **Preference share capital.** The Preference share capital is very attractive to the company as long-term source, because the owners of such share capital can not interfere on the control of the company as they have no voting rights. The characteristics, classification, advantages and disadvantages of such type of shares are discussed below :

- **Features of Preference Share :** The salient features of preference shares are —

(i) ***Fixed Dividend*** **:** The rate of dividend on Preference share is always fixed *i.e.*, the holders of this type of shares get dividend at a fixed rate whatever be the amount of profit of the company.

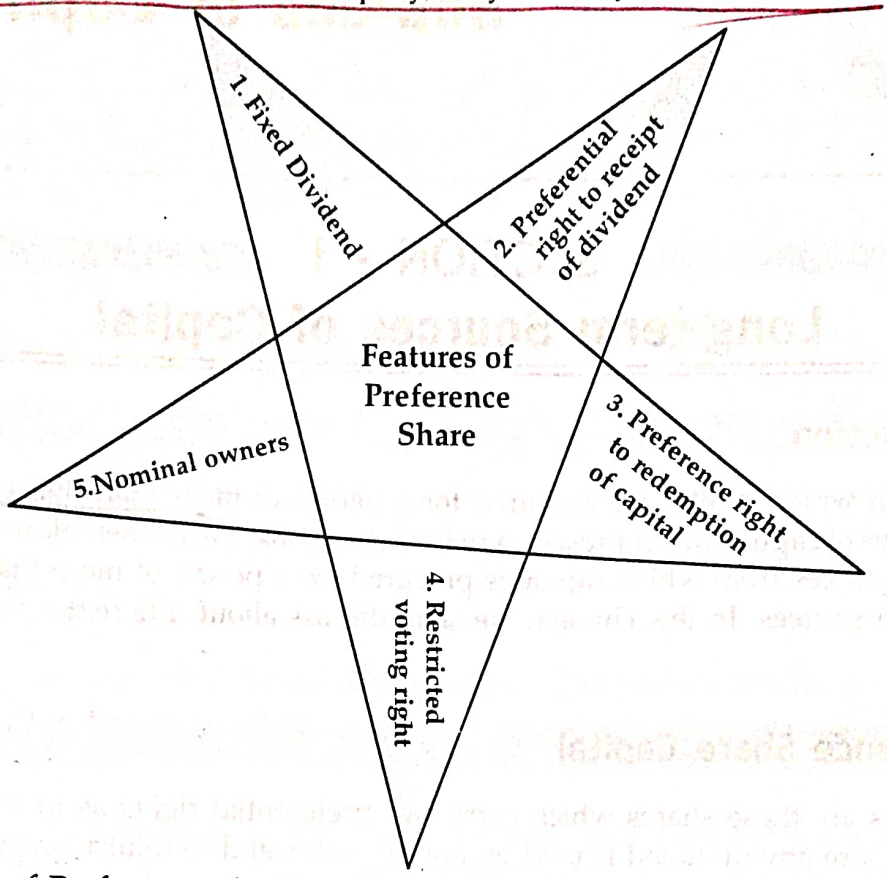
(ii) ***Preferential Right to receipt of Dividend*** **:** The preference shareholders enjoy preferential rights to receive dividend *i.e.*, they are paid dividend from the profit of the company before giving any dividend to the equity shareholders.

(iii) ***Preferential Right to Redemption of Capital*** **:** The preference shareholders enjoy preferential right to get back their capital *i.e.* the preference shareholders are paid back their capital ahead of equity shareholders in the event of liquidation of the company.

(iv) ***Restricted Voting Right*** **:** The preference shareholders have the limited voting right. According to section 87 of the Companies Act, they can cast their votes only for those matters in which they have their interest.

(v) ***Nominal Owner*** **:** Those who carry all the risk of the business and who have absolute controlling power on its affairs are considered as the owners of the business. The preference shareholders get dividend at fixed rate and they enjoy the preferential right

to get back their capital at the time of liquidation of the company but they don't have any right to interfere in the administration and control of the company. So, they are not treated as real owners of the company, they are only nominal owners.



- **Classification of Preference Share :** There are eight types of preference share, which are —

(i) ***Redeemable Preference Share*** **:** If the money received on Preference share has to be repaid after a stipulated period in accordance with the term of issue, the shares are known as **Redeemable Preference Shares.**

(ii) ***Irredeemable Preference Share*** **:** Irredeemable Preference Shares are those Preference shares which are not redeemed before the winding up of the company.

(iii) ***Convertible Preference Share*** **:** The preference shares which can be converted into Equity Shares after a particular period of time according to the terms of issue, are called **Convertible Preference Shares.**

(iv) ***Non-convertible Preference Share*** **:** The preference shares which can not be converted into Equity Shares, are known as **Non-convertible Preference Shares.**

(v) ***Cumulative Preference Share*** **:** The preference shares on which the arrears of dividend go on accumulating if the company is unable to pay dividends in any year(s) and such arrears are paid before paying any dividend on equity shares, are called **Cumulative Preference Shares.**

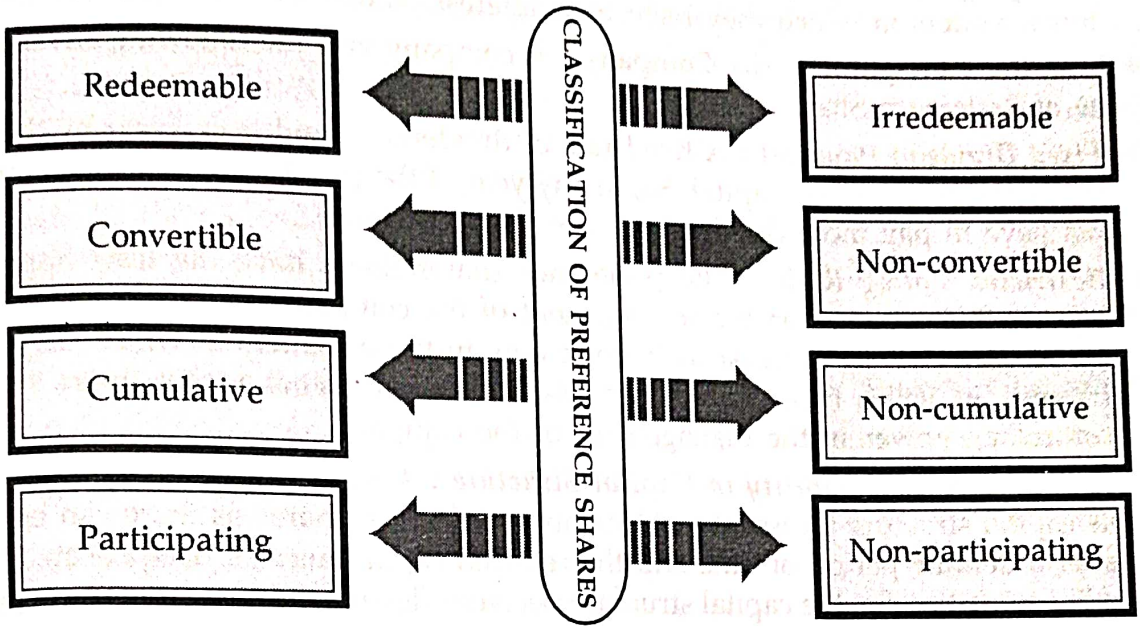
(vi) ***Non-cumulative Preference Share*** **:** The preference share on which the arrears of dividend do not go on accumulating if the company is unable to pay dividend in any year and such arrears are lapsed in the same year when those are accrued, are called **Non-cumulative Preference Shares.**

(vii) ***Participating Preference Share*** **:** The preference shares which enjoy the right to participate in surplus profits after paying dividend to equity shareholders and also in surplus assets

available at the time of liquidation of the company after refund of paid up value of equity shares and preference shares, are called **Participating Preference Shares**.

(viii) ***Non-participating Preference Share*** : The preference shares which are entitled only to a fixed rate of dividend and do not enjoy the right to participate in any surplus profit or surplus assets, are called **Non-participating Preference Shares**.

The classification of Preference Shares is shown below with the help of the following diagram.



Advantages and Disadvantages of Preference Share

■ **Advantages :** The advantages of preference share may be discussed from two view-points, *viz., (a) from the view-point of the Shareholders* and *(b) from the view-point of the Company*. The Advantages of Preference Share are discussed below :

● **From the view-point of the Shareholders :** The preference shareholders enjoy the following advantages if they invest their funds in Preference Share :

(i) ***Fixed Dividend*** : The rate of dividend on preference shares is fixed. So, the owners of this type of share get a fixed dividend every year whatever may be the amount of profit of the company. So, they remain confirmed regarding the return on their investment.

(ii) ***Low Risk*** : As there is certainty about getting dividend of fixed amount or at a fixed rate, the risk associated with the investment is less. Moreover, the shareholders do not have to bear the losses of the company like the equity shareholders and they enjoy the preferential right to get back their capital in the event of liquidation of the company. So, investment in this type of shares is less risky.

(iii) ***Safety in investment*** : The holders of Redeemable Preference Shares remain confirmed regarding getting back of their invested amount after a certain period of time. Again, if the company goes into liquidation under any circumstances, the preference shareholders are paid back their capital ahead of equity shareholders. So, investment in Preference shares is more safe than Equity shares.

(iv) ***Good investment in the time of Depression*** : At the time of depression, the market rate of interest gradually decreases. But the rate of dividend on preference share is fixed. So, the shareholders of this type of shares do not have any loss at the time of depression.

That is why, investment in preference shares is considered as a good investment at the time of depression.

(v) ***Fulfilment of desires of the investors*** : Every investor expects safety of his investment and regular dividend on the investment. The investment in this type of shares is safer than investment in equity shares and a regular return is obtained on the investment in Preference share. So, this type of investment can fulfil the desires of the investors.

(vi) ***Voting right for safety of interest*** : The preference shareholders can cast their votes in those matters in which they have their interest. Thus their interest is safeguarded.

- **From the view-point of the Company :** A company gets the following advantages from the issue of Preference Shares :

(i) ***Fixed Dividend Payment*** : A fixed rate of dividend is paid every year by the company on its preference share capital. So, in any year, if the profit increases, the company does not have to pay more dividend on this share capital.

(ii) ***Restricted Voting Right*** : The preference shareholders have the least opportunity to express their opinion on the management of the company. Because their voting rights are restricted. They can cast their votes only in those matters in which they have their interest. So, if this type of shares are issued, there remains no possibility of losing the controlling power in the management of the company.

(iii) ***Maintenance of Flexibility in Capital Structure*** : A company can maintain flexibility in its capital structure by issuing redeemable preference shares as these can be redeemed after a definite period of time and the reduced capital may be compensated by issuing other securities. So, the capital structure becomes flexible if this type of shares are issued.

(iv) ***Conservation of Bailable Assets*** : The company need not mortgage any asset for collecting capital by issuing this type of share. So, it enables the company to conserve mortgageable assets. As a result, when additional capital is needed, the company can easily collect it by mortgaging the assets.

(v) ***Possibility of Trading on Equity*** : The rate of dividend payable on preference share capital is less than the normal rate of return on capital employed of the company. So, trading on equity is possible by issuing such type of shares.

(vi) ***Enhancing the Credit-worthiness*** : The credit-worthiness of a firm depends largely on debt-equity ratio. The preference share capital is considered as a part of equity while calculating the debt-equity ratio. Again, the equity is the numerator of the debt-equity ratio. So, the preference share capital increases the debt-equity ratio. Hence, it enhances the credit-worthiness of the firm.

■ **Disadvantages :** Like advantages, disadvantages of Preference Share Capital may also be discussed from two view-points, *viz., (a) from the view-point of the Shareholders* and *(b) from the view-points of the Company.* The dis-advantages of Preference Share are discussed below :

- **From the view-point of Shareholders :** The disadvantages of preference shares from the view-point of the shareholders are —

(i) ***Possibility of receiving Lower Dividend*** : The rate of dividend on preference shares is fixed. So, if the company earns huge profit in any year, the preference shareholders do not get anything in excess over their fixed dividend.

(ii) ***Restricted Voting Right*** : Preference shareholders have the limited voting rights. They can enjoy the voting rights only for those matters in which they have their interest. So, though they invest enough capital in the company, they are not given status equal to the equity shareholders.

(iii) ***Nominal Owner*** : Every owner has full controlling capacity on his business. But the preference shareholders have no controlling capacity on the affairs of the company and they can not participate in the management of the business. So, they are merely nominal owners of the company.

(iv) ***No Guarantee of Assets*** : A company does not provide security to the preference shareholders as is made in the case of Debentureholders. Thus, their interests are not protected by the assets of the company.

- **From the view-point of the Company :** The disadvantages of Preference shares from the view-point of the Company are —

(i) ***Costly and Complexity*** : The method of raising finance by issue of preference shares is complex as well as costly. So many rules, regulations and procedures are required to be followed for issuing preference shares.

(ii) ***Payment of Dividend inspite of Incurring Loss*** : If a company runs at a profit and is able to earn adequate amount of profit, there will be no difficulty in paying dividends at a fixed rate to the preference shareholders. But unfortunately if, in any year, the company incurs loss, still has to pay dividend for that year also at the fixed rate. In that case the company suffers another burden of more losses which is absolutely unwanted.

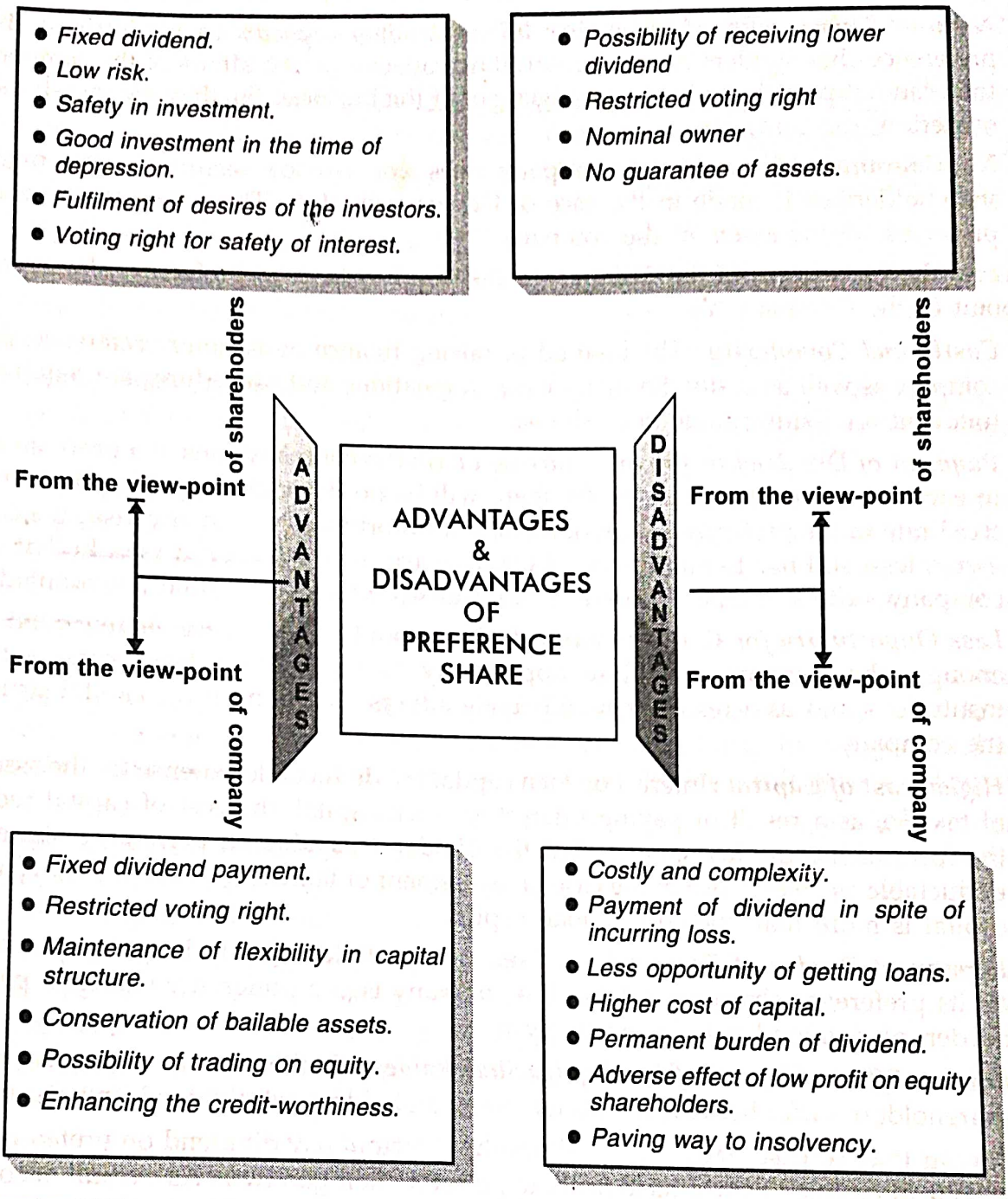
(iii) ***Less Opportunity for Getting Loans*** : If the amount of preference share capital is large enough, the company may lose opportunity of raising loan from various financial institutions and as a result, this will create adverse reaction on the capital structure of the company.

(iv) ***Higher cost of Capital*** : Interest on loan capital is a deductable expense for the assessment of tax. So, as a result of paying interest on such capital, the cost of capital reduces in the form of income tax savings. But the dividend payable on preference shares is not deductable as an expense in the case of assessment of tax. So, the cost of preference share capital is more than the cost of loan capital.

(v) ***Permanent Burden of Dividend*** : A fixed rate of dividend is to be paid by a company on its preference share capital. So, if a company issues preference shares, a permanent burden of dividend is to be borne by it.

(vi) ***Adverse Effect of Low Profit on Equity Shareholders*** : In the case of less profits, the Equity shareholders suffer because the preference shareholders get dividend first at a fixed rate.

(vii) **Paving Way to Insolvency :** Sometimes the directors pay dividend on preference shares in spite of having low profits in order to preserve their goodwill. As a result of continuous payment of dividends under such condition, the possibility of insolvency of the company gradually increases.



C Equity Share Capital

According to section 85 (2) of the Indian Companies Act, 1956, those shares which are not Preference shares, are called the Equity shares. From this definition, it is clear that the equity shareholders do not get preferential rights in respect of receiving dividend and getting back capital as preference shareholders. This means, the equity shareholders get dividend after payment of dividend to the preference shareholders and get back capital after payment of the dues to the preference shareholders.

On the basis of the above discussion, ***it can be said that the owners of that type of shares are paid dividend after paying dividend to the preference shareholders and paid back their capital after repaying the capital of the preference shareholders at the time of liquidation of the company, such shares are called Equity Shares. The capital which is collected by a company by sale of this type of shares is called Equity Share Capital.***

■ **Features of Equity Share :** The salient features of Equity shares are —

(i) ***Ownership*** **:** Those who carry all the risks of their business and who have absolute controlling power on its affairs are considered the owners of the business. The equity shareholders carry all the risks of the company and they have absolute controlling power on its affairs. So, those who purchase equity shares, they are the owners of the company.

(ii) ***Uncertain Return*** **:** Return on equity shares is called dividend. But the rate of dividend on equity shares is not fixed. It depends on the amount of profits earned by the company. Generally, if the amount of profit goes high, then the dividend also is declared high and vice-versa.

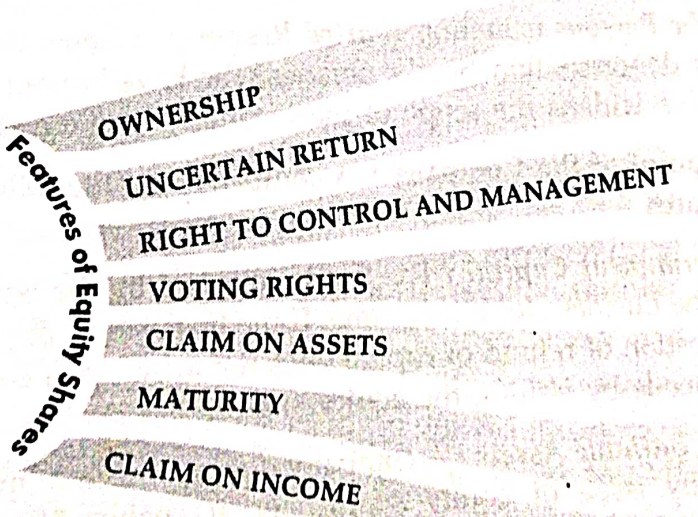
(iii) ***Right to Control and Management*** **:** Administration and control of a company lies in the hand of its equity shareholders. The equity shareholders elect directors by their voting rights in order to form Board of Directors. The company's major policies and decisions are approved of by the Board of Directors while day-to-day operational activities are carried out by managers appointed by the Board.

(iv) ***Voting Rights*** **:** The equity shareholders are required to cast their votes for taking decisions on a number of important matters, such as, Election of Directors, change in Memorandum of Association, change in Objectives of Business etc. An equity shareholder has the voting right upto the number of shares held by him. It can be mentioned in this context that the shareholders may cast their votes in person or by proxy.

(v) ***Claim of Assets*** **:** The equity shareholders are the last claimants to assets of the company. In the event of liquidation of the company, the realised amount from the assets are distributed to the lenders first and then to Preference shareholders and the rest, if any, are distributed to the Equity shareholders.

(vi) ***Maturity*** **:** The money collected by the issue of equity shares is invested in the business for a long period. The shares can not be redeemed in the life span of the company. Thus, if the business of the company is not wound up, then the question of refund of capital does not arise.

(vii) ***Claim on income*** **:** The equity shareholders are the last claimants to incomes of the company though they first provide capital. Out of the incomes of the company, at first, the company pays off the interest on loan capital, then to the corporate tax and preference dividend and finally the balance, if any, would be distributed to the Equity shareholders.



Advantages and Disadvantages of Equity Share

■ **Advantages :** The advantages of Equity shares can be discussed from two view-points, *viz.*, *(a) from the view-point of the Shareholders* and *(b) from the view-point of the Company*. The advantages of Equity share from these view-points are discussed below :

• **From the view-point of the Shareholders :** The Equity shareholders enjoy the following advantages if they invest their funds in Equity share :

(i) ***High Dividend*** **:** The rate of dividend on equity share is not fixed. It depends on the amount of profits earned by the company. So, if the company earns more profit then the equity shareholders will be given more dividend.

(ii) ***Increase in the Value of Share*** **:** When a company carries on its business successfully, it is expected that the company would earn a fat amount of profit. In that case the company obviously declares higher dividend to the equity shareholders. As a result, the goodwill of the company as well as the market price of its share will be increased.

(iii) ***Ownership*** **:** Investment of funds in equity shares of a company provides the investors with a scope of becoming the owner of that company. This facility is not available in case of other investments.

(iv) ***Scope of Capital Gain*** **:** If a company carries on its activities successfully and pays dividend on its equity shares at a high rate, the market price of equity shares of the company increases quickly. In such a case, the equity shareholders can transfer their holding at a high price and earn a substantial amount of capital gain. The scope of getting such capital gain is least possible in case of other investment.

(v) ***Participation in Management*** **:** The equity shareholders have voting rights or rights on control over the affairs of the company. They can express their individual opinion in making decisions for the management of the company by their voting rights and can participate in the management of the company.

(vi) ***Chance of getting Bonus Shares and Right Shares*** **:** Only the equity shareholders enjoy the right to get bonus shares. When a company issues bonus shares among its existing shareholders, the equity shareholders get these shares without investing anything. Again, when a company issues right shares, the equity shareholders get the right of purchasing the new share at a lower price.

(vii) ***Attraction to the Persons who have limited Resources*** **:** Generally, the equity shares are mostly of lower denomination. So, the persons who have limited resources can purchase these shares. This widens the scope of marketability of these shares.

• **From the view-point of the Company :** A company gets the following advantages from the issue of equity shares :

(i) ***Financing of Permanent Capital*** **:** The funds collected by the issue of equity shares can be invested in the business for a long-time. If the business of the company is not wound up, then the question of refund of capital does not arise. So, a company fulfils the long-term financial needs by issuing the equity shares.

(ii) ***Conservation of Bailable Assets*** **:** A company does not need of mortgaging any asset for raising capital by issue of equity shares. So, it enables the company to conserve mortgageable assets. As a result of it, when additional capital is needed, the company can easily procure it by mortgaging the assets.

(iii) ***Help for Securing Loan*** : The lenders do not hesitate to provide loan to the company who has huge amount of equity share capital. Because, they know, if the company goes into liquidation in any circumstance, they will get back their capital ahead of equity share-holders. So, the larger the amount of equity share capital, the greater the security to the lenders and hence they agree to provide loan to the company on favourable terms.

(iv) ***Absence of Fixed Charge*** : The rate of dividend on equity shares is not fixed. It depends on the amount of profits of the company and the discretion of the directors. So, the company has no obligation to pay dividend on its equity shares if there is inadequate profits or losses.

(v) ***Stability in Control*** : The more the equity share capital, the less is the interference of the lenders on the affairs of the company. As a result, the controlling system of the company becomes stable and the way of expanding the business is widened.

■ **Disadvantages :** Like advantages, the disadvantages of equity share may be discussed from the view-points of the shareholders and the company. The disadvantages of this type of shares from these two view-points are discussed below :

From the view-point of the shareholders : The disadvantages of equity shares from the view-point of the shareholders are —

(i) ***Taking all the Risks*** : The equity shareholders are the real owners of the company. So, they have to bear all the risks of the company. That is why, the investment in equity shares is highly risky.

(ii) ***Uncertain Return*** : The equity shareholders do not get dividend at a fixed rate on their investment. If the company is able to earn sufficient profits, the shareholders get dividend, otherwise not. So, the shareholders do not expect a certain amount of return on their investment in this type of shares.

(iii) ***Possibility of Capital Loss*** : If the rate of dividend on equity shares is reduced for any reason or if there is a depression in the market, the market price of equity shares reduces. As a result of it, there is a possibility of capital loss.

(iv) ***Risk of Refunding Capital*** : The investors can not get back their invested money without selling the shares at any time other than the time of liquidation of the company. Again, at the time of liquidation of the company, if there remains any surplus after the payment of all liabilities and of the dues to the preference shareholders, only then the surplus amount will be distributed among the equity shareholders. But if there is no surplus, the equity shareholders do not get anything. So, the equity shareholders always have to bear a risk regarding getting back their invested money.

(v) ***Long Waiting Period*** : The newly formed companies have to bear various expenses relating to the formation of the company. So, it is not possible for a newly formed company to pay dividend to its equity shareholders at the first year of the commencement of business. As a result, the equity shareholders have to wait for a long-time regarding the receipt of dividend.

(vi) ***Not Attractable to all the Investors*** : Investment in equity shares is highly risky and the rate of return on such investment is not fixed. So, the investors who do not want to take more risk and expect a minimum regular income dislike to invest their funds in equity shares.

- **From the view-point of the Company :** The disadvantages of equity shares from the view-point of the company are —

(i) ***Trading on Equity is not Possible*** **:** A company can not trade on equity if equity shares alone are issued. Trading on equity is possible only when fixed interest / dividend bearing securities are issued alongwith the equity shares and the rate of interest / dividend on such securities is less than the rate of return on capital employed of the company.

(ii) ***Costly Raising of Rinance*** **:** So many rules and regulations are required to be followed by a company for issuing equity shares. So, raising of finance by issuing equity shares is a time-consuming and cost-consuming matters.

(iii) ***High Cost of Capital*** **:** Interest on debt-capital is a deductable expense for discharging tax liability. But the dividend payable on equity shares is not a deductable expenses for computation of tax liability. Again, investment in equity shares is more risky than investment in debt-capital. So, the equity shareholders expect comparatively a high rate of dividend. Hence, naturally, the cost of equity share capital is more than the cost of debt-capital.

(iv) ***Creation of Problem in Management*** **:** As the equity shareholders have voting rights, they can create obstacles, at any times, in the management of the company by putting their voting rights in order to fulfil their interest. 'Holding' is such an example.

(v) ***Problem of Over-capitalisation*** **:** If a company raises its capital through issue of equity shares much more than its actual need then a part of raised capital will remain idle. In that case the return on investment will come down and the investors will be looser and the company will face the problem of over-capitalisation. If the amount of capital is too much, a part there of many remains idle and as a result, the rate of return on capital employed is reduced. So, if high amount of capital is procured by a company through issue of equity shares, it may face the problem of over-capitalisation.

(vi) ***Groupism in Management*** **:** It is often found that the equity shareholders involve in groupism for hankering after power and position in the management. This may create difficulties for sound management.

(vii) ***Problem of Change in Management System*** **:** The ownership of the company is changed through buying and selling of equity shares. Due to such change in ownership, the management system of the company also changes. The frequent changes in the management may bring dissatisfaction among the workers, investor, creditors, etc. and for which they may lose their faith on the company.

(viii) ***Speculation*** **:** Equity shares of good companies are subject to a lot of speculation in the share market. As a result, the price of this type of shares are fluctuated frequently. It is not favourable to the interest of the company.

- *High dividend.*
- *Increase in the value of share.*
- *Ownership.*
- *Scope of capital gain*
- *Participation in Management.*
- *Chance of getting bonus shares and right shares.*
- *Attraction to the persons who have limited resources.*

- *Taking all the risks.*
- *Uncertain Return.*
- *Possibility of capital loss.*
- *Risk of refunding capital.*
- *Long waiting period.*
- *Not attractable to all the investors.*

ADVANTAGES & DISADVANTAGES OF EQUITY SHARE

ADVANTAGES

From the view-point of the shareholders

From the view-point of the company

DISADVANTAGES

From the view-point of the shareholders

From the view-point of the company

- *Financing of permanent capital.*
- *Conservation of bailable assets.*
- *Help for securing loan.*
- *Absence of fixed charge.*
- *Stability in control.*

- *Trading on equity is not possible*
- *Costly raising of finance.*
- *High cost of capital.*
- *Creation of problem in management.*
- *Problem of over-capitalisation.*
- *Groupism in management.*
- *Problem of change in management system.*
- *Speculation*

C.1. Differences between Equity Share and Preference Share

Subject	Equity Share	Preference Share
(i) **Rate of dividend**	The rate of dividend on equity share is not fixed.	The rate of dividend on preference share is fixed.
(ii) **Right of receiving the dividend**	Dividend is paid on equity shares after payment of dividend on Preference shares. So, the equity shareholders get dividend after the preference shareholders.	Dividend is paid on preference shares before payment of dividend on equity shares. So, the preference shareholders get dividend before the equity shareholders.
(iii) **Voting Right**	The equity shareholders can cast vote in case of taking decision for any matter of the company.	The preference shareholders can cast vote only for those matters in which they have their interest.

(iv) **Classification**	There are only one type of equity shares *i.e.*, it has no classification.	There are eight types of Preference share, such as Redeemable and Irredeemable ; Convertible and Non-convertible ; Cumulative and Non-cumulative and Participating and Non-participating.
(v) **Face Value**	The face value of equity shares is generally lower than the preference shares.	The face value of preference share is generally more than the equity shares.
(vi) **Redemption**	The equity shares can never be redeemed other than the time of liquidation of the company and at the time of liquidation of the company, the equity shares are redeemed after paying off the claim of the preference shareholders.	The redeemable preference shares are redeemed after the expiry of a certain period and at the time of liquidation of the company, the preference shares are redeemed before redemption of equity share capital.
vii) **Risk**	The equity shareholders have to bear all the risks of the business. So, their risk is very high.	The risk to the preference shareholders is comparatively less.
(viii) **Receipt of Bonus shares**	The equity shareholders can get bonus shares.	The preference shareholders can never get bonus shares.
(ix) **Right to elect the directors**	The equity shareholders can elect the directors of the company.	The preference shareholders can not elect the directors of the company.
(x) **Compulsion of issue**	It is compulsory for every company to issue equity shares.	Issue of preference shares is not compulsory. It depends on the discretion of the company.
(xi) **Choice**	Those who do not hesitate to take risk for high rate of return like to invest in this type of share.	Those who expect a regular dividend and do not want to take more risk like to invest in this type of share.
(xii) **Outstanding dividend**	No dividend is to be paid on equity shares if there is no profit. So, dividend on equity shares never remains outstanding.	If dividend on preference shares is not paid, then it remains outstanding year after year.

C.2. Classification of Equity Share

An existing company can issue equity shares in three ways. On the basis of such issuing procedures, the equity shares are classified under the following three categories :

1. Right Share ;
2. Bonus Share ; and
3. Sweat Share.

These are being discussed below :

D Right Share

Right share is not an special type of share. In fact, it is equity or preference share. When an existing company intends to issue new shares, the company gives right to its existing shareholders to purchase the new shares in proportion to their holdings. In such a case, if a shareholder

purchases shares on the basis of the right given to him by the company, then such shares are known as **Right Shares. According to Section 80 (1) of the Indian Companies Act,** when an existing public limited company intends to issue new shares at any time after the expiry of two years from the date of formation of the company or of one year after the first allotment of shares, whichever is earlier, the existing shareholders of the company will get preference to purchase these shares. When the existing shareholders are offered such preferential right to purchase these shares, the shares so purchased by them on the basis of such right is called **Right Shares.** Thus we can say in brief — ***When a shareholder purchases new shares on the basis of right of the shares already held by him, such new shares are called Right Shares.***

- **Features of Right Shares :** The salient features of right shares are —

(i) **Not a Special Type of Share :** Right shares do not refer to any special type of shares. Actually, it is either equity or preference share.

(ii) **Time of Issuing the Share :** A company can issue right share at any time after the expiry of two years from the date of formation of the company or of one year after the first allotment of shares in that company, whichever is earlier.

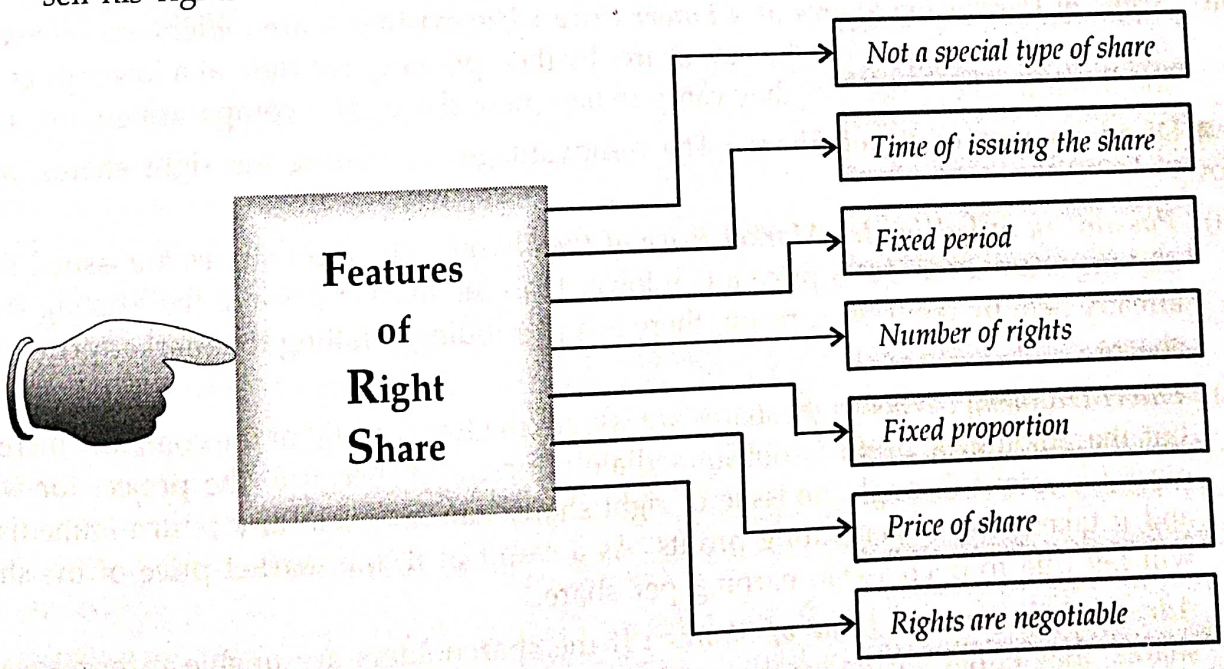
(iii) **Fixed Period :** Right shares can be exercised only within a fixed period which is usually about 30 days.

(iv) **Number of Rights :** A shareholder gets right equivalent to the number of shares held by him. This means, if a shareholder holds 50 shares, he will get 50 rights.

(v) **Fixed Proportion :** An existing shareholder is offered to purchase new shares at a fixed proportion on the basis of his pre-emptive right. This means, a certain number of rights are required for purchasing a new share. For example, suppose 5 rights are required for subscribing one share. In such a case, a shareholder, who has been given 50 rights, can subscribe to $\left(50 \times \frac{1}{5}\right)$ or, 10 new shares.

(vi) **Price of Share :** Generally, the right shares are issued to the existing shareholders at par or at a premium but much below than the market price.

(vii) **Rights are Negotiable :** The shareholder who gets rights for subscribing new shares can sell his rights.



■ **Advantages of Right share :** The advantages of issuing the right shares can be discussed from two view-points, such as, from the view-point of the company and the shareholders. The advantages of right share are discussed below from these two view-points :

● **From the view-point of the Company :** The advantages of right share from the view-point of the company are :

(i) ***Stability in Control*** : If right shares are issued to the existing shareholders, a new shareholder can not participate in the ownership of the company. As a result, the controlling power remains in the hands of the existing shareholders. So, the controlling system of the company is stable.

(ii) ***Less Costly*** : The cost of issue of right shares is lower than the cost of issue of non-right shares. So, the cost of issuing the right share is less.

(iii) ***Wilful Reception*** : When a company gives scopes to its existing shareholders to subscribe new shares by their pre-emptive right, a good impression is created about the company in the minds of the existing shareholders.

(iv) ***Quick Financing*** : Generally the existing shareholders are required to purchase new shares by their pre-emptive right within 15 days. So, financing can be raised very quickly through issue of right shares.

(v) ***Increase in Financial Status*** : If the existing shareholders accept the right shares enthusiastically, it proves that the financial position of the company is very sound. So, the issue of right shares increases the financial status of the company. In such a case, if the company wants to take loan, it can easily get the loan at a favourable rate of interest.

● **From the view-point of Shareholders :** The advantages of right shares from the view-point of the shareholders are :

(i) ***Stability in Control*** : As the existing shareholders can purchase new shares by their pre-emptive right, no new shareholder is created by the company. As a result, the existing shareholders are able to maintain their controlling capacity in the company.

(ii) ***Chance of Additional Income*** : The existing shareholders can sell their right to other if they do not want to subscribe new shares by their pre-emptive right. As a result of it, they can earn additional income without any further investment.

(iii) ***Scope of Purchasing Shares at a Lower Price*** : The existing shareholders are offered the opportunity of purchasing the new shares by their pre-emptive right at a lower price than the usual market price. So, they can purchase new shares at a comparatively low price.

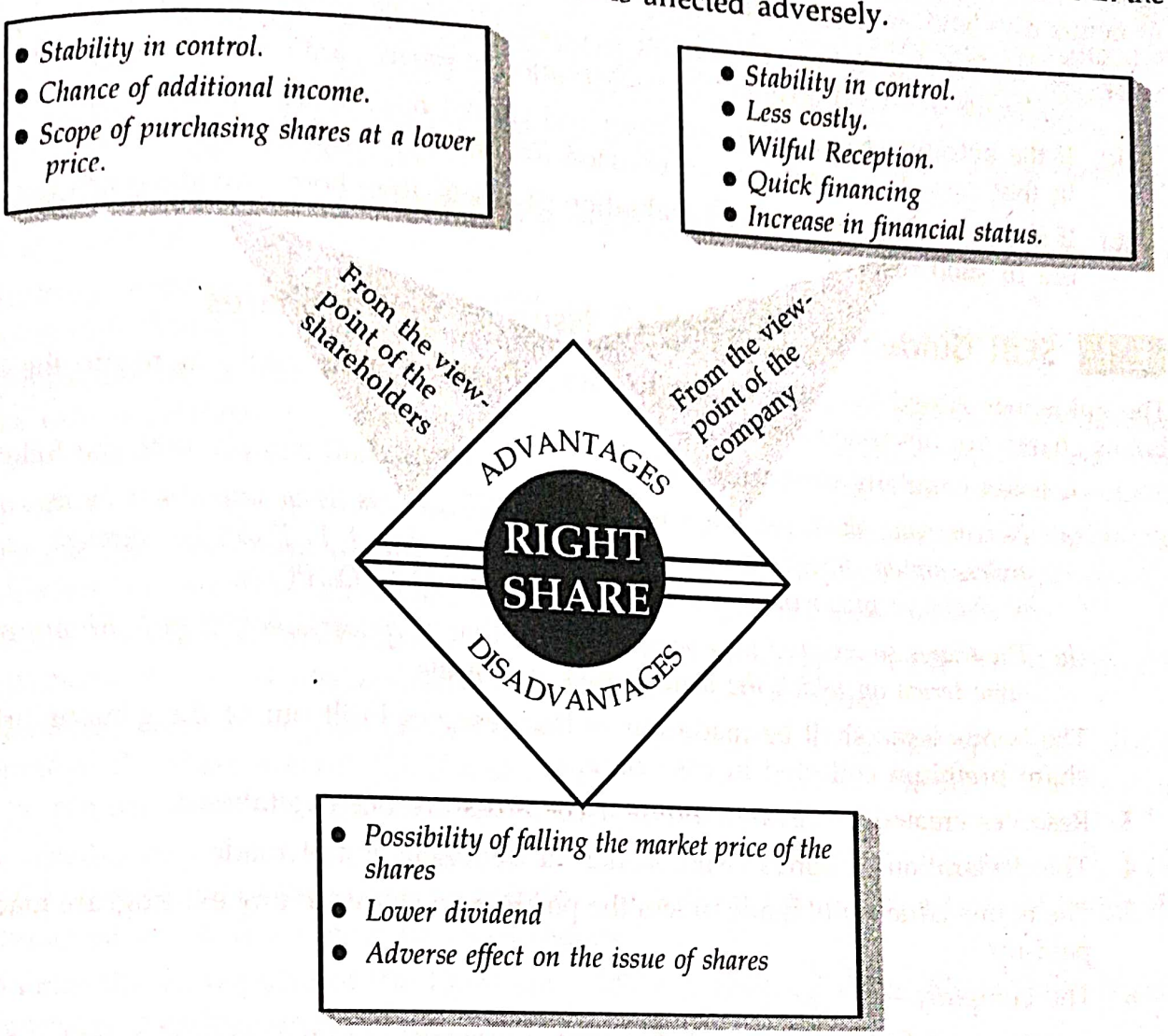
■ **Disadvantages of Right Share :** The disadvantages of issuing the right shares are as follows :

(i) ***Possibility of Falling the Market Price of the Shares*** : The right shares are issued to the existing shareholders at a price much lower than the market price of the existing shares already held by them. As a result, there is a possibility of falling the market price of the shares.

(ii) ***Lower Dividend*** : When right shares are issued, the total capital of the company increases but the amount of profit is not immediately increased. Because, the project for which capital is raised through the issue of right shares can not yield any return immediately and it takes time in generating profits. As a result of it, the market price of the shares will fall due to decrease in earning per share.

(iii) ***Adverse Effect on the Issue of Shares*** : If the shareholders are unable to purchase the shares, they either surrender their rights or renounce them in favour of their nominee.

But, if any reason, the nominees surrender such shares, these shares are available in the market and the marketability of the shares is affected adversely.



E Bonus Share

A process of converting the accumulated profits into capital is the issuing bonus share. The bonus share does not refer to any special type of share. When a company issues equity shares to its existing shareholders as bonus dividend, the equity shares are called Bonus Shares. When a large amount of reserves is created in the hand of a company, the company can able to pay dividend from such reserves according to the rule of its articles of association. Such type of dividend is called **Bonus dividend**. A company can pay bonus dividend in two ways :

Firstly, bonus dividend can be paid through conversion of partly paid up shares into fully paid up without realising any money from the shareholders.

Secondly, it can be paid through issue of fresh fully paid up shares among the existing shareholders at a free of cost. When shares are issued, in such a way, at a free of cost, the shares are called Bonus Shares. Thus it can be said, ***when a company issues equity shares as bonus dividend to its existing shareholders in proportion to their holdings at a free of cost, the equity shares are known as Bonus Shares.***

■ **Different sources of Bonus Dividend :** The reserves which can be used for issuing bonus shares are—(i) Capital redemption reserve, (ii) Securities premium, (iii) Capital reserve, (iv) Any

E.2. Advantages and Disadvantages of issuing Bonus share

■ **Advantages :** The advantages of issuing the bonus share can be discussed from two view-points, *viz., (a) from the view-point of the company* and *(b) from the view-point of the shareholders.* The advantages of issuing such share are discussed below from these two view-points :

● **From the view-point of the Company :** The advantages of issuing the bonus share from the view-point of the company are —

Firstly, dividend can be paid by issuing the bonus share without reducing any asset or working capital of the company.

Secondly, consequent to the issue of bonus share, it is possible to bring a consistency between the share capital and the actual capital employed in the business.

Thirdly, as a result of issuing the bonus share, the number of shares of the company increases. So, the rate of dividend per share is reduced. As a result of it, if the company pays a high dividend, then it will not be easily understood by the workers, customers and competitors.

Fourthly, if a company issues bonus shares, its goodwill will increase in the share market.

● **From the view-point of the Shareholders :** When a company issues bonus shares, its shareholders are benefited with the following advantages from such issue :

Firstly, the shareholders have to pay income tax on dividend if they receive it in cash. But they do not have to pay any tax on bonus shares received by them.

Secondly, when a company issues bonus share, it occupies a seat of dignity as a company of repute in the share market. So, if a shareholder of the company intends to sell his shares, then he can sell it very easily.

■ **Disadvantages :** Like advantages, the disadvantages of bonus share can also be discussed from the view-points of the company and the shareholders. The disadvantages of bonus share are discussed below from these two view-points :

● **From the view-point of the Company :** When a company issues bonus share, it suffers the following disadvantages —

Firstly, as a result of issuing the bonus shares, the number of shares of the company increase. So, the company has to earn more amount of profit in order to maintain the past rate of dividend per share. But it is very difficult for a company to increase its earning suddenly.

Secondly, a company is required to bring up various legal formalities for issuing the bonus shares, which are not necessary for paying dividend in cash.

● **From the view-point of the Shareholders :** As a result of issuing the bonus shares, the number of shares of a company is increased. So, the company has to earn additional profits in order to maintain the past rate of dividend per share. But if the company is unable to earn additional profit, then the rate of dividend per share reduces. As a result of it, the market price of the share may fall.

F Sweat Share

The amended Companies Act, 1999 has introduced a new section 79A regarding the issue of Sweat Shares. According to this section, if a company gets any benefit for taking possession of intellectual property or know-how or value addition from its employee or director, then it can issue equity shares to him at a discount or without any cash-consideration. When a company issues equity shares to any of its employee or director in such a way, such equity shares are called Sweat Shares. It can be mentioned in this regard that no new type of equity

shares are issued as sweat shares, these are the same type of equity shares which were already issued by the company. Thus, it can be said that—***When a company issues same type of equity shares, which have already been issued by it, to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value addition, the shares are called Sweat Shares.*** A company is required to follow certain conditions for issuing such type of shares. These conditions are —

(i) The issue of this type of shares must be authorised by a special resolution in the general meeting of the company. The following matters must be mentioned in that resolution —

(a) how many number of shares are to be issued ;

(b) how much is the market price of those shares ;

(c) at what price or consideration other than cash the shares are to be issued ; and

(d) to what sort of directors or employees such shares are to be issued.

(ii) Such type of share can be issued at least one year after the commencement of the business of the company.

(iii) The company, whose equity shares are listed on a recognised stock exchange, at the time of issuing the sweat shares, has to follow the guidelines given by the SEBI.

H Debenture

The next phase of issue of shares is the issue of debentures for meeting the requirement of long-term finance to a Joint Stock Company. A debenture is a document of recognition for the acceptance of loan. This document contains the seal and name of the company which accepts the loan. Apart from the recognition of the loan taken, it contains some other clauses, such as, rate of interest, time and condition for redemption of debt, whether the company has given any security for the debt etc. The company is required to pay interest on debentures at a fixed rate every year whether the company earns profit or not.

According to Section 2 (12) of the Indian Companies Act, 1956, the term 'debenture' means a *document of recognition containing the name and seal of the company, given to the lender of money in support of loan accepted by the company.*

Sir Alfred Palmer, a renowned lawyer has given the definition of debenture in this way —*It is such a document which contains the seal of the company and gives evidence of loan taken ; recognition of loan taken in its essence.*

In 1887 while giving the Judgement, **L. J. Chitti** told regarding debenture— *It is that type of document which creates credit or recognises credit. That document which fulfils the either of the condition, is called Debenture.*

According to **Prof. Naidu and Datta** —*A debenture is an instrument issued by a company under its common seal acknowledging a debt and setting forth the terms under which they are issued and are to be paid.*

According to **Elvyn Thomas** — the term debenture means *a document under the company's seal which provides for the repayment of principal sums and interest thereon at a regular interval which is usually secured by a fixed or floating charge on the company's property and which acknowledges loan of the company.*

On the basis of above discussion, we can say — ***The document which is issued by a company to its lender as a recognition for the acceptance of a long-term loan at a condition of paying fixed rate of interest with mentioning the rate of interest payable on the loan, time and condition for redemption of the loan, whether the company has given any security for such loan etc. is called Debenture.***

H.1. Characteristics of Debenture

The salient features of debenture are as follows :

(i) **Long-term Financing :** Debentures are issued by a company with a long maturity period in order to procure long-term capital. So, it is a source of long-term financing.

(ii) **Written Acknowledgment :** A debenture is issued by a company in the form of a certificate which is a written acknowledgement of a debt of the company.

(iii) **Rate of Interest :** Interest is paid on debenture at a fixed rate on a periodical basis such as annually, half-yearly, quarterly etc. It can be mentioned in this regard that debenture interest is tax deductible for computing the company's corporate tax.

(iv) **Security :** Debentures are either secured or unsecured. The secured debentures are issued against the mortgage of any asset of the company. On the other hand, no asset is mortgaged for issuing the unsecured debentures.

(v) **Voting Right :** The debentureholders do not have any right to vote at the general meeting of the company.

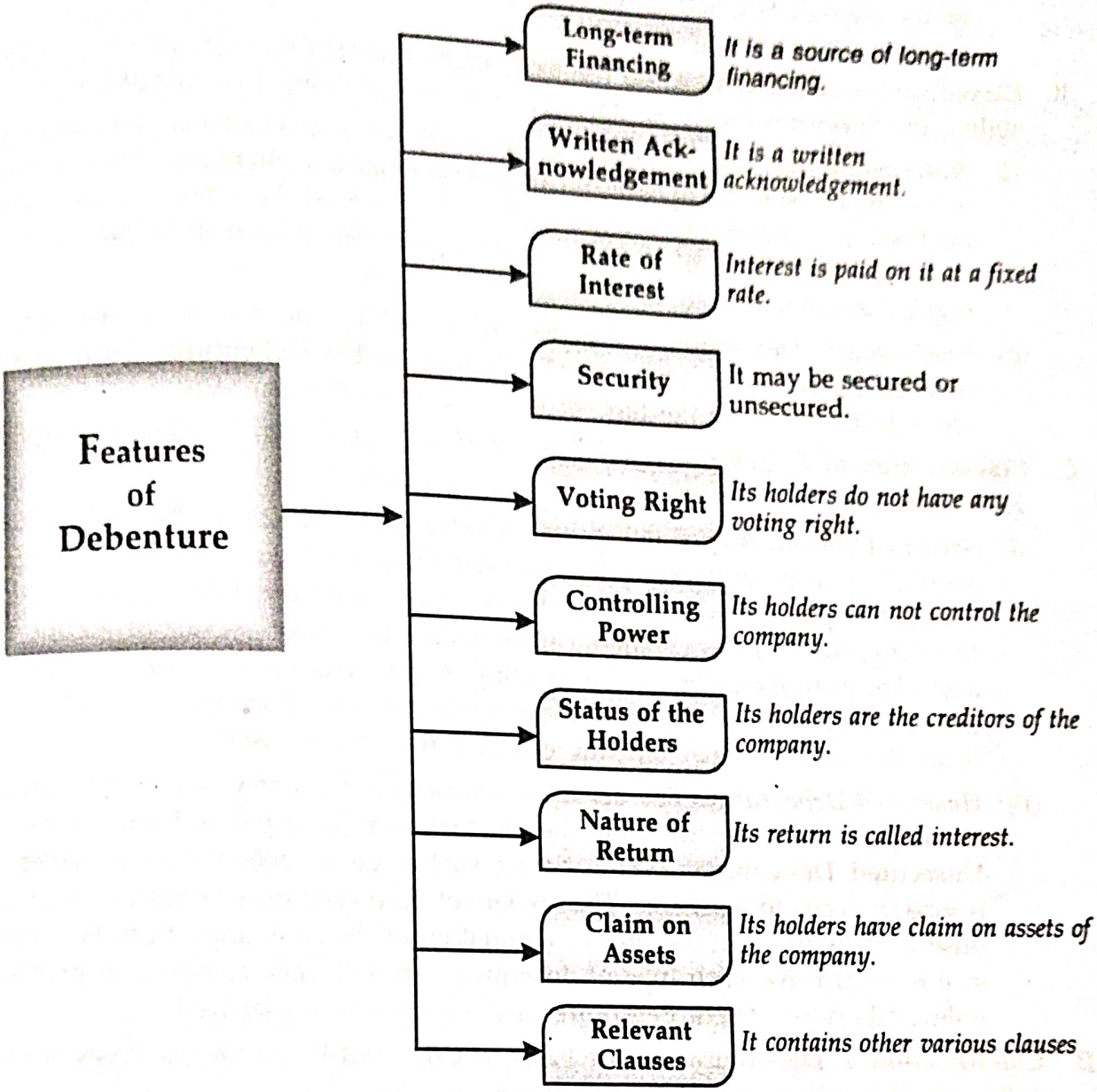
(vi) **Controlling Power :** The debentureholders do not have any controlling power because they have no right to vote for the election of directors and they do not have any right to know the determination of managerial policies.

(vii) **Status of the Holders :** The debentureholders are not the owners of the company. They provide loan to the company for a long period. So, they are the creditors of the company.

(viii) **Nature of Return :** The debentureholders get return on the amount invested in debentures in the form of interest. Such interest is paid to them before paying any dividend to the shareholders.

(ix) **Claim on Assets :** The debentureholders have priority over shareholders in respect of their claim on assets of the company. Such claim arises only at the time of liquidation of the company. If the company goes into liquidation for any reason, their dues are paid back before paying anything to the shareholders.

(x) **Relevant Clauses :** A debenture contains various clauses, such as the seal and name of the company, rate of interest, time and condition for redemption, whether the company has given any security for the debt or not etc.



H.2. Classification of Debentures

Debentures are classified in different ways from different angles, such as, on the basis of transferability, redeemability, security and finally on the basis of convertibility. These are discussed below :

A. **Classification of Debentures on the basis of Transferability :** On the basis of transferability, the debentures may be classified into the following two categories :

(i) ***Registered Debenture*** **:** Registered debentures are those debentures which are payable to only those persons whose names and addresses are recorded in the register of Debentureholders of the company. If a holder of such debentures transfers his holding to other, the transferee is required to submit an application to the company alongwith the requisite registration fee. When the directors grant this transfer, they remove the name of the transferor from the register and record the name of the transferee.

(ii) ***Bearer Debentures*** : Bearer Debentures are those debentures which are payable to the bearer or holder of the debentures. Such type of debenture does not require anything to be recorded in the register of the company and its ownership can easily be transferred. For transfer of such debenture, no transfer application needs to be submitted to the company.

B. Classification of Debentures on the basis of Redeemability : On the basis of redeemability, the debentures may be classified into the following two categories :

(i) ***Redeemable Debentures*** : The debentures which are redeemed after a certain period according to the terms of issue, is called **Redeemable Debentures**. There are various methods of redemption, such as—(a) redemption of the whole amount after the period of maturity ; (b) purchase and cancellation of own debentures ; or (c) by regular instalments.

(ii) ***Irredeemable Debentures*** : The debentures which are not redeemed before the winding up of the company, is called **Irredeemable Debentures**. Such debentures are redeemed only at the time of winding up of the company.

C. Classification of Debentures on the basis of Security : On the basis of security, the debentures may be classified into following two categories :

(i) ***Secured Debentures*** : The debentures which are issued against the mortgage of any asset of the company, are called **Secured Debentures**. In case if the company is unable to repay the debentures on the due date or on the date of liquidation of the company, the debentureholders can realise their money by sale of the mortgaged asset. The charge may be fixed or floating. A fixed charge is on particular assets and the company can not deal with these assets. On the other hand, a floating charge is on all assets and the company can deal with these assets.

(ii) ***Unsecured Debentures*** : The debentures which do not carry any specific charge on the assets of the company about the repayment of principal and interest, are called **Unsecured Debentures**. While issuing such type of debentures, no asset of the company needs to mortgage. The holders of such type of debentures are treated as unsecured creditors at the time of liquidation of the company. It can be mentioned in this regard that such type of debentures are not very common in practice and unless otherwise stated, debentures are assumed to be secured.

D. Classification of Debentures on the basis of Convertibility : On the basis of convertibility, the debentures may be of two types, such as :

(i) ***Convertible Debentures*** : The debentures which can be fully or partly converted into shares according to the option given to the debenture-holders at a specific rate after a specified period, are called **Convertible Debentures**.

(ii) ***Non-convertible Debentures*** : The debentures which can never be converted into shares are called **Non-convertible Debentures**.

In addition to the above classification, there are some other types of debentures, such as—

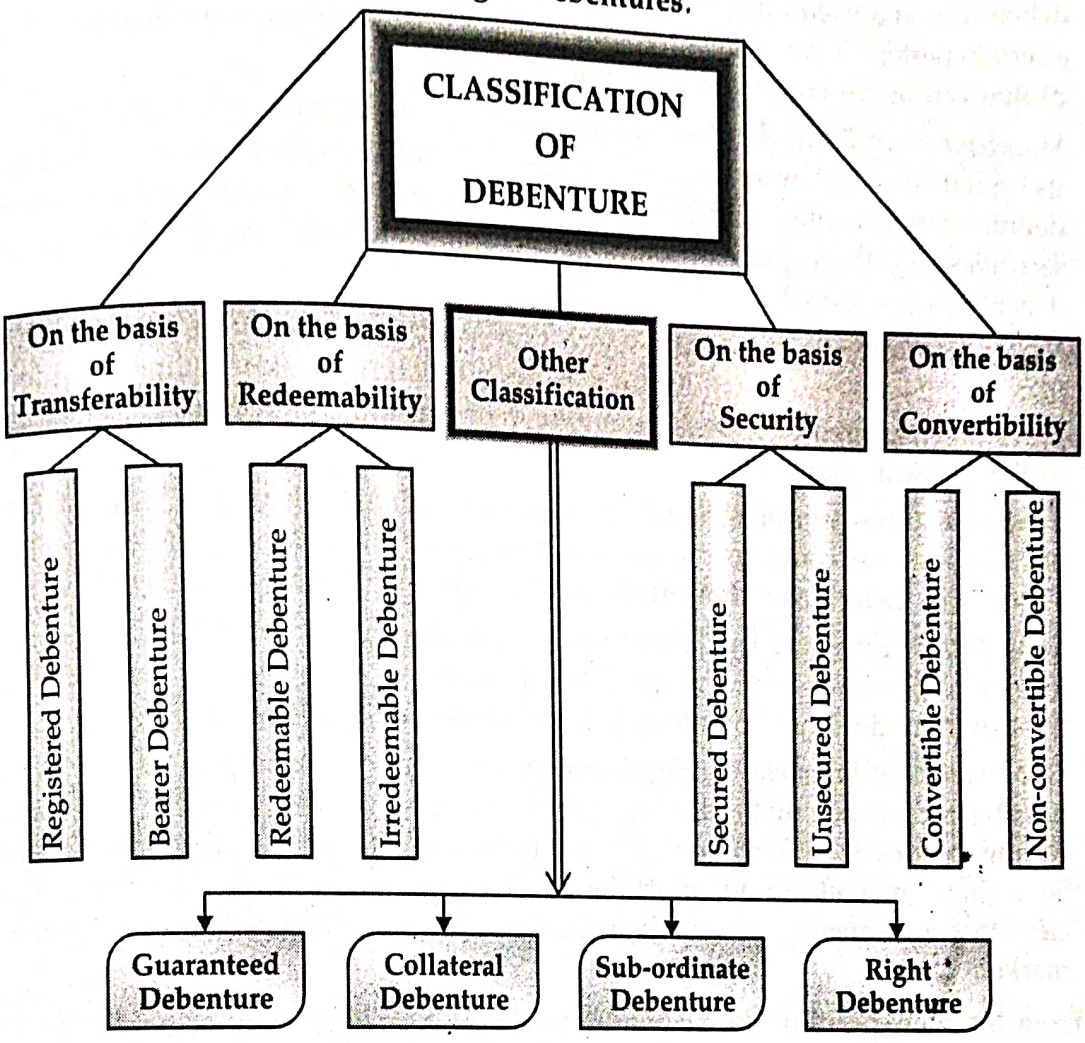
(i) ***Guaranteed Debentures*** : When a third party gives guarantee at the time of issuing the debentures in respect of payment for interest and repayment of principal, the debentures are called **Guaranteed Debentures**.

(ii) ***Collateral Debentures*** : When a company issues own debentures in the name of a lender as an additional security in addition to mortgaging any particular asset for a loan taken by it to the equivalent amount of the loan, the debentures are called **Collateral Debentures**. It is important to mention here that no interest is paid on

such debentures. Moreover, if the company is unable to repay its loan, the lender can sale the debentures in the market to realise his / her debt.

(iii) ***Sub-ordinate Debentures*** : The value of which type of debentures is paid back after the redemption of all kinds of secured and unsecured debentures, are called **Sub-ordinate Debentures.**

(iv) ***Right Debentures*** : The Debentures which are issued by a company among its existing shareholders on the basis of their pre-emptive right in order to collect long-term working capital, are called **Right Debentures.**



H.3. Advantages and Disadvantages of Debenture

Advantages : The advantages of debenture can be discussed from two view-points, such as, *from the view-point of the company* and *from the view-point of the debentureholders*. The advantages of debentures are discussed below from these two view-points.

- **From the view-point of the Company :** The advantages of debenture from the view-point of the company are —

(i) ***Intact of Controlling Power*** : The debentureholders have no voting right. So, if capital is Procured by issuing the debentures, there is no possibility of changing the controlling power in the management of the company. The controlling power remains intact with the equity shareholders.

(ii) ***Benefit of Tax Relief*** : The interest payable on debentures is considered as an admissible expense in case of ascertainment of tax liability. So, if capital is procured by issuing the debentures, the average cost of capital is less.

(iii) ***Benefit of Trading on Equity*** : The rate of interest payable on debentures is lower than the rate of return on capital employed. So, if a part of the capital employed is Procured by the issue of debentures, the earning to equity shareholders increases. As a result, the company can pay a high rate of dividend on equity shares. So, it is possible for a company to trade on equity by issuing the debentures.

(iv) ***Easy Saleable*** : Generally, the investors expect a certain rate of return on their investment and want to get back their invested money after a certain period. Interest is paid on debentures at a fixed rate and the value of the debentures is paid back to its holders after a certain period. So, investment in debentures is very attractive to the investors. Therefore, capital can be procured easily by sale of debentures.

(v) ***Maintenance of Flexibility in Capital Structure*** : A company can maintain flexibility in its capital structure by issuing redeemable debentures as these can be redeemed after a definite period of time and the reduced capital may be compensated by issuing other securities. So, the capital structure of the company becomes flexible if such type of debentures are issued.

(vi) ***Proper Utilisation*** : The capital which is procured by the issue of debentures may be used as a long term capital. As there is no question of quick redemption of debenture, the capital procured by issue of debenture may be utilised in the proper sectors according to the financial plan.

(vii) ***Control on Over-capitalisation*** : If there is redeemable debentures in the capital structure of a company, the company can easily solve the problem of the state of over-capitalisation, because the redeemable debentures can be redeemed after a definite period of time.

(viii) ***Low Rate of Interest*** : The rate of interest payable on debentures is fixed and usually lower than the rate of dividend payable on shares. So, in any year, if the profit increases, the company does not have to pay more interest on its debentures.

(ix) ***Good Source of Financing during Depression*** : If there is a slump in the market, it is not possible for a company to earn high profits. So, in such a situation, the investors are not willing to invest their funds in shares. But the rate of interest on debentures remains fixed. So, a slump market can not affect the financing through issue of debentures. Thus, it is clear that a company can issue debentures to fulfil its financial needs even in a slump market.

- **From the view-point of the Debentureholders** : The advantages of debenture from the view-point of the debentureholders are —

(i) ***Regular Income*** : The rate of interest on debentures remains fixed and it is obligatory for each company to pay such interest whether it earns profits or incurs losses. So, if the investors invest their funds in the debentures of a company, they can earn return regularly.

(ii) ***Low Risk*** : In most of the cases, debentures are issued against a particular security. Moreover, if the company goes into liquidation for any reason, the debentureholders are paid back their invested money ahead of shareholders. So, the amount of risk is very less for investment in debentures.

(iii) ***Investors' Preference*** : Every investor expects a regular return on his investment and wishes to get back his invested money at the end of a certain period. Interest is paid on debentures at a fixed rate and the value of the debentures is paid back after a certain period of time. So, investment in debenture is very attractive to the investors.

(iv) *Scope of Conversion into Shares* : The convertible debentures are converted into shares after a certain period of time according to the terms of issuing the debentures. So, if the investors invest their funds in this type of debentures, they get the scope of converting their debentures into the shares.

■ **Disadvantages** : Like advantages, the disadvantages of debentures can also be discussed from the view-points of the company and debentureholders. The disadvantages of debentures are discussed below from these two view- points :

• **From the view-point of Company** : The disadvantages of debentures from the view-point of the company are —

(i) *Fixed Financial Charges* : A company has to pay interest on debentures at a fixed rate in each year whether it earns profits or incurs losses. So, if a company issues debentures, a fixed financial charge is imposed on it.

(ii) **Problem of Getting Loan from Other Sources** : In most of the cases, various assets are mortgaged at the time of issuing the debentures. So, the company, which issued debentures earlier, finds a great difficulty in taking other long-term loan latter on from banks or from other financial institutions due to lack of mortgageable assets.

(iii) **Trading on Equity is not Always Possible** : Trading on Equity is possible only if the return on capital employed is more than the rate of interest payable on debentures. So, if the rate of return on capital employed is lower than the rate of interest on debentures for any reason, it is not possible for a company to trade on equity.

(iv) *Discouraging the Issue of Debentures* : The managing agents of the company would supply medium-term loan for requirements of the company. Thus, in order to keep control and predominance in their hands, they do not encourage the issue of debentures.

(v) *Risk of Liquidation* : If the interest on debentures is not paid by the company, the debentureholders have a right to claim liquidation of the company. So, with the issuing the debentures, a company has to bear the risk of liquidation.

(vi) *Unreliable Source* : Only well-established companies can take the advantages of financing through issue of debentures, because the investors invest their money in debentures only with the renowned companies. So, it is quite difficult for the newly formed companies or small companies to raise capital by issuing the debentures.

• **From the view-point of the Debentureholders** : The disadvantages of debentures from the view-point of the debentureholders are —

(i) *High Stamp Duty* : High stamp duty is charged on debentures. The duty is charged at ₹ 7.50 per ₹ 1,000 for registered and ₹ 15 per ₹ 1,000 for bearer debentures. For the cause of High Stamp Duty, the investors are discouraged on investing in debentures.

(ii) *High Unit Price* : The unit price of debentures is generally higher than that of shares. As a result, the investors of the low and medium income group are not encouraged to invest their funds in debentures.

(iii) *Presence of Government Security* : There is hundred per cent safety in investment in Government Security. So, the investors are more encouraged to invest in Government Securities than debentures of a company.

(iv) *Incapability of Participating in Management* : The debentureholders can not participate in the management of the company. For this reason, many investors prefer to invest in shares than in debentures.

ADVANTAGES & DISADVANTAGES OF EQUITY SHARE

ADVANTAGES

From the view-point of the Company

- *Intact of Controlling Power*
- *Benefit of tax relief*
- *Benefit of trading on Equity*
- *Easy saleable*
- *Maintenance of flexibility in capital structure*
- *Proper utilisation*
- *Control on over-capitalisation*
- *Low rate of interest*
- *Good source of financing during depression*

From the view-point of the Debentureholders

- *Regular income*
- *Low Risk*
- *Investors' preference*
- *Scope of conversion into share*

DISADVANTAGES

From the view-point of the Company

- *Fixed Financial Charges*
- *Problem of getting loan from other sources*
- *Trading on Equity is not always possible*
- *Discouraging the issue of debentures*
- *Risk of Liquidation*
- *Unreliable source*

From the view-point of the Debentureholders

- *High Stamp Duty*
- *High Unit Price*
- *Presence of Government Securities*
- *Incapability of participating in management*

H.4. Distinction between Share and Debenture

Subject	Shares	Debentures
(i) **Nature of Capital**	The capital which is procured by a company through sale of shares, is called owned capital.	The capital which is procured by a company through sale of debentures, is called Debt-capital.
(ii) **Type of Income**	The return which is received by the shareholders on their investment, is called dividend.	The return which is received by the debentureholders on their investment, is called interest.
(iii) **Voting Right**	The shareholders have voting right.	The debentureholders have no voting right.
(iv) **Security**	The company is not required to keep any assets as security at the time of issuing the shares.	Generally, the company is required to keep any of its asset as security at the time of issuing the debentures.

(v) Status of the Investors	The shareholder are the owners of the company.	The debentureholders are the creditors of the company.
(vi) Tax Relief	The dividends payable on shares is not considered as an admissible expense in case of ascertainment of tax.	The interest payable on debentures is considered as an admissible expense in case of ascertainment of tax.
(vii) Nature of Return	The dividend payable on shares is a charge against appropriation.	The interest payable on debentures is a charge against profit.
(viii) Strictness	Issuing shares is compulsory for each company.	Issuing debentures depends on the option of the company *i.e.*, it is not compulsory.
(ix) Repayment of Capital at the time of Liquidation	At the time of liquidation of the company, the value of shares is paid back after repaying the value of the debentures.	At the time of liquidation of the company, the value of debentures is paid back before repaying the value of the shares.
(x) Funds Creation	No sinking fund is created for repaying the dues to the shareholders.	On many occasions, sinking fund is created to pay back the dues to the debentureholders.
(xi) Restriction on Issue at a Discount	The Companies Act imposes certain restrictions on the issue of shares at a discount.	There is no restriction on the issue of debentures at a discount.
(xii) Risk	The shareholders are the owners of a company. So, they have to bear all the financial risks of the company.	The debentureholders are not the owners of a company, they are the creditors of the company. So, they are not required to bear any risk of the company.

I Institutional Financing

Different types of Financial institutions have been set up for rendering long-term financial assistance to the business firms. These financial institutions can be divided into two categories. They are— 1. *National Financial Institutions* and 2. *International Financial Institutions*. These are discussed below in brief.

1. **National Financial Institution :** In the industrial development of our country, the contribution of the national financial institutions is quite significant, because these institutions render financial assistance for the development and expansion of the industrial undertakings. Some of these institutions are —

   (i) ***Industrial Finance Corporation of India* (IFCI) :** In 1984, the Government of India passed in the Lok Sahba the Industrial Finance Act and established the Industrial Finance Corporation of India (IFCA). This corporation helps large-scale industries by purchasing their shares and debentures and renders financial assistance, loans and advances for not more than 25 years. When a public limited company sells its shares and debentures in the market, this corporation can underwrite those shares and debentures. This institution can lend upto ₹1 crore to the industrial undertakings @11.25% p.a. as interest. In addition to these, if the Central Government or the World Bank intends to give loan to an undertaking, this corporation may represent on behalf of them.

(ii) ***Industrial Credit and Investment Corporation of India*** **(ICICI) :** The Industrial Credit and Investment Corporation of India (ICICI) was set up in January, 1955 and began its operation as a wholly Privately-owned institution. This financial institution renders loan against security for not more than 15 years to the industrial undertakings. It becomes a guarantor for any concern taking loan from another concern. It invests in shares and debentures of the joint stock companies and underwrites for selling of those shares. In addition to these, it provides loan to the industrial concerns in foreign currency to get foreign technology and import of machinery.

(iii) ***Industrial Development Bank of India*** **(IDBI) :** The Industrial Development Bank of India was set up in July 1964 under the Industrial Development Bank of India Act as a wholly owned subsidiary of the Reserve Bank of India. However, In February, 1976, this bank was delinked from the Reserve Bank and became an autonomous financial institution.

This bank provides medium-term and long-term loan to the industrial concerns and renders financial assistance to them by purchasing their shares and debentures. It refinance loans between 3 and 25 years granted by IFC, SFC and other financial institutions. This financial institution can guarantee deferred payments due from any industrial undertaking. It can also guarantee Loans floated by an industrial concern in the market or raised loans from scheduled banks or co-operative banks or any other public financial institution.

(iv) ***National Industrial Development Corporation*** **(NIDC) :** On 20th October, 1954, National Industrial Development Corporation was set up as a Private Limited Company. This financial corporation provides required long-term finance for industrial reconstruction and modernisation.

(v) ***Unit trust of India*** **(UTI) :** An important landmark in the history of the investment trust movement in India is the establishment of the Unit Trust of India. This institution was established in 1964 under the Unit Trust of India Act, 1963. It started the sale of units from 1st July, 1964. The main aim of this institution is to arouse the desire for savings among the low and middle-income group of individuals and to procure money from them with the object to invest them.

This institution provides long-term capital to the industrial undertakings by purchasing their equity shares, preference shares and debentures. The main sectors where the trust invests most of its investible fund are chemical industry, cotton textile industry, engineering and medicine etc.

(vi) ***General Insurance Corporation of India*** **(GICI) :** In 1971, the general insurance businesses have been nationalised. After nationalisation the General Insurance Corporation was formed. This corporation with its allied institutions renders financial assistance to the industrial undertakings by providing loans, by underwriting and sometimes directly purchasing shares and debentures of them.

(vii) ***Life Insurance Corporation of India*** **(LICI) :** This financial Institution invests its investible funds in Government and government approved shares and debentures and renders financial assistance to the joint stock companies by purchasing their shares and debentures.

(viii) ***Industrial Reconstruction Bank of India*** **(IRBI) :** In April, 1971, the Industrial Reconstruction Corporation of India was established as a government company. Latter on, in March 1985, after amalgamating this Reconstruction Corporation, the Industrial Reconstruction Bank of India was set up. As a result, with the formation

of the corporation, the former Industrial Reconstruction Corporation was abolished. This financial institution renders financial assistance in order to revive the weak and sick units. It may give loan subject to maximum of ₹50 Lakhs at low rate of interest for the reconstruction of the sick industries and makes arrange for repayment of old loans on long-term instalments. In addition to these, it makes provision for capital expenditure, essential expenditure and working capital for the weak and sick units.

(ix) ***State Financial Corporation* (SFC) :** In September, 1951, the Government of India passed the State Financial Corporation Act in the parliament in order to provide financial assistance to small-scale and medium-size industries. The Act is applicable to all states except the state of Jammu and Kashmir.

This financial institution provides long-term loan to the small and medium-scale industries for a maximum period of 20 years. Besides, it underwrites to sell shares and debentures of industrial undertakings and renders financial assistance to them by acting as a guarantor of loan.

(x) ***National Small Industries Corporation* (NSIC) :** In order to make success the efforts for industrial development of the country and to make an overall improvement of the cottage industries, the Central Government established National Small Industries Corporation as a privately-owned company in February, 1955. This financial institution provides long-term loan to the industrial undertakings. It offers guarantee for granting loans to the small industries by the banks and other financial institutions and sometimes underwrites shares.

2. **International Financial Institutions :** International Finance Corporation, Asian Development Bank, World Bank etc. are the international Financial institutions which render long-term financial assistance to the industrial undertaking. They provide long-term loan to the industrial undertakings in foreign currency to get foreign technology and import of raw materials and machinery.